

Understanding China's Approach to Anticorruption

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Multinational companies with substantive connections to the United States have long established systems to comply with the requirements of the U.S. Foreign Corrupt Practices Act (FCPA). In addition, many multinationals also have systems to comply with the anticorruption laws of the respective host countries where they operate (in particular, the UK Bribery Act and the EU Criminal Law Convention on Corruption). Fewer companies, however, have developed and put in place compliance systems designed specifically to ensure compliance with Chinese anticorruption laws. With the increased focus by Chinese regulators on anticorruption enforcement, companies must work to understand Chinese anticorruption law and take appropriate remedial measures in response.

The past 10 years have seen several high-profile FCPA enforcement actions related to corruption issues in China. In some cases, the relevant corporation admitted to participating in corrupt practices. Nevertheless, in many of these cases, the Chinese government did not initiate any action against the bribe recipient, and did not bring charges against the relevant company for the bribery alleged to have taken place within China.

This has changed. For example, earlier this year, Chinese authorities disclosed an investigation into GlaxoSmithKline (GSK) and other companies regarding potentially corrupt practices. The news triggered an explosive reaction in the market. While Chinese anticorruption laws and regulations have been in place for quite some time, enforcement actions (especially enforcement against the Chinese subsidiaries of foreign based multinationals) previously had been relatively few and far between.

China's Anticorruption Laws

Chinese anticorruption laws and regulations are scattered across a variety of sources. Two statutes in particular constitute the primary controlling authority:

- The Criminal Law of the People's Republic of China (Criminal Law)
- The Anti-Unfair Competition Law of the People's Republic of China (AUCL)

Additional anticorruption-related laws, judicial interpretations and administrative regulations supplement these statutes, such as the Provisional Measures on the Prohibition of Commercial Bribery issued by the State Administration for Industry and Commerce (AIC Measures). Furthermore, China is a signatory to the UN Convention against Corruption, which has been effective for China since 2006.

While the AUCL addresses only commercial bribery, the Criminal Law recognizes two forms of bribery, each based on the identity of the bribe recipient: “official bribery” (offering a bribe to a state functionary) and “commercial bribery” (offering a bribe to a representative of a private enterprise or institution). The Criminal Law defines a “state functionary” as a person who performs public services in a state organ, including: (i) a person who performs public services in a state-owned company or enterprise, institution or people's organization; (ii) a person who is assigned by a state organ, state-owned company, enterprise or institution to a company, enterprise or institution that is not owned by the state or a people's organization to perform public services; and (iii) any other person who performs public services. Due to this broad definition, it is prudent for multinationals to proceed carefully when dealing with the managerial staff of state-owned enterprises, as actions perceived as official bribery may trigger severe criminal liability.

The Criminal Law contains an exception for payments extorted by a state functionary that do not impart any benefit on the gift provider. The AIC Measures also contain certain exceptions for payments to an otherwise prohibited recipients, including small gifts for marketing and promotions.

The penalties for the bribe-giver under the Criminal Law can be substantial, and vary depending on the identity of the bribe giver and the bribe recipient. For acts involving official bribery, an individual bribe-giver may face penalties from criminal detention to life imprisonment, and possible confiscation of property; for an act of commercial bribery, an individual bribe-giver may be subject to penalties from criminal detention to 10 years’ imprisonment, and a possible criminal fine. Further, in case of an entity bribe-giver, the entity may face criminal fines; the management personnel or other staff of the entity who are directly responsible for the matter may also be subject to similar criminal penalties as in an individual bribery case.

Under the AUCL, where the violation does not amount to a criminal act, penalties typically include a fine of up to RMB 200,000 (approximately \$32,000) in addition to disgorgement of illegal income (if any). The AUCL also gives rise to a cause of action for competitors who can allege they were harmed by such commercial bribery, allowing such competitors to bring a civil claim for damages before a People’s Court.

Relationship to the FCPA

The most notable distinction between the FCPA and its Chinese counterparts lies in the potential sanctions available to each government. Under the criminal provisions of the FCPA, companies face potential fines of up to \$2 million per violation, while individuals may be fined up to \$100,000 per violation. In addition, individuals face up to five years in prison for each count of bribery under the FCPA. With respect to the FCPA's accounting provisions, companies can be fined up to \$25 million for such violations, and individuals may be fined up to \$5 million and sentenced to up to 20 years in prison. In addition, the Securities and Exchange Commission has the ability to pursue the equitable remedy of disgorgement of all profits attributed to the corrupt activity. In spite of the availability of significant prison terms for violations of the FCPA, the longest sentence handed down in an FCPA case to date has been no more than 15 years.

Monetary penalties are also adopted in China. Criminal fines and confiscation of property (potentially up to all assets of an individual) are provided under the Criminal Law. The AUCL also sets up legal remedy of disgorgement of illegal income. In practice, the actual monetary penalties imposed in Chinese authorities' enforcement have been modest, compared against the large settlement figures seen in FCPA actions. The potential for life imprisonment, however, is a significant difference from the FCPA, and one that should be of substantial concern for executives and other individuals operating in China.

A New Approach to Anticorruption in China

The increased enforcement activity of the government in China has had an immediate impact on the business culture in China, requiring a new approach to anticorruption compliance. The GSK case is instructive. In July 2013, the PRC Ministry of Public Security officially announced that senior executives of GSK were under criminal investigation on suspicion of offering large bribes to government officials, hospitals, doctors and medical industry associations through falsified travel expenses. Local administrative authorities subsequently visited the China offices of several multinational pharmaceutical companies, including Novartis, Eli Lilly, UCB and Roche. Using the GSK case as an example, one can classify this impact of Chinese enforcement officials' new activity into three distinct categories:

Impact No. 1: Companies Must Consider Chinese Anticorruption Enforcement

First, it is clear that authorities in China are now actively taking a hard line against bribery. In addition to new enforcement cases, China has taken steps to strengthen its ability to pursue corruption. On January 1, 2013, a Judicial Interpretation issued by the Supreme People's Court and the Supreme People's Procuratorate took effect that provided guidance on the government's interpretation of its anticorruption laws. The Judicial Interpretation set forth the relatively low threshold amount that can trigger a criminal penalty for bribing a State functionary (RMB 10,000, or approximately \$1,600) and provides guidance on the application of mitigated punishments or exemptions to encourage voluntary confessions. In addition, on February 6, 2013, the Provisions of the Supreme People's Procuratorate on Bribery Case File Inquiries became effective. The Provisions further improve China's file-inquiry system, enabling individuals and enterprises under certain circumstances to examine the bribery records in the file system operated by the People's Procuratorate. Although such access to anticorruption enforcement records is subject to various conditions and restrictions, it creates collateral litigation and reputational risk for multinationals operating in China.

Companies should consider more closely their compliance with Chinese anticorruption laws and regulations and should ensure that Chinese anticorruption legal requirements are integrated as key components of their internal compliance programs.

Impact No. 2: Old Systems May Not Be Sufficient

Second, the GSK case raises another issue with a potentially more far-reaching impact. GSK is a sophisticated company with substantial resources available for anticorruption compliance, and a company that purportedly had internal and external compliance mechanisms in place. A few months before the Chinese police alleged the potentially serious violations, GSK declared that based on its own investigation there had been no violations. In spite of GSK's resources and its professed commitment to ensuring compliance with anticorruption laws, Chinese enforcement officials nevertheless felt that sufficient evidence existed to pursue a bribery case against the company.

Assuming GSK and similar companies tend to follow generally accepted anticorruption investigation practice in their approach to an anticorruption crisis, there may be a need for all companies to reassess (i) whether their procedures are sufficient; (ii) whether the practical implementation of them is robust enough; and (iii) whether (and to what extent) they need to be further developed and updated. In addition, possible

deficiencies raise questions on the reliability of pre-existing compliance programs that monitor daily work.

Impact No. 3: Expect More Enforcement Under Chinese Law

Third, in the current climate of tightening the enforcement of Chinese and foreign anticorruption laws, it is reasonable to expect an onslaught of new investigations and enforcement actions against Chinese companies and multinationals for anticorruption practices, both from Chinese authorities and from U.S. and other foreign agencies. While many companies are taking a wait-and-see approach to developments in Chinese enforcement, some have already taken steps to tighten up their internal compliance. The increased activity from enforcement officials, along with the risks associated with the potential failure to identify and correct problems, makes waiting a less attractive option.

It will take time to see how all of these issues will play out, but if Impact 1, Impact 2 and Impact 3 all play out together, anticorruption compliance practices in China will begin to resemble the anticorruption compliance practices for companies doing business globally.

Foreign companies operating in China should consider reviewing and improving their anticorruption compliance programs to mitigate any potential operating risks. The GSK case and the current climate of increased Chinese investigation and enforcement prove that one size does not fit all, and a “standard” FCPA compliance and investigation system may not be sufficient in China. Instead, anticorruption compliance systems and practices should be modified to suit local legal requirements, local market practices and local risks.

In response, companies operating in China should consider the following steps:

1. Thoroughly evaluate the impact of the Criminal Law, the AUCL, and any additional relevant laws and regulations in China on the company’s existing compliance programs.
2. Adapt the company’s internal compliance program to accommodate local market-specific risks and to curb noncompliant practices.
3. Update such programs as needed to ensure the systems are up to date, robust and fully implemented.

4. Verify that all personnel receive appropriate and ongoing training and education specific to the risks and practices in China.
5. Provide appropriate training and education to related third parties such as suppliers, dealers and agents.
6. Deliver a locally adapted training course to management and employees on how to handle local investigations should crisis situations arise.

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