

On the Straight and Narrow

Keeping your Business Compliant

by DR. HOLGER HANISCH AND DR. FLORIAN KESSLER

In the middle of summer this year, when most people in China were suffering from the high temperatures, a few westerners were facing a very different kind of heat: The Chinese authorities started investigating GlaxoSmithKline (GSK) and China Why's, a small investigation firm that had worked on behalf of GSK. GSK has since been under scrutiny for alleged bribing of numerous hospitals and medical practitioners to increase the sales of GSK prescription drugs. China Why's has been investigated for the way in which it obtained non-public information (e.g. personal data).

Following the Rio Tinto case in 2010, when several managers of the global mining company were investigated by Chinese authorities for the way in which they had allegedly tried to obtain information on their Chinese customers' negotiation position, this is the second time major criminal actions by Chinese authorities against a leading western company for non-compliant conduct in China have made headlines. This article will take a closer look at the legal implications of these criminal actions and what possibilities multinational companies in China have to avoid running into similar problems.

Applicable Laws

If reports in Chinese and international media are correct, GlaxoSmithKline has, with the help of several local travel agencies, set up black accounts in a total amount of about USD 300mn by paying to these travel agencies inflated fees for their service. These funds were then used by GSK's sales people to pay bribes and kickbacks to hospitals and doctors that prescribed GSK's medicine to their patients.

The legal environment regarding corrupt practices in which western companies in China operate consists of several layers. It goes without saying that any company and individual in China is subject to Chinese laws for everything which this company or individual does. But by now, many



OECD member countries have given their anti-bribery laws extraterritorial reach, so that normally at least the laws of two countries – China and the company's home country – apply.

Chinese Laws

Chinese law subjects not only individuals but also companies to direct criminal liability for bribery. Under the Chinese Criminal Code, further detailed by the Provisional Measures on Prohibiting Commercial Bribery, bribery is a crime whether it is used between two companies or between companies and public authorities. Even the giving of discounts and rebates to customer companies and distributors is regarded as bribery if the giver and receiver do not both record them properly. In most Western jurisdictions this would only be regarded as a violation of accounting provisions.

Thresholds for criminal behavior are relatively high; in many instances, only bribes of more than RMB 5,000 in value are prohibited. On the recipient's

side, though, much lower thresholds may apply if, for example, the recipient is a member of the Communist Party of China.

The US Foreign Corrupt Practices Act

The oldest of the western anti-bribery laws with extraterritorial application, the FCPA forbids payments and the giving of other valuables to foreign governmental officials for unlawful actions. The FCPA does not address corruption between private companies: for example, payments from one company's seller to another company's purchaser for winning a particular order. But the American authorities have adopted a very broad definition of who is a governmental official, and include all employees of state owned companies.

The FCPA also contains very strict rules on the accuracy of company records. Payments for bribery must be recorded as such; otherwise the improper recording-keeping constitutes an offense in itself.

While bribery might be hard to prove, faulty bookings are normally much easier to detect. The FCPA applies to all US companies as well as to most other companies having issued securities in the US.

The UK Bribery Act

The UK Bribery Act, the youngest of the anti-corruption laws with extraterritorial reach introduced here, has in many respects the strictest and clearest rules. These include the explicit stipulation that a company is also responsible for third-party providers it employs to reach its business goals, and that a company can avoid liability for wrongdoings of its employees and service providers if it puts into place sufficient safeguards to prevent such wrongdoings.

The UK Bribery Act is also the most aggressive with regard to its extraterritorial application. It applies to any company with a close business link to the UK, including any overseas company that has a business or part of a business in the United Kingdom. The effect is that this law can potentially be applied by the UK authorities to most internationally active companies. The UK authorities have, for example, initiated investigations against GSK for bribery reported in China.

German Laws

The German provisions on sanctions in the case of corrupt practices are spread over several laws, in particular the Criminal Code StGB and the Administrative Offence Act. While the latter stipulates the responsibility of a company's senior management for actions carried out on behalf of the company, the first contains several provisions on bribery.

Under these laws, both bribery between individuals working for private companies and bribery of officials is outlawed. Unlike under the FCPA, even small payments for legal official actions – so-called facilitating payments – are not allowed. The extraterritorial reach of these provisions with the exception of facilitating payments was established in 1999.

Possible Sanctions

Therefore, if a China-based employee of a German company with subsidiaries in China and the United Kingdom, but not listed in the U.S. (provided that German company has not issued securities in the U.S.) pays bribes in China for winning orders for his company, this German company would be subject to Chinese, German and British laws. Possible sanctions under all of these laws include fines and potentially long prison terms for the individual offenders, as well as fines and forfeiture of illegally obtained earnings for the companies.

Apart from these possible sanctions, even before a company is not found guilty of bribery, the company would have to go through legal proceedings in each of these countries, with all of the lawyers' fees and consumption of internal resources that this implies. These always lead to considerable expenses, and in cases of less serious misconduct, the costs for handling the ensuing legal procedures frequently by far outweigh the public fines that in the end might be imposed.

Preventive Measures

What can companies do to manage and minimize the risks that result from misconduct by their employees and service providers? As there is some uncertainty in terms of the authorities of which country or countries might take action if non-compliant activities become known, companies have to put into place their own internal systems ensuring that the company's actions as well as those of its employees and service providers always reach the requirements of the strictest laws that might possibly apply.

The UK Bribery Act even states explicitly that a company can exculpate itself if it can demonstrate that it had put into place and properly implemented internal compliance systems. General principles of criminal law lead to much the same result in other jurisdictions as well: if a company can demonstrate that it has done all that can reasonably be expected to do to prevent corrupt and other non-compliant practices from occurring within its organization, the company and its managers will normally not be blamed for any misconduct, and sanctions will remain limited to the individual culprits.

Options for such preventive measures are numerous. The most common – which by now should be regarded as a must-have for any company – is the issuance of an internal code of conduct. Such a code of conduct has to state clearly and in plain language what the company expects of its employees and service providers.

Essential stipulations in such a code of conduct with regard to bribery include what presents and gestures of hospitality might be presented to business partners and governmental officials, under what circumstances business trips, seminars and the like for customers can be arranged and paid for, and how such trips need to be structured, what other actions might constitute bribery and how non-compliant conduct can be reported. The company should give a stern warning that it will not tolerate violations, and will instead take appropriate actions against violators, up to and including dismissal and demand for damages. Finally, all employees and third-party providers should be required to confirm that they are aware of the code and that they commit to abide by it.

Other measures companies might also be required to take depend on the way in which the company conducts its business. If, for example, agents are employed to win orders, there should be a clear and detailed agent management process. This is because agents, due to their success-based remuneration, normally experience greater temptation to use corrupt practices to generate business than long-term salaried employees. The company's management process should stipulate under which conditions agents may be employed in the first place.

Furthermore, there need to be selection criteria put into place to assure that the agents chosen are sufficiently qualified and provide the necessary assurance that they will act in a compliant way. The agents should provide information on their own situation, including possible close personal ties to customers and officials, and this information should be checked against information from other sources.

The agents should be obliged to provide detailed information on their work and expenses incurred. The engagement contract with the agents should reference the agent's compliance obligations and allow for termination in the case of non-compliant conduct. The responsibility for deciding upon the engagement of an agent should be shared between at least two employees, and all related documents should be carefully collected and archived.

Further dedicated internal processes might be necessary in other instances: for example, if a company frequently interacts with governmental officials.

Closing Remarks

It is a safe bet to predict that the GlaxoSmithKline case will not be the last incident of Chinese authorities taking strict action against foreign invested companies suspected of breaking the law in China. In the context of the overall anti-corruption campaign that the new Chinese leadership under President Xi Jinping has started after taking office in spring this year, it cannot be much of a surprise that the authorities are taking action not only against Chinese nationals and companies, but also against their foreign competitors.

Dr. Holger Hanisch and Dr. Florian Kessler are members of the China-Desk of the WZR Group. The China-Desk of WZR provides legal advice in all matters relating to Chinese commercial law. The China office of the WZR group is located in Beijing and headed by Mr. Kessler. For more information please visit www.wzr-legal.com or contact Mr. Kessler directly at florian.kessler@wzr-legal.com or Mr. Hanisch at holger.hanisch@wzr-legal.com.