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Recent trends in anti-corruption enforcement in China

The Chinese government has embarked on an unprecedented anti-corruption campaign for the past two years. This increase in enforcement activity, coupled with new and amended anti-corruption rules, has led to improved compliance practices for many foreign companies and their affiliates in China (PRC). This article examines the impact of the surge in enforcement actions, particularly the GlaxoSmithKline (GSK) investigation and decision. It also provides a series of steps that can be taken in developing an appropriate corporate compliance strategy in China.

A changed landscape: new norms or old dramas?

The strength of the anti-corruption crackdown in China in the past two years is without precedent. Some commentators question whether the anti-corruption campaign is merely a political purge that will recede once the current leadership consolidates power. Observers have noted the government's somewhat selective approach to enforcement, as well as its failure to refute criticism of the lack of judicial transparency. However, Chinese president, Xi Jinping, strongly denied this kind of speculation during his visit to the USA in September 2015. The 2014 GSK case, together with various legislative changes, has reinforced the impression that the Chinese government is determined to continue to aggressively prosecute instances of public and private sector bribery and corruption. Multinational companies operating in China are particularly concerned by the recent turn of events.

Increased enforcement activity

The seniority of the government officials being targeted for public sector bribery and the breadth of the private sector bribery enforcement programme, sweeping across several different business sectors, have not been seen before. Prominent examples include:

- Zhou Yong Kang, former head of the Political and Legal Committee of the Central Communist Party and a member of the Central Politburo, was found guilty of corruption, intentionally disclosing state secrets and abuse of public powers in June 2015.
- Xi Xiaoming, Vice President of the Supreme People's Court (SPC), was reportedly detained and put under investigation for "serious violations of discipline and laws", a common reference to corruption, in July 2015.
- Ling Jihua (Vice Chairman of the National Chinese People's Political Consultative Conference (CPPCC), and the head of the United Front Work Department of the Communist Party Central Committee), Rong Su (Vice Chairman of the CPPCC) and Xu Caihou (General in the People's Liberation Army and Vice Chairman of the Central Military Commission) have been targeted in recent months.

- Suppliers, vendors, and business partners of state-owned enterprises have been caught up in the slipstream of public sector bribery enforcement efforts, including the detention of dozens of senior managers of Sinopec and China National Petroleum Corporation.
- The GSK case, which has demonstrated how vulnerable multinationals can be during criminal proceedings in China and how much damage can be caused to business operations as a result of poor corporate compliance practices.

New and amended anti-corruption legislation

The National People's Congress of China recently passed the ninth amendment to the *Criminal Law of the People's Republic of China 2015* (2015 Criminal Law), making China's anti-corruption rules among the strictest in the world. In addition, various judicial and administrative authorities have issued other rules to improve government procedures, record-keeping, interagency communications and transparency.

Ninth amendment to 2015 Criminal Law

The ninth amendment to the 2015 Criminal Law:

- Increased the criminal fines applicable to individuals.
- Criminalised the act of giving bribes to retired officials as well as to persons who are not themselves serving or retired government officials but who may be in a position to exert influence over them.
- Restricted the circumstances in which sentences for bribery offences can be mitigated or exempted for self-reporting.

Before the ninth amendment, criminal bribery fines were enforced primarily against corporate offenders, instead of individuals. The ninth amendment expanded the application of criminal fines for the offence of giving a bribe to include the following individual offenders:

- Individuals bribing non-government officials (*Article 164*).
- Individuals bribing government officials (*Article 390*).
- Individuals brokering bribery to government officials (*Article 392*).

The *2015 Criminal Law* does not delineate a method for calculating fines, and local courts have wide discretion in sentencing individuals. Consequently, the amount of a criminal fine imposed on an individual bribe payer is unpredictable and potentially very high, especially for directors and senior managers of multinationals. This is particularly troublesome given the record criminal fines imposed in the past year.

While it has been a crime to receive a bribe since 2009, the ninth amendment to the 2015 Criminal Law for the first time criminalises the giving of a bribe to a person who may exert influence on a current or former government official. This amendment is aimed at preventing government officials from receiving bribes through their "inner circle" of contacts, whether during or following their government service.

Previously, bribe payers could mitigate or become exempt from criminal liability if they voluntarily confessed their crimes before being prosecuted. Under the ninth amendment, to be eligible for reduced penalties, the offence must be relatively minor and the bribe payer must either:

- Provide crucial information leading to a successful investigation of others in a significantly important case.
- Make a significant contribution to the investigation in other ways.

Other new anti-corruption rules

China's judicial organs and industry regulators have issued rules improving government record-keeping, tightening interagency communications, enabling background searches and increasing transparency. For example:

- The National Healthcare and Family Planning Commission issued the Regulation on the Establishment of Commercial Bribery Records in Medical Device and Pharmaceutical Sales and Purchase Areas 2013, which requires local healthcare regulators to maintain bribery records for business operators who receive criminal or administrative penalties for giving bribes to healthcare institutions, and bans convicted business operators from selling products to public hospitals.

- The Supreme People's Procuratorate issued the *Provisions of the Supreme People's Procuratorate on Bribery Case File Inquiry 2013*, which makes the criminal records of those convicted of bribery publicly available.
- The State Administration for Industry and Commerce (SAIC) issued the *Interim Provisions on the Disclosure of the Information on Administrative Punishments concerning Industrial and Commercial Administration 2014*, which requires decisions and basic information on parties and offences to be uploaded to the SAIC's new online enterprise credit information disclosure system within 20 working days after issuance of an SAIC administrative penalty.

New constraints on regulator

The SAIC is charged with enforcing private sector bribery under the *Law of the People's Republic of China Against Unfair Competition 1993* (1993 Unfair Competition Law). Previously, the SAIC and its local subordinates (each, a local AIC) were criticised for deliberately being vague on the legal and factual grounds for their decisions. This was due to ambiguities in the legal definition of bribery and also to the consequent dynamics in play between the SAIC and the parties under investigation.

There are two types of penalty under Article 22 of the 1993 Unfair Competition Law: monetary fines up to RMB 200,000, and the confiscation of illegal profits. According to the *Measures for the Determination of Illegal Gains in Cases Involving Administrative Penalty by Administrative Authority for Industry and Commerce 2008*, the formula used by the SAIC for calculating illegal profit allows very few deductible expenses, meaning that the amount confiscated may be much higher than the profits themselves. For example, the formula does not allow for the deduction of labour expenses in arriving at the final figure. In addition, there is also no clearly accepted method or standard for identifying which transactions can be shown as having taken place as a consequence of bribery.

This lack of an accepted accounting standard is proving to be a double-edged sword for the SAIC. Although it affords wide discretion, it also leaves SAIC decisions open to challenge by way of administrative or judicial review. To reduce the threat of a review procedure, some local AICs try to avoid citing bribery as the legal basis for a decision and instead persuade parties under investigation to agree to a particular outcome. Although such an agreement is not legally binding, a company could choose to abide by its terms to avoid internal and external reporting obligations and swiftly conclude the matter. This practice, however, is not without its risks. SAIC investigations often turn into negotiating rather than fact-collecting procedures, where the discussion turns on the amount of the penalty and the nature of the offence cited. Moreover, unless it is based on solid legal or factual grounds, this kind of informal settlement could itself be regarded as an act of public sector bribery.

Increased tension in investigations

The legislative changes immediately affected the dynamics surrounding SAIC investigations. For local AICs, the requirement to publish their decisions on penalties, as well the legal grounds for reaching those decisions, led to a far greater risk of internal and external scrutiny. As a result, they became much more reluctant to replace the charge of bribery with any alternative grounds without sufficient legal or factual basis for doing so. For companies under investigation, however, any penalty based on the offence of bribery results in the loss of business for at least two years, plus the risk of reputational damage or a related investigation in another jurisdiction. Consequently, tensions between the AICs and their target companies began to increase dramatically.

Companies began to assert all possible legal defences to resist pressure from the SAIC to accept a charge involving bribery. In-house counsel and external lawyers came to attend face-to-face meetings with SAIC officials, an approach previously viewed as too aggressive for a company under investigation.

Companies also became far more cautious in responding to document requests from the SAIC. Instead, they began to question the procedural justification of every step that an investigator took. Before getting into a discussion on the amount of possible penalties, companies would insist on the presentation of solid evidence and a clear legal basis for a bribery charge.

SAIC officials also came under increasing pressure to close bribery cases within the statutory deadline, while also being required to invest more time, personnel and expense in the collection of evidence. Because of the challenges involved in collating evidence, the AICs usually relied on the target of the investigation to provide evidence. To meet internal deadlines, some local AICs would even push back the recorded date the case was opened on until the investigation was almost finished. Despite these efforts, the increased resistance by companies accused of bribery would often result in serious delays in closing the case.

Impact of GSK case

The GSK case is without doubt the most high-profile criminal case of private sector bribery made public in 2014. It marked the first time that the senior managers of a multinational company were convicted together with the company. GSK China's CEO (a UK citizen) and general counsel were convicted along with several other senior managers of being directly responsible for the corporate offence and were sentenced to two to four years of imprisonment with probation. The case also involved a record criminal fine of RMB 3 billion (USD 470 million).

Criminal investigations: high profile, low transparency

Before the final judgment was rendered in the GSK case, the individual defendants appeared on a CCTV news programme. They described the company's bribery activities and expressed remorse for their personal involvement in the scheme. Although unusual at the time, it has now become more common for a defendant in a highly political or sensitive criminal case to publicly confess before a final judgment is issued.

The convictions of Peter Humphrey (a UK citizen) and his wife Yu Ying Zeng (a US citizen), the private investigators hired by GSK to investigate bribery claims at the company, were a by-product of the GSK case. The Humphreys were convicted of illegally purchasing and selling personal information and sentenced to:

- Imprisonment for 24 and 30 months, respectively.
- Deportation (for Peter Humphrey).
- Criminal fines.

Although China's state media emphasised the Humphreys' involvement in the GSK scandal, the judgment did not show a connection between their conviction and that of GSK. The Humphreys were also made to confess on a CCTV news programme before the final judgment was issued. This was reportedly the first prosecution and conviction of foreigners for illegally purchasing personal information.

Despite the high profile of these two cases, the government released few factual details aside from general information. The GSK hearing was not public on the grounds that trade secrets were involved, and many key facts were kept from the public, including the names of the alleged bribe recipients, the details of the bribery activities, and the specific involvement of each of the individual defendants. Only the names of the offences and the relevant sentences in the final judgment were published. The public hearing in the *Humphrey* case was not announced until the day before it was scheduled, and most of the information on the hearing came from a note published on social media by the court.

Conflicts of interest in criminal cases

The demand for advice and training on director liabilities under the *2015 Criminal Law* has soared since the GSK judgment was issued. A common question is how to distinguish a director's personal liability from that of any liability for an offence committed by the company.

Under the 2015 Criminal Law, if a crime is committed through a transaction conducted in the name of a company, it may be classified as a corporate offence (that is, an offence committed by the company) or an individual offence committed by the employee.

In the case of an individual offence, only the individual who committed the offence may be penalised. If the company is convicted, the company, the person-in-charge of the company, and any person in the company who is directly responsible for the crime may be penalised. Moreover, the penalties for an individual offence are far more severe than those for an individual who is liable for a corporate offence as a person-in-charge or as being directly responsible for the crime. In the case of public sector bribery, for example, the penalty for a person-in-charge in regard to a corporate offence is capped at five years imprisonment, whereas in the case of an individual offence the penalty can be life imprisonment.

Despite these significant differences, the distinction between corporate and individual offences is not always entirely clear under the 2015 Criminal Law, and prosecutors and courts are given broad powers of interpretation. In practice, the authorities may use this lack of clarity as leverage to persuade an individual defendant to testify against his employers in exchange for leniency and reduced penalties. This potential conflict of interest is becoming increasingly important in the light of the increased possibility of criminal charges being brought against senior managers and directors.

This conflict was apparent in the GSK case. Although the details of their actual testimony were not available to the public, the televised confessions of the individual defendants served as strong evidence against GSK. After confessing, each defendant was held liable for GSK's corporate offence, instead of their own individual offence. Each also received a reduced penalty, including two to four years of probation, which meant that they would not serve time in prison, unless they committed a new crime during the probation period. Although Peter Humphrey did not receive probation in his judgment, he was released in June 2015 for health reasons, seven months short of his 30 month sentence. A link between their public statements against GSK and the leniency accorded to them in their sentences seems altogether likely.

This conflict is also evident in other matters involving foreign-owned companies operating in China. For example, more frequently, we are seeing cases arise in which a senior manager involved in a criminal investigation rejects an employer's proposal of joint representation and hires his own criminal lawyer. We have advised in-house counsel to be alert to any signs of conflict in cases where both the company and its employees are involved, and to be ready to appoint separate counsel where there is a conflict.

Due diligence background checks

As a result of the Humphrey case, multinational companies and international law firms have become far more careful in using private investigators to carry out due diligence background checks. Instead of outsourcing the checks, companies now often prefer to carry out the due diligence themselves, relying on voluntary responses to questionnaires or performing their own online searches across social media and the internet. In more complex cases, reputable investigators are often still preferred, but are asked to present detailed investigative steps in their proposals so as to prevent the possibility of reckless activities by the investigator.

Where company searches are involved, the feedback is mixed. On the one hand, the SAIC has recently launched an online platform to facilitate searches of basic information. On the other hand, access to the SAIC's more comprehensive files is restricted. For example, some local AICs have required evidence of ongoing litigation involving the company before releasing comprehensive records. To minimize the risks arising from overzealous external investigators, in-house counsel and private practitioners need to understand the practice of the relevant local AIC and closely monitor the activities carried out by the external investigator.

In addition, the changes to the *2015 Criminal Law* mean that due diligence on payees should be expanded to include not only current and former government officials, but also their close associates.

Corporate compliance practices

The lack of factual information in the GSK case caused confusion in the market. Once details of the investigation were announced, the greatest concern was whether other multinationals would be targeted. Although this has not happened to date, the GSK case persuaded many multinationals, particularly those operating in the healthcare sector, to revise their anti-bribery compliance practices to include:

- Greater emphasis on compliance with the specific provisions of Chinese law.
- Increased focus on the substance, as opposed to the form, of the internal controls process.

Before the GSK case, the compliance system of most multinationals was mainly tailored to address the US *Foreign Corrupt Practices Act of 1977*(FCPA) because it was so aggressively enforced by US authorities. Although AIC investigations were common, penalties were minimal compared to those involved in US investigations and AIC enquiries were rarely escalated to criminal investigations.

Once the Chinese court authorities showed their muscles in the GSK case, however, the number of enquiries seeking guidance on compliance with Chinese anti-bribery provisions grew sharply. The compliance due diligence questionnaire used by many multinationals has been "localised" to identify particular issues under Chinese law. In addition, companies have begun to move beyond reliance on good record keeping toward verification of the substantive details of each transaction.

New compliance strategies

Anti-corruption compliance is now an area of sharpened focus among in-house counsel. A commonly shared view is that due to the aggressive enforcement trend in China, companies need to be innovative in strengthening their compliance systems. From our experience, the new compliance strategy can be understood best by examining each of its four main components:

- Pre-emptive mechanisms.
- Proactive dialogue with government authorities.
- Progressive internal investigations.
- Post-investigation analysis.

Pre-emptive mechanisms

The purpose of a compliance system should not be limited to record keeping or building document trails. It must also aim to verify the substance of a particular transaction and deter any internal efforts to breach company policy. We recommend the following four measures, which have become accepted market practice:

Tailoring compliance policies to meet specific risk and cost tolerance levels

It has become common practice for multinationals to localise their global policies for China. For example, some aspects of Chinese anti-bribery law would cause an otherwise innocent act under the FCPA to be classified as a bribery offence in China, and these aspects need to be reflected in the policy applicable to operations in China. Since a compliance policy is a risk-control measure, it must be tailored to the company's compliance risk and cost tolerance level. There is no standard "one size fits all" policy, and a company must fashion a policy that reflects its unique situation. Therefore, a company first must identify its own level of risk tolerance and understand the business costs of implementing a policy. To be successful, the process in reaching a final consensus must involve both the legal and business teams.

Drafting contracts to specify the commercial nature of transactions

One classic compliance "red flag" involves a transaction that does not appear to entail legitimate commercial interests. To identify and prevent the occurrence of such a transaction, companies are advised to scrutinise any unusual transactions, especially service contracts. One way to detect and prevent transactions without legitimate commercial interests is to require the business team to specify the commercial purposes of the transaction together with the amount and form of consideration in as much detail as possible in the contract. In a service contract, for example, the form, date and frequency of payment should be set out and supporting documents evidencing the existence and provision of the services should be annexed.

Detailed document requests

The most important tool for verifying the substance of a transaction is to review evidence of performance. Service contracts are among the most difficult, and yet the most important, to verify. In the past, compliance review was limited to confirmation provided by internal departments, leaving open the risk of conspiracy between employees and external vendors. There has been a clear trend since 2014 to address this potential weakness.

Companies should identify, request and review evidence of the completed transaction, including the main documents evidencing the actual performance of the contract. These documents should be originals (rather than copies) produced by the contracting party or a third party providing the goods or services, as opposed to written confirmations by the client's own internal departments. Although it may not be practical to review every supporting document for every transaction, the document request itself, together with a programme of random inspections, should normally be sufficient to deter most suspicious activity.

Continuous training

Training programmes must emphasize the importance of compliance and the need for rigorous implementation of company policies. In-house counsel appear to be inviting more external lawyers to deliver training to senior managers, believing it is easier for an external lawyer to convey a difficult message to a business manager than it is for an internal lawyer to address a colleague. We also have noticed a greater degree of interaction between trainers and participants in courses than we noticed in previous training sessions. This confirms our impression of the growing interest of senior managers in this topic.

Proactive dialogue with government authorities

Companies under investigation need to communicate with investigators to understand the background of and justification for the investigation, as well as the procedural status of the investigation. Companies appear to be more willing to engage with government investigators once an investigation has begun. Companies also seem to be involving external lawyers in external investigations (that is, investigations initiated by a government agency) more often, especially with the growing realisation that exercising one's right to be represented by counsel does not necessarily prejudice one's position in an investigation.

Progressive internal investigations

To encourage co-operation, the tone and methodology of internal investigations is becoming less confrontational and intrusive. Moreover, there is a recognition that, if not handled appropriately, a whistleblowing incident could land the company in an external investigation. Where senior managers are involved, internal politics and potential conflicts of interest may obstruct the investigation.

As an investigation of an existing transaction would inevitably lead to an examination of the company's compliance review and approval processes, using the same compliance personnel who conducted a review to subsequently investigate a transaction would raise questions as to objectivity. Even if an offence is discovered and internal disciplinary action is taken against the perpetrator, the punishment delivered may not satisfy the requirements of the local labour law and may lead to a labour dispute. In the most extreme scenario, a company may have to offer the alleged offender a large severance payment to avoid an employment action by the employee.

Third-party relationships present a further challenge. In some cases, although an employee may have confessed to using a third party to pay or receive bribes, the company may find itself unable or reluctant to verify this with the third party for fear of damaging its own business reputation and the business relationship with the third party. If questioned, the third party may simply make a blanket denial and accuse the employee of embezzlement. In the absence of reliable documents to verify the employee's allegation (which is often the case due to the very nature of bribery), the company may find it difficult to determine whether and how to terminate an ongoing contract with the third party, and also how to extricate itself from tainted transactions already completed by the third party on the company's behalf.

Individuals under internal investigation are also becoming more sophisticated. During investigatory interviews, it is no longer uncommon for individuals to refuse to answer certain questions, to issue blanket denials of involvement, or to request that they be accompanied by their own lawyer.

Introducing external lawyers

The decision as to who should direct and conduct an internal investigation depends on several factors such as who is being investigated, the type of wrongdoing at issue, the internal dynamics of the investigation, and the resources needed to manage the investigation adequately.

Several reasons are often given for using external lawyers to conduct an internal investigation:

- It may be regarded as necessary to handle the constantly changing dynamics of an investigation.
- It may be easier for external lawyers to gain the trust of employees in an internal investigation.
- It may avoid an actual or apparent conflict of interest.
- It may enhance the credibility of an investigation and the strength of the company's compliance commitment.

External lawyers are able to approach an investigation with a neutral outlook, without the influence of internal dynamics arising from work relationships.

As discussed, an anti-corruption investigation may also trigger commercial, labour, corporate governance, and government relationship issues. It may require an experienced litigator with broad knowledge of the interplay of collateral consequences and strong inter-personal skills to persuade the interviewees to co-operate fully while not misleading them as to the aims or likely outcomes of the investigation.

A good interviewer must be able to sense an interviewee's real concerns and intentions to control the conversation and stay focused on the investigative agenda. An effective interview is not only about the discovery of the facts, but also a step toward a successful resolution of the bribery issue. Conducting thorough interviews without alienating the interviewees can encourage their consent to the eventual conclusion. Failing to do so may not only jeopardize the intended result but the interviewer himself may become the target for complaint. In the GSK case, for example, the employees interviewed issued an open letter to the company on social media, accusing the company's lawyers of misleading them and using intimidation to cause them to confess and resign.

It also may be easier for an external lawyer to win trust and credibility from employees, since employees are likely to regard external lawyers as more neutral and independent than in-house counsel, who may be seen as more directly related to the employer. Similarly, regulators see external lawyers as objective evaluators of the facts, given their lack of prior, and continuing, internal working relationships.

Since the dynamics of an internal investigation are constantly changing, especially at the beginning of the process when facts are thin, the earlier the external lawyers are brought in, the easier it may be to keep the dynamics of the investigation neutral and open. Once the target of the investigation senses the company's misjudgment or lack of information, it is possible that he may try to mislead the investigator or conceal evidence. There may be just one chance to get it right.

When to conclude an investigation

Discovering the truth is of course the ideal end to an internal investigation. Realistically, however, this may not always be possible. Deciding when and how to end an investigation can be complicated. Considerations include satisfying due diligence obligations under the applicable law, meeting the expectations of relevant government authorities, and bearing in mind the further financial and relationship costs that would be caused if the investigation is pursued further. By obtaining the views and recommendations of an external lawyer, a company may be viewed as introducing a degree of independence and may protect in-house counsel and management against accusations of bias or self-interest.

Irrespective of the result of an investigation, and whether or not further action is contemplated, it is important to prepare a comprehensive written or verbal report to justify the decision to close the case. This report is particularly important where the facts uncovered during the investigation are insufficient to prove an offence, since that conclusion does not necessarily mean there were no acts of bribery in the first place.

Part of the purpose of preparing a report is to document the efforts made during the investigation to demonstrate reasonable diligence. Questions that remain unanswered or unconfirmed allegations should also be set out in the report to show a complete picture of the investigation. The report, as well as detailed records of document collection and processing, should be preserved for any internal or external queries or challenges.

Employees who are under investigation should be promptly and properly informed of the conclusions reached as they will understandably be worried about their reputation and career path in the company. Even if no bribery is discovered, violations of the company's compliance policy may still have occurred and must be addressed through training or disciplinary actions.

Post-investigation analysis

The most important part of an internal investigation is the post-investigation analysis. Whether or not bribery is discovered, in most cases, a thorough investigation is likely to reveal weaknesses in the company's internal control systems or potential risks inherent in certain business models. In the company's long-term interests, it is crucial for the investigator to include such observations in a separate report and to propose solutions to improve or correct these problems.

Comment

It is not known if the current aggressive enforcement trend in China will continue, but the trend has already led to significant changes in the compliance practices of multinationals. New strategies are recommended to respond to this new reality, including comprehensive due diligence checks, a proactive approach to external investigations, progressive internal investigations, and a thorough post-investigation analysis.

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