

**GSK in China:  
A Game Changer in  
Compliance**

**By**

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## **Author's Note**

This summer has brought the anti-corruption compliance world a first. It is the Chinese government aggressively prosecuting a western company for bribery and corruption of Chinese citizens in China. This case has had so many unusual aspects that I felt it merited a more lengthy treatment than I could give it in my blog or even a more lengthy article for publication. Maurice Gilbert, head of Consileum Inc. and Corporate Compliance Insights (CCI), suggested I write an eBook on the impression of the GlaxoSmithKline PLC (GSK) matter. Using the eBook format, I have tried to provide the reader with some of the lessons which can be taken away from the GSK matter, offer actions that you can take now for any operations you may have in China and what it may mean going forward for the compliance practitioner. So, thanks to Maurice for the idea, and my heart of gold wife, Michele, for editing it.

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## Chapter I - Background

In June of this year, the Chinese government announced that it had found evidence that the UK pharmaceutical giant GlaxoSmithKline PLC (GSK) was involved in bribery and corruption of Chinese doctors. An article in the Financial Times (FT), entitled “*China accuses GSK of bribery*” by Kathrin Hille and John Aglionby, reported that “China has accused GlaxoSmithKline of being at the centre of a “huge” scheme to raise drug prices in three of the country’s biggest cities and said the UK-based drugmaker’s staff had confessed to bribing government officials and doctors. China’s Ministry of Public Security said a probe in Changsha, Shanghai and Zhengzhou found that GSK had tried to generate sales and raise drug prices by bribing government officials, pharmaceutical industry associations and foundations, hospitals and doctors.” They reported that some of the techniques used included the issuance of “fake VAT receipts and used travel agents to issue fake documents to gain cash, according to the ministry. Some executives had also taken advantage of their positions to take kickbacks from organising conferences and projects.” Further, ““There are many suspects, the illegal behaviour continued over a long time and its scale is huge,” the ministry said.”

In another FT article, entitled “*China steps up GSK bribery probe*”, Andrew Jack and Leslie Hook reported that “The Chinese authorities have stepped up their investigation into GlaxoSmithKline accusing it of being the ringleader of a half-a-billion-dollar bribery scandal involving 700 companies.” They reported on a briefing given by “Gao Feng, the lead Chinese investigator on a probe into the UK drugs group, said police were examining Rmb3bn (\$488m) in deals from as far back as 2007. Chinese police believe that GSK used travel agencies and consultancies as a conduit to bribe doctors and lawyers in order to boost sales and profits.”

In an article in the Wall Street Journal (WSJ), entitled “*China Drops Hammer on Glaxo*”, Laurie Burkitt and Chris Matthews reported on a televised interview of Liang Hong, the GSK China Vice President and Operations Manager, where he “described for viewers of China Central Television how staffers would allegedly organize conferences that never happened and divert the money to bribe government officials, hospitals and medical personnel to get them to use Glaxo's products.” He was quoted as saying, “Dealing with some government departments requires some money that couldn't be claimed normally under company expenses.” Burkitt and Matthews said that “The broadcast follows detailed allegations by China's Ministry of Public Security on Monday accusing Glaxo of using travel agencies as vehicles to bribe hospitals, officials and medical personnel to sell more drugs at inflated prices. Officials also alleged the travel agencies offered what the officials called sexual bribes to Glaxo executives to keep company business.”

These findings flew in the face of the company’s own internal investigation into allegations of bribery and corruption brought by a whistleblower. Hille and Aglionby reported that “GSK said it had conducted an internal four-month investigation after a tip-off that staff had bribed doctors to issue prescriptions for its drugs. The internal inquiry found no evidence of wrongdoing, it said.” Indeed after the release of information from the Chinese government, which GSK said was the first it had heard of the investigation, it released a statement quoted in the FT article, which

stated ““We continuously monitor our businesses to ensure they meet our strict compliance procedures – we have done this in China and found no evidence of bribery or corruption of doctors or government officials. However, if evidence of such activity is provided we will act swiftly on it,” the company said.”

In another FT article, by Hook and Jack entitled “*GSK is test case in China’s rules laboratory*”, they noted that GSK had received information from an internal whistleblower back in January. The company investigated claims of bribery and corruption and publicly announced that the company had found no such evidence of “bribery or corruption in relation to our sales and marketing...in China”. Further, the company claimed it was unaware of any allegations of bribery of doctors to prescribe its drugs until there was a public announcement by China’s Public Security Ministry.

Unfortunately for GSK, it appears that not only did the Chinese government uncover evidence of bribery and corruption, such information was viewed and reported on by the WSJ. Laurie Burkitt, in an article entitled “*China Accuses Glaxco of Bribes*”, wrote that “Emails and documents reviewed by the Journal discuss a marketing strategy for Botox that targeted 48 doctors and planned to reward them with either a percentage of the cash value of the prescription or educational credits, based on the number of prescriptions the doctors made. The strategy was called “*Vasily*,” borrowing its name from Vasily Zaytsev, a noted Russian sniper during World War II, according to a 2013 PowerPoint presentation reviewed by the Journal.” Burkitt reported in her article that “A Glaxo spokesman has said the company probed the Vasily program and “[the] investigation has found that while the proposal didn’t contain anything untoward, the program was never implemented.”

Burkitt also reported that the Chinese crackdown may be a part of a larger crackdown on bribery and corruption. While it is not clear at this point, she stated that “scrutiny of foreign corporations operating in China has been heightened in recent months, as the government has launched a campaign to clean up its commercial sector, cracking down on practices authorities view as abusive or anticompetitive.” In an FT article, entitled “*GSK claims show frailty of Chinese system*”, Andrew Jack said that “The Chinese government has been clamping down on such practices [bribery and corruption] and attempting to keep a lid on drug costs, with an increasing focus on multinational companies. The National Development and Reform Commission in Beijing last week signaled that it was examining pricing by 60 companies.”

Initially, GSK seemed to waiver on making any statement about the allegations against it. When the Chinese investigation was originally announced, the company said in a statement that “These allegations are shameful and we regret this has occurred. We are deeply concerned and disappointed by these serious allegations of fraudulent behaviour and ethical misconduct by certain individuals at the company and third-party agencies.” However, by July 22, 2013, GSK’s tune seemed to have changed. In a post in the FCPA Blog, entitled “*GSK apologizes for breaking China law*”, Dick Cassin reported that “Abbas Hussain, the head of emerging markets for the U.K.-based drug maker, said ‘Certain senior executives of GSK China, who know our systems well, appear to have acted outside of our processes and controls which breaches Chinese law.’” There have been no public statements on this matter by GSK since this time.

## **Chapter II - GSK Prior Enforcement Action**

All of the above is pretty eye popping in and of itself. But consider the following about GSK, a little over one year ago, in July of 2012; GSK pled guilty and paid \$3 *billion* to resolve fraud allegations and failure to report safety data in what the US Department of Justice (DOJ) called the “largest health care fraud settlement in U.S. history” according to its press release. The DOJ press release went on to state that “GSK agreed to plead guilty and to pay \$3 billion to resolve its criminal and civil liability arising from the company’s unlawful promotion of certain prescription drugs, its failure to report certain safety data, and its civil liability for alleged false price reporting practices.” The press release noted that the resolution was the largest health care fraud settlement in US history and the largest payment ever by a drug company for legal violations.

As a part of the agreement, GSK agreed to plead guilty to a three-count criminal information, including two counts of introducing misbranded drugs, Paxil and Wellbutrin, into interstate commerce and one count of failing to report safety data about the drug Avandia to the Food and Drug Administration (FDA). Under the terms of the plea agreement, GSK paid a total of \$1 billion, including a criminal fine of \$956,814,400 and forfeiture in the amount of \$43,185,600. GSK also paid \$2 billion to resolve its civil liabilities with the federal government under the False Claims Act, based on a whistleblower’s allegations. The civil settlement resolved claims relating to GSK’s drugs Paxil, Wellbutrin and Avandia, additional drugs, and pricing fraud allegations.

The criminal plea agreement also included certain non-monetary compliance commitments and certifications by GSK’s US president and Board of Directors, which specifically included an executed five-year Corporate Integrity Agreement (CIA) with the Department of Health and Human Services, Office of Inspector General. The plea agreement and CIA included provisions which required that GSK implement and/or maintain major changes to the way it does business, including changing the way its sales force is compensated to remove compensation based on sales goals for territories, one of the driving forces behind much of the conduct at issue in the prior enforcement action. Under the CIA, GSK is required to change its executive compensation program to permit the company to recoup annual bonuses and long-term incentives from covered executives if they or their subordinates, engaged in significant misconduct. GSK may recoup monies from executives who are current employees and those who have left the company. Additionally, the CIA also required GSK to implement and maintain transparency in its research practices and publication policies and to follow specified policies in its contracts with various health care payors.

The importance of the CIA for this anti-corruption investigation is that the CIA not only applied to the specific pharmaceutical regulations that GSK violated but all of the GSK compliance obligations, including the Foreign Corrupt Practices Act (FCPA). In addition to requiring a full and complete compliance program, the CIA specified that the company would have a Compliance Committee, to include the Compliance Officer and other members of senior management necessary to meet the requirements of the CIA; the Compliance Committee’s job was to oversee full implementation of the CIA and all compliance functions at the company.

These additional functions required a Deputy Compliance Officer for each commercial business unit, Integrity Champions within each business unit and management accountability and certifications from each business unit. Training of GSK employees was specified as a key component. Further, the CIA specifically state that all compliance obligations applied to “contractors, subcontractors, agents and other persons (including, but not limited to, third party vendors)”.

GSK’s Code of Conduct (entitled “*One Company One Approach*”) states quite clearly, “The GSK attitude towards corruption in all its forms is simple: it is one of zero tolerance, whether committed by GSK employees, officers, complementary workforce or third parties acting for or on behalf of the company. Accordingly, we must never make, offer to make, or authorise any improper payments or provide anything of value to any individual, or at the request of any individual, for the purpose of influencing, inducing or rewarding any act, omission or decision to secure an improper advantage, or obtain and retain business.”

In its Code of Practice for Promotions and Customer Interactions, there is a detailed procedure laid out for any sponsorship of a corporate event, conference or travel. This procedure requires that “The Scientific Engagement Operating Practice “Congress Sponsorships” must be followed for sponsorships of scientific and medical congresses (conferences) at international and local (country) levels”. Further, if there is a grant a specific procedure must be followed.

Additionally GSK has a Third Party Code of Conduct, which states:

Third Parties shall conduct their business in an ethical manner and act with integrity. The ethics elements include the following statement:

**1. Business Integrity, Reputation and Fair Competition**

Corruption, extortion and embezzlement are prohibited. Third Parties shall not pay or accept bribes or participate in other illegal inducements in business or government relationships.

Third Parties should never communicate externally about GSK’s prospects, performance or policies nor disclose inside Information which would affect the price of GSK securities without proper authority. Third Parties are forbidden from making any public posting of confidential or proprietary information related to any aspect of GSK’s business.

Third Parties shall conduct their business consistent with fair and vigorous competition and in compliance with all applicable anti-trust laws. Third Parties must strictly adhere to the letter and spirit of the Competition laws in all jurisdictions. Third Parties shall employ fair business practices including accurate and truthful advertising.

According to the GSK Code of Conduct, all of this is to be backed up by “a Global Ethics & Compliance team which is responsible for providing oversight and guidance to ensure compliance with applicable laws, regulations, and company policies, as well as fostering a positive, ethical work environment for all employees.” The Code of Conduct also states that “GSK has an active system of internal management controls to identify company risks, issues



and incidents with appropriate corrective actions taken. Our Risk Management and Compliance Policy provides the framework for these internal controls, to ensure significant risks are escalated to the proper levels of senior management.”

Frankly I do not know how much clearer a company can *state* that we will not engage in bribery and corruption. But the problem for GSK seems to be that none of the above was effective because the company did not follow its own stated protocols regarding its operations in China. You would think that any company which has paid *\$3 billion* in fines and penalties for fraudulent actions and is under a five year agreement to do business within the compliance laws would take all steps possible not to engage in bribery and corruption, but there is more. In addition to this prior enforcement action, GSK is currently under separate investigations by the DOJ and Securities and Exchange Commission (SEC) for specific FCPA violations, although GSK phrased it as they were ‘contacted’ by the DOJ and SEC. Nevertheless, the company’s most recent 10K reports that there is such an investigation.

### Chapter III - Some Chinese Law

In FT article, entitled “*China dream sours for foreign companies*”, Tom Mitchell wrote that “The “Chinese dream” articulated by China’s new president, Xi Jinping, is fast becoming a nightmare for some of the world’s most powerful corporations.” This is because “since then, government investigations and state media exposés targeting foreign investors have become a regular feature of the country’s business landscape.” Mitchell reported that some western executives “complain that foreign groups appear to be encountering particularly heavy scrutiny under the new leadership.” That complaint might certainly be considered by GSK as they have become the poster child for Chinese enforcement of its own internal anti-bribery legislation.

One of the things that compliance practitioners should not lose sight of in the ongoing bribery and corruption investigation of GSK is that the investigation, detentions and arrests all involve allegations of violations of *Chinese* law, not the FCPA or UK Bribery Act. And while prosecution and even indictment or arrest under the FCPA or Bribery Act could not be termed a pleasant experience, I am relatively certain that it would pale in comparison to indictment or arrest under the applicable Chinese law prohibiting bribery of Chinese officials.

But what is the Chinese law regarding bribery and corruption of Chinese officials inside of China and what might that portend for US, UK or other western companies doing business in China? In a recent client alert, entitled “*Recent Developments in Chinese Antibribery Laws and Enforcement*”, the law firm of Akin Gump Strauss Hauer & Feld LLP, wrote that “The recent, very public crackdowns against alleged bribery activities by foreign firms, however, should be seen in a broader historical context and as a manifestation of developments in the legal arena that have been taking place over some time.” This is because Chinese officials had previously focused on prosecution of bribe recipients, not the bribe payers. They noted that “Chinese laws against bribery can be found in the PRC Criminal Law, first promulgated in 1997. Importantly, in contrast to bribery laws in many other jurisdictions, the Chinese law applies only to the actual giving of a bribe, not to the offering of one; there is no law against attempted bribery in China. In contrast to the FCPA, the rules in China apply to bribing private individuals and entities, not just government officials.”

The client alert also reported that that the Interpretations on Several Issues Concerning the Application of the Law in the Handling of Criminal Bribe-Giving Cases, adopted jointly by the Supreme People’s Court and the Supreme People’s Procuratorate in December 2012, which became effective in January 2013, defined more clearly the various levels of bribery, issues regarding the amount of money involved, the identity of the recipient and penalties. Additionally, it noted that “Various Chinese court rulings provide some guidance on the issue; per these rulings, the following factors are key: (i) the nature and history of the relationship between the parties; (ii) the value of the gift; (iii) the purpose and timing of the gift relative to what is obtained; and (iv) to what extent the recipient has used his or her position to promote the interests of the gift giver.” However and perhaps more ominously, the client alert also said that “given the general nature of these guidelines, prosecutors and judges have considerable discretion in determining whether a particular act amounts to an illegal bribe.”

### ***A. Penalties Under Chinese Law***

Helen Zhang, Partner in the Shanghai office of the Zhong Lun Law Firm, in a presentation entitled “*Management of Corruption Exposure Legal Framework & Company Approaches*”, detailed the legal framework on Chinese anti-corruption laws. Under the criminal proceedings section, the definition of what might constitute a bribe can include “money, property, material object or interest on property that can be counted by money, such as providing house renovation, membership card containing money, token card (coupon), traveling expenses, etc., or anything of a property nature.” In the administrative proceedings, there can be prosecutions for “any incorrectly recorded sales discounts or rebates” and there are several tests on what might constitute a legitimate gift, contrasting it with indicia of bribery. They include the following:

the transaction background, such as whether the transaction parties are relatives or friends and the circumstances and degree of communications between the transaction parties in history;

value of the money or property transacted;

cause, time and manner of the transaction, and whether the person offering money or property has brought forward any request towards the recipient in connection with the recipient’s duties; and finally

whether the recipient secures benefits for the provider by taking advantage of his duties.

### ***B. Defenses Available***

There are defenses available to rebut allegations of bribery, pursuant to the PRC Supreme Court’s interpretation, which states “if the company adopts a collective decision or the in-charge manager of the company makes a decision to voluntarily confess the bribery activities before being pursued, the penalties on the company and its relevant responsible persons can be reduced or even exempted.” Further, Zhang noted that there are additional defenses available. Under general Chinese law, these are voluntary confessions and contributions to other enforcement actions and other defenses specific to bribery cases which include “blackmailed bribery and no improper interest involved”.

Facilitation payments are not excluded or exempted from the Chinese bribery statutes, as facilitation payments may be deemed bribery if the facilitation of the relevant government procedures constitutes an “improper interest acquired by the briber. Pursuant to the judicial interpretations of the PRC Supreme People’s Court, any attempt to obtain advantage of competition inconsistent with the principle of fair and just may also be deemed a kind of “improper interest.” Most relevant to the GSK matter, “Indirect payment of bribes through an intermediary is not a defense and both the intermediary and the briber may be criminally prosecuted: (a) if the intermediary introduces the briber to a public official, he may be prosecuted for the “crime of introduction of bribery”; or (b) if the intermediary assists in the payment of bribes for the briber, he may be prosecuted for the “crime of bribery” as an accomplice of the briber.”

The Akin Gump client alert ended with “For many years, U.S. companies doing business in China have had to concern themselves only with the strictures of the FCPA. The recent

developments in antibribery enforcement in China will add to those burdens. While the FCPA and Chinese antibribery laws are similar in many respects, they are not identical. For example, as noted above, the FCPA applies only to bribery involving government officials; the Chinese law is not so limited. Furthermore, the FCPA contains an exception for “facilitation payments,” while the Chinese law contains no such express exception. Effective compliance programs for U.S. firms operating in China will therefore need to take account of, and address, both sets of laws.”

## Chapter IV - Missed Red Flags

One of the questions that GSK will have to face during the next few years of bribery and corruption investigations is how an allegedly massive bribery and corruption scheme occur in its Chinese operations? The numbers thrown around have been upwards of \$500MM. It is not as if the Chinese medical market is not well known for its propensity towards corruption, as prosecutions of the FCPA are littered with the names of US companies which came to corruption grief in China. GSK itself seemed to be aware of the corruption risks in China. In a Reuters article, entitled “*How GlaxoSmithKline missed red flags in China*”, Ben Hirschler reported that the company had “more compliance officers in China than in any country bar the United States”. Further, the company conducted “up to 20 internal audits in China a year, including an extensive 4-month probe earlier in 2013.” GSK even had PricewaterhouseCoopers (PwC) as its outside auditor in China. Nevertheless, he noted that “GSK bosses were blindsided by police allegations of massive corruption involving travel agencies used to funnel bribes to doctors and officials.”

### A. Types of Bribery Schemes

The types of bribery schemes in China are also well known. In an FT article, entitled “*Bribery built into the fabric of Chinese healthcare system*”, reporters Jamil Anderlini and Tom Mitchell wrote about the ‘nuts and bolts’ of how bribery occurs in the health care industry in China. They opened their article by noting that the practice of bribing “doctors, hospital administrators and health officials is rampant.” They quoted an un-named senior health official in Beijing for the following, “All foreign and domestic pharmaceuticals operating in China are equally corrupt”. The authors also quoted Shaun Rein, a Shanghai-based consultant and author of “*The End of Cheap China*”, for the following “This is a systemic problem and foreign pharmaceutical companies are in a conundrum. If they want to grow in China they have to give bribes. It’s not a choice because officials in health ministry, hospital administrators and doctors demand it.”

Their article included a diagram which visually represented two methods used to pay bribes in China, which were designated the *direct incentives* and *indirect incentives* methods. Whichever method is used, the goal is the same – to boost sales.

In the *direct incentives* method, a third party representative of a company would provide cash to the department head of a clinic or hospital. The department head would in turn pay it to the individual physicians to encourage them to prescribe the company’s medical products. But a third party representative could also contact a physician directly and reward them with “gifts such as storecards, vouchers and travel” expenses. Other direct methods might include the opening of bank accounts or charge accounts at luxury goods store and then the company would hand “the debit card or VIP card directly to the recipient.”

The FT noted that the *indirect incentives* method tended to be “used by larger pharmaceutical groups with stricter governance procedures.” Under this bribery scheme there were two recognized manners to get benefits into the hands of prescribing physicians. The first is to have cash incentives paid to a third party representative, such as a travel agency, which would then

“pass on some of these rewards to the physician directly.” Another method was for the company itself to make a “lump sum sponsorship paid to hospitals”. The hospitals would then distribute perks “to the doctors as a monthly or annual bonus.” Another *indirect* method noted was that companies might organize overseas conferences and site visits, which might also include first class travel arrangements with stays at “five-star accommodations.”

Anderlini and Mitchell reported that “The 2012 annual reports of half a dozen listed Chinese pharmaceutical companies reveal the companies paid out enormous sums in “sales expenses”, including travel costs and fees for sales meetings, marketing “business development” and “other expenses”. Most of the largest expenses were “travel costs or meeting fees and the expenses of the companies’ sales teams were, in every case, several multiples of the net profits each company earned last year.” They cited the example of the company Guizhou Yibai Pharmaceutical which earned a net profit last year of Rmb333.3m. However its “sales expenses came to a total of Rmb1.25bn, including meetings expenses of more than Rmb295m and wages of just Rmb88m.” Indeed the “largest expense for the company’s sales team of 2,318 people was Rmb404m spent on travel, for an average of more than Rmb174,000 per sales representative for the year. That is roughly what it would cost every single sales representative to fly 10 times a month between Beijing and Guiyang, where the company is based.”

### ***B. Auditing Responses - Missed Red Flags?***

But what should GSK have done if such expense were kept ‘off the books’? Hirschler, in his Reuters article, quoted one un-named source for the following, ““You'd look at invoices and expenses, and it would all look legitimate,” said a senior executive at one top accountancy firm.” The problem with fraud - if it is good fraud - is it is well hidden, and when there is collusion high up then it is very difficult to detect.”” Jeremy Gordon, director of China Business Services was quoted that “There is a disconnect between the global decision makers and the guys running things on the ground. It's about initially identifying red flags and then searching for specifics.”

There are legitimate reasons to hold Continuing Medical Conferences (CME), such as to make physicians aware of products and the latest advances in medicine. However, this legitimate purpose can easily be corrupted. Hirschler quoted Paul Gillis, author of the China Accounting Blog, for the following “Travel agencies are used like ATMs in China to distribute out illegal payments. Any company that does not have their internal audit department all over travel agency spending is negligent.” Based on this, GSK should have looked more closely on marketing expenses and more particularly, the monies spent on travel agencies. Hirschler wrote, “They [un-named auditing experts] say that one red flag was the number of checks being written to travel agencies for sending doctors to medical conferences, although this may have been blurred by the fact that CME accounts for a huge part of drug industry marketing.”

One other issue might be materiality. If GSK’s internal auditors had not been trained that there is no materiality standard under the FCPA, they may have simply skipped past a large number of payments made that were under a company’s governance procedure for elevated review of expenses. Further, if more than one auditor was involved with more than one travel agency, they may not have been able to connect the dots regarding the totality of payments made to one travel agency.

What about the external auditors, PwC? Francine McKenna, who writes and speaks extensively on all things related to Big 4 auditing, wrote last year, in blog post entitled “*What The SEC And PCAOB Fail To Acknowledge About Chinese Fraud*”, that Pam Chepiga of Allen & Overy, “told the audience that FCPA investigations in China are difficult because, “you can’t take the documents out of the country.”” After her panel, Chepiga told McKenna “that not only does China restrict the dissemination of documents outside of China, but internal investigations by multinationals must be done by Chinese lawyers with support from the Chinese accounting firms. Given the experience that the SEC is having with Deloitte, it seems, “previous cooperation agreements are not in force. The SEC would have a hard time going over and investigating a fraud or FCPA violation by the Chinese arm of a US based company”. So things may not have been any easier for PwC as well. However the recent agreement between the SEC and the Chinese Securities Regulatory Commission will allow the SEC some access to audit the work papers of Chinese companies listed in the US may influence this question.

### ***C. Ongoing Monitoring***

Another response that GSK could have implemented was to engage in greater ongoing monitoring. An article in the Texas Lawyer, Out of Order column, entitled “*5 Tips for Avoiding Email Compliance Traps*”, by Alexandra Wrage, President of TRACE International, cited back to a WSJ article, entitled “*Glaxo Probes Tactics Used to Market Botox in China*”, which reported that internal Glaxo documents and emails reviewed by the Wall Street Journal show Glaxo's China sales staff was apparently instructed by local managers to use their personal email addresses to discuss marketing strategies related to Botox. In the personal emails, sales staff discuss rewarding doctors for prescribing Botox with cash payments, credits that could be used to meet medical education requirements and other rewards.”

With the technology available to companies today it is possible that companies have the ability to determine if employees are accessing personal email accounts from business computers. Wrage used the GSK matter as a jumping off point “For companies wanting to get a handle on the compliance risks they face through email (mis)uses and other forms of technology”. She gives five tips. (1) Encourage communication between compliance and IT departments. (2) Map out your universe of data. (3) Know your obligations, then develop an established set of policies and procedures around them. (4) Train employees to speak up about the new uses in technology. (5) Stress-test your program.

## Chapter V - Use of Fake Invoices in China

In an article in the New York Times (NYT), entitled “*Coin of Realm in China Graft: Phony Receipts*”, reporter David Barboza wrote about the buying and selling of business and tax receipts on the black market in China. Barboza said that “To begin to comprehend China’s vast underground economy, one need only visit this city’s major transportation depots and watch as peddlers openly hawk fake receipts. A scalper mumbles, ‘Fapiao, fapiao,’ or ‘Receipts’ at the Shanghai Railway Station. The trade in receipts is more or less open. A woman in her 30s called out to passers-by as her two children play near the city’s south train station, ‘We sell all types of receipts.’ While many buyers use them to defraud employers and evade taxes, they have recently come under FCPA and UK Bribery Act scrutiny due to the ongoing investigation of GSK which apparently is “still trying to figure out how four senior executives at its China operation were able to submit fake receipts to embezzle millions of dollars over the last six years. Police officials say that some of the cash was used to create a slush fund to bribe doctors, hospitals and government officials.”

In many cases it is not the paper that the receipts are printed on that is fake, only the information contained therein which is fraudulent. For instance, the unused receipts from a hotel may be pilfered and “then resold to dealers and enter the black market. In Shanghai, companies actually advertise by fax that they buy unused receipts. One such advertisement sent by fax read “Due to our diverse accounting service for other companies, we now need invoices from various industries (13% or 17% VAT).” Another ad sent by the Shanghai Fangyuan Accounting Agency reads, referring to the value-added tax receipts, “If your company has leftovers of 13% or 17% VAT invoices, we can offer good rates to buy them.”

Using an older form of advertising, Barboza noted that, “Signs posted throughout this city advertise all kinds of fake receipts: travel receipts, lease receipts, waste material receipts and value-added tax receipts. Promotions for counterfeit “fapiao” (the Chinese word for an official invoice) are sent by fax and through mobile phone text messages. On China’s popular e-commerce Web site, Taobao.com, sellers even promise special discounts and same-day delivery of forged receipts.”

As bad as this system of selling fraudulent invoices is, it pales beside the danger created by the sale of invoices by government officials themselves. Barboza wrote that “state employees, whether they work for government agencies or state-owned enterprises, seem as eager as anyone else to bolster their compensation by filing fake invoices.” He quoted Wang Yuhua, an assistant professor of political science at the University of Pennsylvania and the author of a study on bribery and corruption in China, for the following “Their salaries are relatively low, so they supplement a lot of it with reimbursements. This is hard to monitor.”

Barboza reported that “In the Glaxo case, Chinese investigators say the drugmaker’s top Chinese executives worked closely in recent years with a Shanghai travel agency to falsify documents. For instance, airline ticket receipts were filed for trips that never took place and when executives listed 100 guests at a conference, perhaps only 80 showed up, making it possible to file false



inflated receipts and thus embezzle from Glaxo's London headquarters." Six other international pharmaceutical companies have also acknowledged that they have used this travel agency in the past three years.

Barboza detailed that such corruption schemes were not unknown to FCPA enforcement. He cited to the SEC complaints against IBM where its "employees in China created "slush funds" with its travel agencies and business partners, partly to "provide cash payments and imported gifts, such as cameras and laptop computers to Chinese government officials."" In another SEC Complaint, it found that "between 2005 and 2010, Wyeth, a division of the drug company Pfizer, had "submitted false or inflated invoices for organizing large-scale consumer education events.""

The FCPA Blog reported, in a post entitled "*Baxter confirms China payment offenses*", that the company in question paid for an event which never occurred. It paid a travel agency identified as the Beijing Youth Travel Service Co. approximately \$15,100 for a conference at the Crowne Plaza Shenyang Parkview. The article quoted the WSJ which had written, "But an employee in the banquet and meeting department of the Crowne Plaza Shenyang Parkview said no event was organized for that date involving Baxter or medicines. She also said the hotel had no record of a meeting on that date organized by the Beijing Youth Travel Agency."

Barboza refers to some un-named analysts who "say the cost of monitoring is high and would involve the tedious work of verifying millions of receipts by calling hotels, airlines and office supply stores and scrutinizing countless transactions for signs of fraud." My response to these analysts is to say that if your compliance risks are known for a certain profile, then you should devote the necessary resources to making sure you are in compliance in that area. Eric Carlson pointed out in his three post series in the FCPA Blog, entitled "*Corruption Risk—China Travel Edition*", that there have been a plethora of FCPA enforcement actions related to travel in China. With regard to the abuse through travel agencies, Carlson wrote about four different corruption scenarios, including (1) event abuse planning, (2) mixture of legitimate and illegitimate travel; (3) other collusion with travel agencies; and (4) parallel itineraries. So those risks are well known and have been documented.

## Chapter VI - Board of Directors and Doing Business in China

While many questions are still unanswered, one that seems to be at the forefront of the inquiry was where was the GSK Board of Directors? The role of a Board of Directors is becoming more important and more of a critical part of any effective compliance program. Indeed Board involvement is listed as one of the ten hallmarks of an effective compliance program, set out in last year's FCPA Guidance. In addition to helping to set the proper tone in an organization, the Board has a specific oversight role in any FCPA or UK Bribery Act compliance program.

### A. *Some Case Law*

As to the specific role of *best practices* in the area of general compliance and ethics, one can look to Delaware corporate law for guidance. The case of *In Re Caremark International Inc. Derivative Litigation* 698 A.2d 959 (Del.1996) was the first case to hold that a Board's obligation "includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards." The Corporate Compliance Blog, in a post entitled "*Caremark 101*", said that the Caremark case "addressed the board's duty to oversee a corporation's legal compliance efforts. As part of its duty to monitor, the Board must make good faith efforts to ensure that a corporation has adequate reporting and information systems. The opinion described this claim as "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment," with liability attaching only for "a sustained or systematic failure to exercise oversight" or "[a]n utter failure to attempt to ensure a reporting and information system.""

In the case of *Stone v. Ritter* 911 A.2d 362, 370 (Del. 2006), the Supreme Court of Delaware expanded on the Caremark decision by establishing two important principles. First, the Court held that the Caremark standard is the appropriate standard for director duties with respect to corporate compliance issues. Second, the Court found that there is no duty of good faith that forms a basis, independent of the duties of care and loyalty, for director liability. Rather, *Stone v. Ritter* holds that the question of director liability turns on whether there is a "sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists."

Andrew J. Demetriou and Jessica T. Olmon, writing in the ABA Health Esource blog, said that "This standard aims to protect shareholders by ensuring that corporations will adopt reasonable programs to deter, detect and address violations of law and corporate policy, while absolving the Board from liability for corporate conduct so long as it has exercised reasonable responsibility with respect to the adoption and maintenance of a compliance and reporting system. Although the standard protects the Board, consistent with most jurisprudence under the business judgment rule, it also requires that the Board follow through to address problems of which it has notice and this may include adopting modifications to its compliance program to address emerging risks."

Lastly, I recently heard Jeff Kaplan discuss the oversight obligations of the Board regarding the compliance function. In addition to the above cases, he discussed the case of *Louisiana Municipal Police Employees' Retirement System et al. v. David Pyott, et al.*, 2012 WL 2087205 (Del. Ch. June 11, 2012)(rev'd on other grounds, No. 380, 2012, 2013 WL 1364695 (Del. Apr. 4, 2013), which was a shareholder action that went forward against a Board based upon a claim that the Board knew of compliance risk based on the company's business plan. The Delaware Court pointed out the possibility that "The appearance of formal compliance cloaked the reality of noncompliance, and directors who understood the difference between legal off-label sales and illegal off-label marketing continued to approve and oversee business plans that depended on illegal activity." Kaplan believes this case more generally, supports the need for risk-based oversight by board.

### ***B. FCPA Guidance and US Sentencing Guidelines***

A Board's duty under the FCPA is well known. In the Ten Hallmarks of an Effective Compliance Program, set out in the FCPA Guidance, there are two specific references to the obligations of a Board. The first in Hallmark No. 1, entitled "*Commitment from Senior Management and a Clearly Articulated Policy Against Corruption*", stated "Within a business organization, compliance begins with the board of directors and senior executives setting the proper tone for the rest of the company." The second is found under Hallmark No. 3, entitled "*Oversight, Autonomy and Resources*", where it discussed that the Chief Compliance Officer (CCO) should have "direct access to an organization's governing authority, such as the board of directors and committees of the board of directors (e.g., the audit committee)." Additionally, under the US Sentencing Guidelines, a Board must exercise reasonable oversight on the effectiveness of a company's compliance program. The DOJ's Prosecution Standards posed the following queries: (1) Do the Directors exercise independent review of a company's compliance program? and (2) Are Directors provided information sufficient to enable the exercise of independent judgment?

Board failure to heed this warning can lead to serious consequences. David Stuart, a senior attorney with Cravath, Swaine & Moore LLP, noted that FCPA compliance issues can lead to personal liability for directors, as both the SEC and DOJ have been "very vocal about their interest in identifying the highest-level individuals within the organization who are responsible for the tone, culture, or weak internal controls that may contribute to, or at least fail to prevent, bribery and corruption". He added that based upon the SEC's enforcement action against two senior executives at Nature's Sunshine Products, "Under certain circumstances, I could see the SEC invoking the same provisions against audit committee members—for instance, for failing to oversee implementation of a compliance program to mitigate risk of bribery". It would not be too far a next step for the SEC to invoke the same provisions against audit committee members who do not actively exercise oversight of an ongoing compliance program.

There is one other issue regarding the Board and risk management, including FCPA risk management, which should be noted. It appears that the SEC desires Boards to take a more active role in overseeing the management of risk within a company. The SEC has promulgated Regulation SK 407 under which each company must make a disclosure regarding the Board's role in risk oversight which "may enable investors to better evaluate whether the board is exercising appropriate oversight of risk." If this disclosure is not made, it could be a securities

law violation and subject the company, which fails to disclose it, to fines, penalties or profit disgorgement.

In addition to the pronouncements set out in the FCPA Guidance, other commentators have discussed the legal duties set out for Board members regarding compliance. Donna Boehme, writing in the SCCE Complete Compliance and Ethics Manual, 2nd Ed., entitled “*Board Engagement, Training and Reporting: Strategies for the Chief Ethics and Compliance Officer*”, said that these state court decisions establish the parameters of Board duty of care for corporate compliance activities. Moreover, this case law on the duty of a Board member, read in conjunction with the US Sentencing Guidelines, set out the elements of an effective program to be overseen by the Board. The US Sentencing Guidelines also require that a Board “be “knowledgeable” about the content and operation of the company program and exercise “reasonable oversight” over its implementation and effectiveness.”

### ***C. Boards and Operations in China***

In the July/August issue of the NACD Directorship, in an article entitled “*Corruption in China and Elsewhere Demands Board Oversight*”, Eric Zwisler and Dean Yoost noted that as “Boards are ultimately responsible for risk oversight” any Board of a company with operations in China “needs to have a clear understanding of its duties and responsibilities under the FCPA and other international laws, such as the U.K. Bribery Act”. Why should China be on the radar of Boards? The authors reported that “20 percent of FCPA enforcement actions in the past five years have involved business conduct in China. The reputational and economic ramifications of misinterpreting these duties and responsibilities can have a long-lasting impact on the economic and reputation of the company.”

The authors understand that corruption can be endemic in China. They wrote that “Local organizations in China are exceedingly adept at appearing compliant while hiding unacceptable business practices. The board should be aware that a well-crafted compliance program must be complemented with a thorough understanding of frontline business practices and constant auditing of actual practices, not just documentation.” Further, “the management cadence of monitoring and auditing should be visible to the board.” Echoing one of the Board’s roles, as articulated in the FCPA Guidance, the authors considered that a “board must ensure that the human resources committed to compliance management and reporting relationships are commensurate with the level of compliance risk.” So if that risk is perceived to be high in a country, such as China, the Board should follow the prescription in the Guidance which states “the amount of resources devoted to compliance will depend on the company’s size, complexity, industry, geographical reach, and risks associated with the business. In assessing whether a company has reasonable internal controls, DOJ and SEC typically consider whether the company devoted adequate staffing and resources to the compliance program given the size, structure, and risk profile of the business.”

To help achieve these goals, the authors suggested a list of questions that they believe every director should ask about a company’s business in China.

How is “tone at the top” established and communicated?

How are business practice risks assessed?

Are effective standards, policies and procedures in place to address these risks?

What procedures are in place to identify and mitigate fraud, theft, corruption?

What local training is conducted on business practices and is it effective?

Are incentives provided to promote the correct behaviors?

How is the detection of improper behavior monitored and audited?

How is the effectiveness of the compliance program reviewed and initiated?

If a problem is identified, how is an independent and thorough investigation assured?

The authors correctly pointed out that third parties generally present the most risk under a FCPA compliance program and that “more than 90 percent of reported FCPA cases involve the use of third-party intermediaries such as agents or consultants.” However, they also noted that “all potential opportunities in China will have some level of compliance related issues.” As joint ventures (JV) and the acquisition of Chinese entities are an important component of many organizations’ strategic plans in China, it is important to have Board oversight in the mergers and acquisition (M&A) process.

The authors understand that “non-compliant business practices and how to bring these into compliance is often a major and defining deal risk.” But, more importantly, it is a company’s “inability to understand actual business practices, the impact of those practices on the core business, and effectively dealing with a transition plan is one of the main reasons why joint ventures and acquisitions fail.” So even if the conduct of an acquisition target was legal or tolerated in its home country, once that target is acquired and subject to the FCPA or Bribery Act, such conduct must stop. However, if such conduct ends, it may so devalue the core assets of the acquired entity so as to ruin the business basis for the transaction. The authors cited back to the FCPA Guidance and its prescribed due diligence in the pre-acquisition stage as a key to this dilemma. But those guidelines also make clear that post-acquisition integration is a must to avoid FCPA liability if the illegal conduct continues after the transaction is completed.

The authors concluded by articulating that many Boards are not engaged enough to understand the way that their company is conducting business, particularly in a business environment as challenging as China. They believe that a Board should have a “detailed understanding of the business if it is to be an effective safeguard against fraud or corrupt practices.” They remind us that not only should a Board understand the specific financial risks to a company if a FCPA violation is uncovered; but perhaps more importantly the “potential impact on the corporate culture and the risk to the company’s reputation, including the reputations of individual board members.” Finally, the authors stated that “effective oversight of corruption in China will only become increasingly more important”. That may be the most important lesson for any Board collective or Board member individually to take away from the ongoing GSK corruption and bribery scandal.

## **Chapter VII - Is a Country Sweep Coming to China?**

### ***A. What is a sweep under the FCPA?***

The FCPA Professor, in a blog post entitled “*Industry Sweeps*”, posted an article from FCPA Dean Homer Moyer, entitled “*The Big Broom of FCPA Industry Sweeps*”. In his article, Moyer said that an industry sweep is the situation where the DOJ and/or SEC will focus “on particular industries – pharmaceuticals and medical devices come to mind — industry sweeps are investigations that grow out of perceived FCPA violations by one company that enforcement agencies believe may reflect an industry-wide pattern of wrongdoing.” Moyer further wrote, “Industry sweeps are often led by the Securities and Exchange Commission (“SEC”), which has broad subpoena power as a regulatory agency, arguably broader oversight authority than prosecutors. They are different from internal investigations or traditional government investigations, and present different challenges to companies. Because the catalyst may be wrongdoing in a single company, agencies may have no evidence or suspicion of specific violations in the companies subject to an industry sweep. A sweep may thus begin with possible cause, not probable cause. In sweeps, agencies broadly solicit information from companies about their past FCPA issues or present practices. And they may explicitly encourage companies to volunteer incriminating information about competitors.”

### ***B. China Sweeps Itself?***

As bad as a DOJ/SEC country sweep of China might seem to western companies, it might well blanch next to a sweep by Chinese authorities. Whether this is based on politics, nationalism, the rising cost of domestic drugs, anti-competitive practices or any other reason, it really does not matter. In a FT article, entitled “*China drug bribe probes broaden*”, reporters Patti Waldmeir, Jamil Anderlini and Andrew Jack wrote that Chinese authorities are widening their probe of western pharmaceutical companies. One example they cited was that the government of Shanghai “told hospitals to look for corruption in the purchasing and prescribing of drugs, as well as in clinical trials conducted with hospital participation.” This broadening also included investigations of doctors. Separately the State Administration for Industry and Commerce announced that it would investigate “bribery, fraud and anti-competitive practices in a range of industries that touch the lives of consumers, from drugs and medical services to school admissions.”

As the number of companies either being investigated in China or engaging in their own internal investigations increases Homer Moyer’s statement that “Inevitably, industry sweeps become organic and evolve, with government investigators using information from one company as the basis for additional requests to others” may well some omniscient. So in addition to the DOJ and SEC perhaps taking a different tack than simply focusing on one industry and starting a China sweep; the Chinese themselves may take up the task. If so there will most probably be cooperation between the various investigative agencies involved. All of that means more pain for the companies involved.

## Chapter VIII - One More Nail in the Coffin of a Compliance Defense

I believe that one of the side effects from the GSK matter will be that one more nail is driven the coffin of amending the FCPA to add a compliance defense. I find it amazing that some commentators are still arguing for amendment of the FCPA to add such an affirmative defense. In a post on the FCPA Blog by Philip Fitzgerald, entitled “*From Europe, the case for an FCPA good-faith defense*”, posits that enforcement of foreign bribery in the US is effective under the FCPA because such enforcement is aided by the doctrine of *respondeat superior*. Fitzgerald then argues that a good-faith compliance defense has been considered for some time as a potential counterweight to *respondeat superior*. The reason being that if companies had incentives for effective compliance programs and were “accused of violating the FCPA could mount a defense based on their efforts to prevent the bribery are evident. Corporations accused of violating the FCPA would have access to courts and jury trials to contest and challenge FCPA allegations, would probably be encouraged to discover and self-report overseas bribery, and may not feel compelled to enter into settlements with enforcement agencies that can prejudice the rights of both the organizations and their employees.”

Here is the problem with that argument. It apparently makes no difference what the incentives will be for a company to put a compliance program in place. For even if you have a compliance program it still has to be effective. Last year this was driven home by Wal-Mart and its allegations of wide spread bribery and corruption in its Mexico subsidiary. This year we have GSK running amok with allegations that it engaged in bribery and corruption in its Chinese operations.

### A. *The Uselessness of a Compliance Defense*

So how does all of this portend the end of efforts to add a compliance defense to the FCPA? As stated in its Code of Conduct, “The GSK attitude towards corruption in all its forms is simple: it is one of zero tolerance.” What do you think a compliance defense would do for GSK about now? GSK prided itself on its world-wide FCPA anti-corruption compliance program. It even said it would do so in settlement documents with the DOJ. The claim that companies would act more ethically and in compliance if they could rely on a compliance defense would seem to be negated by facts reported about GSK. Do these facts seem like a rogue employee or even junta of rogue China subsidiary employees going off on their own? Whatever your thoughts on that question may be, it certainly appears that having a *best practices* compliance program did not lead to GSK doing business more ethically. And what if GSK’s corporate headquarters in London was not involved in any illegal conduct or were even kept in the dark by GSK China? What does that say about having a robust compliance program?

Amending the FCPA to protect corporate headquarters in the US from liability under the doctrine of *respondeat superior*? At this point, I do not think that anyone can argue with anything close to a straight face that this problem was exclusive to China. The corporate parent received the benefits from any profits made due to the bribery so it is difficult to image why a corporation

should not be a part of any enforcement action. I suspect that both the DOJ and the UK Serious Fraud Office (SFO) will be asking the dreaded “*Where Else*” question about now.

The GSK tale drives home the point that having a compliance program is useless unless it is effective. Further, it is clear that by putting such an affirmative defense in place, companies may well go the paper compliance defense route and not dedicate the time and resources to make it effective. So whether you were pro or anti-compliance defense, I think that GSK is a stand-in for the Grim Reaper and what the matter will portend in this brave new world of global anti-bribery and anti-corruption enforcement.



## Chapter IX - What Can You Do?

If your company has Chinese operations, what should you do? Chris Matthews, in a WSJ article entitled “*Western Companies Sweat as Glaxo Probe Unfolds*”, warned that “The rapidly unfolding bribery probe by Chinese authorities into the U.K. drug maker has alarmed Western companies with business there that are accustomed to highly-publicized corruption crackdowns on Chinese officials, but who sees the Glaxo matter as new territory, China watchers said. The push against Glaxo could signal that a new anticorruption push in China could now also include foreign companies.” I would suggest that an immediate review of your sales operations is in order. Matthews quoted Joe Warin, a partner at Gibson Dunn & Crutcher LLP, who said, “In particular, companies should examine relationships with travel agencies and event-planning companies, which have long been an “Achilles heel” in China”. The first thing that you should check on is to see the spend that you have with any Chinese travel agencies. You should then match up all receipts and other documentation with all costs to see if there is anything out of line.

You should also look at your own employee base. Regarding a company’s own employees, Matthew quoted Jerome Cohen, co-director of New York University School of Law’s U.S.-Asia Law Institute, for the following, “This is a fairly obvious warning that companies need to conscientiously scrutinize the activities of their employees there”. Remember the Eli Lilly and Company (Lilly) FCPA enforcement action brought by the SEC late last year? The bribery scheme which got Lilly into trouble in China involved its own employees, who inflated their expense accounts and used the extra money to pay bribes to secure sales.

It is clear that companies should follow Matthews’ advice that “multinationals need to scour their operations in China to limit their vulnerability to future investigations.” Now is the time to begin your own investigations because you certainly do not want to be like GSK and find out about allegations that your employees engaged in a multi-year, multi-million dollar bribery and corruption scheme through a public pronouncement from the Chinese Public Security Ministry.

Mike Volkov has provided information to the compliance practitioner to assist in this new world order in China. In a blog post, entitled “*China and Compliance Solutions: Choking Off the Money Supply*” and webinar, entitled “*How to Avoid Corruption Risks in China*”, Volkov gave some specific suggestions for the compliance professional to utilize in the current enforcement environment in China. In his webinar, he said that western companies operating in China need to understand that the cost of compliance will exceed the amount spent in other countries. While there is certainly an upside in revenues from China business, it also involves greater compliance costs and risks. Companies need to construct enhanced compliance controls and implement aggressive monitoring programs, demand adherence to strict documentation policies and to integrate non-Chinese controls and personnel into China operations to supervise and monitor the local operations.

Volkov identified third party risks as the greatest risk because companies have a limited ability to control the outgoing expenditures of third parties than they do of their own. Some of the key questions that need to be explored in the due diligence process include what specific services

will the third parties be providing and have you verified that the potential agent can deliver those services? You need to care that there is an absence of relationship between your Chinese employees and third party. You also need to inquire about how the third party came to your company's attention, for example does it have an internal sponsor in your company? Volkov notes that not only must audit rights be secured by western companies; they need to exercise those rights. Lastly, he advises that any unjustified expenditures have to be aggressively pursued both through the audit process and into the investigative process, if needed.

Additional questions you can ask, in the review of third parties who might provide such services, are:

What is the ownership of the third party? Is there a business justification for the relationship?

Is there anyone in the company who is responsible for maintaining the relationship?

Is there ongoing accountability?

How is the relationship being managed?

Are you engaging in any transaction monitoring?

Are you engaging in any relationship monitoring?

What is the estimated or budgeted size of the spend with the third party?

What do the actual spends show going forward?

Volkov believes that a key control involves focusing on internal expenditures. Unfortunately, he notes that external auditors often rely on Chinese affiliates, who he believes are "notorious for bending to company resistance to auditing standards and inquiries." Therefore companies need to require their external auditors to install quality controls. Companies should also demand strict adherence to auditing standards. He suggests that there should be both forensic auditing and transaction testing to review individual receipts and transactions. Lastly, he suggests that money should only be doled out through strict supervision by a non-Chinese controller.

In his blog post, Volkov drills down into some specific protections that a company can take to control its cash outlays in China to try and prevent some of the more well-known bribery schemes. He believes that "The strategy for compliance is then to focus on access to the money which the bribe payor needs to complete the bribe. Resources and controls need to be allocated and designed based on this analysis and focus." He provides a scenario where bribery and corruption can occur and a possible strategy to combat such actions.

In his scenario, an employee obtains company money by fraud and then pays a government official. The employee uses a fake invoice(s), which is typically required in China to satisfy tax authorities, and the fake invoice, which may involve another party as the recipient of the payment, is a means by which to "steal" the money from the company and use it for an improper purpose. This was the bribery scheme used by Lilly's employees in China where employees submitted false expense accounts and used the difference to fund their bribery scheme.

Volkov's proscription for this is that the company's compliance function must ensure that internal financial controls are scrupulously followed, so that any potential fake invoice is identified in advance. He believes whether the offender is an ex-pat or a local employee it is important to enforce such rules, it is an issue which can be debated and the outcome will depend on the personnel and the specific situation facing the company. The reason would seem rather self-obvious; that is, if no one is watching the invoicing process, verifying the accuracy of the invoice and ensuring that the payment is justified, money will slip out from the company for bribes. This means the focus of internal controls should include not only fake invoices but systems, procedures and forms to ensure that only approved and appropriate payments are made.

## Chapter X - What Does It All Mean?

Most ominously FT reporters, Patti Waldmeir, Jamil Anderlini and Andrew Jack wrote in a piece entitled “*China drug bribe probes broaden*”, that Chinese authorities are widening their probe of western pharmaceutical companies. The entry of the Chinese government into the international fight against corruption and bribery is truly a game-changer. While there may be many reasons for this very public move by the Chinese government, it is clear that foreign companies are now on notice. Doing business the old fashioned way will no longer be tolerated. I agree with Volkov, that the GSK bribery and corruption investigation will be the Number 1 development for the year in anti-corruption compliance. This means that international (read: western) companies operating in China have a fresh and important risk to consider; that being that they could well be subject to prosecution under domestic Chinese law.

The international component of this investigation may well increase anti-corruption enforcement across the globe. First of all, when other countries notorious for their endemic corruptions, for example India, see that they can attack their domestic corruption by blaming it on international businesses operating in their company; what lesson do you think they will draw? Most probably that all politics are local and when the localities can blame the outsiders for their own problems they will do so. But when that blame is coupled with violations of local law, whether that is anti-bribery or anti-price fixing, there is a potent opportunity for prosecutions.

Just as importantly is the individual perspective. For many western ex-pats who are considering working in China, this may cause them to rethink whether or not they are willing be stationed in the country for fear of being caught up in the Chinese judicial system, which is a system not known for protecting individual due process rights and this factor cannot be overstated because wherever you do not want to be, imprisoned in China is near the top of the list.

Just as the Wal-Mart FCPA investigation has reverberated throughout the US, I think that the GSK matter will be with us for some time. As bad as it seems about now, and it certainly appears bad, there are many lessons which the compliance practitioner can not only draw from but use for teaching moments within your company. The prior premonition “if you are subjected to a FCPA sweep” may now have changed to “when” so one of those lessons should be expanded to include investigations by local or national officials regarding violations of their own domestic laws against bribery and corruption.

## About the Author

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