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Russian Hospitals Paying Over the Odds for Western Medical Equipment

By The Moscow Times

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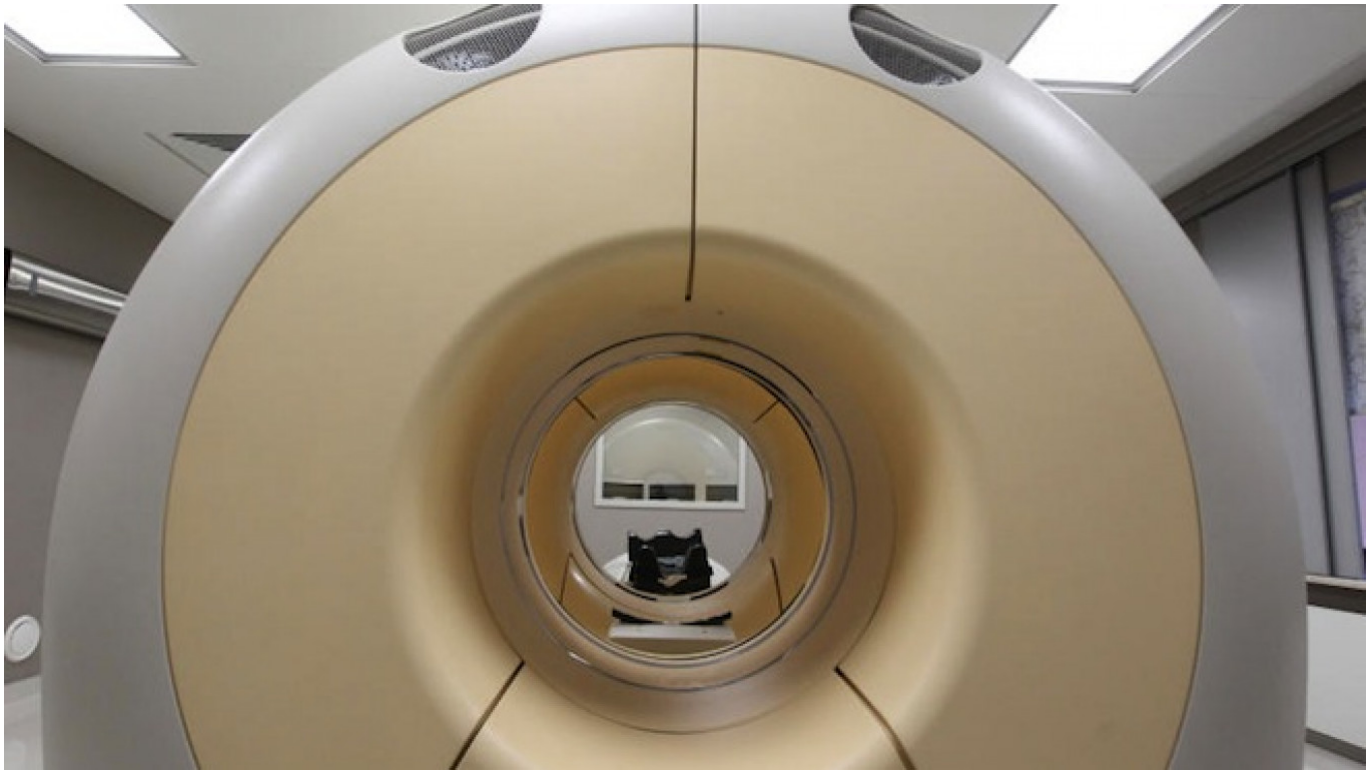

MOSCOW/LONDON — Russia pays hugely inflated prices for vital medical equipment made by Western companies, in part because some manufacturers channel sales through obscure intermediary companies, an examination has found.

These middlemen firms, which have no easily traceable owners or offices, add mark-ups that mean Russian state hospitals frequently pay two or three times more than hospitals in the West for the same equipment. An examination of Russian customs data and state procurement records shows the price differences can be hundreds of thousands of dollars on a single item.

An analysis of 20,000 transactions dated between January 2006 and July 2013 found that international companies sold Russia medical devices worth more than $2.8 billion through more than 150 obscure companies and partnerships. These offshore intermediaries give addresses that are letterboxes at law and accounting firms. Their ownership is hidden behind nominees or held in jurisdictions where public shareholder registers are not available.

The transactions illustrate how Western companies play a part in the brand of capitalism that has developed under Russian President Vladimir Putin. As documented this year, in Putin's Russia intermediaries are sometimes inserted into deals to exploit state spending.

The use of opaque intermediaries signals a risk that the hidden owners may inflate profits, siphon off funds or facilitate bribery, according to lawyers and corporate governance specialists. By agreeing to deal with such middlemen, Western firms help sustain the system that has flourished under Putin.

Moscow itself has recognized the issue. In 2010, then President Dmitry Medvedev ordered an investigation into how state hospitals overpaid for equipment. After the probe, some manufacturers, including America's General Electric Co and Japan's Toshiba Corp, stopped doing business with Russia through obscure intermediaries. GE and Toshiba had no comment on the change.

But reporters found that other big international firms, including the Dutch electronics company Philips and Germany's Siemens, continued to use non-transparent intermediaries. Between January 2011 and July 2013, Philips and Siemens combined sold $120 million of equipment through such go-betweens — in each case about 35 percent of their Russian sales during that time.

Overall, sales of medical equipment by Western and other international firms that went through obscure intermediaries amounted to more than $600 million between January 2011 and July 2013, according to the most recent Russian data available. That accounts for about 18 percent of foreign manufacturers' equipment sales to Russia that reporters could identify during that period.

Officials at several multinationals that still regularly use offshore intermediaries said they screen partners by searching publicly available information and data. These people said manufacturers should not be blamed for using intermediaries if such searches reveal nothing wrong with the companies.

A spokesman for Siemens said the company conducted "thorough due diligence" on intermediaries, including resellers of medical equipment.

Stephen Klink, a spokesman for Philips, said: "We have dedicated governance programs in place relating to our business partners. This program consists among other things of a company-wide mandatory due diligence process that screens the use of third parties, such as distributors."

There is nothing intrinsically unlawful about doing business with little-known intermediaries. Still, U.S. and European anti-bribery laws require firms to make checks on all business partners. The International Chamber of Commerce's guidelines on combating corruption say companies should look out for "red flags." These include transactions involving countries with a high reputation for bribery; situations where a third party does not reside in the country where the final customer is located; and cases where due diligence reveals that the third party "is a shell company or has some other non-transparent corporate structure."

Michael Hershman, president of the Fairfax Group, which advises multinational companies and governments on tackling corruption, said: "There is absolutely no good business reason to use these cut-out companies in these offshore locations ... It's an absolute, 100 percent red flag. Western companies know this is a risky area of activity."

Asked why intermediaries are used, Alexei Levchenko, spokesman for Olga Golodets, the Russian deputy prime minister in charge of health care, said: "The state is interested in buying the best product for the most favorable price ... It is not important who is the seller — a subsidiary of an importer, a distributor or any other company."

He said that if there was evidence of hospitals being overcharged, it should be investigated by anti-monopoly and law enforcement bodies.

Inflated Prices

Russia's health care system deteriorated in the last days of the Soviet Union and grew even worse in the chaotic 1990s. The country has high incidences of AIDS, tuberculosis, cancer and cardiovascular disease compared with Europe. In the Putin era, health standards have improved, but problems remain.

Public health officials say many patients suffer from poor and late diagnosis of their ailments. Medical scanners can help doctors detect illnesses before they become untreatable — but such equipment is expensive. The average cost of an ultrasound machine in the U.S. is about $110,000, according to the Modern Healthcare/ECRI Institute Technology Price Index.

In Russia, prices are much higher.

In May 2011, the Centre of Cardiovascular Surgery in Astrakhan, in south-west Russia, bought a Philips iE33 ultrasound scanner, which is used to diagnose heart disease. Under the exchange rate prevailing at the time, the hospital paid $580,000 for the machine, public procurement records show. In December that year the Almazov Medical Research Centre in St. Petersburg bought the same model scanner for $490,000, according to procurement records.

At that time, hospitals in Europe and North America were paying around $145,000 for the iE33, according to information from dealers in the U.S., Europe and Africa and a database of public procurement in EU countries.

The large difference between prices in Russia and the West wasn't just an anomaly with one particular machine. In another case, the Endocrinology Research Centre in Moscow bought a Philips iU22 scanner, a device used to identify breast and other cancers, for $360,000, according to Russian state procurement filings. That was about three times the price hospitals in the U.S. and Europe were paying at the time for the same scanner.

Reuters studied 22 cases where Russian hospitals purchased Philips' iE33 and iU22 ultrasound machines between January 2011 and July 2013, according to procurement records. On average, the prices were more than double those paid by hospitals outside Russia for the same machines. Neither Philips nor the dealers involved in the sales would comment on why the machines were so expensive in Russia.

"Just a Postbox"

The high prices in Russia arise from mark-ups added by intermediaries, said Felix Lam, senior analyst at health care research provider Decision Resources Group, who has studied the Russian medical scanner market. That conclusion is supported by Russian data seen. Customs records show that when companies such as Philips and Siemens sell directly to importers in Russia, they charge prices in line with what they charge in the West.

When Philips sold an iU22 direct to a Russian distributor in December 2012, for instance, it charged just $106,000.

The convoluted trail behind the sale of another Philip's iU22 scanner to Russia in 2012 produced a very different result. The device was sold through a British firm, Rainham LLP, which sold it to a Russian firm called Tierbach, which is one of Philips' official distributors in Russia. Tierbach then sold it to the Endocrinology Research Centre in Moscow. The final price: $360,000.

Rainham is a partnership registered at the offices of Carey Group, a financial and tax planning firm in the English town of Milton Keynes. "We're just a postbox for them," said Carey Group's office manager, Christine Hallett. The partners of Rainham are two companies in the Caribbean island of Anguilla, which does not require companies to reveal their owners.

It's not clear how much Rainham paid Philips for the iU22 scanner. But if it bought the scanner at the normal wholesale price in the West of around $110,000, Rainham stood to make a large profit. Customs documents show Rainham sold the machine for $325,000 to Tierbach; procurement records show that Tierbach then sold the machine on to the Endocrinology Center for $360,000.

Russian data show that between 2006 and 2013, Rainham supplied Tierbach and an affiliated company, Darton MS, with at least eight scanners that ended up being sold to Russian state hospitals for multiples of their normal Western prices. Tierbach, Darton, and Rainham did not respond to requests for comment. The hospitals involved declined to comment. Philips said it did not comment on other companies, whether business partners or not.

Rainham's accounts show that its auditor refused to sign off its accounts between 2009 and 2012. The auditors objected because Rainham paid more than £5 million in commissions and another £5 million in other costs for which the auditors were "unable to obtain sufficient appropriate audit evidence." The audit firm declined to provide more details. The registered agents of Rainham and its owners did not respond to requests for comment.

Hard to Trace

In all, reporters found that between January 2011 and July 2013 foreign manufacturers sold Russia products worth hundreds of millions of dollars a year through companies that have no easily traceable office or owners.

In that period Philips sold $63 million of equipment to Russia through such middlemen, while Siemens sold equipment worth $58 million. Those amounts were 37 percent of all the Philips' equipment that reporters could identify as being sold into Russia during that time, and 35

percent of Siemens' sales.

Obscure intermediaries were also involved in some Russian sales by lesser-known companies, including the German firms Draeger and Berver, and the French company Apelem. Berver and Apelem declined to comment. A Draeger spokesman said the company went to "considerable efforts to screen the distributors we work with."

Reporters found that more than 150 intermediaries involved in the equipment sales to Russia had addresses that proved to be the offices of law or accounting firms, "virtual office" providers or other stand-ins.

Owners of these intermediaries could not be traced. Most of the firms were registered in or owned via jurisdictions such as the British Virgin Islands, Liechtenstein, Switzerland and Panama, where owners do not have to be publicly disclosed. Others were owned by businesses or individuals acting as nominees — in other words, acting on behalf of unidentified people.

Reporters attempted to contact lawyers, accountants, nominee owners, agents and directors for over 150 middlemen firms, either in person or by email, letter or telephone. None of them responded to requests for comment.

"Commissions"

There was no evidence that any manufacturer named in this story knew of or condoned illegal activity by intermediaries in their supply chains.

A nominee director involved in two British-based intermediaries said these middlemen companies had been established for two purposes: To help Russia-based businessmen keep profits beyond the reach of the Russian tax authorities and to channel "commissions" to hospital officials.

"On occasion, he [the Russian beneficial owner] will say, we have to pay a commission to some guy," the nominee director said. "It happens every couple of months. It's maybe $10,000 to $15,000." The nominee director did not specify what the commissions were for.

Russian authorities, aware of the risk of inflated prices and potential corruption, have mounted some investigations. In one case, Russia's Federal Anti-Monopoly Service (FAS) alleged that in 2010 Siemens sold equipment to a Swiss firm called Diatech SA for $3 million. This equipment was then sold to a state hospital in eastern Russia for $12 million, according to the FAS.

The FAS said the procurement process had been inappropriate and put the increased price down to the use of an intermediary. It fined Siemens' Russian affiliate 23.5 million rubles ($680,000 at the time). Siemens said it appealed against that ruling in court and won, rendering the fine unenforceable.

Diatech SA, whose address is the office of a Swiss lawyer, did not respond to requests for comment.

Siemens declined to say whether $12 million was a reasonable price for the MRI, CT and X-ray

scanners it supplied. It said that resellers were free to set their own pricing.

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