

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

JUDGE FAILLA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

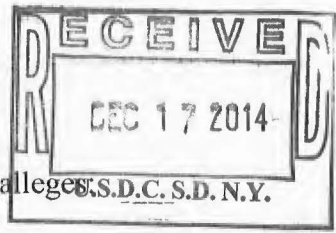
v.

AVON PRODUCTS, INC.,

Defendant.

14 CV 9956  
Civil No. \_\_\_\_\_

COMPLAINT



Plaintiff Securities and Exchange Commission ("Commission") alleges S.D.C. S.D. N.Y.

SUMMARY OF ALLEGATIONS

1. This matter concerns violations by Avon Products, Inc. ("Avon") of the corporate recordkeeping and internal controls provisions of the federal securities laws.
2. Avon is a global provider of beauty products, primarily using a direct sales method. Avon's common stock is registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §78l(b)].
3. From 2004 through the third quarter of 2008, Avon's books and records failed to accurately and fairly reflect payments by Avon Products (China) Co., Ltd. ("Avon Products China") to Chinese government officials.
4. Avon Products China provided cash and things of value, including gifts, travel, and entertainment, to various Chinese government officials, including government officials responsible for awarding a test license, and subsequently a direct sales business license, that would allow a company to utilize direct door-to-door selling in China. Avon Products China

was, in fact, awarded a test license and, then, the first official direct selling business license in China. Avon Products China also adopted an internal “no penalty policy” and provided cash and things of value to Chinese government officials to avoid fines and other penalties in order to maintain an ostensibly pristine corporate image. Avon Products China also paid a third-party consultant for purportedly legitimate interactions with government officials, even though Avon Products China management knew the consultant’s invoices were often false and could not point to legitimate services provided by the consultant. At times, payments were made to suppress negative news in state-owned media and to obtain competitor information. In addition, Avon Products China provided cash to government officials on behalf of other Avon subsidiaries in China.

5. Avon Products China falsified its books and records so as to conceal the cash and things of value provided to government officials.

6. Near the end of 2005, an Avon internal audit team reported potential issues concerning things of value provided to Chinese government officials. Nevertheless, remedial measures sufficient to address the issues were not implemented at Avon Products China. Similar issues related to Avon Products China were raised at the end of 2006. Again, responsive remedial measures were not implemented.

7. The books and records at Avon Products China were consolidated into the books and records of Avon. Avon thus violated Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)] by failing to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflected the transactions and disposition of assets of the issuer.

8. By failing to ensure that it maintained adequate internal controls sufficient to record the nature and purpose of payments, or to prevent improper payments, to government

officials, Avon failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that its transactions and the disposition of its assets were recorded correctly, accurately, and in accordance with authorization of management. Avon thereby violated Section 13(b)(2)(B) of the Exchange Act [15 U.S.C. § 78m(b)(2)(B)].

9. Finally, in May 2008, Avon began a review of its compliance with the Foreign Corrupt Practices Act (“FCPA”), the U.S. legislation that, among other things, prohibits payments to foreign government officials to obtain or retain business. As a result of its review, the company instituted extensive, related reforms.

#### **JURISDICTION AND VENUE**

10. This court has jurisdiction over this action pursuant to Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), and 78aa].

11. Venue is proper in this District pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa].

#### **DEFENDANT**

12. **Avon Products, Inc.** is a New York corporation that has its headquarters in New York City. The company is a global manufacturer and marketer of beauty products. Avon primarily sells its products through direct selling by over 6 million active independent sales representatives. The company has wholly owned subsidiaries throughout the world with sales or distribution of its products in over 100 countries located in North America, Latin America, Europe, the Middle East, Africa, and Asia. The financial results of Avon’s wholly owned subsidiaries are ultimately consolidated into the financial statements of Avon. Throughout the relevant period, Avon’s shares were registered pursuant to Section 12(b) of the Exchange Act [15 U.S.C. § 78l(b)] and quoted on the New York Stock Exchange (symbol: AVP).

## RELATED ENTITIES

13. Avon Products (China) Co. Ltd. is headquartered in Guangzhou, China. Avon Products China is a wholly owned indirect subsidiary of Avon. Avon controls two other Chinese subsidiaries through Avon Products China: Avon Manufacturing (Guangzhou) Ltd. (“Avon Manufacturing China”) and Avon Healthcare Products Manufacturing (Guangzhou) Limited (“Avon Healthcare China”).

## STATEMENT OF FACTS

### **Avon’s Business Operations in China**

14. Avon Products China began operations in the People’s Republic of China in 1989 as part of a joint venture that manufactured its products and used a direct selling model. However, in 1998 the Chinese government banned all direct selling. For a number of years, Avon then marketed its products in independently owned retail operations called “Beauty Boutiques.” When China subsequently expressed an interest in joining the World Trade Organization (“WTO”), the WTO requested that the Chinese government consider allowing direct selling in the country as part of its admission into the organization. In 2001, the Chinese government agreed to allow direct selling within three years. Avon wanted to influence the legislation and regulations governing the reimplementation of direct selling in China. Avon also wanted to be the first company to implement direct selling if, and when, the new regulations became effective.

### **Avon Products China’s Books and Records Attempt to Hide Payments to Government Officials**

15. In the years leading up to 2003, Avon Products China had expanded its government relations department to liaise with the Ministry of Commerce (“MOFCOM”) and the State Administration for Industry and Commerce (“AIC”), the government agencies responsible

for the implementation of direct selling regulation. In April 1999, an Avon Asia-Pacific subsidiary hired an executive to, as stated in his employment agreement, “bring [Avon] to the attention of relevant organizations and help open doors and develop the required ‘Guanxi’ to successfully conduct business.” (“Guanxi” is a Chinese term that roughly translates as “goodwill.”) The executive was seconded to Avon Products China as its Vice President in Corporate Affairs, the department with oversight and liaison responsibility for government agencies on a national, provincial, and local level. Employees in the Corporate Affairs department provided gifts, entertainment, and travel to government officials in these agencies for the purpose of influencing the direct selling laws and to position Avon Products China as one of the companies to be selected to test direct selling when the new regulations were implemented.

16. In October 2003, Avon was told informally that when China opened its markets to direct selling, Avon Products China would be the first company to receive a test license. During this period, Avon Products China continued to provide meals, travel, and entertainment to MOFCOM and AIC officials. Avon Products China also sponsored cultural events, paid for journalists to attend corporate announcements, and purchased the placement of positive news stories--or the suppression of negative news stories--in government media, to maintain a positive corporate image of the company.

17. In April 2004, when the form of the direct selling regulations was being negotiated within the Chinese government agencies, Avon continued to receive informal communications that Avon Products China would be the first company allowed to test the new regulations. After these communications, Avon Products China continued to provide travel, meals, and entertainment and began to meet more frequently with provincial and local MOFCOM and AIC officials. Avon Products China also retained the services of a third-party

consultant (“Consulting Company 1”) to manage public-relations-related affairs with the government and external parties and to handle media matters in provinces and localities where the subsidiary did not maintain an office. Avon Products China did not contractually bind Consulting Company 1 to comply with the FCPA.

18. The Chinese government decided to issue one company a temporary license to conduct direct sales to test the planned regulations. In April 2005, MOFCOM and AIC officially approved Avon Products China as the first company to receive test approval to conduct direct selling in Beijing, Tianjin, and Guangdong Province.

19. In April 2005, based on interviews and preliminary procedures it had conducted in China, Avon’s global internal audit flagged gifts to government officials and inadequacies in related recordkeeping as an area of concern. Then, in a limited review conducted in May 2005, Avon’s internal audit personnel observed that employees of Avon Products China had incurred meals and entertainment expenses with government officials, but had failed to record the names of the government officials or the business purpose of the expenses. As a result, Avon’s Vice President, Internal Audit opened an internal compliance case and noted that a further review of discretionary payments would be made in an upcoming limited scope internal audit.

20. During the spring and summer of 2005, Avon’s global internal audit department considered the need to provide training on the provisions of the FCPA in the Asia-Pacific region, including China. However, ultimately, Avon determined that its budget for that year would not allow it to provide stand-alone FCPA training in the region.

21. In September 2005, an Avon internal audit team conducted field work for the limited scope audit, including looking at discretionary payments at the Corporate Affairs department in China. In late September, the team generated a draft report prominently noting

that it was a common business practice for Avon Products China to offer gifts and meals to various government officials and that the majority of the government-related activities at Avon Products China were not adequately documented. The draft report also noted that the gifts and meals might be construed as the company's intent to expedite licenses from the government or to avoid unfavorable rulings against the company, therefore potentially violating the provisions of the FCPA. The day before the audit closing meeting, the senior management of Avon Products China told the internal audit team that recording the name of the government official and the purpose of the meeting would have a chilling effect with the officials. The internal audit team and the senior management of Avon Products China brought the draft report to the attention of the V.P. Internal Audit, who headed Avon's global internal audit department. The V.P. Internal Audit in turn brought the draft audit report and its language to the attention of Avon's General Counsel.

22. Avon's Legal Department took the position that conclusions about potential FCPA violations fell within the purview of Legal, and not Internal Audit. The V.P. Internal Audit directed the internal audit team to have the FCPA conclusions removed from the draft, pending further study of the issues. After the V.P. Internal Audit conferred with the Vice President of Finance, Asia-Pacific, the internal audit team was directed to redraft the report, recall and destroy all hard copies, and delete any e-mail to which the draft was attached.

23. Avon's General Counsel discussed the issues raised in the report with Avon's Vice President, Legal & Government Affairs, and Avon's Regional Counsel, Asia-Pacific. They determined to follow-up on the information with the internal audit team and to consult outside counsel. Avon's V.P. Legal & Government Affairs contacted a major law firm to consult about potential FCPA issues. In early November 2005, Avon's General Counsel, V.P. Internal Audit,

V.P. Legal & Government Affairs, and V.P. Finance, Asia-Pacific, directed the internal audit team to return to Avon Products China and to expand to the beginning of 2005 the timeframe of their review of the expenses of the Corporate Affairs department. The internal audit team was told not to create any electronic documents, not to send any e-mails regarding the follow-up review, and not to use the term "FCPA" in any written document.

24. The internal audit team completed the field work and created several handwritten spreadsheets that confirmed the concerns the team had reported in their draft audit report. Avon's V.P. Finance, Asia-Pacific then hand-carried the spreadsheets on a flight from Hong Kong to New York.

25. In mid-November 2005, after Avon's V.P. Legal & Government Affairs received the spreadsheets, he consulted the outside law firm and sent the spreadsheets to the firm. After two subsequent telephone conferences with the law firm, Avon's V.P. Legal & Government Affairs, in mid-December 2005, sent the law firm a short e-mail stating that the company had "moved on" from the issues and asking for an estimate of the fees incurred.

26. In December 2005, China's new direct selling regulations came into effect, lifting the ban on direct selling and allowing companies to apply for licenses to conduct direct selling. Under the direct selling regulations, a company was required to obtain a national direct selling license and a direct selling license from each province and municipality in which it sought to make direct sales. For a company to obtain a license, it was required to satisfy a number of conditions, including having "a good business reputation" and a record of no serious illegal operations for the previous five years.

27. The direct selling regulations also banned the recruitment of certain types of persons as direct sales staff, including persons under the age of 18, full-time students, foreigners,



teachers, medical personnel, civil servants, active service members of the armed forces, and any person who was prohibited from taking any part-time job under applicable laws and regulations.

28. In late December 2005 and January 2006, Avon's General Counsel, Avon's V.P. Legal & Government Affairs, and Avon's Regional Counsel, Asia-Pacific decided to implement certain remedial measures at Avon Products China, including the creation of a log listing the government officials entertained or provided with gifts, and to require representations and warranties in Avon Products China's contracts with third parties, including Consulting Company 1, that interacted with government officials and government agencies on behalf of Avon Products China.

29. The ordered remedial measures did not require a description of the business purpose of any meeting with government officials. Moreover, Avon Products China was allowed to keep the log off-premises. In fact, none of the responsive measures were implemented. Moreover, there was no instruction to the employees at Avon Products China to otherwise change the practice of providing things of value to Chinese government officials.

30. In March 2006, the Chinese government did grant Avon Products China the first national direct selling business license. (Avon competitors did not receive test or permanent licenses until, or after, December 2006.) In the time between Avon Products China's receiving the test direct selling license, in April 2005, and the time when it received the permanent direct selling business license, the company provided over \$100,000 in cash or things of value to government officials.

31. Between March 2006 and July 2006, Avon Products China obtained all sought provincial and municipal approvals to conduct direct selling.

32. After March 2006, Avon Products China continued providing things of value to Chinese government officials at the national, provincial, and local levels to ensure that Avon had a clean corporate image in China. Avon Products China's General Manager and its V.P. of Corporate Affairs implemented a "zero penalty policy."

33. Under the zero penalty policy, Avon Products China and Consulting Company 1 provided cash and things of value to Chinese government officials and government media to reduce or eliminate potential fines against the company and to prevent negative news articles from appearing in the media.

34. In December 2006, an Avon Products China executive informed an Avon Asia-Pacific executive and Avon's new head of internal audit by e-mail that Avon Products China's Associate Director of Corporate Affairs had been terminated because he had submitted false expense reports seeking reimbursement for gifts and entertainment provided to government officials. Avon's General Counsel was provided with a copy of the e-mail.

35. After consultation with the General Counsel, a new head of internal audit at Avon asked two members of the audit team that had conducted the 2005 Avon Products China internal audit to do follow-up work looking into expenses at the China Corporate Affairs group and to confirm that the remedial measures had been implemented. Based on their review, the two internal auditors advised the new head of internal audit that they had concluded that problematic payments and inadequate recordkeeping continued at Avon Products China and that the measures had not been implemented. No remedial measures were implemented in response to the review.

36. In May 2008, the Avon Products China Corporate Affairs executive who had been terminated wrote to Avon's Chief Executive Officer alleging improper payments to Chinese government officials over several years in the form of meals, entertainment, travel, sponsorship

of cultural events, gifts of art, and cash. The letter was forwarded to Avon's Legal Department and, in turn, to the audit committee of Avon's board of directors. The audit committee commenced an internal investigation into the allegations and, in October 2008, Avon informed the Commission and the Department of Justice.

37. As a result of its internal investigation, Avon subsequently initiated substantial remedial processes and procedures, on a global basis. Avon also instituted worldwide FCPA training for all employees of the company.

### **Representative Categories of Improper Payments**

38. From at least 2004 through the third quarter 2008, Avon Products China provided cash and things of value to government officials, government entities, and state-owned media. Avon Products China's books and records were created in a manner that would not allow a reviewer to ascertain the specific government official or entity that received the payment or the purpose for which the payment was made. In some instances, the documentation for the payments contained almost no details.

39. Altogether, Avon Products China provided approximately \$8 million dollars in cash and things of value to Chinese government officials during the period from 2004 through the third quarter 2008. The following are examples:

40. During the period, Avon Products China employees made approximately 9,600 payments totaling \$1.65 million for meals and entertainment involving government officials. The majority of these payments were for meals and entertainment expenses under \$200 per occurrence, without indication as to who attended the meal/entertainment or the business purpose of the expense. One expense report submitted by a Corporate Affairs associate in May 2007 listed \$8,100 for entertainment of government officials in a two-month period during the time that Avon Products China was negotiating a certification of apparel for sale in China. Another

expense of \$4,147 in April 2007 paid for a Pearl River cruise for 200 State and Regional AIC officials during a conference of officials with responsibility for the oversight of Avon Products China's direct selling business license. During the cruise, Avon Products China also placed free products in each official's hotel room. In January 2008, an expense of \$4,808 was incurred to "accompany government officials" in Guangdong Province during a period in which Avon management met with the Governor of that Province.

41. Avon Products China employees also provided gifts totaling \$400,000, in addition to at least \$1.7 million worth of Avon products. Approximately \$70,000 to 90,000 of that total is attributable to tickets or corporate boxes at the China Open tennis tournament, given to AIC and other government officials in 2004 and 2005 "to thank them for their support." During these years, Avon Products China was a corporate sponsor of the tournament and received the tickets as part of that sponsorship. Avon Products China also provided government officials with gifts that included Louis Vuitton merchandise, Gucci bags, and Tiffany pens.

42. During the period, Avon Products China employees provided approximately \$1 million in payments for travel by government officials. Half of that amount was spent on the following trips: (1) \$93,000 for an eighteen-day, all-expenses-paid trip to the United States by Guangdong Food and Drug Administration officials, in December 2005 and January 2006, that included one half-day of visiting Avon's research facilities in Suffern, NY; (2) \$328,000 for three-to-five days of travel by more than 200 AIC officials to visit Avon Products China's Guangzhou property, with one half-day at that property and the remainder of the time spent touring resort areas in southern China; (3) \$23,000 for travel and expenses for government journalists to attend the ceremony at which Avon Products China launched its direct selling test; and (4) \$22,000 for a trip by a provincial governor to Hong Kong without any Avon business

purpose. Avon Products China also sponsored trips of AIC officials to Europe during this period. However, no records can be located that show the expenses for these trips.

43. Employees at Avon Products China also made payments totaling \$1.5 million to vendors and consultants, with knowledge that a significant portion of the funds would in turn be paid to government officials. Of that amount, approximately \$1.2 million was paid to Consulting Company 1 to provide government relations and media crisis management. The payments to Consulting Company 1 were often made in cash by Avon Products China's V.P. in Corporate Affairs, who then would submit, or would have a subordinate submit, false expense reports for reimbursement.

44. Employees of Avon Products China made a cash payment of approximately \$12,500 to an AIC official in Hunan Province to avoid a fine. The official told Avon Products China that the AIC did not have a bank account and directed Avon Products China to wire the funds to his personal bank account, structured in several deposits to avoid Chinese bank reporting regulations.

45. Avon Products China's employees also made payments to government officials for conferences, and related meals, gifts, and entertainment, in 150 instances aggregating \$143,000. Records for these expenses do not indicate who attended the conferences, or the business purpose of the expenses. Approximately \$15,000 of this amount was for expenses related to government journalists' attendance at an Avon Products China media event.

46. On occasion, an AIC official would request that Avon Products China sponsor an activity in lieu of paying a fine related to the direct selling or Beauty Boutique business. Similarly, rather than having a news story appear in the Economic Information Daily alleging that Avon Products China had unlawfully recruited students to be sales promoters, Avon

Products China, at the behest of the publication's editor, paid \$81,000 to sponsor an article contest at that publication.

47. Employees at Avon Products China also made payments to state-owned media to purchase advertising, in order to avoid negative news articles. During the relevant period, Avon Products China made approximately 16 purchases of advertising totaling \$41,000 to avoid negative press.

48. Avon Products China's employees also paid for association fees, at the request of Chinese government officials. These payments totaled approximately \$5,000 and were often made in cash.

49. During the relevant period, employees at Avon Products China also made payments of approximately \$740,000 that lacked documentation sufficient to place the payments in any of the exemplary categories set forth herein.

## **FIRST CLAIM FOR RELIEF**

### **Corporate Books and Records**

[Violations of Section 13(b)(2)(A) of the Exchange Act,  
15 U.S.C. § 78m(b)(2)(A)]

50. Paragraphs 1 through 49 are realleged and incorporated by reference.

51. Section 13(b)(2)(A) of the Exchange Act requires each issuer with securities registered with the Commission pursuant to Section 12 [15 U.S.C. § 78l] to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and the dispositions of the assets of the issuer.

52. As described above, Avon, through its officers, employees, and agents, failed to keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflected its transactions and the disposition of its assets.

53. By reason of the foregoing, Avon violated Section 13(b)(2)(A) of the Exchange Act [15 U.S.C § 78m(b)(2)(A)].

## **SECOND CLAIM FOR RELIEF**

### **Internal Controls**

[Violations of Section 13(b)(2)(B) of the Exchange Act,  
15 U.S.C. § 78m(b)(2)(B)]

54. Paragraphs 1 through 49 are realleged and incorporated by reference.

55. Section 13(b)(2)(B) of the Exchange Act requires issuers of registered securities to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are executed in accordance with management's general or specific authorization; transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements; transactions are recorded as necessary to maintain accountability for assets; and access to assets is permitted only in accordance with management's general or specific authorization.

56. Avon failed to devise and maintain such a system of internal controls and was therefore unable to record the nature and purpose of, or prevent, the provision of cash and things of value to government officials by Avon Products China, as set forth above.

57. By reason of the foregoing, Avon violated Section 13(b)(2)(B) of the Exchange Act [15 U.S.C. § 78m(b)(2)(B)].

**PRAYER FOR RELIEF**

WHEREFORE, the Commission respectfully requests that this Court enter judgment:

- a. Permanently enjoining Defendant Avon from violating Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A) and 78m(b)(2)(B)];
- b. Ordering Defendant Avon to disgorge ill-gotten gains wrongfully obtained as a result of its illegal conduct described herein, plus prejudgment interest thereon; and
- c. Granting such other relief as this Court may deem just and appropriate.

Dated: December 17, 2014

Respectfully submitted,



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