

# Anti-Corruption Compliance in China

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*A Broader Perspective*<sup>SM</sup>

# Today's Presenters



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# Agenda

- Reach of the FCPA in China
- Recent Anti-Corruption Cases in China
- Chinese Bribery and Corruption Laws
- High Risk Industries and Transactions
- Compliance Issues
- Challenges for Anti-Corruption Investigations in China



# Reach of the FCPA in China



# Landscape and Corruption Risk Profile

- Convergence of FCPA enforcement and the cultural landscape in China
  - > Letter of the law and the culture of gift giving
    - Business culture based on “guanxi”
- Travel to U.S. by Chinese officials
  - What’s on their itinerary?
- Vast network of government officials
- Many regulatory touches with government officials
- Government ownership/control of commercial entities
- Prevalent use of third parties

# Who Could Be Liable

- An issuer or domestic concern
  - > Diebold, Inc.
- A foreign subsidiary of an issuer or domestic concern can be considered its “agent”
  - > DPC (Tianjin) Ltd.
- Action by foreign companies and individuals in furtherance of prohibited conduct “while in the territory of the United States”
  - > Syncor Taiwan, SSI International Far East Ltd. (“SSI Korea”)
- Issuers liable under books and records and internal controls provisions for foreign subsidiaries’ misconduct
  - > York International, Faro Technologies, Inc.

# U.S. Enforcement Priority

- Pharma and medical device investigations
- Software investigations
- Any FCPA investigation will result in questions asked about the company's business in China





# Recent Chinese Anti-Corruption Cases



# GlaxoSmithKline

- Chinese authorities detained four GSK executives in July 2013
- Allegations that GSK funneled \$490 million to doctors in China through 700 travel agencies in exchange for sales of drug products

## GSK (cont.)

- GSK officials allegedly have confessed that they used middlemen who helped stage conferences and overcharged for them and the middlemen then used the extra money to pay the bribes.
- Chinese papers report that the investigation found that GSK's alleged bribery of doctors “was coordinated by the British company and was not the work of individual employees.”

## GSK (Cont.)

- Spread further – Chinese investigations of Sanofi, AstraZeneca, UCB, Baxter, Novartis, Novo Nordisk
  - > Specific allegations include that Eli Lilly & Co. paid 30 million yuan (\$4.9 million) to doctors to promote its insulin products.
  - > In August 2013, Baxter International Inc. said it investigated whistleblower allegations and found improper expense payments by a China joint venture.
- GSK opened internal investigation and is coordinating with both U.S. and UK officials
- UK and U.S. authorities now investigating GSK and industry for similar potential wrong-doing



## Additional Cases

- JPMorgan Chase is being investigated whether the hiring of the children of Chinese officials related to business generation
  - > Hired the son of the chairman of the China Everbright Group, a China state-controlled conglomerate, and won business from the group that included a stock offering by a subsidiary.
  - > Hired the daughter of a Chinese railway official. The bank went on to help China Railway raise more than \$5 billion in its 2007 IPO.
- In July 2013, Qualcomm announced: “instances in which special hiring consideration, gifts or other benefits...were provided to several individuals associated with Chinese state-owned companies or agencies.”



## Additional Cases (cont.)

- August 2013, Juniper Networks, a U.S. company announced an FCPA investigation.
  - > In 2011, the ex-Vice Chairman of China Mobile Ltd. received a suspended death sentence for taking bribes
  - > China Mobile is Juniper's largest foreign customer.
- Agilent Technologies – announced internal investigation of employees in China working with third-party intermediaries; may have violated the FCPA; voluntary disclosure to SEC/DOJ
- Avon disclosure of FCPA issues in China

## Diebold Inc.

- Paid \$48 million in October 2013 to settle civil and criminal allegations
- DOJ criminal charges under the books and records provisions, not the anti-bribery provisions
  - > Both state-owned and privately-held banks
- Used Chinese subsidiary to spend \$1.6 million for travel and entertainment to state-owned bank officials
  - > Paris, Amsterdam, Florence, Rome, the Grand Canyon, Napa Valley, Disneyland, Las Vegas
  - > Called trips “training”
- Cash gifts from \$100 to \$600 given as well
- Diebold executives on notice but did not take action



# **Chinese Bribery and Corruption Laws**





# China Anti-Bribery Laws

- Commercial Bribery
  - > Article 8 of Anti-Unfair Competition Law
  - > Prohibits both offering and accepting bribery in the form of “money, valuables, and other means to buy or sell goods.”
  - > Articles 163 and 164 of the PRC Criminal Law
  - > Criminal liability for giving and accepting bribes in commercial settings.
- Public Official Bribery
  - > Articles 385 and 389 of the PRC Criminal Law
  - > Prohibits state officials from accepting “money or property” to secure benefits.
  - > Prohibits giving state officials “money or property” to secure benefits.



## Laws (Con't.)

- 8<sup>th</sup> Amendment to China Criminal Law
  - > First China law to criminalize bribery of foreign officials.
  - > Prohibits “giving money or property” to “foreign government functionaries or officials of international public organizations” seeking “improper commercial interests and benefits.”
  - > Relatively large bribe: <3 years imprisonment or penal servitude.
  - > Large bribe: 3<years<10 imprisonment and fine
- 2013 Interpretation of the Supreme People’s Court and the Supreme People’s Procuratorate on Several Issues Concerning the Specific Application of the Law in the handling of Criminal Bribe-Giving Cases
  - > Expands harshness of sentencing options
  - > Provides incentives for voluntary disclosure (leniency)

# China Developments

- National Development and Reform Commission (NDRC)
  - > 20 probes in the past three years
  - > NDRC Division Chief, Xu Xinyu, in September told foreign companies to write up “self criticisms” for leniency
- Weibo – Chinese “twitter” allows for pressure to be brought against corrupt officials (another form of whistleblowing)
  - > Yang Dacai, provincial official, eight different luxury watches, ultimately convicted of corruption (14 years)
- Punishing bribe givers as harshly or more harshly than bribe takers

# Additional Considerations

- Chinese investigations now reach outside of China
  - > Wison Engineering, Hong Kong listed company whose major customer is CNPC – trading stopped, records seized and bank accounts frozen
  - > A senior executive from a major parts supplier of Toyota has been arrested in Japan for violating that country's Unfair Competition Prevention Law
  - > ChinaWhys Co. Ltd. (Hong Kong), a private investigation firm that offered investigatory services to corporations and law firms doing business in China
    - Peter Humphrey and wife arrested for obtaining information illegally
- Does self-disclosure/co-operation work in China?





# High Risk Industries and Transactions



# Private Equity Funds/ Hedge Funds/Sovereign Wealth Funds

- High profile sovereign wealth funds in high risk countries
  - > Employees of SWFs may satisfy “foreign official” element of FCPA
- Investments made by U.S.-based PE or Hedge Funds in foreign private company could become FCPA focus
  - > Sensata Technology Holding NV, owned by private equity firm Bain Capital, voluntarily disclosed to the SEC the possibility of FCPA violations in China
- SEC focused on role of third parties and placement agents in investments made by Funds sponsored by states and municipalities in the U.S. (“pay-to-play” cases)
  - > Gift, travel and entertainment expenses
- Also focused on hiring of relatives of foreign officials

# Other Industries



- Healthcare
- Telecom
  - > China Mobile
  - > Lucent Technologies
  - > Juniper Networks
- Infrastructure
  - > ITT Corporation, Siemens
- Oil & Natural Gas
  - > Investigation of China National Petroleum Company (CNPC) and its subsidiary, PetroChina (August 2013)

# High Risk Counterparties and Business Partners

- State-owned Enterprises
  - > Government ownership in business across numerous industries
- Government Regulators
  - > Project approvals, business licensing, regulatory compliance
    - extensive processes and high government interaction
  - > Opaque and highly discretionary
- Agents, Distributors, or other Third-party Representatives



# High Risk Activities



- Mergers and Acquisitions
  - > Reverse Merger
  - > Entertainment and Travel
    - Siemens AG, Avon Products, Lucent Technologies, Paradigm B.V., Medical Device Manufacturers (Medtronic, Stryker, Zimmer, Smith & Nephew, Biomet, etc.)
  - > Government Licenses and Approvals
- Joint Ventures
  - > RAE Systems





# Compliance Issues

# China Compliance Challenges

- Perceptions reported in U.S.-China Business Council Report on Best Practices for Managing Compliance in China:
- U.S. companies' competitive positions are at a disadvantage due to FCPA compliance
- Three reasons given:
  - > Compliance benefits are underappreciated in the China operating environment
  - > Potentially bureaucratic processes
  - > High costs

# Recognized Compliance Benefits

- Protection
- Company branding
- Lower costs
- Better ability to manage government expectations
- Human resources – hiring

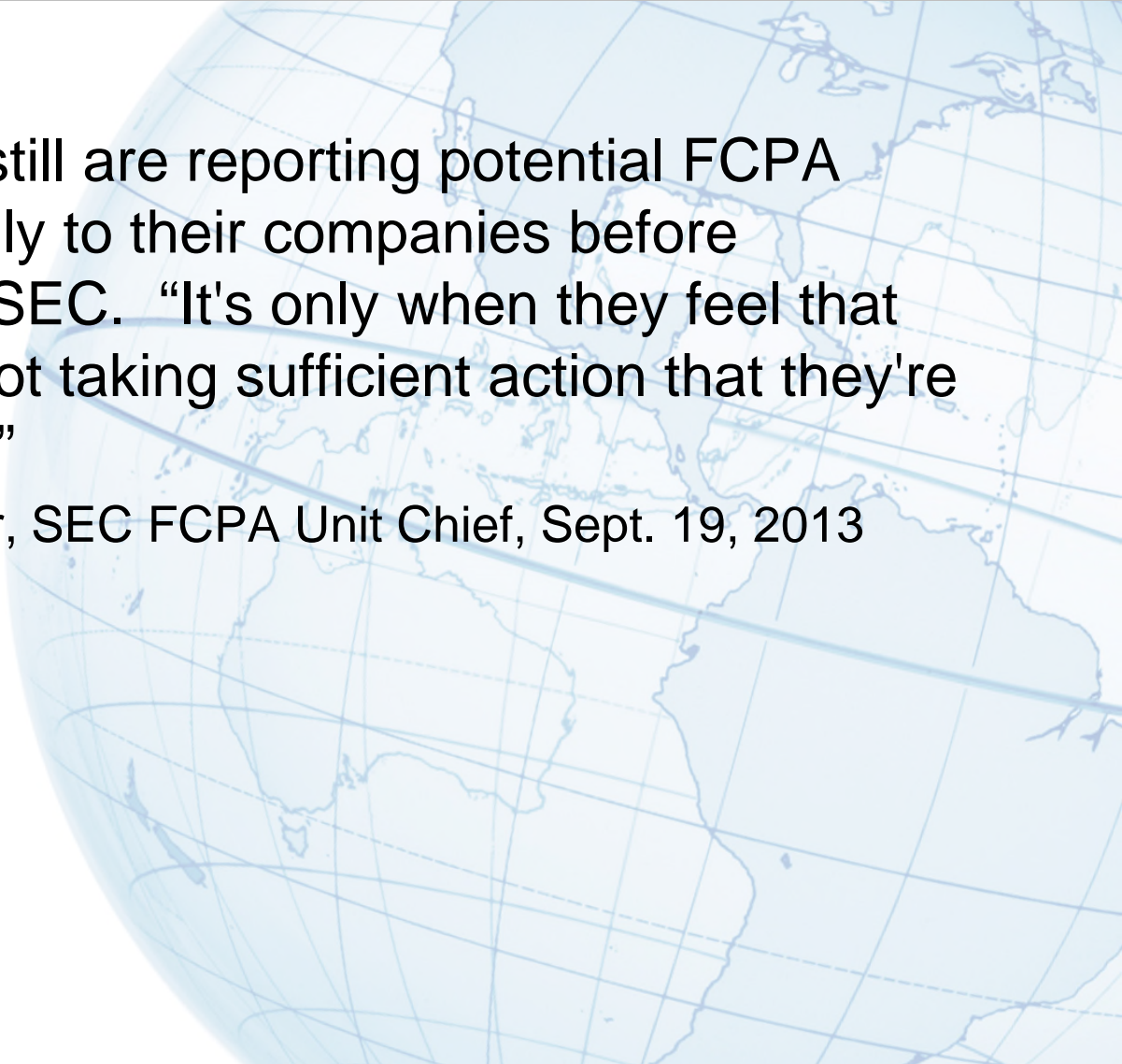


# Specific Requests from Officials

- Foreign travel (to manufacturing center or global headquarters)
- Jobs or internships for individuals
- Sponsorship or advertising
- Services from a specified third-party service provider
- Gift cards
- General expectations for gifts including “red envelopes”

# Build a Working Compliance Program

- Conduct a risk assessment
- Establish a tone at the top
- Set appropriate entertainment and gift limits
- Implement due diligence procedures for third-parties
- Train employees
- Monitor and audit the program
- Ensure anonymous reporting procedures
- Conduct investigations when appropriate
- Impose discipline and remedial measures when needed

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- Whistle-blowers still are reporting potential FCPA violations internally to their companies before approaching the SEC. “It's only when they feel that the company is not taking sufficient action that they're coming out to us.”
    - > Kara Brockmeyer, SEC FCPA Unit Chief, Sept. 19, 2013





# **Challenges for Anti-Corruption Investigations in China**

# Specific Challenges

- Attorney-client privilege issues
- Overlap with PRC audits and investigations
- Local language and cultural sensitivity
- Document review issues
- Effective handling of Chinese language characters by data analytics tools
  - > There may be several different ways in Chinese to convey one concept (e.g., hospitality – at least 5 different ways).
  - > Chinese is a highly contextual language – one character in different contexts and paired with other characters can have different meanings.
  - > Especially important to build a good list of search terms

# Limitation on Dodd-Frank and SOX Whistleblowers

- Two recent cases have held that Dodd-Frank Act and SOX does not protect foreign whistleblowers
  - > Liu v. Siemens (S.D.N.Y.)
  - > Asadi v. GE Energy (5<sup>th</sup> Cir.)
- Limitation on the retaliation protection of these whistleblowers
- Not clear whether affects discretionary recovery of 10 to 30%



# Attorney-Client Privilege Issues

- Who is conducting the investigation?
  - > Routine audit/compliance v. counsel-led investigation
- No effective privilege in China
- Upjohn warnings

# Overlap with PRC Audits and Investigations

- Lack of due process
- Enlargement of PRC investigations to information/data sources outside of PRC

# Local Language and Cultural Sensitivity

- Conducting interviews
- Employees' rights
- Privacy rights
- Perception of what constitutes a bribe



# Document Review Issues

- Subject to U.S. Jurisdiction?
- Review off-shore or in U.S.
- Insuring date-review tool properly handles Asian characters
- State secret/political sensitivity issues



# Questions & Answers

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