China Law & Practice

Anti-corruption Toolkit: Part 1 of 4

Essential guidance on anti-corruption compliance in China

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How to create an anti-corruption compliance programme

Greenberg Traurig

Calvin Ding

dingc@gtlaw.com

Recently, the number and size of FCPA investigations and prosecutions have soared. While these cases carry the threat of substantial terms of imprisonment and frequently result in significant fines, the government investigations that foreshadow prosecutions often plague a company for years and very often generate internal and external costs that eventually dwarf the size of the fine itself. Against this backdrop, an effective anti-corruption programme can serve as an important measure for fulfilling a company's obligation to comply with anti-corruption laws. The US government has been indicating that the existence of an FCPA compliance programme is an important mitigating factor taken into account when deciding whether to bring charges, the extent of charges brought and assessed penalties. Simultaneously, China's continuous efforts to strengthen its own anti-corruption enforcement regime make compliance with anti-corruption laws more important than ever.

Assessing the risk profile

In order to frame an appropriate anti-corruption programme, it is essential to fully understand potential direct and indirect interface points between the company and any arm of the government, including state-owned enterprises. Needless to say, it is at these points that anti-corruption risks are heightened. Under the FCPA, companies may be held responsible for violations by agents that benefit the company with the government assuming a company's knowledge and intent via circumstantial proof. Accordingly, the foundational work of an effective anti-corruption programme is to ground it with full knowledge of core interface points.

The identification and evaluation of these interface points occur primarily through interviews of company personnel and are supplemented by a basic business documents review. The extent of this exercise is a direct reflection of the complexity of a company's business, industry, and risk profile.

Creating FCPA policies and procedures

Once the nature and extent of a company's direct and indirect governmental interface points are identified, appropriate anti-corruption policies and procedures can be drafted. While some elements of these rules are present in many procedures, effective procedures tend to supplement such basic provisions with those designed to address the specifics of the company's business. For example, companies operating in the Chinese healthcare and real estate sectors may find it prudent to implement more tailored controls given those sectors' vulnerability to public corruption.

Internal anti-corruption structure

For many anti-corruption compliance programmes, individuals within the company are tasked to lead anti-corruption compliance efforts. Upon completing the fundamental scoping groundwork, the company will need to sketch out an internal anti-corruption compliance structure. This often occurs at the same time that anti-corruption policies and procedures are being drafted. For businesses with straightforward anti-corruption profiles, a single person may be sufficient to staff this function, while businesses with more complex anti-corruption footprints face larger anti-corruption challenges.

Training

Training is critical to an effective anti-corruption compliance programme. Such training involves two to three stages: basic anti-corruption education, teaching employees and executives the way in which a company's anti-corruption procedures operate, and routine follow-up/refresher training. While the first two elements are self-explanatory, the third step is equally important. It is essential to make sure that the company demonstrates a clear commitment to anti-corruption principles commonly referred to as the "tone at the top" and that employees keep their anti-corruption obligations squarely in mind. It is also vital to provide a continuing education function as the company's risk profile or as anti-corruption laws change. A company can have first-class anti-corruption procedures, but if it lacks robust training, the effectiveness of the programme will be limited.

> **"An effective anti-corruption programme can serve as an important measure for fulfilling a company's obligation to comply with anti-corruption laws**

Counselling and assistance

Once a company's programme is set up and training is completed, an effective anti-corruption programme generally requires upkeep and problem solving. Upkeep usually takes the form of counselling on the best ways to manage programmes and adjust for changes arising from a fluid anti-corruption and business environment. Management counselling can also include advice on how the highest layer of a company can best emphasise "tone at the top", which is essential to the success of any anti-corruption programme. Most important among a company's responsibilities, however, is how a company handles potential anti-corruption problems when they arise, also known as red flags. While it is a company's wish that its anti-corruption compliance programmes shields it from problems, the US government recognises that this is often impossible, especially in environments in which corruption is endemic. Accordingly, the US government places tremendous weight upon the way a company responds when its anti-corruption compliance programme signals a potential problem. Committed identification of trouble and robust remediation of issues is essential to protect a company from FCPA prosecutions.

Five tips for managing corruption risks

Strategies include undertaking a full risk assessment, conducting comprehensive due diligence, establishing adequate contractual protections, developing proper monitoring procedures and designing and implementing a thorough compliance system

China contributes around one quarter of the world's economic growth. With a population of 1.4 billion people and a rapidly-growing middle class, it is little wonder that the country exerts an irresistible attraction on foreign organisations seeking new markets and growth opportunities. Impressive as these statistics are, the Chinese market also presents a number of challenges, including the risk of corruption. The Chinese government is making a determined, and very public, effort to tackle this issue with a growing number of high profile investigations and prosecutions. Local Chinese regulators and enforcement agencies are also increasingly active in enforcing commercial bribery laws in the private sector. As a result, foreign organisations operating in China are faced with a dynamic environment where anti-corruption compliance must be a core component of their business model.

The *PRC Criminal Law* (中华人民共和国刑法) and the *PRC Anti-Unfair Competition Law* (中华人民共和国反不正当竞争法) are the primary pieces of anti-corruption legislation applicable to organisations doing business in mainland China. These organisations must also take into account the potential international reach of legislation in their home country or in the jurisdictions where

Analysing the risks

Common strategies used by organisations to collect and assess information on corruption risk include:

- Understanding where and how any potential interactions with government agencies and officials will occur;
- Conducting desktop and other research into their industry sector together with country-specific information;
- Organising workshops to identify and analyse potential corruption exposure and developing appropriate responses when a risk is identified;
- Reviewing internal audit and other reports of previous incidents and compliance risks as well as the steps that were taken to address any failures; and
- Carrying out interviews and discussions with employees on the ground in China, together with other corporate team members, including legal, risk, audit, ethics, compliance and procurement.

their securities are traded. Statutes such as the *US Foreign Corrupt Practices Act* (FCPA) and the UK *Bribery Act*, for example, have the potential to apply to a multinational organisation and regulate the conduct of its employees in China. An organisation should develop a comprehensive strategy to ensure that it is adequately protected from the risks of both civil and criminal prosecution arising from any improper conduct in China.

1 Identify and assess the risks

Managing corruption risk requires a robust and proactive approach to assessing how and why corruption-related issues can arise in China. All too often, the first indication that there is a problem is when a whistleblower makes a report or a Chinese regulator or enforcement agency announces an investigation. The directors and executives back at corporate headquarters are often left wondering how the organisation failed to identify the risk.

When investing or contracting in China, it is particularly important to tailor these strategies to ensure that cultural differences and language barriers are adequately addressed. This requires a detailed and sensitive understanding of Chinese business culture and the inherent legal risks that can result. Failure to appreciate the differences between the Chinese and Western approaches to doing business as well as the potential impact of local practices on a Western business operating in China almost guarantees that a risk assessment exercise will be unsuccessful before it has even begun.

The conviction of Peter Humphrey

Corporate investigators Peter Humphrey and his wife were convicted in August for illegally obtaining personal information on Chinese citizens. The couple was prosecuted for obtaining more than 250 separate items of personal information on Chinese citizens, paying up to US$350 for each and selling them to multinational clients through their firm ChinaWhys.

The case was brought to light by the recent bribery investigation into British drugmaker GlaxoSmithKline, one of their key clients.

Humphrey was sentenced to two and a half years in prison and fined Rmb200,000 (US$32,500). He will be deported after serving his sentence. His wife Yingzheng Yu was sentenced to two years and fined Rmb150,000.

This was the first case involving foreign investigators in China and highlights the legal risks of data privacy and state secrecy. It brings to light the absolute importance of conducting due diligence on employees, business partners and any third parties, as well as the vague nature of the laws protecting personal information in China and what little it achieved to clarify what information is legally accessible.

By Katherine Jo

Guanxi, or relationship building, is the traditional basis of building and doing business in China, where the concept of legally enforceable contracts remains a relatively recent innovation. *Guanxi* is based on developing relationships, often by exchanging favours, including gifts and entertainment. This Chinese custom of gift giving in a business context frequently strikes many Westerners as unusual and, in some cases, at odds with applicable rules and regulations. Indeed, from a risk management perspective, *guanxi* can magnify the compliance challenges facing an organisation, especially when coupled with other issues, such as different practices for maintaining books, records and high employee turnovers.

> **The challenging matrix of domestic regulations and the need for regulatory approvals, which increases the need for and frequency of governmental interaction, also lead to difficulties**

A factor that further increases the compliance challenges faced by organisations in China is the prevalence of state-owned entities (SOEs) in the Chinese market. As a result, a significant percentage of China's workforce will be treated as foreign government officials – prohibited bribe recipients under the FCPA, the Bribery Act and other foreign bribery laws in many organisations' home jurisdictions. The Chinese government owns approximately 70% of the country's productive capacity, and is the majority shareholder in more than 30% of China's publicly listed companies. SOEs also dominate key sectors of the economy including banking, energy and healthcare. The challenging matrix of domestic regulations and the need for regulatory approvals, which increases the need for and frequency of governmental interaction, also lead to difficulties.

While SOEs play an important role in the Chinese economy, there are also a large number of private organisations. In 2013, the State Administration for Industry and Commerce estimated there were over 40.6 million individually-owned businesses and private enterprises in the mainland. Many of these organisations are still developing their own systems and controls and, as a result, there is frequently a limited (or non-existent) separation between company and personal assets. This can sometimes lead to the creation of separate sets of accounts for off the books dealings and related party transactions – all of which present further risks for the inexperienced investor.

2 Conduct comprehensive due diligence

Conducting and documenting the due diligence process is essential to protecting an organisation operating in China. It is particularly important to address third party risk, which continues to be the most challenging issue facing foreign organisations. Third party agents are frequently used in China

and pose significant risk management issues for organisations hoping to enter the market. Engaging corrupt third party agents or investing in a venture or deal that is already tainted by corrupt practices is one of the most common causes of anti-corruption enforcement actions against organisations.

It is crucial to know and understand the business practices of third party partners and agents. To do this and to fully protect themselves, organisations must conduct comprehensive due diligence. Typical due diligence will include gathering background information about a prospective third party agent, partner or target. Key issues to assess can include identifying the third party's beneficial ownership structure, its qualifications, reputation and any connections or dealings it may have with prohibited bribe recipients.

That being said, undertaking a due diligence exercise in the Chinese market often presents its own unique challenges. Legal and financial information is often incomplete or non-existent and the quality of public records varies significantly from one province to another. This situation can be further complicated by language barriers and differences in business culture.

The core values of a compliance system

To be effective, an anti-corruption compliance system must be customised to meet the specific needs (and risks) facing an organisation. There are, however, a number of fundamental features that a well-designed system should incorporate. In addition to the factors already discussed in this article they include:

- Creating a business culture that encourages compliance and is supported by a commitment from the highest levels of an organisation. Senior management, including the board, have an important role to play in reinforcing the organisation's anti-corruption compliance system;
- Drawing clear lines of oversight and accountability for compliance, including ensuring that those charged with managing the organisation's anti-corruption compliance system are independent and have the resources and support they require to undertake their role;
- Setting forth written policies and procedures which provide practical guidance to all employees;
- Conducting regular anti-corruption training which is reinforced by periodic communications and reminders about the importance of a "compliance culture"; and
- Establishing processes for quick and effective responses to any compliance issues. Policies and procedures must be enforced throughout the organisation and include disciplinary actions for any violations.

Data privacy is another complex area that comes into play when conducting due diligence. There are a multitude of laws and regulations designed to protect the personal information of Chinese citizens. Unfortunately, none are simple or straightforward. There is currently no single piece of legislation which provides a comprehensive framework covering all aspects of data privacy. Rather, there is an assortment of rules and regulations addressing various matters related to the gathering, use and dissemination of information that has been collated. As a result, considerable caution must be exercised in how this information is used.

In seeking to overcome these constraints, many organisations engage a third party provider to assist with due diligence enquiries. In doing so, organisations must ensure that these third party providers do not themselves engage in corrupt practices in the course of the information gathering exercise. Irrespective of whether background checks and other on-the-ground enquiries are undertaken directly or indirectly, organisations must remember that Chinese laws apply; the investigation and information gathering processes have to be fully compliant with all local laws. Serious consequences can arise if Chinese authorities suspect that local laws have been infringed in the context of the due diligence process.

3 Establish contractual protections

Ensuring that contracts contain adequate protections is important to mitigate against corruption risk. These protections can take a number of different forms, including reinforcing due diligence enquiries, outlining detailed standards of conduct or providing rights and options in the event that improper conduct is suspected or occurs. Regulators in the home countries of many organisations have made it clear that they expect contracts to incorporate these types of clauses and to ensure that all business partners agree to comply with their requirements.

It is also important to appreciate that Chinese parties may not confer the same level of significance to a written contract as their Western counterparts. In China, a written contract is often viewed as one component of a business relationship. For example, if economic circumstances change, a Chinese counterparty may expect to renegotiate the terms of a contract. Contractual enforcement in Chinese courts can also be challenging. Against this backdrop, ensuring contracts contain anti-corruption clauses is clearly important, but is not an adequate means of protecting an organisation against risks of corruption, investigation or prosecution.

4 Develop monitoring procedures

In China, where relationships play such a fundamental role in business, establishing monitoring procedures is critical, particularly when investing in a joint venture or engaging third parties.

For joint ventures, effective monitoring will require investors to review whether a joint venture already has in place the appropriate anti-corruption polices and processes before deciding to proceed with an investment. Without these policies and processes, effective monitoring becomes an impossible task. Throughout the life of the joint venture, regular health checks should also be conducted to ensure policies and processes remain adequate, enforced and consistent with the investor's current approach to anti-corruption compliance. Internal audit, financial controllers, company lawyers and compliance teams are critical in ensuring that any corrupt, or potentially corrupt, behaviour is identified and addressed at the earliest possible moment.

> **Monitoring and audit procedures should include proactive reviews of any high value and high risk transactions. *Ad hoc* inspections, together with regular compliance audits, are also important and useful tools**

Potential investors can take a number of steps to ensure third parties are effectively monitored. Employees responsible for managing these third parties must be trained to recognise warning signals, including pro forma requests for reimbursement of costs and expenses, abnormally high commissions, discounts or rebates or unusual payment arrangements. Third parties operating in high risk areas, particularly where they have any dealings with government bodies and officials, should be regularly audited at the transaction level. Expectations regarding appropriate standards of conduct must be reinforced through regular anti-corruption training and internal communications.

More broadly, monitoring and audit procedures should include proactive reviews of any high value and high risk transactions. *Ad hoc* inspections, together with regular compliance audits, are also important and useful tools in reinforcing the organisation's commitment to a compliance culture.

Organisations are well-advised to fully document all the steps they have taken to monitor compliance. Detailed records of all training activities should be maintained together with the results of compliance audits and reviews, and, in particular, the steps that have been taken to address any breach of the organisation's compliance policies.

5 Design and implement a thorough compliance system

Organisations seeking to manage corruption risks need to integrate risk assessment processes, due diligence, contractual protections and comprehensive, ongoing monitoring procedures into a thorough and holistic anti-corruption compliance system.

Exposure to corruption risk is a reality of doing business in many places around the world and China is certainly not alone in posing challenges for organisations. Like many other countries, there are language barriers coupled with significant business and cultural differences and limited access to public source information. There is no one-size-fits all compliance solution for foreign organisations that are either already doing business in China or considering their first investment. Organisations must develop a detailed compliance system based on a full analysis of their business and the risks they face. Increased vigilance has to be their guiding principle.

Kyle Wombolt, Hong Kong, and Jacqueline Wootton, Melbourne, Herbert Smith Freehills

What should I do when I'm being investigated?

What must I do when a regulator conducts an investigation into my company? What documents and evidence must I prepare and how do I show I am in full compliance? What are the pitfalls to avoid and what measures should I take to protect the company?

The domestic perspective

2014 marks the 22nd year of the *PRC Anti-Unfair Competition Law* and eighth year of the *PRC Anti-monopoly Law*. We have witnessed an unprecedented upsurge of enforcement actions of investigations and punishments against companies in recent years. Understanding how to respond effectively and appropriately to the relevant PRC enforcement agencies is of critical significance to the multinational corporations (MNCs) with businesses in China.

When the regulator comes knocking

First of all, any employee being investigated or informed of an investigation must immediately notify the company's management including sales leaders, financial officers, CEO, in-house lawyers and compliance offices. The management team must determine the preliminary risks and conduct a legal assessment of the case, as well as work out how to produce any documents or testimony as requested by the enforcement agency. Cooperation may also be needed from third party business partners and/or intermediaries.

Secondly, employing experienced counsel is recommended at the outset of the investigation, so they are able to provide an accurate risk assessment, formulate a response plan and to follow up with the agencies in an efficient manner. In addition, during the entire investigation process, the legal team of the company, including in-house lawyers and external legal counsel, should provide opinions on whether the investigation procedures conducted by the enforcement agencies, which can be the Administration for Industry and Commerce (AIC) or Public Safety Bureau (PSB), comply with the relevant PRC administrative rules and regulations. It is important to note compliance, especially regarding the search approval documents and identification certificates presented by the officers, as well as the search scope and authority over those employees and/or documents of the company being searched and detained.

A company under investigation needs to be cooperative, because, in criminal investigations, the PSB is able to summon witnesses without the consent of the company, pursuant to Article 64 and Article 122 of the *PRC Criminal Procedure Law*; and in administrative investigations, although the enforcement agencies may lack the power and authority explicitly provided in the relevant laws and procedures to conduct investigations against the company by force, they could nonetheless impose harsher punishments and cause negative, public exposure on an uncooperative company.

Evidence and compliance

In response to any enforcement agency's request to produce evidence, the company should prepare and submit the following documents or evidence to show the company is in full compliance under the relevant PRC law:

1) relevant documents as provided in the document request lists issued by the agencies to the company being investigated to the extent reasonable;
2) policies, internal controls, compliance requirements and procedures of the company with regard to the issues of the investigation;
3) any explanation, declaration or statement of the company's management team or its controlling shareholder to clarify the issues of investigation and its cooperation; and
4) relevant anti-commercial bribery or anti-monopoly trainings that have been provided to employees or its intermediaries.

In addition to the provision of these documents, any acts of self-disclosure, including offering unrequested but relevant evidence and making prompt corrections during the investigation, are encouraged and deemed as compliance efforts as well.

> **"It is important to carefully screen and scrutinise documents, not only to avoid any irrelevant responses to the issues of the investigation but to also prevent detrimental consequences in other respects, such as a breach of confidentiality obligations**

Preventing mistakes

During the process of responding to requests or orders of the enforcement agencies, companies have a right to raise a timely and reasonable objection to any investigation action that is in violation of the relevant PRC laws and procedures.

It is important to carefully screen and scrutinise documents, not only to avoid any irrelevant responses to the issues of the investigation but to also prevent detrimental consequences in other respects, such as a breach of confidentiality obligations.

Ensuring consistency between all documents is also critical, especially between any submitted documents and verbal or written testimonies of interviewees being interviewed by the agencies.

Lastly, companies must not only be able to deal with any emerging or urgent crises but also need to ensure compliance efforts are being made continuously. Such efforts include setting up an efficient internal whistle-blowing and reporting system and conducting internal investigations and taking disciplinary actions by experienced teams.

Haixiao (Helen) Zhang, Zhong Lun Law Firm, Shanghai

The international perspective

Investigations of foreign-invested enterprises (FIEs) in China by local regulators and the Public Security Bureau (PSB) have made headlines recently with investigations into GlaxoSmithKline and other pharmaceuticals companies for alleged criminal and, in some cases, antitrust law violations.

Administrative investigations of FIEs in specific industry sectors by local Administrations for Industry and Commerce (AICs), or local Customs have long been a feature of doing business in China. Faced with a government review, FIEs generally comply with the requirements of officials and provide all requested information, often without instructing lawyers. More often than not, the outcome of such reviews is payment of a penalty that is capped under relevant laws, which is absorbed into the cost of doing business. On rare occasions, an FIE instructs Chinese counsel to challenge an administrative penalty through the Chinese administrative and judicial review process. Until recently, criminal investigations of FIEs for corruption have been rare and antitrust investigations in relation to cartel activity are a new development. Further, criminal investigations of FIEs for corruption-related offences have raised the possibility of related investigations in jurisdictions where the FIE parent or investor may have exposure, such as the *Foreign Corrupt Practices Act* in the US or the *Bribery Act* in the UK.

> **Faced with potentially serious violations and complex legal and jurisdictional situations, in-house counsel must make quick decisions regarding an FIE's response to local government investigators and take appropriate measures**

Faced with potentially serious violations and complex legal and jurisdictional situations, in-house counsel must make quick decisions regarding an FIE's response to local government investigators and take appropriate measures to protect the company. In such circumstances, it may be appropriate to instruct both local counsel, whose role generally is to advise on local laws and directly interact with government investigators, and foreign counsel, whose role is to shadow the investigation to identify exposure under foreign laws and potentially to extend legal privilege. Both Chinese and foreign counsels are likely to agree on the procedures to be taken regarding the company's response to local government investigators; however, foreign counsel may recommend that additional procedures be undertaken in anticipation of subsequent offshore regulatory actions.

Typical responses and recommended procedures in relation to criminal and administrative investigations by Chinese authorities include:

- Designate at least one management member to interact with regulators or the PSB. Ideally, a core team of HR, IT, finance, legal/compliance and other relevant management should be formed to support the investigation.
- Inform head office immediately of any visit from authorities and bring external counsel on board as soon as possible. Since PRC law does not include the concept of legal privilege that pertains in common law jurisdictions, it is prudent to ask external counsel to sign a confidentiality agreement. Consider whether it is helpful for foreign counsel to engage local counsel in order to preserve legal privilege.
- Depending on the nature of the investigation (in some

circumstances investigators may require a more discreet approach), communicate with employees as soon as possible, requesting them to be calm, polite and cooperative. It is important to take control of the situation and demonstrate that the company is working to support investigators in order to minimise the risks of overreaction by employees. Employees must also understand that the investigation is an internal matter and that it should not be discussed with persons outside the company.

- If the investigation is serious, ask compliance, legal or HR to set up specific whistle blower and counselling channels.
- Take a positive and compliant approach and move efficiently to make materials requested by authorities available, at the same time keeping a record and copies of relevant materials taken by investigators. Depending on the approach of the investigators, it may be possible to request time for the company to gather materials and/or make lists of potential materials that could be of interest to the investigators. In other scenarios, company personnel may have to stand back while investigators search for and remove documents, review computer accounts and remove hard drives.
- If there is a risk that investigators will remove laptops or desktop computers and if sufficient time is available, consider imaging hard drives of key employees, provided that imaging will not negatively impact the investigation.
- Issue a bilingual document retention notice, instructing employees to retain all company soft and hard copy documents, emails and SMS. Turn off any email auto-delete function on relevant servers.
- If employees are to be interviewed by authorities, brief each employee before their interview and encourage cooperation. If circumstances permit, discuss any potential violations with an employee before or after they are interviewed in order to understand the facts, but be careful not to interfere with the investigators' fact finding procedures.
- Work with external counsel to conduct a shadow review of the materials that government investigators have shown an interest in, or might be interested in. It is important to engage counsel who can mobilise quickly and efficiently. If the authorities are interested in the company's financial statements and sufficient information regarding the purpose of the investigation is available, consider engaging forensic accountants to review the companies accounting records. If it is important to preserve legal privilege, ask foreign counsel to engage the accountants in order to do so.
- If the investigation is serious and high profile, and particularly if authorities decide to disclose the investigation in Chinese media, consider engaging experienced public relations professionals to manage the company's communications with the media.

While much can be done to smoothen the path of an investigation, some conduct is unhelpful and potentially high risk. It is important not to:

- Interfere with or try to control an authority's investigation;
- Destroy, hide or create documents in response to an investigation;
- Influence an employee's responses in an interview, even if the employee is confused; or
- Assume that you know what the investigators are looking for, unless they tell you.

Susan Munro, Steptoe & Johnson, Beijing

GSK: A case study

GlaxoSmithKline was handed the largest ever corporate fine in China as enforcement has grown fierce. The entwining Chinese anti-bribery laws, the US FCPA and UK Bribery Act call for immediate attention to risks and compliance on both a national and global scale

The Chinese government has substantially beefed up its anti-corruption enforcement in recent years, resulting in arrests and trials of high-level state officials and prominent executives of state-owned entities (SOEs) as well as multinational companies (MNCs).

Among the many corruption investigations that took place in China, the GlaxoSmithKline (GSK) bribery case has stood out most. Prosecutors not only charged the company's Chinese and British executives, but also the corporate entity of its Chinese subsidiary. The case in China was followed by investigations in the US and UK, which further compounded the consequences and liabilities facing GSK.

Chinese anti-bribery laws

China has two major laws that impose administrative penalties for commercial bribes and criminal penalties for both public and commercial bribes.

PRC Anti-Unfair Competition Law

The *PRC Anti-Unfair Competition Law* (中华人民共和国反不正当竞争法) (AUCL) was enacted in 1993 to prohibit unfair competition practices, including intellectual property infringement, abuse of dominance power and commercial bribery. Article 8 of the AUCL prohibits any business operators from "giving bribes in the form of property or other means for the purpose of selling and purchasing products and services". Kickbacks or secret commissions not properly documented in the books and records are also prohibited. Article 22 prescribes criminal liability under the Criminal Law if the commercial bribery constitutes a crime, and administrative penalties for less serious violations.

In 1996, the State Administration for Industry and Commerce (SAIC), the enforcing regulator of the AUCL, promulgated the *Provisional Rules on Prohibition of Commercial Bribery Activities* (关于禁止商业贿赂行为的暂行规定) (SAIC Rules) to clarify the definition of commercial bribery under the AUCL and defined property as "any cash and non-cash payments, including, but not limited to, property disguised as marketing fees, publicity fees, sponsorship fees, R&D fees, labour service fees, consulting fees or commission fees, as well as reimbursement of various expenses, etc". Offering domestic or international tours, excessive meals or entertainment may be regarded as bribes in the form of "other means".

Local SAIC offices have investigated a number of MNCs for alleged commercial bribes, which often resulted in modest administrative fines ranging from Rmb10,000 (US$1,610) to Rmb200,000 (US$32,200) plus the confiscation of illegal income. In the case of GSK, local SAIC offices in Beijing and Shanghai were reported to have previously investigated GSK China for commercial bribes. *Xinhua* reported that GSK China executives also tried to bribe local SAIC officials to influence and end SAIC investigations.

PRC Criminal Law

The *PRC Criminal Law* (中华人民共和国刑法), enacted in 1979 with eight subsequent amendments, penalises both public and commercial bribery for the purpose of securing illegitimate benefits. Historically, the Criminal Law limited bribery to a state official or state functionary. After China adopted a market-oriented economic system, commercial bribery to a non-state official (i.e., a representative of a business enterprise or institution who is not state official or state functionary) was identified as a serious and widespread problem, and was therefore outlawed in the subsequent amendments.

Distinguishing state and commercial bribery is highly complex given the role the state plays in the private sector. A state official or state functionary is defined as "a person who performs public services in a state organ," and the definition is further exemplified in the Criminal Law and various legal interpretations. The scope of "state official" under the Criminal Law is slightly different from that under the bribery laws in other jurisdictions. For instance, the conviction of commercial bribery in the GSK case suggests that the Chinese courts do not consider the healthcare professionals in public hospitals who received the

bribery payments to be state officials. This does not preclude US regulators from potentially penalising GSK for bribing foreign government officials, under the same facts, in violation of the US FCPA.

Whether criminal bribery has been committed depends largely on the cumulative bribery amounts and the intention behind the offered money or property.

The Supreme People's Court and the Supreme People's Procuratorate have promulgated many legal interpretations to supplement the Criminal Law, including the *Opinions on Several Issues Concerning the Application of the Law in Handling Criminal Commercial Bribery Cases* (关于办理商业贿赂刑事案件适用法律若干问题的意见), which identified the eight different types of commercial bribery crimes.

In most criminal bribery cases, the MPS and local police departments will lead the investigation before passing it on to the prosecutors for official charges. The police may work with other regulators during the investigation. More complex cases that implicate state officials or high-level party members may also involve the party's disciplinary organs. In the end, a criminal bribery case will be put to trial in a Chinese court.

The facts

June 28 2013: the police in Changsha City announced investigations into certain GlaxoSmithKline (China) Investment (GSK China) executives for potential economic crimes.

July 11 2013: the Ministry of Public Security (MPS) confirmed that it had led police departments in various cities to investigate GSK China's executives for "serious economic crimes," including commercial bribery and embezzlement. Shortly thereafter, GSK pledged to fully cooperate with the Chinese authorities and confirmed that Mark Reilly, a British citizen and the CEO of GSK China, would return to China to cooperate with the investigations.

May 14 2014: China's official *Xinhua News Agency* reported that the bribery investigation of GSK China was complete and the case had been transferred to prosecutors for official charges, after more than a 10-month probe. According to the *Xinhua* reports, the management of GSK China had expanded various sale departments, built in bribery costs in drug prices and ordered the subordinates to offer bribes to hospitals, doctors, healthcare institutions and associations in order to boost sales. It was alleged to have illegally gained billions of *renminbi*. Based on the sales through bribes, GSK China's annual revenue increased from Rmb3.9 billion (US$626 million) in 2009 to Rmb6.9 billion (US$1.11 billion) in 2012.

September 19 2014: the Changsha Intermediate People's Court in Hunan Province found GSK China guilty of commercial bribery and fined the company a record Rmb3 billion (US$490 million), the largest ever fine handed down by a Chinese court. Five of GSK China's top executives, including Mark Reilly, were convicted of bribery-related charges and received suspended prison sentences of two to four years.

Liability under the Criminal Law

The trial of the GSK case was not open to the public at the company's request for the protection of commercial secrets, and the official judgment documents are not yet publically available. Our preliminary analysis is therefore largely based on the reports from *Xinhua*, the official state news outlet. According to the *Xinhua* reports, the Chinese court found that GSK China adopted a bribery sales model and used various forms to bribe professionals in different healthcare establishments in huge amounts. As a result, the Chinese court found the company guilty of bribery to non-state officials (对非国家工作人员行贿) according to Article 164 of the Criminal Law, which requires an element of offering money or property for the purpose of securing illegitimate benefits.

> **Whether criminal bribery has been committed depends largely on the cumulative bribery amounts and the intention behind the offered money or property**

While it is uncommon to convict a corporate entity under the Criminal Law, GSK China, the corporate entity, was convicted of the crime of bribes committed by a unit under Article 393, which requires an element of corporate intent with regard to the illegal conduct. Based on the *Xinhua* reports, the Chinese court confirmed this corporate intent since GSK China actively organised, encouraged and adopted a bribery sales model to increase sales revenue and secure illegitimate benefits.

Under the Criminal Law, penalties for corporate entity crimes could include fines for the corporate entity and imprisonment for responsible executives and personnel. In the GSK case, the Chinese court imposed the largest ever corporate fine of Rmb3 billion (US$490 million) on GSK China, likely having considered the circumstance of the crime, such as illegal gain and damages caused, as well as the financial ability of the corporate entity, according to the Supreme People's Court's *Rules on the Application of Penalties Imposed on Properties* (关于适用财产刑若干问题的规定).

Five individual executives, including the GSK China CEO and the China legal head, were all convicted of commercial bribery and given suspended prison sentences of two to four years. It should be noted that the penalties for those individuals were reduced because they had voluntarily cooperated with the investigation and pled guilty, and the Chinese court acknowledged and gave credit to the China CEO for returning from the UK to cooperate with the investigation.

US FCPA and UK Bribery Act

Aside from the severe criminal liabilities imposed on GSK China and its executives by the Chinese court, the GSK case was also followed by investigations by the US and UK regulators.

Surviving the new environment

Educate your local staff: Your local business and compliance staff should be regularly alerted of the bribery risks and educated on the development of the FCPA, the *Bribery Act* and Chinese bribery laws. For instance, in the healthcare sector, the National Health and Family Planning Commission promulgated the *Nine Prohibitions for Strengthening Ethical Conduct in the Healthcare Industry* (Nine Prohibitions) on December 26 2013. Educating your local staff to understand and cease any unlawful or unethical practices highlighted by the Nine Prohibitions is advised to improve overall compliance.

Examine your local business practice: The GSK bribery case is a warning call for MNCs blindly following local business practices and customs. MNCs should carefully review and analyse the relevant laws before adopting any local business practices.

Enhance your compliance and internal investigation programmes: While most established MNCs have compliance programmes in place, the programmes are not always tailored to the risks specific to China. It is recommended to establish a comprehensive compliance programme that takes into consideration Chinese anti-bribery laws given their differences from the FCPA and the Bribery Act. Effective internal controls and investigation functions are also important in order to deter and detect violations of compliance policy.

Elevate compliance role within your organisation: Due to competition and business culture, compliance in China is given insufficient priority in some cases. For instance, GSK China was alleged to "emphasise sales but ignore compliance." Ensuring that the compliance function is properly resourced and structuring its reporting lines to maintain sufficient independence from the business function are important considerations.

The US *Foreign Corrupt Practices Act* (FCPA) of 1977, as amended, was enacted to make it unlawful to make payments of money or anything of value to a foreign official for the purpose of obtaining or retaining business. While doctors are generally not regarded as state officials in China, the FCPA defines "foreign official" very broadly to include government officers or employees of foreign government, department, agency or instrumentality, such as SOEs and public hospitals. In addition to the anti-bribery provision, the FCPA has a set of books, records and internal control provisions applicable to issuers that have securities registered, and with shares listed, in the US. In September 2013, two months after the Chinese investigation commenced, GSK confirmed that US authorities had begun an investigation of its potential violations of the FCPA in China.

The UK *Bribery Act*, which was enacted in April 2010 and came into force on July 1 2011, prohibits bribery, being bribed, bribery of foreign public officials and the failure of a commercial organisation to prevent bribery on its behalf. The *Bribery Act* has an even broader jurisdiction than the FCPA and allows for the prosecution of an individual or company with links to the UK, regardless of where the crime occurred. Shortly after the formal charges in China, the UK Serious Fraud Office (SFO) opened a criminal investigation into GSK, according to a report by *The Telegraph* on May 27 2014. The SFO investigation will be closely monitored given the crime of failing to prevent persons associated with them from bribing on its behalf under the *Bribery Act*.

While the GSK investigations by the US Department of Justice and UK SFO are still ongoing, they will likely be impacted by the investigation and trial in China. *Reuters* on July 23 2014 reported that the UK SFO was working with Chinese authorities for the first time as it was carrying out its own investigation into GSK.

Fierce enforcement

As the most high-profile corruption investigation conducted by Chinese regulators, the GSK case revealed significant enforcement trends in China.

Firstly, the unprecedented scale and level of the investigation of GSK led by MPS with regulators in different regions, along with the increase in the overall number of anti-corruption investigations, showed that the Chinese regulators are no longer sitting on the sidelines and will aggressively enforce the anti-bribery laws.

Secondly, the GSK case showed that the Chinese government is now focusing on tackling commercial bribes by punishing both bribe givers and recipients, unlike the historical emphasis on punishing only recipients.

Thirdly, regulators are increasingly going after the corporate entity, while most commercial bribery cases have previously been brought against individual offenders rather than the corporate entity.

Lastly, based on the actions and statements of the government, certain industries such as healthcare, food, energy, real estate, financial services and telecommunications will likely remain as the focus of enforcement in the coming years.

Most MNCs have already put in place internal control and compliance programs to comply with the FCPA and the Bribery Act. There are, however, still many improvements to be made to effectively address the increased regulatory risks and enforcement trends.

Martin Rogers, Bernard Chen Zhu and Jianwei (Jerry) Fang, Davis Polk & Wardwell, Hong Kong