

Compliance Risks and Pitfalls in China –

- Navigating the FCPA and the Use of Third Parties



Greg Wajnowski
March 18, 2014

TI Index.pdf - Adobe Reader

File Edit View Document Tools Window Help

3 / 5 48.4% Find

177 COUNTRIES. 177 SCORES. HOW DOES YOUR COUNTRY MEASURE UP?

The perceived levels of public sector corruption in 177 countries/territories around the world.

SCORE

Highly Corrupt 0-9 10-19 20-29 30-39 40-49 50-59 60-69 70-79 80-89 90-100 Very Clean No data

RANK	COUNTRY/TERRITORY	SCORE	RANK	COUNTRY/TERRITORY	SCORE	RANK	COUNTRY/TERRITORY	SCORE
1	Denmark	91	68	Kuwait	43	114	Indonesia	32
2	New Zealand	91	69	Romania	43	115	Albania	31
3	Finland	89	70	Seychelles	42	116	Nepal	31
4	Sweden	89	71	Costa Rica	42	117	Vietnam	31
5	Norway	88	72	Brazil	42	118	Mauritania	30
6	Singapore	88	73	Sao Tome and Principe	42	119	Mozambique	30
7	Switzerland	88	74	Senegal	41	120	Sierra Leone	30
8	Netherlands	83	75	Tunisia	41	121	Timor-Leste	30
9	Australia	81	76	China	40	122	Belarus	29
10	Canada	81	77	Greece	40	123	Dominican Republic	29
11	Luxembourg	80	78	Switzerland	39	124	Ken	29
12	Germany	78	79	Namibia	38	125	Guatemala	29
13	Iceland	78	80	Oman	38	126	Togo	29
14	United Kingdom	75	81	Slovenia	38	127	Rapua New Guinea	28
15	Belgium	75	82	Cuba	38	128	Ukraine	28
16	Poland	80	83	Ghana	38	129	Gambia	28
17	Hong Kong	75	84	Saudi Arabia	38	130	Lebanon	28
18	Japan	74	85	Jordan	38	131	Madagascar	28
19	United States	73	86	Macdonia (FYR)	44	132	Angola	28
20	Uruguay	73	87	Montenegro	44	133	Mali	28
21	Ireland	72	88	Italy	43	134	Nicaragua	28
22	Bahamas	71	89			135	Russia	28
			90			136	Bangladesh	27
			91			137	Cote d'Ivoire	27
			92			138	Myanmar	21
			93			139	Zimbabwe	21
			94			140	Cambodia	20
			95			141	Eritrea	20
			96			142	Venezuela	20
			97			143	Chad	19
			98			144	Equatorial Guinea	18
			99			145	Guinea-Bissau	18
			100			146	Haiti	18
			101			147	Yemen	18
			102			148	Byria	17
			103			149	Turkmenistan	17
			104			150	Uzbekistan	17
			105			151	Iraq	16
			106			152	Libya	16
			107			153	South Sudan	14
			108			154	Sudan	11
			109			155	Algeria	8
			110			156	Korea (North)	8
			111			157	Somalia	8
			112			158		
			113			159		
			114			160		

- 5. Singapore
- 18. Japan
- 19. US
- 36. Taiwan
- 46. S. Korea
- 80. China
- 94. India, Philippines
- 114. Indonesia

US Foreign Corrupt Practices Act



Don't Bribe Foreign Officials

Keep Accurate Records



US Foreign Corrupt Practices Act: Anti-Bribery Provisions



The FCPA's anti-bribery provisions prohibit:

- directly or indirectly. . .
- with corrupt intent. . .
- offering, paying, or promising to pay *anything of value*. . .
- to a "*foreign official*" . . .
- in order to obtain or retain business

Who Is a “Foreign Official”?

- Employees of government agencies and institutions
Ex: SAIC, AQSIQ, MOC
- Employees of state-owned commercial enterprises (SOEs)
- Procurement managers at state-owned enterprises
- University researchers and professors
- Members of official advisory committees
- Political parties and political party officials
- CCP officials
- Employees of public international organizations such as the WHO, World Bank, or UN

What Is “Anything of Value”?

- Cash
- Cash equivalents (shopping cards, gift cards, etc.)
- Liquor
- Cigarettes
- Jewelry
- Electronics (mobile phones, watches, laptops, TVs, etc.)
- Antiques
- Meals
- Leisure activities (karaoke, golf, spa)
- Travel
- Bribes or kickbacks masquerading as “fees”
- Loans of money, car, housing, etc.
- Stocks/securities
- Discounts on products or services
- Tuition/scholarship for relatives
- Employment/internships for relatives
- Paying for medical treatment
- Donations to favored organization

China's Anti-Bribery Laws

No less strict than US laws

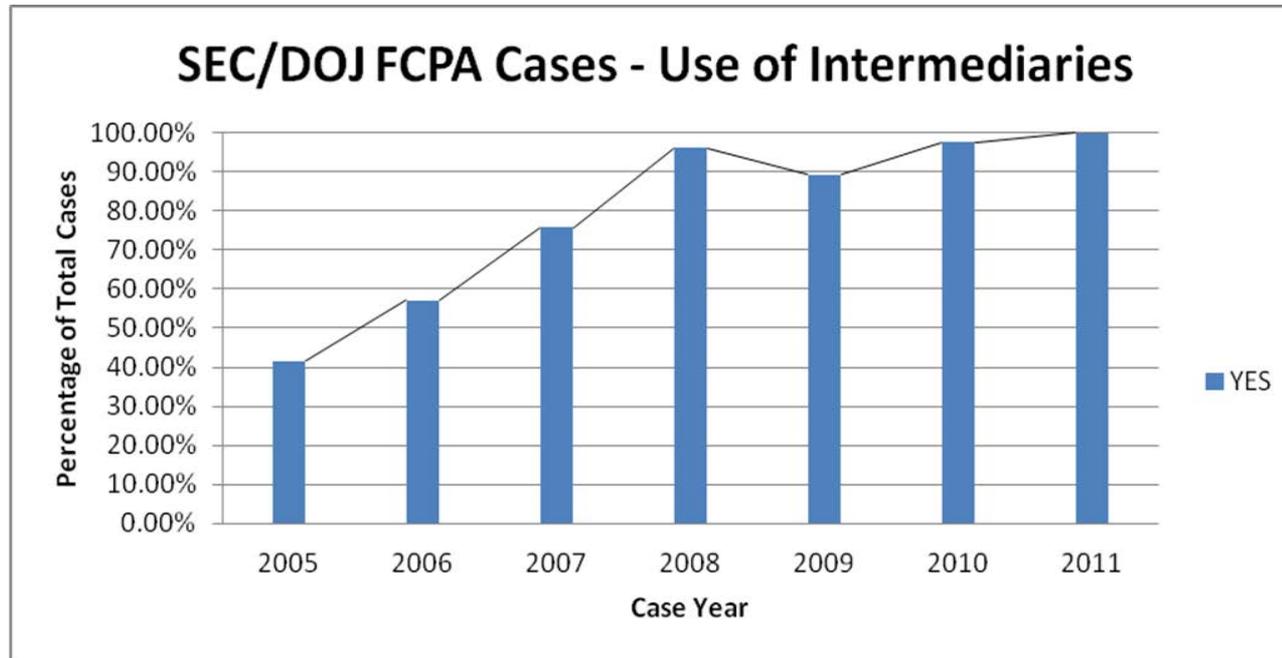
PRC Criminal Law prohibits

- Commercial bribery
- Corruption of public officials
- Overseas bribery



“whoever provides property to a foreign official or an official of an international public organization for the purpose of seeking an improper commercial benefit, will be punished [in accordance with the provisions applicable to commercial bribery].”

SEC/DOJ Focus on Third Parties



United States Department of Justice (DOJ) and Securities Exchange Commission (SEC) Combined Foreign Corrupt Practices Act Cases, Courtesy of Deloitte LLC. Copyright © 2012 Deloitte Development LLC. All rights reserved.

FCPA cases increasingly involve third parties and focus on third-party due diligence and companies' responses to red flags

Who is a “Third Party”?

Agents (including sales, marketing and travel agents)

Consultants

Distributors

Dealers

Government service providers (visa processor, customs brokers)

Transportation companies & freight forwarders

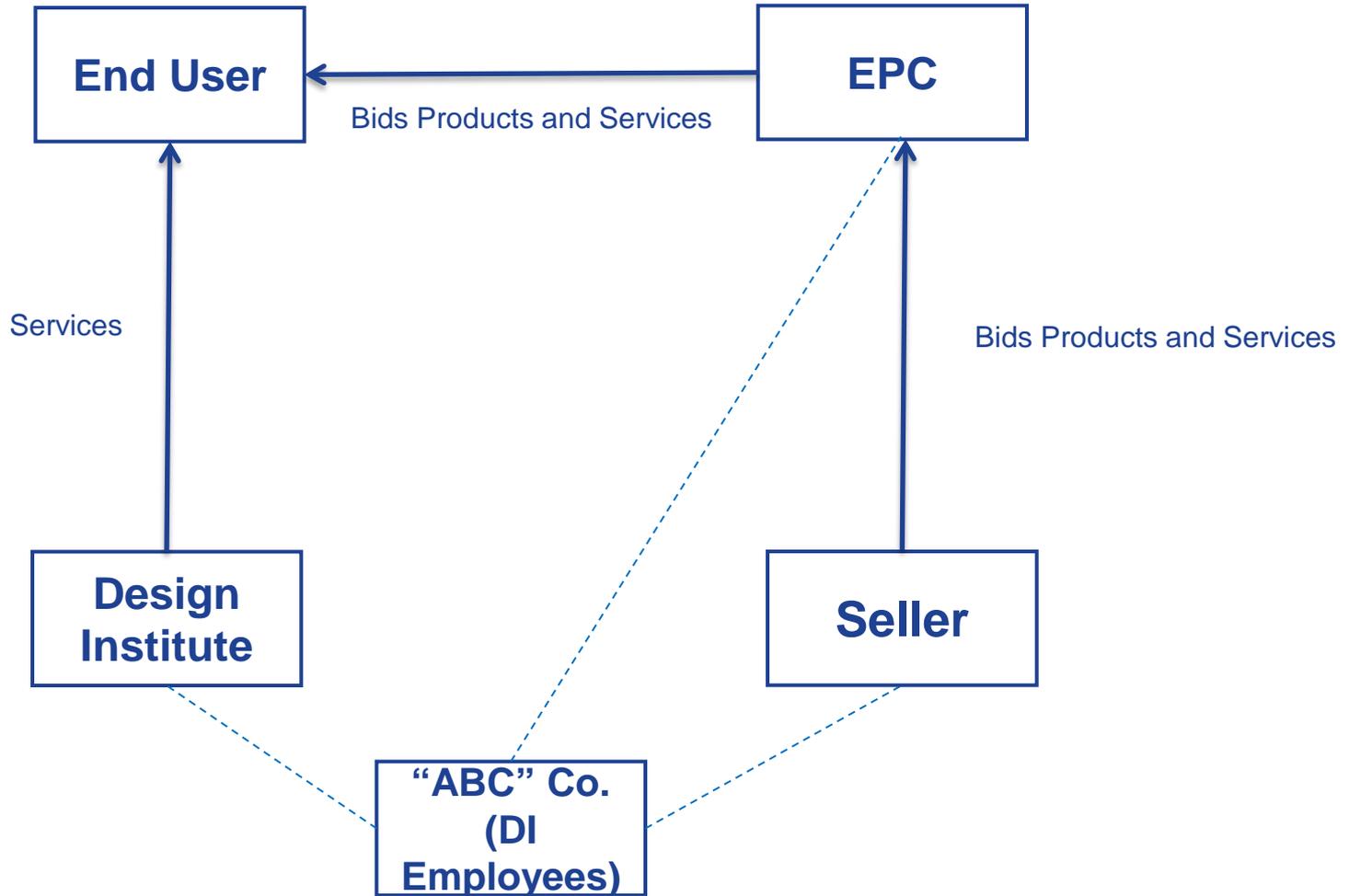
Attorneys and accountants

Labor contractors

Design Institutes

Joint venture partners

The Design Institute Game



Design Institutes – Rockwell

From 2003 to 2006, certain employees of Rockwell Automation Power Systems (Shanghai) Co., Ltd. (Rockwell) **paid approximately \$615,000 to Design Institutes**, which were typically state-owned enterprises that provided design engineering and technical integration services that **can influence contract awards** by end-user state-owned customers.

The **payments were made through third-party intermediaries at the request of Design Institute employees** and at the direction of Rockwell's Marketing and Sales Director.

Payments made directly to the Design Institute employees, with the expectation that they would influence the ultimate state-owned customers to purchase Rockwell products.

Even though the Design Institutes did provide some bona fide engineering and other services, **Rockwell could not substantiate the specific services rendered or the value of those services.**

Design Institutes – Watts

A Chinese subsidiary of Watts Water Technologies (“Watts”) allegedly paid employees of Chinese state-owned **design institutes** to recommend Watts’ products and **to create design specifications** that favored Watts’ products

Watts’ sales policy provided that all sales-related expenses—including travel, meals, entertainment and “consulting fees” paid to design institutes—would be paid by sales employees out of their sales commission, which was approximately **7% of the contract price**, and provided that **sales personnel could use their commission to make payments to employees of design institutes** of up to 3% of the total contract amount.

Watts agreed to pay penalties of \$3.7 million.

Travel and Entertainment – IBM

The SEC alleged that employees of IBM's two wholly-owned subsidiaries in China engaged in a **widespread practice of providing overseas trips, entertainment, and improper gifts to Chinese government officials** of an unspecified total value.

More than 100 IBM-China employees were allegedly involved in an improper travel and entertainment scheme planned by two key IBM-China managers. There were also allegedly more than 114 instances of **fabricated invoices**, improperly documented and/or funded trips, and unapproved **sightseeing activities**.

In addition, IBM-China personnel allegedly **falsely designated travel agents as training providers** and submitted fraudulent purchase requests to funnel payments for unapproved trips for Chinese officials.

Agents – Maxwell

Maxwell Technologies Inc. (“Maxwell”), a California-based manufacturer of energy storage and power-delivery products, settled **criminal** and civil FCPA charges stemming from **improper payments** related to sales of Maxwell’s products to state-owned enterprises in China.

DOJ and the SEC alleged that Maxwell **used a Chinese agent** to bribe officials at SOEs to secure contracts worth more than \$15.4 million. Maxwell allegedly made these payments at the agent’s instruction by **adding 20% to invoice prices and passed the surplus to the agent**, who then used the amount to bribe officials at the customers.

Maxwell **mischaracterized the bribes as sales commissions** and reclassified the kickbacks as a reduction in revenue.

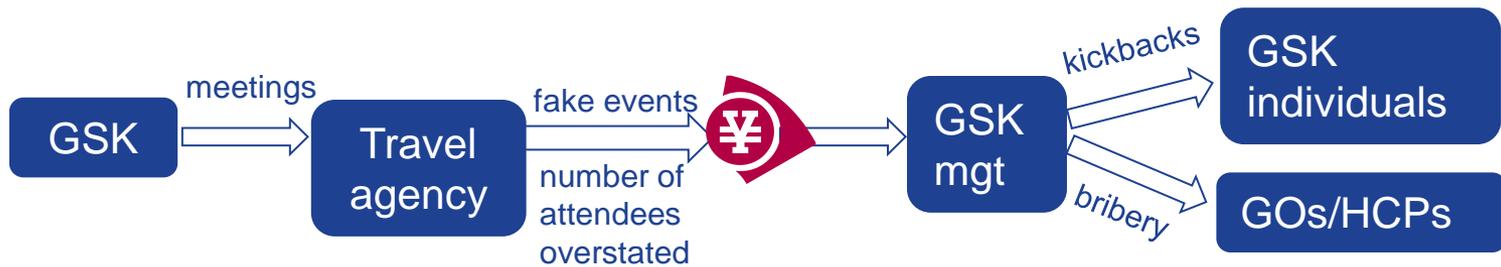
Maxwell agreed to pay more than \$14 million to settle the charges.

Chronology

- **Jan 2013:** whistleblower says sales staff in China were involved in widespread bribery of HCPs between 2004 and 2010, but internal investigations found “no evidence” of bribery
- **Jun & Jul 2013:** 4 executives (BD Director, HR Director, GC, VP of Operations) and 18 employees were detained; GSK China head of finance barred from leaving country
- **Jul 2013:** GSK headquarters called the bribery accusations “shameful” and “deeply disappointing”; acknowledged “some of its Chinese executives appeared to have broken the law” and apologized publicly; also replaced China CEO
- **Sept 2013:** Chinese government investigation shows GSK bribery in China was “organized by GSK China rather than drug salespeople’s individual behavior”
- **Sept 2013:** GSK issued a statement denying wrongdoings had been part of a sanctioned corporate strategy
- **Sept 2013:** GSK China Head of Recruitment commented that GSK turned a blind eye to illegality and “pushed all responsibilities to individual employees when the problems were exposed”

Alleged Misconduct

- Funneled up to RMB3B (\$489M) to more than 700 travel agencies and consultancies to facilitate bribes to doctors and officials since 2007
- Based on local news reports, bribery may include providing HCPs speakers fees (i.e. to non-speaking HCPs), arranging fake conferences to cover expenses of sightseeing tours, giving cash kickbacks, inappropriate gifts and luxury meals



So... How *do* you select third parties and manage the relationship?

3 Stages in the Relationship:

1. Due Diligence
2. The Contract
3. Monitoring & Auditing

Due Diligence Resources

Desk-top due diligence – internet searches

Application questionnaire

References and credit checks

US Embassy (Foreign Commercial Service's
International Company Profile – ICP – report)

Investigation firms, but be careful...

- Many of the best are not licensed in China
- Use of independent contractors
- China Whys case...sale of private data

DD & Screening – Spot the Red Flags

Reputation

- Reputation for unethical conduct?
- Terminated by other companies for improper conduct?
- Subject to civil or criminal enforcement actions?

Government ties

- Family or business ties to gov't officials?
- Employs a current or former government official?
- Owned or controlled by a current or former gov't official?
- Large or frequent political contributor?
- Recommended by a gov't official?

DD & Screening – Spot the Red

Flags

Capability

- Sufficient staff or facilities to perform required work?
- Industry/technical experience and track record?
- Financial stability?

Other goofy stuff

- Requests for anonymity or that the relationship remain a secret?
- Lack of cooperation with due diligence investigation or refusal to make representations and warranties?
- Suspicious statements such as needing money to “get the business” or “make necessary arrangements”?
- Obtains info to which he should not have access?

Contractual Protections

Once vetted and approved, these third parties should enter into a written contract with the following:

- Anticorruption representations and undertakings relating to compliance with the anticorruption laws
- Rights to review the books and records of the third party that are related to their business with your company
- Rights to terminate the third party as a result of any breach of anticorruption laws and regulations or representations and undertakings related to such anticorruption laws and regulations.

Monitoring & Auditing – Red Flags

Compensation

- Is compensation significantly above market rate?
- Substantial up-front payment requested?
- Request for payment to be made in cash or in checks payable to cash or bearer?
- Request for payment be made through a third party or in a third country?
- Commissions are improperly calculated?

Expenses

- Refusal to properly document expenses?
- Records provided are suspect?

Rebates and Discounts

- Excessive or unusual rebates or discounts?

Monitoring & Auditing – Red Flags

Affiliated Entities

- Failure to report affiliated entities (this should have been on your due diligence questionnaire)?
- Corporate name changes?

Shared Marketing Expenses

- Outside the contractual provisions?

Training Costs

- Outside the contractual provisions?