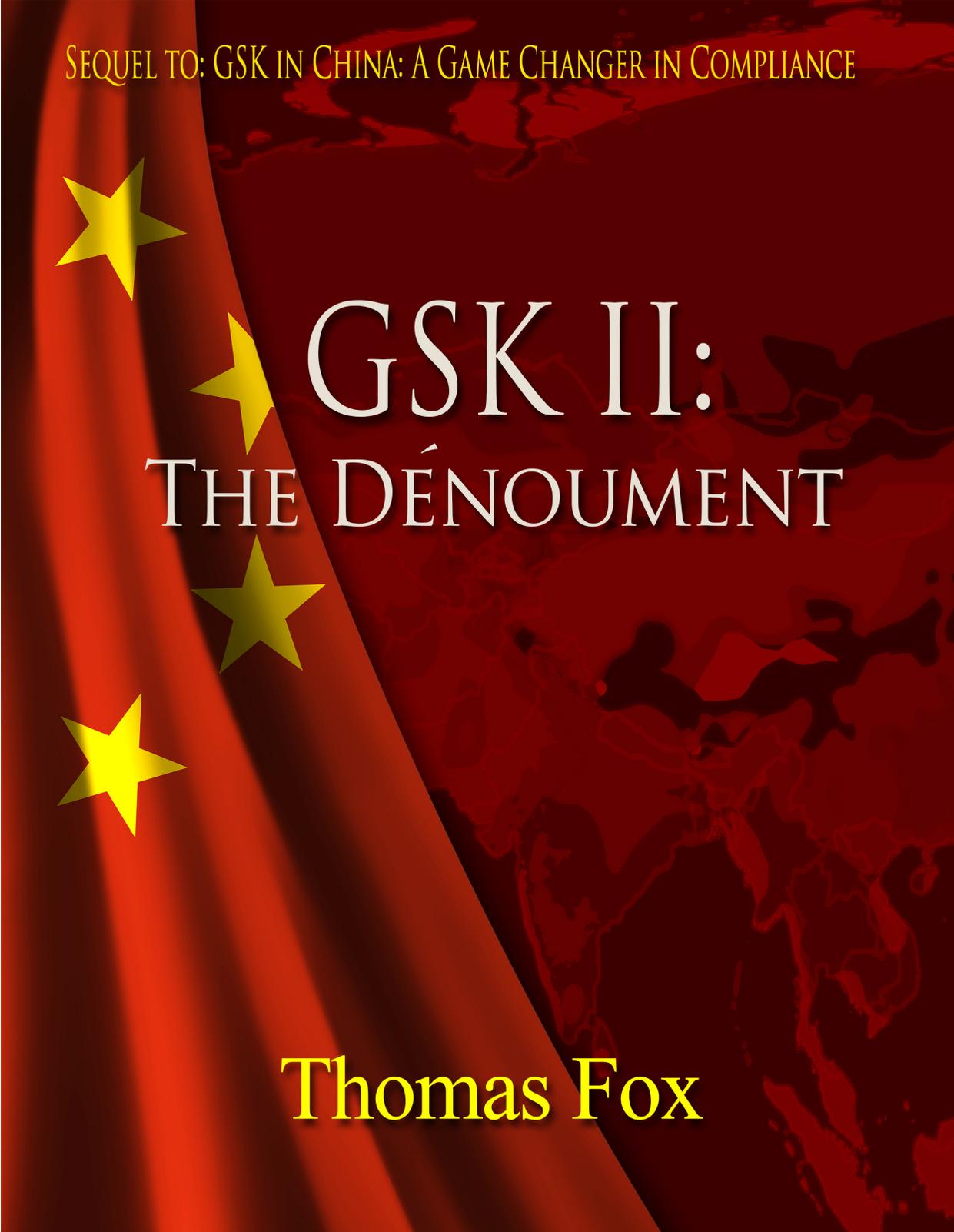


SEQUEL TO: GSK IN CHINA: A GAME CHANGER IN COMPLIANCE

The cover art features a dark red background with a faint map of China. On the left side, there is a vertical strip of the Chinese national flag, showing the red field and four yellow stars. The title 'GSK II: THE DÉNOUEMENT' is centered in a white, serif font.

# GSK II: THE DÉNOUEMENT

Thomas Fox

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## **Author's Note**

Last summer brought the anti-corruption compliance world a new situation as the Chinese government aggressively investigated, for the first time a western company for bribery and corruption of Chinese citizens in China. Last year I published an eBook on the investigation phase of GlaxoSmithKline PLC (GSK) corruption matter in China. This year, as the Chinese government moved into the prosecution phase, I have updated the GSK matter through its conviction for bribery and corruption by a Chinese court. I have also tried to collect some of the most significant lessons to be learned for any compliance practitioner from the facts and events surrounding this case and what it may mean going forward for the compliance practitioner. Once again, thanks to Maurice Gilbert at Consileum for the idea to update my book, and my heart of gold wife, Michele, for editing it.

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# **Part I-the Bad News Continues**

## Chapter I - Background

In late June, 2013 the international anti-corruption community literally exploded when 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. We are not just talking about nickel and dime stuff but over \$500 million in illegal payments were alleged to have been made by the company's China business unit over a several year period. But the thing that made this matter stand out for the anti-corruption compliance community was how public the allegations, company statement and counter-statements were. Never had we seen such a spectacle played out in the international press.

For those not familiar with the allegations, they were well-reported in the international press. 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 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.”

| <b>GSK Prosecution Timeline (2014)</b> |   |
|--|---|
| May                                    | UK Serious Fraud Office and US Department of Justice announce they have opened separate investigations into GSK.  |
| May                                    | Chinese authorities accuse GSK China Country Manager Mark Reilly of orchestrating China bribery scheme.   |
| June                                   | Allegations of GSK bribery in Syria, Iraq, Poland and Greece surface. GSK China unit employees bring claims that were forced by management to pay bribes and told to lie to investigators |
| July                                   | It is revealed that GSK was sent a ‘sex tape’ of China country manager and his girlfriend by same anonymous whistleblower who made allegations of bribery.                                |
| July                                   | Trial of Humphreys and wife is announced.   |
| August 8                               | One day trial held for Humphreys and wife. Both convicted.  |
| Sept. __                               | GSK pleads guilty in secret one-day trial. Fined \$491MM  |

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.

The bad news continued to be reported in the international press through July and up until early August, 2013 when the Chinese government ceased making its almost daily announcements about the matter and GSK had relatively little to say about the case for the remainder of the year. But in mid-2014, more information began to come out regarding more specific allegations of GSK’s misconduct in China, allegations about corruption issues in other countries and the anonymous whistleblower and internal investigation. All of this culminated in a secret one-day trial on August \_\_\_\_, 2014 where GSK was convicted of corruption in China and receiving a (Chinese) record fine of approximately \$491MM.

This book will bring the GSK corruption scandal up to date, detail the facts, information and allegations that continued to dribble out over the past year and end with the GSK conviction for corruption. I will also present some of the lessons which a

compliance practitioner may take away from this matter to use in the review, implementation and enhancement of a *best practices* compliance program going forward. We pick up the story in May, 2014....

## ***Chapter II-The GSK Corruption Investigation Deepens***

In May, 2014 the UK Serious Fraud Office (SFO) announced that it had “opened a criminal investigation into the commercial practices of GlaxoSmithKline plc and its subsidiaries.” In the same Press Release the SFO said, “Whistleblowers are valuable sources of information to the SFO in its cases. We welcome approaches from anyone with inside information on all our cases including this one - we can be contacted through our secure and confidential reporting channel, which can be accessed via the SFO website.” It then proceeded to provide the SFO’s secure reporting website.

In an article in the New York Times (NYT), entitled “*GlaxoSmithKline Under Investigation by Serious Fraud Office*”, Chad Bray reported that the SFO “is investigating Glaxo’s business activities in “multiple jurisdictions,” according to a person familiar with the investigation who was not authorized to speak publicly.” Further, “Chinese authorities have been investigating the drugmaker’s business practices related to payments to doctors and other health care professionals since last year and questions have been raised in recent months about the company’s practices in Iraq and Poland.”

James Titcomb, reporting in The Telegraph, in an article entitled “*SFO opens criminal investigation into GlaxoSmithKline*”, went further when he noted that GSK has been in contact with the SFO “in recent months in the wake of claims that it funnelled hundreds of millions of pounds to doctors and officials in countries around the globe to boost sales of its drugs.” Moreover, “Chinese police have accused the company of dispensing 3bn yuan (£285m) in bribes under the leadership Mark Reilly, the former head of its Chinese business. Authorities in the country say the bribes resulted in billions of pounds in “illegal revenue” for the company.”

On the Chinese side of the investigation, the NYT article reported that during the month of May, “Chinese authorities accused Mark Reilly, the former head of Glaxo’s operations in China, of ordering employees to bribe doctors and other hospital staff to use the drug maker’s products, resulting in more than \$150 million in illegal revenue. Two other Chinese-born Glaxo executives were also charged in the matter.”

When news of the Chinese investigation broke last summer, GSK claimed that “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,” Glaxo said in July, after meeting with the Chinese authorities. “We have zero tolerance for any behavior of this nature.” The Chinese authorities did not fall for this age-old attempt at corporate misdirection. Andrew Ward, reporting in a FT article entitled “*SFO opens criminal inquiry into GSK*”, said that the Chinese authorities had engaged in a “ten-month investigation” which had identified 46 current or former GSK employees as “suspects”.

Where were the US Department of Justice (DOJ) or Securities and Exchange Commission (SEC) be on these issues as the might relate to violations of the US Foreign Corrupt Practices Act

(FCPA)? Consider the following about GSK; in July of 2012 GSK pled guilty and paid \$3 billion to resolve fraud allegations and failure to report safety data in what the 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 “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.

You would think that any company that has paid \$3 billion in fines and penalties for fraudulent actions would take all steps possible not to engage in bribery and corruption. Indeed as part of the settlement GSK agreed to a Corporate Integrity Agreement (CIA). This CIA not only applied to the specific pharmaceutical regulations that GSK violated but all of the GSK compliance obligations, including the FCPA.

In addition to requiring a full and complete compliance program, the CIA specified that the company would have a Compliance Committee, inclusive of the Compliance Officer and other members of senior management necessary to meet the requirements of this CIA, whose job was to oversee full implementation of the CIA and all compliance functions at the company. These additional functions required Deputy Compliance Officers 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. Further, there was detail down to specifically state that all compliance obligations applied to “contractors, subcontractors, agents and other persons (including, but not limited to, third party vendors)”. So while GSK may have separate FCPA liability to be investigated by the DOJ; it may be more of an issue that the company could be in violation of its CIA.

GSK has of course averred that it is fully cooperating with all of the various investigations into its alleged bribery and corruption. Further, as reported in Ward’s FT article, “GSK said it was “committed to operating its business to the highest ethical standards”. The company had “previously denied any systemic problem with corruption and said the latest Chinese allegations were “deeply concerning to us and contrary to the values of GSK”.”

### ***Chapter III-GSK Faces a Bad Day at Black Rock***

You know it is going to be a rainy day when your employees line up to testify against your company in an ongoing investigation for bribery and corruption. But those rainy day sighs can move up to a *Bad Day at Black Rock* level when these same employees publicly announce that the company they work for owes them for the creation of fraudulent invoices used by a business unit to fund bribery and corruption which violates not only the FCPA and the UK Bribery Act but also domestic Chinese anti-corruption laws. This happened to GSK when it was announced that certain current employees in its China operation were petitioning the company to reimburse them for bribes they were ordered to pay by their superiors.

In an article in the FT, it was reported “the UK pharmaceutical company at the centre of a Chinese corruption scandal, is facing protests from junior employees who say the company is refusing to reimburse them for bribes they were ordered to pay by their superiors.” While my initial thought was that these Chinese employees had quite a bit of ‘cheek’ in raising this claim, the more I read into the story, the more I think it may portend serious problems for GSK in any attempt to defend the company going forward. Moreover, “some Chinese sales staff are complaining that GSK has denied bonuses, threatened dismissal or refused to reimburse them for bribes they say were sanctioned by their superiors to boost the company’s drug sales. In some cases, managers instructed them to purchase fake receipts that were used to cover up bribes paid in cash or gifts to doctors and hospitals, according to salesmen interviewed by the Financial Times.”

The article went on to highlight just how some of these fake invoices, used to gain funds from the corporate headquarters to facilitate bribery and corruption, were generated. “In some instances, managers disguised their involvement by using their personal email address to instruct staff to pay bribes and by ordering junior staff to claim on their personal expense accounts – even if the bribe was actually paid out by the manager – according to these people.” Last March, a group of current GSK employees sent a letter to the company that said, in part, ““All the expenses were approved by the company,” the group wrote in a letter to management. “The expenses were paid with our own money, and although the receipts were not compliant, it was our managers who told us to buy the fake receipts,” said one former GSK salesman.”

The article quoted that GSK said, “We have zero tolerance for unethical or illegal behaviour and anyone who conducts such behaviour has no place in our company. We believe the vast majority of our employees uphold our values and we welcome employees speaking up if they have concerns.” Talk about a ‘Speak Up’ culture at your company. Probably not exactly what the company had in mind when it invited employees to raise their concerns.

However, as damning as this is, and it would certainly appear to be quite damning, was the following revelation, regarding witness prep during GSK’s internal investigation. The article noted, “Some staff were warned not to implicate their supervisors, according to a former

salesman: “Our manager approached each person before they were questioned and asked them not to mention his name. He even prepared a story for them to tell the investigator.””

Dissecting all of the above, it would appear that GSK has several real problems on several fronts. The first is that there appears to have been clear China business unit management participation in the bribery and corruption scheme. While it is still not clear whether the corporate home office was involved in the scheme, simply knew of it or choose to bury its collective head in the sand as to what was going on in China, if your in-country business unit management is involved, it is not too many steps to the corporate home office. Conversely, the question might be that if this fraud against the corporate home office was so open and obvious, why did the corporate office not detect it going forward?

Yet the real issue for the corporate office may be the information about employees being coached to hide evidence during the investigation. If such activity was limited to the ‘managers’ in the Chinese business units only, what does it say about a corporate office, which allows such witness intimidation? Think that is an investigation *best practice*? However, if the corporate office was involved in any way in such witness intimidation, it will bode extremely poorly in the eyes of the regulators, the UK SFO, which has opened an investigation into the GSK matter and probably the DOJ as well, since GSK is still subject to the CIA it signed back in July of 2012; when it pled guilty and paid *\$3 billion* to resolve fraud allegations. Think witness tampering or hiding of evidence might garner the attention of the DOJ for a company already under the equivalent of a Deferred Prosecution Agreement (DPA)?

## ***Chapter IV-GSK's 2001 China Bribery Scandal***

It turns out that GSK's 2013/14 bribery scandal in China was not the company's first brush with such problem in such a place. An article in the FT by Demetri Sevastopulo and Andrew Ward, entitled "*GSK admits to 2001 Chinese bribery scandal*", reported that GSK had been involved in a prior bribery scandal in China back in 2001, stating, "The Financial Times has learnt that GSK also found problems with its China vaccine business in 2001 that led to the firing of about 30 employees." The article went on to say, "Two people familiar with the 2001 scandal said GSK found that staff were bribing Chinese officials and taking kickbacks. The company acknowledged the matter for the first time to the Financial Times, but said it had dealt with the issue rigorously."

Obviously having a prior bribery scandal in the very same country as another current scandal portends poorly for GSK, "The US Department of Justice, which is investigating the current allegations, will take a close look at the earlier scandal, said a former senior DoJ official who asked to remain anonymous. If it found a pattern of such behaviour, the justice department was likely to take a tougher stance towards the company, legal experts said." The FT article quoted Timothy Blakely, a partner at the US law firm of Morrison & Foerster, who said, "US prosecutors would have to examine the 2001 case under justice department guidelines to see whether there was a pattern of behaviour. "It is something that a prosecutor would have to take into account."

Unfortunately for GSK the 2001 scandal has some other rather inconvenient facts, which may well impact how the company fares in the current imbroglio in which it finds itself. The first fact is that unlike the current scandal, which unfolded beginning in 2013 when an anonymous whistleblower presented evidence of bribery and corruption in the company's China operations, in the 2001 scandal the company took swift actions to investigate the allegations. In 2001, GSK hired PricewaterhouseCoopers (PwC) to investigate the allegations "at the time the corruption suspicions emerged." The 2001 investigation, as noted above, led to the termination of "about 30 (GSK) employees".

One of the difficulties for GSK is this robust response in 2001 contrasts dramatically with its response in 2013. It is now known that GSK was notified by the anonymous whistleblower of allegations of bribery and corruption as early as January 2013. Yet the company gave itself a clean bill of health, finding no evidence of any wrongdoing. However, it did not take Chinese authorities long at all to investigate and conclude that there was "evidence of "massive and systemic bribery"" in GSK's China business operations.

Interestingly, one of the PwC investigators back in 2001 has played prominently in circumstances around this current bribery scandal. That person is Peter Humphrey who was indicted for his actions around some of GSK's current bribery and corruption issues. The FT reported that "One member of the PwC team in 2001 was Peter Humphrey. Now an independent

investigator, he is being held in China on charges of illegally buying private information in connection with GSK's current scandal." If he was part of the investigation team back in 2001, do you think he might have inquired about any current allegations of bribery or corruption or any ongoing company investigations? What are the implications for GSK if he did make such inquiries but was not given correct information? Does he have a claim back against GSK?

Another very interesting issue for GSK is that its current Chief Executive Officer (CEO), Sir Andrew Witty, "was the company's head of Asia-Pacific, but his responsibilities excluded China. GSK said Sir Andrew "was not involved in and was not aware of" the 2001 Chinese bribery case at the time. Sir Andrew has tried to cast GSK as a leader in ethical reforms since it was hit with a record \$3bn DoJ fine for marketing abuses in 2012. But his clean-up effort, including measures to cut the link between sales volume and pay for marketing personnel, has been overshadowed by the latest scandal in China."

All of these 'coincidences' may lead the DOJ or the UK SFO to conclude that GSK has a culture of non-compliance or worse yet - a culture of corruption. The FT article cited to un-named legal experts for the following, "If prosecutors find a pattern of such behavior, they are likely to take a tougher stance towards the company." Do not forget that GSK had paid a \$3bn fine for false marketing and is currently under a Corporate Integrity Agreement (the equivalent of a DPA) for those illegal actions.

## *Chapter V-No Sex Please, We're British: The Sex Tape*

I thought about that ubiquitous work of British visual and audio entertainment, *No Sex Please, We're British* when the revelations from late June that the GSK corruption scandal all started with a sex tape. In an article in the MailOnline, entitled “*How a secret sex tape plunged British drugs giant Glaxo in a £90million bribery probe*”, Rebecca Evans reported “A covert sex tape involving a senior executive and his Chinese lover was the trigger for a major investigation into corruption at British drugs giant GlaxoSmith-Kline, it was revealed yesterday. The video of married Mark Reilly and his girlfriend was filmed by secret camera and emailed anonymously to board members of the pharmaceutical firm. It led to an investigation that has rocked the £76billion company – which stands accused of bribing doctors and other health officials in China with £320million of gifts, including sexual favours from prostitutes, to persuade them to prescribe its drugs.”

This sex tape, along with allegations of bribery and corruption, were sent to GSK Board members, including CEO Sir Andrew Witty in March 2013 by someone with the email address “*GSK Whistleblower*”. Evans reported that two additional emails “making serious fraud allegations” were sent as well, one in January and one in May. In an article in the WSJ, entitled “*Sex Video Sheds Light in Glaxo China Case*”, Laurie Burkitt reported that “The British drug maker regarded the video—apparently shot without the executive's knowledge—as a breach of security, the person said.” Evans reported that in addition to this security breach, GSK believed the sex tape to be a “threat or blackmail attempt”.

One of GSK's responses was to hire the firm ChinaWhys Co., to investigate the matter. The firm's principals, former journalist Peter Humphrey and Yu Yingzeng, a naturalized US citizen, were not able to determine who placed the video camera in Reilly's Shanghai apartment, who shot the video or who sent it to GSK executives. However Evans reported “But a few months after starting to investigate Miss Shi, Mr Humphrey was arrested along with his wife Yu Yingzeng, a US citizen and daughter of one of China's most eminent atomic weapons scientists. According to the Sunday Times, Mr Humphrey's arrest and detention in July was at around the same time that China began a police probe into GSK's alleged bribery.” And, unfortunately for Humphrey and his wife, they were arrested last August for allegedly breaking of Chinese laws relating to information privacy.

In addition to the investigation into the provenance of the sex tape and its sender, GSK had also engaged in an internal investigation into the substantive allegations of bribery brought forward by the “*GSK Whistleblower*” in emails to the GSK Board in January and May, 2013. As reported by Evans, “The emails laid out a series of sales and marketing practices described as ‘pervasive corruption’.” Unfortunately for the company, GSK “found ‘no specific evidence’ to substantiate the claims. However, the accusations are virtually identical to the charges laid by police against Mr Reilly and 45 other suspects. Last month, Britain's SFO announced it is to investigate the company's ‘commercial practices’.”

‘Honey-pots’ and ‘Sparrow-nests’ are well known terms for anyone who has read cold war tales of espionage between the former Soviet Union and the US. However, the Reilly sex-tape and the GSK bribery scandal would seem to be an entirely different can of worms. In an article in Time, entitled “*What the GSK Sex Tape Says About Surveillance in China*”, Hannah Beech wrote that in China, “Surveillance - or the threat of surveillance — is a constant in China. As a journalist, I may be more interesting to the powers that be than some other foreigners here. But other expat friends who’ve been followed, hacked or otherwise tracked in China include diplomats, NGO staff and businesspeople. Also, artists and academics.” Such surveillance includes having “email auto-forwarding mysteriously activated or to be tailed by a black Audi while on assignment in the Chinese countryside.”

It does seem incredible at this point that any serious internal investigation could fail to turn up any of the evidence that the Chinese government has been able to develop against GSK. This points to the absolute importance of your internal investigations. Although the GSK investigation was focused in China, the same is true in the US, particularly for a US listed company subject to Dodd-Frank. Further, we must invoke that well-known British author George Orwell for reminding you that in some countries Big Brother really is watching you. And finally, you may not be paranoid as people really may be watching you and filming your most intimate acts.

## ***Chapter VI-Things Only Get Worse for GSK***

Christopher M. Matthews and Hester Plumridge writing in the WSJ, in an article in entitled “*FBI, SEC Start Glaxo Inquiries Over China*”, reported that in late July that “Glaxo received an anonymous email claiming its employees in Syria bribed doctors and pharmacists over the past five years to promote products including painkiller Panadol and toothpaste Sensodyne. The bribes took the form of cash payments, speaking fees, trips, free dinners and free samples, said the email, which was reviewed by The Wall Street Journal. The email cited names and dates. Syrian health officials allegedly received bribes from Glaxo employees to fast-track registration of its Sensodyne dental products, including cash payments and a trip to a 2011 conference in Rome, the email maintains. Glaxo employees also were involved in smuggling a narcotic product from Syria into Iran, the email alleges. The product in question, pseudoephedrine, is a raw ingredient of Glaxo's congestion medicine Actifed.”

GSK once again reiterated its previously announced position that it was firmly against the payments of bribes by its employees. In response to the allegations of bribes paid in Syria the WSJ article said, “Glaxo said it would thoroughly investigate all claims made in the Syria email, and said it has asked the sender for more information. The company said it has zero tolerance for unethical behavior, adding, “We welcome people speaking up if they have concerns about alleged misconduct.””

Much more problematic for GSK is the fact that both the SEC and DOJ have opened formal investigations into allegations of bribery and corruption by the company. The WSJ piece notes, “Federal Bureau of Investigation agents have been interviewing current and former GlaxoSmithKline employees in connection with bribery allegations in China, according to a person familiar with the matter, as fresh claims of corruption surfaced against Glaxo's operations in Syria. The interviews have taken place in Washington, D.C., in the past few months and are part of a Justice Department investigation into Glaxo's activities in China, the person added. The U.S. Securities and Exchange Commission also is investigating the company's business in China, according to people familiar with the matter.”

In 2012 GSK pled guilty and paid \$3 *billion* to resolve fraud allegations and failure to report safety and entered into a Corporate Integrity Agreement (CIA). The importance of the CIA for this anti-corruption investigation is that it not only applied to the specific pharmaceutical regulations that GSK violated but all of the GSK compliance obligations, including the 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 now finds itself under investigation, either internally or by anti-corruption regulators across the globe in at least four countries. Unlike other companies that have found systemic issues of bribery and corruption or systemic failures in internal controls, the allegations of bribery and corruption are not 10-15 years old. I fear that things will not turn out well for the company.

## ***Chapter VII-International Ripples From the Chinese Corruption Investigations***

The effects of the GSK bribery scandal have expanded far beyond the geographic limits of China. In an article in the FT, entitled “*Beijing probe touches west’s cereal bowls*” by Lucy Hornby wrote about some of the ripple effects of the GSK corruption investigation. Her basic thesis was set out in the first line of her piece, “Never before have China’s domestic politics had such ramifications for global business.” She wrote about two tangible examples of what she termed the “ripple effects” of the Chinese anti-corruption investigation, which began in earnest last summer with the revelations of corruption by GSK.

Hornby reported that the stock price for the Canadian company, Athabasca Oil Corporation, “the partner company for major Chinese investments in Canadian oil sands – fell 13 per cent this week. It is down 24 per cent since the beginning of April, when Athabasca announced PetroChina, a listed unit of CNPC, would buy the 40 per cent of the Dover oil sands project that it did not already own. Since then, two executives from PetroChina’s Canadian operations have fallen prey to the corruption purge – and the C\$1.32bn (US\$1.23bn) transfer payment has not been made.” But these ripples have also reached the British breakfast table as Chinese authorities announced they were investigating the owner of the company that makes the breakfast staple Weetabix.

Business ventures in other countries such as Cambodia and Australia have been put off due to the Chinese corruption investigation. This has been because of both corrupt payments made to Chinese officials and in some cases corrupt payments alleged to have been made by Chinese officials. For instance in Cambodia a project that was mired in such problems that the primary funding partner, The World Bank, had suspended funding has now run into such problems that Standard Chartered may lose up to \$250MM in funding which it provided. Further, Hornby reported that “In Australia last year, a A\$1.4bn bid for Sundance Resources – which had proposed a \$A5bn iron ore mine on the border of Cameroon and the Republic of Congo – collapsed after high-flying Chinese entrepreneur Liu Han abruptly vanished. Mr Liu had built his mining business by cultivating ties with Mr Zhou while the latter governed southwestern Sichuan province. He was sentenced to death in May for organised crime. His defence was that he was carrying out orders for unnamed “leaders”.”

Things are particularly difficult at PetroChina, a major investor in Canadian oil sands, because, as Hornby noted, “dozens of senior executives have been detained or questioned in the past year. Many, including the head of its Indonesian business, played key roles in its international projects.” However Hornby believes that “capital expenditure commitments by state-owned enterprises are likely to be honoured as the investigation continues, because China’s large and growing economy has a fundamental need for resources.”

Another large Chinese energy concern CNPC has also been hard hit by the corruption scandal. Attached, as a diagram, to Hornby’s article is a graphic that shows the extent of the company’s

investments of the past 10 years or so. The graphic also notes that the company “has been hardest hit by the ongoing corruption purge, with dozens of senior executives detained or questioned.” The chart below shows the “ripple effects” of CNPC investment.

| <b>Country</b> | <b>Investment Amount</b> |
|----------------|--------------------------|
| Kazakhstan     | \$12.7bn                 |
| Peru           | \$2.6bn                  |
| Turkmenistan   | \$1.2bn                  |
| Scotland       | \$1bn                    |
| Ecuador        | \$0.7bn                  |
| Australia      | \$4.1bn                  |
| Canada         | \$3.3bn                  |
| Syria          | \$0.6bn                  |
| Mozambique     | \$4.2bn                  |

Hornby’s article touched on another area, which has significance for the FCPA practitioner, that begs the question of whether a state-owned enterprise is an instrumentality or in any other way covered by the FCPA? She wrote that “the unusually public nature of this corruption investigation has given outsiders a clearer insight into the way money and power have become entwined, and influence dealmaking, in today’s China.” She quoted Luke Patey, author of the book *The New Kings of Crude*, for the following, ““For years, Chinese national oil companies have fought hard against the label that they are political instruments of the Chinese government and Communist party. That political nature is now on full display.””

Hornby’s article demonstrates not only the pervasive nature of Chinese corruption but also how many countries such corruption may have effected. It also dispels those FCPA naysayers who argue that the law brings a competitive disadvantage to US companies. Many of these Chinese investments are now on hold with no hope of completion or even funding because of the domestic turmoil inside China over corruption. Companies and countries want a reliable business partner, starting with one which does not engage in bribery and corruption to obtain a contract and then onto a company which fulfills its contractual obligations. Think about that as a selling point the next time you are overseas.

# **Part II-The Convictions**

## ***Chapter VII-Humphrey and Wife Convicted***

When it was announced in July, 2014 that Peter William Humphrey, a 58-year-old British national, and his wife, Yu Yingzeng, a 61-year-old American, would go on trial on charges of illegally purchasing personal information about Chinese nationals would go on trial, on August 8, 2014, Shanghai's No. 1 Intermediate People's Court, the trial was originally scheduled to be closed to the public. However later in July, Chinese officials announced that the trial would be 'open' although the degree of openness is not completely clear.

Further the couple's son, Harvey Humphrey, was allowed visited his parents in their detention center in Pudong, Shanghai, for the first time since their arrest. The visit came after some fierce lobbying by the US and UK consulates. As reported in the online publication FiercePharma, in an article entitled "*GSK private eyes' son allowed first visit to parents in China jail as trial nears*", their son said, "They didn't quite believe I was coming. They were quite overwhelmed. My mum was shocked. My dad held himself together," the younger Humphrey told the paper. "It's a bit unusual for the Chinese to do this. I feel something has changed in the Chinese approach to my parents." Son Harvey had written to the GSK's Chief Executive Officer (CEO) Sir Andrew Witte last December to "take a few minutes to raise my father's case" during a visit to the country, he told the FT, "I understand everything is complicated in China but it seems my parents are paying a big price".

In that one-day trial Peter Humphreys and his wife Ms. Yu, were convicted of illegally purchasing information on Chinese citizens. In an FT article, entitled "*China court hands GSK investigator jail term and orders deportation*", Gabriel Wildau and Andrew Ward reported that husband Humphreys received a two and a half year jail term which was "just short of the three-year maximum". In an article in the WSJ, entitled "*China Convicts Two Corporate Investigators*", James T. Areddy and Laurie Burkitt reported that he was also ordered to pay a fine of approximately \$32,500 and will be deported from the country when his jail term is completed. Wife Yingzeng received a two year jail term and was ordered to pay a fine of approximately \$23,000 but will be allowed to remain in the country after her sentence is completed. Both announced after the trial that they would not appeal their sentences.

In a NYT article, entitled "*In China, British Investigator Hired by Glaxo, and Wife, Sentenced to Prison*", David Barboza reported that the couple "acknowledged that from 2009 to 2013, they obtained about 250 pieces of private information about individuals, including government-issued identity documents, entry and exit travel records and mobile phone records, all apparently in violation of China's privacy laws." According to the NYT article, wife Yu claimed that she did not know her actions were illegal and was quoted as saying, "We did not know obtaining these pieces of information was illegal in China. If I had known I would have destroyed the evidence." According to the WSJ, the privacy law which was the basis of the conviction, was enacted in 2009 "to make it illegal to handle certain personal medical records and telephone records" but that the law itself "remains vague" on what precisely might constitute violation.

From the court statements, however, it did appear that the couple had trafficked in personal information. As reported by the WSJ, “In separate responses over more than 10 hours, Mr. Humphreys and Ms. Yu denied that their firm trafficked in personal information, saying they had hired others to obtain personal data when clients requested it.” From the documents presented by the prosecution, it would seem clear that the couple had obtained my items which were more personal in nature. They were alleged by prosecutors to have “used hidden cameras to gather information as well as government records on identification numbers, family members, real-estate holdings, vehicle owner, telephone logs and travel records.”

Recognizing the verdicts under Chinese laws are usually predetermined and the entire trials are scripted affairs, there is, nonetheless, important information communicated to the outside world by this trial. First and foremost is, as reported in the NYT article is a “chilling effect on companies that engage in due diligence work for global companies, many of whom believe the couple may have been unfairly targeted.” The WSJ article went further quoting Geoffrey Sant for the following, “It impacts all attempts to do business between the U.S. and China because it will be very challenging to verify the accuracy of company or personal financial information.” In other words, things just got a lot tougher to perform, what most companies would expect to be a minimum level of due diligence.

Second is the time frame noted in the court statements as to the time of the violations, from 2009 to 2013. Many had assumed that Humphreys and Yingzeng’s arrests related to their investigation work on behalf of the GSK, which was trying to determine who had filmed a sex tape of the company’s head of Chinese operations, which was then provided to the company via an anonymous whistleblower. This would seem to beg the question of whether the couple would have been prosecuted if they not engaged in or accepted the GSK assignment.

## ***Chapter IX-GSK Convicted***

*“GSK plc sincerely apologies to the Chinese patients, doctors and hospitals, and the Chinese Government and the Chinese people.”*

With those words, GSK was convicted in a secret trial in a court in the Hunan province of China for bribery and corruption related to its Chinese business unit. The amount of the fine was approximately \$491MM. This fine was the largest levied on a western company for bribery and corruption in China. Moreover, if it had been in the United States for a violation of the FCPA, it would have come in as the third highest fine of all-time, behind those of Siemens and Halliburton. In a FT article, entitled “*GSK hit with record \$490m China fine for bribing doctors*”, reporters Andrew Ward and Patti Waldmeir noted that the fine is “equal to the Rmb 3bn in bribes that Chinese investigators said had been paid by GSK.”

While it is not entirely clear how long the trial lasted, it appeared that it was in the same range as the one-day trial given to Peter Humphrey and his wife last month, when they were both found guilty for violating China’s privacy laws. In an article in the NYT, entitled “*Glaxo Fined \$500 Million By China*”, Keith Bradsher and Chris Buckley reported, “Chinese authorities accused Glaxo of bribing hospitals and doctors, channeling illicit kickbacks through travel agencies and pharmaceutical industry associations — a scheme that brought the company higher drug prices and illegal revenue of more than \$150 million. In a rare move, authorities also prosecuted the foreign-born executive who ran Glaxo’s Chinese unit.” Moreover, GSK China’s country manager, Mark Reilly and four other in-country executives were each convicted with potential sentences of up to four years in prison. The NYT noted, “the sentences were suspended, allowing the defendants to avoid incarceration if they stay out of trouble, according to Xinhua. The verdict indicated that Mr. Reilly could be promptly deported. The report said they had pleaded guilty and would not appeal.”

A WSJ article, entitled “*Meet the Glaxo Executives Convicted in China*”, detailed the five GSK executives’ crimes and sentences, the summary is as follows:

- Mark Reilly: GSK’s former China chief. He was sentenced to prison for three years with a four-year suspension. He was also the victim of an illicit recording of he and his girlfriend with the sex tape delivered to GSK management in London.
- Zhang Guowei: GSK China’s former HR Director, who was sentenced to three years in prison with a three-year suspension. Chinese state media said he admitted that the company has used many bribery schemes to ensure the sales of high price drugs to Chinese consumers.
- Liang Hong: Former GSK China’s vice president and operations manager. He was sentenced to two years in prison with a three-year suspension. On Chinese state-

controlled television he said he gave bribes to government officials, hospital administrators and doctors via travel agencies to pave the way for drug sales.

- Zhao Hongyan: GSK China's former legal-affairs director. Ms. Zhao was sentenced to two years in prison with a two-year suspension. On state-controlled television Ms. Zhao said she destroyed evidence relating to bribery to avoid punishment.
- Huang Hong: Huang was a GSK China's business-development manager. She was sentenced three years in prison with a four-year suspension. The WSJ article reported that she was accused of giving and taking bribes; and informed Chinese officials that GSK China used funds labeled for public relations uses to maintain relationships with "major clients," who she said were hospital administrators.

The suspension of the sentences was highly significant. The FT article quoted from the trial court that the sentences had resulted directly because "they confessed the facts truthfully and were considered to have given themselves up." The WSJ article reported that the court also took into account that GSK China country manager Mark Reilly had "voluntarily returned to China, assisted in the investigation and confessed...and had "truthfully recounted the crimes of his employer." Also they were in stark contrast to the three-year and two-year sentences handed down to Humphreys and his wife respectively last month. There was no word from GSK, however, on whether it would terminate some or all of the convicted executives.

GSK itself made several interesting statements about the bribery allegations and conclusions of the trial court. The FT article quoted CEO Sir Andrew Witty, for the following, "Reaching a conclusion in the investigation of our Chinese Business is important, but this has been a deeply disappointing matter for GSK. We have and will continue to learn from this. GSK has been in China for close to a hundred years, and we remain fully committed to the country and its people." The company went further in statements. In addition to the quote above, GSK was quoted in the NYT article as saying, "that it "fully accepts the facts and evidence of the investigation, and the verdict of the Chinese judicial authorities." The FT article added further clarification when it said that GSK " had "co-operated fully with the authorities and has taken steps to comprehensively rectify the issues identified at the operations of GSK China.""

These statements of contrition are quite a distance from the place where GSK started last summer when the bribery allegations broke when the company tried to use the 'rogue employee(s)' defense, when it said that the bribery and corruption involved only a "few rogue Chinese-born employees" that were "outside our systems of controls" *Oops*.

The NYT reported that GSK also said, "that the court, the Changsha Intermediate People's Court, had found the company guilty only of bribing nongovernmental personnel." This is significant because the bribery of a government official (defined as such in China and not under the FCPA) is a much more serious crime in China. The British Embassy in China also weighed in, at least slightly, with the following statement, "We note the verdict in this case. We have

continually called for a just conclusion in the case in accordance with Chinese law. It would be wrong to comment while the case remains open to appeal.”

# **PART III-RESPONSES**

## *Chapter X-Some Thoughts on the Verdict*

Did GSK obtain a negotiated settlement with the Chinese government when it was announced that the company pled guilty to bribery and corruption and was fined almost \$500MM by a Chinese court? Further, what lessons can be drawn from the GSK matter for companies operating in China and the compliance practitioner going forward?

I think the first lesson to draw is that the Chinese government will focus more on companies than on individuals. Andrew Ward, Patti Waldmeir and Caroline Binham, writing in a FT article, entitled “*Pain from graft scandal likely to linger*”, quoted Mak Yuen Teen, a corporate governance expert at the National University of Singapore for the following, “By handing suspended sentences rather than jail terms to Mark Reilly, GSK’s former head of China, and four of his top lieutenants, the court in Hunan province was holding the company more accountable than the individuals.”

However other commentators said, “GSK got off more lightly than expected for bribing doctors to prescribe its drugs.” The article went on to note, “People close to the situation denied that the outcome amounted to a negotiated settlement. But Bing Shaowen, a Chinese pharmaceuticals analyst, said it was likely that GSK made commitments on research and development investment and drug pricing to avoid more draconian treatment. A further FT article by Andrew Ward, Patti Waldmeir and Caroline Binham, entitled “*GSK closes a chapter with £300m fine but story likely to run on*”, cited Dan Roules, an anti-corruption expert at the Shanghai firm Squire Sanders, who said that he had expected the penalty to be harsher. Roules was quoted as saying “The fact that GSK co-operated with the authorities would have made a difference.” The article went on to say that Roules “pointed to GSK’s statement on Friday pledging to become “a model for reform in China’s healthcare industry” by “supporting China’s scientific development” and increasing access to its products “through pricing flexibility”.”

What about reputational damage leading to a drop in the value of stock? The market had an interesting take on the GSK conviction, it yawned. Moreover, as noted in the FT Lex Column “The stock market was never bothered. The shares moved little when the investigation, and then the fine, were disclosed.” Why did the market have such a reaction? The Lex Column said that one of the reasons might be that the “China may be too small to matter much for now” to the company.

Another lesson is one that Matt Kelly, editor of Compliance Week, wrote about in the context of the ongoing National Football League (NFL) scandal, in an article entitled “*The NFL’s True Problem: Misplaced Priorities Trumping Ethics & Compliance*”, when he said that a company must align its “core values with its core priorities.” GSK moved towards doing that throughout the last year, during the investigation into the bribery and corruption scandal in China. Although CEO, Sir Andrew Witty, has been a champion for ethical reform in both the company and greater pharmaceutical industry, the FT reporters noted that the China corruption scandal, coupled with

“smaller-scale corruption allegations in the Middle East and Poland, has raised fresh questions about ethical standards and compliance.” If Witty wants to move GSK forward, he must strive to align the company's business priorities with his (and the company's) stated ethical values.

Which brings us to some of the successes that GSK has created in the wake of the bribery and corruption scandal. These successes are instructive for the compliance practitioner because they present concrete steps that the compliance practitioner can do to help facilitate such change. As reported by Katie Thomas, in a NYT article entitled “*Glaxo to Stop Paying Doctors To Boost Drugs*”, one change that GSK has instituted is that it will no longer pay doctors to promote its products and will stop tying compensation of sales representatives to the number of prescriptions doctors write, which were two common pharmaceutical sales practices that have been criticized as troublesome conflicts of interest. While this practice has gone on for many, many years it had been prohibited in the United States through a pharmaceutical industry-imposed ethics code but is still used in other countries outside the US.

In addition to this ban on paying doctors to speak favorably about its products at conferences, GSK will also change its compensation structure so that it will no longer compensate sales representatives based on the number of prescriptions that physicians write, a standard practice that some have said pushed pharmaceutical sales officials to inappropriately promote drugs to doctors. Now GSK pays its sales representatives based on their technical knowledge, the quality of service they provided to clients to improve patient care, and the company's business performance.

In addition to the obvious conflict of interest, which apparently is an industry wide conflict of interest because multiple companies have engaged in these tactics, there is also clearly the opportunity for abuse leading to allegations of illegal bribery and corruption. Indeed one of the key bribery schemes alleged to have been used by GSK in China was to pay doctors, hospital administrators and other government officials, bonuses based upon the amount of GSK pharmaceutical products, which they may have prescribed to patients. But with this new program in place, perhaps GSK may have “removed the incentive to do anything inappropriate.”

This new compensation and marketing program by GSK demonstrates that companies can make substantive changes in compensation, which promote not only better compliance but also promote better business relationships. A company spokesman interviewed the NYT piece noted that the changes GSK will make abroad had already been made in the US and because of these changes, “the experience in the United states had been positive and had improved relationships with doctors and medical institutions.”

In addition to these changes in compensation and marketing, Ward/Waldmeir/Binham, reported that GSK announced it would strive to be “a model for reform in China's healthcare industry” by “supporting China's scientific development” and increasing access to its products “through pricing flexibility”. They further stated “Rival companies will now be watching nervously to see

whether more enforcement action takes place in a sector where inducements for prescribing drugs have long been an important source of income for poorly paid Chinese medics,” which is probably not going to be a return the wild west of bribery and corruption that occurred over the past few years in China. Bing Shaowen was quoted as saying that the GSK matter “is a very historic case for the Chinese pharmaceutical industry. It means that strict compliance will become the routine and the previous drug marketing and sales methods must be abolished.” But the company still faces real work to rebuild its reputation in China. Moreover, it still faces legal scrutiny for its conduct in the UK under the Bribery Act and the US under the FCPA.

## ***Chapter XI-Due Diligence Going Forward in China***

With the Humphreys and Yu convictions in China for performing investigations, a reasonable question that you might ask yourself whether or not you can get adequate due diligence going forward in China for your anti-corruption compliance program? You should always remember that performing due diligence is but one of five steps in the management of the third party life cycle. If you cannot perform due diligence at a level that you do in other countries or that you could even have done in China before the Humphreys and Yu trial, you can beef up the other steps to help proactively manage your third parties. I often say that your real work with third parties begins when the contract is executed because then you have to manage the relationship going forward. So, if you cannot perform the level of due diligence you might like, you can put more resources into monitoring the relationship, particularly in the area of invoice review and payments going forward.

In a timely article found in this month's issue of the SCCE magazine, Compliance and Ethics Professional, Dennis Hast and Caroline Lee published an article, entitled "*China clamps down on bribery and corruption: Why third-party due diligence is a necessity*" where they discussed a more robust response to the issue as well. They note that the retention of third party's to do business in China is an established mechanism through which to conduct business. They advise "For multinationals with a Chinese presence, or plans to enter the market in the near future, now is the time to pay close attention to the changing nature of the business landscape as it relates to bribery and corruption." Further, they suggest that "In order to ensure compliance with ABAC [anti-bribery/anti-corruption] regulatory scrutiny, multinationals must demonstrate a consistent, intentional and systematic approach to third-party compliance." But in addition to the traditional background due diligence, they believe that companies should consider an approach that moves to proactively managing and monitoring third parties for compliance. Lastly, at the end of the day if a regulator comes knocking from the DOJ or SFO, you will need to demonstrate the steps you have put in place and your active management of the process.

One clear lesson that persons performing due diligence should strongly consider is based upon the convictions of Humphreys and Yu. Humphreys had previously said that he would not have taken on the GSK sex tape assignment if it had been disclosed to him that the company had sustained allegations of corruption by an internal whistleblower. If you are investigator it may be well incumbent on you to ask if the company is undergoing a corruption investigation or enforcement action. Perhaps another lesson might be that in the future companies will have to disclose more to those they approach to perform such investigative services.

## ***Chapter XII-What Can You Do When Risk Changes in a Third Party Relationship?***

The more I think about the convictions of Peter Humphrey and his wife, for violating China's privacy laws regarding their investigation of who filmed the head of GSK's China unit head *in flagrante delicto* with his Chinese girlfriend, the more I consider the issue of risk in the management of third parties under the FCPA. In an article in the WSJ, entitled "*Chinese Case Lays Business Tripwires*", reporters James T. Areddy and Laurie Burkitt explored some of the problems brought about by the investigators convictions.

They quoted Manuel Maisog, chief China representative for the law firm Hunton & Williams LLP, who summed up the problem regarding background due diligence investigations as "How can I do that in China?" Maisog went on to say, "The verdict created new uncertainties for doing business in China since the case hinged on the couple's admissions that they purchased personal information about Chinese citizens on behalf of clients. Companies in China may need to adjust how they assess future merger partners, supplier proposals or whether employees are involved in bribery."

I had pondered what that meant for a company that wanted to do business in China, through some type of third party relationship, from a sales representative to distributor to a joint venture. What if you cannot get such information? How can you still have a *best practices* compliance program around third parties representatives if you cannot get information such as ultimate beneficial ownership? At a recent SCCE event, I put that question to a Department of Justice representative. Paraphrasing his response, he said that companies still need to ask the question in a due diligence questionnaire or other format. What if a third party refuses to answer, citing some national law against disclosure? His response was that a company needs to very closely weigh the risk of doing business with a party that refuses to identify its ownership.

The more that I thought about that answer the more I became convinced that it was not only the right answer under any type of FCPA compliance program but also the right response from a business perspective. A company must know who it is doing business with, for a wide variety of reasons. The current situation in China and even the convictions of Humphrey and Yu do not change this basic premise. You can *ask* the question. If a party does not want to disclose its ownership, you should consider this in any business relationship going forward.

The Humphrey and Yu conviction do not prevent you from asking the question about ownership. Their convictions mean that you may not be able to *verify* that information through what many people thought was publicly available information, at least publicly available in the west. I was struck by one line in the Areddy and Burkitt article, "It's not just that the tactical business practices need to change; it's the mind set" quoting again from Maisog.

I breakdown the management of third parties under the FCPA into five steps, which are:

1. Business Justification and Business Sponsor;
2. Questionnaire to Third Party;
3. Due Diligence on Third Party;
4. Compliance Terms and Conditions, including payment terms; and
5. Management and Oversight of Third Parties After Contract Signing.

The due diligence step is but one of these five. Further due diligence is performed in large part to verify the information that you receive back from a proposed third party. So what if you can no longer use avenues previously open to you in markets such as China? Perhaps there are other ways to manage this issue. Areddy and Burkitt also interviewed Jerry Ling, a partner at Jones Day, for the following “companies will need to analyze Chinese accounting documents themselves and conduct more in-person interviews with anyone they want to know more about in China.”

Ling’s point dovetails directly into what I heard from the DOJ representative. There is nothing about the Chinese law, or any other country’s law, which prevents you from asking some basic questions that are found in the Step 2 Questionnaire cited above. You can always ask who the owners of a company are, whether they are direct or beneficial. You can always ask if a company, its owners or its senior management have been involved in any incidents involving bribery and corruption and you can always ask if the company has a Code of Conduct and/or compliance program and whether its owners or senior management are aware of the FCPA and have had training on it.

Assuming the company will answer your questionnaire, the difficulty you may find yourself in now is verifying the information that you receive. In Ronald Reagan parlance, you may trust but you may not be able to verify it. Ling said in the WSJ article that “The challenge now for clients is that it’s hard to get good information.”

However, due diligence is but one step in the management of any third party in a FCPA compliance program. Just as when risk goes up and you increase your management around that risk, the situation is similar in here. Putting it another way, if you cannot obtain private information such as personal identification numbers during the due diligence process, you can put greater management around the other steps that you can take. Further, there has been nothing reported which would suggest that publicly filed corporate licenses or other information that might show ownership can no longer be accessed. Court records and public media searches also seem to still be available.

But what if you simply cannot determine if the information you are provided regarding ownership is accurate or even truthful? You can still work to manage the relationship through your commercial terms by setting your commission or other pay rates at a reasonable amount of

scale. If you are dealing with a commissioned sales representative, you can probably manage this area of the relationship by setting the commission in the range of 5%. You can also manage the relationship by reviewing invoices to make sure there is an adequate description of the services provided so that they justify whatever compensation the third party is entitled to receive under the contract. You may also want to schedule such a third party for an audit ahead of other parties to help ensure adherence to your compliance terms and conditions.

There may be times when you cannot verify the true or ultimate beneficial owner of a third party. That does not have to be the end of the analysis. If that situation arises, you may want to see if there are other risk mitigation tools at your disposal. Put another way, if such a red flag arises, can it be cleared? Can it be managed? If your company is looking a major deal for multi-millions and your agent will receive a six or seven figure commission, the risk of not knowing with certainty may be too great because in such a case, an unknown owner could be a government official who has awarded the contract. But if your agent receives a considerably smaller commission and hence there is a considerably small amount of money to constitute a bribe, you may be able to manage that risk through a close and effective relationship management process.

### ***Chapter XIII-Management of Corruption Risks - Business Lessons from GSK***

The DOJ and SEC have made it abundantly clear over the past several years that companies should assess their risk and then manage their own risks. In the anti-corruption space, simply putting in a *Check-the-Box* paper compliance program does not help to prevent, detect or remediate under laws such as the FCPA or UK Bribery Act. In their joint FCPA Guidance, the DOJ and SEC make clear there are a variety of steps a company can take to manage anti-corruption risks.

One of the tired excuses for cutting back on FCPA enforcement is that it costs US companies business overseas because they cannot engage in bribery and corruption, while the commercial enterprises of countries which do not have robust anti-corruption laws essentially bribe at will. However, there are many business solutions available in the management of risk, which companies can profitably use to help ameliorate bribery and corruption risk.

In an article in the FT, entitled “*Witty comes out fighting for GSK*”, Andrew Ward reviewed some of the business responses that GSK has contemplated over the past year since the revelations about allegations of bribery in China. Ward reported that in addition to the uncertainty of the ongoing corruption investigation by Chinese authorities, the UK SFO for violations of the UK Bribery Act and the DOJ for violations of the FCPA; the company “issued a profits warning that exposed weakness in the company’s core respiratory medicines business.” These warning turned on “the decline in the company’s best selling drug. Revenues from Advair, an asthma treatment that accounts for a fifth of sales, fell 12 per cent in the second quarter, on top of the 15 per cent drop in the three months before that.” Moreover, the company’s stock is down some 14% in the past year.

I was intrigued by the response of Sir Andrew. He did not bemoan the corruption investigations that his company is going through or somehow try to claim that the company simply could not compete because of the scrutiny it is under. On the business front Ward reported, “GSK’s innovation engine is working” as Witty noted that the company had “six new drugs approved across all therapeutic areas last year and a further 40 in advanced development”.

In addition to the specific response regarding the development of new pharmaceutical products, Witty is looking at other sales products and models that will lessen the company’s corruption risk while providing a strong business base. Ward reported that Witty is “strengthening GSK’s two other businesses: vaccines and healthcare.” This move “was reinforced by a \$20bn asset swap with Novartis in April under which GSK traded its subscale oncology business for the Swiss group’s vaccines division, while the pair agreed to set up a joint-venture in consumer products.” This means that when this structuring is completed, “half of GSK’s revenues will come from outside [the sale of] pharmaceuticals.”

Witty has also worked to change internal GSK compensation incentives to help manage corruption risks. Late last year, the company announced that it would “sever the link between

sales and pay for drug reps and from 2016, stop payments to doctors for promoting its products.” Ward noted that others in the industry have not followed GSK’s lead in changing the way it compensates its sales team but Witty said, “in the long-run, the company will benefit from being the first-mover towards a new marketing model.”

Finally, and perhaps most interestingly, Witty has attempted to become an industry-wide “standard-bearer for [pharmaceutical] industry ethics.” Ward reported that the ongoing scandal has helped Witty “drive home to employees the need for greater transparency.” Ward even quoted Witty for the following, “It gives me the ammunition to say we are in the public eye and our behaviour counts. It’s not just about generating prescriptions, it’s how you do it.”

In another article on the GSK corruption scandal by Ward, entitled “*GSK chief floats break-up option*”, Ward quoted said that Witty has “zero tolerance for any form of corruption” and that “he was pleased if wrongdoing had been brought to light so that it could be stamped out.” Witty went on to say that “Any company that doesn’t get whistleblower letters isn’t looking hard enough. If you are not getting any don’t dream. It can’t be perfect 100 per cent of the time.” But this promises to be a long rebuilding process and for GSK the process will largely be rebuilding trust rather than maximizing profits.

Another perspective on business solutions to the management of corruption risks came from Tom Mitchell, also writing in the FT in an article entitled “*Expats in China should read GSK potboiler carefully*”. Mitchell focused on a book by Joe Studwell called *The China Dream*, which detailed some of the business failures that had befallen western companies in China. Mitchell drew the lesson from Studwell’s book that “When foreign investors’ interests are aligned with those of their domestic partners – as they generally are today in the auto sector – those investors do very well indeed... However, when interests are not aligned - or when outside operators in sectors where they are not required to have joint ventures - foreigners are vulnerable to sudden reversals of fortune instigated by either a bitter partner or by unsympathetic officials.”

How closely does that sound like what happened to GSK? Mitchell noted that GSK “made money from selling goods in China at prices that were - Chinese police allege - were high by the standards of many markets. At the same time, GSK was not sharing revenue streams with a local partner that could help with damage limitation when local authorities appeared on its doorstep.”

The management of risk is essentially a business exercise. That is because risk is what can cause a company to lose money. Some legal risk is embodied in statutes such as the FCPA or UK Bribery Act. Sometimes risk is a change in the market circumstance. Yet GSK may well come out the other side of the Chinese corruption scandal stronger because they seem to understand that there is a market based solution to corruption risks. GSK has changed the way it will compensate its sales force and will delete its compensation to doctors. This may take away incentives to cut corners or engage in bribery and corruption. But think about Witty’s steps to diversify the GSK product base. If you are in an industry that is corrupt and you cannot find a

way to do business profitably, your company may have other business lines it can move forward to a more prominent role in your business. Lastly, as with most responses to legal issues by lawyers, business executives are only limited by their imaginations in their response to business issues.

## ***Chapter XIV-Compliance Lessons Learned from GSK In China***

### ***A. Integrating Your Risk Assessment***

One of the things that a compliance program must have is the flexibility to respond to changing events on the ground. Just as the GSK corruption scandal in China brought attention to domestic prosecutions of corruption in China, these very public events should bring the attention of your compliance team. My former *This Week in FCPA* co-host Howard Sklar said that a compliance program needed to be nimble in order to respond to such events in far-flung places. Risks change and they must be evaluated on a regular basis or in response to new facts on the ground, such as those which are present in China.

There may also be more than anti-corruption risk at play in any given situation. If a company only looks at one type of risk, such as anti-corruption, rather than others such as export control or anti-money laundering (AML) it can lead to the concept of what is called the “functional trap” of labeling and compartmentalizing risk. In an article in the June 2014 issue of the Harvard Business Review (HBR), entitled “*Managing Risks: A New Framework*”, authors Robert Kaplan and Annette Mikes declare that good risk discussions must be integrative in order for risk interaction to be evaluated. If not, a business “can be derailed by a combination of small events that reinforce one another in unanticipated ways.”

The authors posit that it is difficult for companies to accurately and adequately discuss risk for a variety of reasons. One of these reasons is the aforementioned silo effect which can lead to a lack of discussion by a wide group regarding a number of risks, for example compliance risk; reputational risk; brand risk; credit risk; human resources risk are but a few of the types of risks mentioned in their article. The authors believe that one of the ways to knock down these silos when it comes to a more complete management of risk is to “anchor their discussions in strategic planning, one integrative process that most well-run companies already have” in place.

The authors cautioned that beyond simply introducing a systematic process for identifying and mitigating key risks, companies should also employ a risk oversight structure. The authors discussed the experience of the Indian IT company, Infosys, which uses a dual structure. It consists of a central team that identifies general strategy risks and then establishes central policy, together with a specialized, decentralized functional team. This second team designs and monitors policies and controls in consultation with local business units. These decentralized teams have the authority and expertise to respond to changes in the company’s risk profile coupled with the nimbleness and agility of being in the field to deal with smaller issues before they become larger problems for the central team back in the corporate office.

I believe that the current political turmoil in China provides an example of the diversity your compliance program and risk assessment must maintain. Just as it is important to perform due diligence on third party representatives, before execution of an appropriate contract, the real

work is in managing the relationship. In risk management, you must identify and assess the risk but the real work begins in managing the risk. This is where the rubber meets the road.

### ***B. Board Oversight and Tone in the Middle***

What are some of the lessons to be learned from GSK in China regarding the role of a company's Board of Directors and 'tone in the middle'? While we have not heard from the GSK Board on this case, it has become clear that the GSK Board was aware of both the anonymous whistleblower allegations and the release of the tape of the GSK China Country Manager and his girlfriend. One of the lessons learned from the GSK scandal is that a Board must absolutely take a more active oversight role not only when specific allegations of bribery and corruption are brought forward but also when companies are operating in high risk environments. Clearly this will be a major task for incoming Board Chairman, Sir Philip Hamilton, who will join the Board this coming January and will become the Chairman, later in the year when a successor is found for his current position as Chairman at the Royal Bank of Scotland.

In an NACD Directorship article, entitled "*Corruption in China and Elsewhere Demands Board Oversight*", authors 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, "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, "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." All of the foregoing would certainly apply to GSK and its China operations.

Moreover, the FCPA Guidance makes clear that resources and their allocation are an important part of any *best practices* compliance program. 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, and 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?

Third parties generally present the most risk under a FCPA compliance program and are believed (at least anecdotally) to comprise over 90 percent of reported FCPA cases, which subsequently involve the use of third-party intermediaries such as agents or consultants. But this is broader than simply third party agents because any business opportunity in China will require some type of business relationship.

One of the major failings of the GSK Board was that it apparently did not understand the actual business practices that the company was engaging in through its China business unit. While \$500MM may not have been a material monetary figure for the Board to consider; the payment of such an amount to any third party or group of third parties, such as Chinese travel agencies, should have been raised to the Board. All of this leads me to believe that the GSK Board was not sufficiently engaged. While one might think a company which had received a \$3bn fine and was under a Corporate Integrity Agreement for its marketing sins might have sufficient Board attention; perhaps legal marketing had greater Board scrutiny than doing business in compliance with the FCPA or UK Bribery Act. The Board certainly did not seem to understand the potential financial and reputational impact of a bribery and corruption matter arising in China. Perhaps they do now but, for the rest of us, I think the clear lesson to be learned is that a Board must increase oversight of its China operations from the anti-corruption perspective.

GSK CEO Sir Andrew Witty has certainly tried to say all of the right things during the GSK imbroglio on China. But did that message really get down into to the troops at GSK China? Moreover, did that message even get to middle management, such as the GSK leadership in China? Apparently not so, one of the lessons learned is moving the Olympian Pronouncements

of Sir Andrew down to lower levels on his company. Just how important is “Tone at the Top”? Conversely, what does it say to middle management when upper management practices the age-old parental line of “Don’t do as I do; Do as I say”? In his article entitled, “*Ethics and the Middle Manager: Creating "Tone in The Middle"*” Kirk O. Hanson, listed eight specific actions that top executives could engage in which demonstrate a company’s and their personnel’s commitment to ethics and compliance. The actions he listed were:

1. Top executives must themselves exhibit all the “tone at the top” behaviors, including acting ethically, talking frequently about the organization's values and ethics, and supporting the organization's and individual employee's adherence to the values.
2. Top executives must explicitly ask middle managers what dilemmas arise in implementing the ethical commitments of the organization in the work of that group.
3. Top executives must give general guidance about how values apply to those specific dilemmas.
4. Top executives must explicitly delegate resolution of those dilemmas to the middle managers.
5. Top executives must make it clear to middle managers that their ethical performance is being watched as closely as their financial performance.
6. Top executives must make ethical competence and commitment of middle managers a part of their performance evaluation.
7. The organization must provide opportunities for middle managers to work with peers on resolving the hard cases.
8. Top executives must be available to the middle managers to discuss/coach/resolve the hardest cases.

What about at the bottom, as in remember those China unit employees who claimed they were owed bonuses because their bosses had *instructed* them to pay bribes? Well if your management instructs you to pay bribes that is a very different problem. But if your company’s issue is how to move the message of compliance down to the bottom, Dawn Lomer, Managing Editor at i-Sight Software, provided some concrete suggestions in an article in the SCCE magazine, entitled “*An ethical corporate culture goes beyond the code*”, where she wrote that that the unofficial message which a company sends to its employees “is just as powerful - if not more powerful - than any messages carried in the code of conduct.” Lomer suggested that a company use “unofficial channels” by which your company can convey and communicate its message regarding doing business in an ethical manner and “influence employee behavior across the board.” Her suggestions were:

1. *Reward for Integrity* - Lomer writes that the key is to reward employees for doing business in an ethical manner and that such an action “sends a powerful message without saying a word.”
2. *The three-second ethics rule* - It is important that senior management not only consistently drives home the message of doing business ethically but they should communicate that message in a short, clear values statement.
3. *Environmental cues* - Simply the idea that a company is providing oversight on doing business ethically can be enough to modify employee behavior.
4. *Control the images* - It is not all about winning but conducting business, as it should be done.
5. *Align Messages* - you should think about the totality of the messages that your company is sending out to its employees regarding doing business and make sure that all these messages are aligned in a way that makes clear your ethical corporate culture clear.

The GSK case will be in the public eye for many months to come. Both the UK SFO and US authorities have open investigations into the company. Just as the five counter-point singing or the rooftop symphonic dance scene to the song *America* demonstrates the best of that art form; you can draw lessons from GSK’s miss-steps in China now for implementing or enhancing your anti-corruption compliance program going forward now.

### ***C. Internal Investigations***

One of the clear lessons from the GSK matter is that serious allegations of bribery and corruption require a serious corporate response. Not, as GSK did in their best Inspector Clouseau imitation, failing to find the nose on their face. I was particularly focused on GSK’s response to at least two separate reports from an anonymous whistleblower (brilliantly monikered as *GSK Whistleblower*) of allegations of bribery and corruption going on in the company’s China business unit.

Further, and more nefariously, is GSK’s documented treatment of and history with internal whistleblowers. One can certainly remember GSK whistleblower Cheryl Eckard. A 2010 article in The Guardian by Graeme Wearden, entitled “*GlaxoSmithKline whistleblower awarded \$96m payout*”, where he reported that Eckard was fired by the company “after repeatedly complaining to GSK’s management that some drugs made at Cidra were being produced in a non-sterile environment, that the factory’s water system was contaminated with micro-organisms, and that other medicines were being made in the wrong doses.” She later was awarded \$96MM as her share of the settlement of a Federal Claims Act whistleblower lawsuit. Eckard was quoted as saying, “It’s difficult to survive this financially, emotionally, you lose all your friends, because

all your friends are people you have at work. You really do have to understand that it's a very difficult process but very well worth it." So to think that GSK may simply have been SHOCKED, SHOCKED, that allegations of corruption were brought by an internal whistleblower may well be within the realm of accurate.

There would have seemed to have been plenty of evidence to let the company know that something askance was going on in its Chinese operations. The international press was certainly able to make that connection early on in the scandal. An article in the FT, entitled "*China accuses GSK of bribery*" by Kathrin Hille and John Aglionby, reported "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, GSK said it was the first it had heard of the investigation. In a prepared statement, quoted in the FT, GSK said "'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."

Laurie Burkitt, reporting in the WSJ in an article entitled "*China Accuses Glaxo 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, the 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.'" From my experience, if you have a bribery scheme that has its own code name, even if you never implemented that scheme, it probably means that the propensity for such is pervasive throughout the system.

I have often written about the need for a company to have an investigative protocol in place so that it is not making up its process in the face of a crisis. However the GSK matter does not appear to be that situation. It would not have mattered what investigation protocol that GSK followed, it would seem they were determined not to find any evidence of bribery and corruption in their China business unit. So the situation is more likely that GSK should have brought in a competent investigation expert law firm to head up their investigation in the face of this anonymous whistleblower's allegations.

In an ACC Docket article, entitled "*Risks and Rewards of an Independent Investigation*", authors James McGrath and David Hildebrandt discuss the use of *specialized* outside counsel to lead an independent internal investigation as compliance and ethics *best practices*. This is based upon the US Sentencing Guidelines, under which a scoring system is utilized to determine what a final sentence should be for a criminal act. Factors taken into account include the type of offense

involved and the severity of the said offense, as well as the harm produced. Additional points are either added or subtracted for mitigating factors. One of the mitigating factors can be whether an organization had an effective compliance and ethics program. McGrath and Hildebrandt argue that a company must have a robust internal investigation.

McGrath and Hildebrandt take this analysis a step further in urging that a company, when faced with an issue such as an alleged FCPA violation, should engage *specialized* counsel to perform the investigation. There were three reasons for this suggestion. The first is that the DOJ would look towards the independence and impartiality of such investigations as one of its factors in favor of declining or deferring enforcement. If in-house counsel were heading up the investigation, the DOJ might well deem the investigative results “less than trustworthy”.

Matthew Goldstein and Barry Meier discussed the need for independence from the company being investigated in an article the NYT about the General Motors (GM) internal investigation entitled “*G.M Calls the Lawyers*”. They quoted William McLucas, a partner at WilmerHale, who said, “If you are a firm that is generating substantial fees from a prospective corporate client, you may be able to come in and do a bang-up inquiry. But the perception is always going to be there; maybe you pulled your punches because there is a business relationship.” This is because if “companies want credibility with prosecutors and investors, it is generally not wise to use their regular law firms for internal inquiries.” Another expert, Charles Elson, a professor of finance at the University of Delaware who specializes in corporate governance, agreed adding, “I would not have done it because of the optics. Public perception can be affected by using regular outside counsel.””

Adam G. Safwat, a former deputy chief of the fraud section in the Justice Department, said that the key is “Prosecutors expect an internal investigation to be an honest assessment of a company’s misdeeds or faults, “What you want to avoid is doing something that will make the prosecutor question the quality of integrity of the internal investigation.”” Also quoted was Internal Investigations Blog editor, Jim McGrath who said, “A shrewd law firm that gets out in front of scandal can use that to its advantage in negotiating with authorities to lower penalties and sanctions. There is a great incentive to ferret out information so they can spin it.”

#### ***D. Internal Controls, Auditing and Monitoring***

There are valuable lessons to be drawn from GSK’s miss-steps in China around internal controls, auditing and monitoring an anti-corruption compliance program. 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 occurred in its Chinese operations? The numbers went upwards of \$500MM, which coincidentally was the amount of the fine levied by the Chinese court on GSK. It is not as if the Chinese medical market was 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, “GSK bosses were blindsided by police allegations of massive corruption involving travel agencies used to funnel bribes to doctors and officials.”

### 1. *Internal Controls*

Where were the appropriate internal controls? You might think that a company as large as GSK and one that had gone through the ringer of a prior DOJ investigation resulting in charges for off-label marketing and an attendant Corporate Integrity Agreement might have such controls in place. It was not as if the types of bribery schemes in China were not well known. In an article in the FT, 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. The authors 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 discussed the two primary methods of paying bribes in China: the *direct incentives* and *indirect incentives* method. Anderlini and Mitchell reported, “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.””

It would be reasonable to expect that internal controls over gifts would be designed to ensure that all gifts satisfy the required criteria, as defined and interpreted in Company policies. It should fall to a Compliance Officer to finalize and approve a definition of permissible and non-permissible gifts, travel and entertainment and internal controls will follow from such definition or criteria set by the company. These criteria would include the amount of the spend, localized down into increased risk such the higher risk recognized in China. Within this context, noted internal controls expert Henry Mixon has suggested the following specific controls. (1) Is the correct level of person approving the payment / reimbursement? (2) Are there specific controls (and signoffs) that the gift had proper business purpose? (3) Are the controls regarding gifts sufficiently preventative, rather than relying on detect controls? (4) If controls are not followed, is that failure detected?

## 2. *Auditing*

Following Mixon's point 4 above, what can or should be a company's response if one country's gifts, travel and entertainment expenses were kept 'off the books'? This is where internal audit or outside auditors are critical. Hirschler quoted an 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 as saying "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 medical conferences, 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's auditors 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."

Another issue for auditing is 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.

## 3. *Ongoing Monitoring*

A final lesson is monitoring. As Stephen Martin often says, many compliance practitioners confuse auditing with monitoring. Monitoring is a commitment to reviewing and detecting compliance programs in real time and then reacting quickly to remediate them. A primary goal of monitoring is to identify and address gaps in your program on a regular and consistent basis. Auditing is a more limited review that targets a specific business component, region, or market sector during a particular timeframe in order to uncover and/or evaluate certain risks.

Here I want to focus on two types of ongoing monitoring. The first is relationship monitoring, performed by companies such Boston-based Catelas, through software products. It was reported in a WSJ article, entitled "*Glaxo Probes Tactics Used to Market Botox in China*", that internal GSK emails showed the company's China sales staff were instructed by local managers to use

their personal email addresses to discuss marketing strategies related to Botox. The Catelas software imports and analyzes communications data, like email, IM, telephony and SMTP log files from systems such as Microsoft Exchange Servers and Lotus Notes. The software then leverages social network analysis and behavioral science algorithms to analyze this communications data. These interactions are used to uncover and display the networks that exist within companies and between the employees of companies. Additionally, relationships between employees and external parties such as private webmail users, competitors and other parties can be uncovered.

The second type of monitoring is transaction monitoring. Generally speaking, transaction monitoring involves review of large amounts of data. The analysis can be compared against an established norm which is derived either against a businesses' own standard or an accepted industry standard. If a payment, distribution or other financial payment made is outside an established norm, thus creating a red flag that can be tagged for further investigation.

GSK's failure in these three areas now seems self-evident. However, the company's foibles can be useful for the compliance practitioner in assessing where their company might be in these same areas. Moreover, as within any anti-corruption enforcement action, you can bet your bottom dollar that the regulators will be assessing *best practices* going forward based upon some or all of GSK's miss-steps going forward.

## ***Chapter XV-What Does it all Mean? China and the International Fight Against Corruption***

GSK may well be a watershed in the global fight against bribery and corruption. Behavior and conduct, which was illegal under Chinese law but previously tolerated and even accepted by Chinese government officials, quickly became a quagmire that the company was caught in when charges of corruption were leveled against them last year. Many westerners were skeptical about the claims made against GSK and its head of China operations, Mark Reilly. That is one of the problems in paying bribes to government officials; it is always illegal under domestic law. David Pilling, writing an article in the FT entitled “*Why corruption is a messy business*”, said “Multinationals are discovering that there is only one thing worse than operating in a country where corruption is rampant: operating in one where corruption was once rampant – but is no longer tolerated.”

When it began, it was not clear why China’s Communist Party Chief Xi Jinping began his anti-corruption push. Some speculated that it was an attack on western companies for more political reasons than economic reasons. Others took the opposite tack that the storm, which broke with the bribery and corruption investigation of GSK, was China’s attack on western companies to either hide or help fix problems endemic to the Chinese economic system. My take is that his campaign has a different purpose but incorporates both political and economic reasons. That purpose is that Xi has recognized something that the US government officials and most particularly the DOJ have been preaching for some time. That is, the insidiousness of corruption and its negative effects on an economic system.

Xi and China have realized that corruption is a drain on the Chinese economic system. Publications as diverse as the Brookings Institute to the WSJ have noted that one of the reasons for the anti-corruption campaign is to restore the Chinese public’s faith in the ruling Communist Party. Bob Ward, writing in the WSJ article entitled “*The Risks in China’s Push to Root Out Wrong*”, said, “China’s anticorruption drive began in late 2012 as a way to cleanse the ruling Communist Party and convince ordinary Chinese that the system isn’t rigged against them. Investigators are targeting some of China’s most powerful officials and disciplining tens of thousands of lower-echelon officials who party investigators contend got used to padding their salaries.” Cheng Li and Ryan McElveen, writing online for Brookings, in an article entitled “*Debunking Misconceptions About Xi Jinping’s Anti-Corruption Campaign*”, wrote, “If there were ever any doubts that Xi could restore faith in a party that had lost trust among the Chinese public, many of those doubts have been dispelled by the steady drumbeat of dismissals of high-ranking officials since he took office.”

But the economic reasons behind the anti-corruption campaign are equally important. One of the more interesting articulations came from one disgraced former Chinese government official, who was one of the earliest senior officials to be charged with corruption. In a WSJ article by James T. Areddy, entitled “*Chinese Ex-Official Admits to Corruption*”, he wrote about the trial of Liu Tienan, the “former head of the National Energy Administration and senior director in the National Development Reform Commission” who had been arrested in May 2013. His trial finally came around in September 2014. At his trial he made some rather extraordinary statements. Areddy wrote that “Liu testified that reducing official power is key to curbing corruption: “The major point, which is based on my own experience, is to give the market a great deal of power to make decisions.”” But Liu did not end there, “as he explained his view that China’s state bureaucracies are too powerful and entrepreneurs are too weak. “Approvals should be developed in a system, rather by an individual’s actions. This would help prevent abuse of power for personal self-interest.””

Whether or not Liu thought those statements up on himself, a smart defense lawyer suggested he make them to reduce his sentence, or the Chinese government told him to say it as his role in the well-known show trials of the Chinese justice system; it really does not matter. That is one of the most incredible statements I have ever heard of coming out of anything close to an official Chinese statement or proceeding. Think about it; first Liu is saying that the Adam Smith’s ‘invisible hand’ of the market should be governing market decisions. Next, he speaks against the arbitrary nature in China for entrepreneurs in giving approval about how businesses can expand and grow in China. This arbitrary process should be replaced with objective criteria. It is almost if Lui is channeling his inner FCPA Professor when he speaks against artificial barriers to market entry. Finally, Liu attacks the small-mindedness of bureaucratic mentality in their use of power for self-interest.

There have already been demonstrated economic benefits to China’s anti-corruption campaign. In September, Bloomberg reported that China’s fight against bribery and corruption could boost economic growth, generating an additional \$70 billion for the budget, in summarizing economists' forecasts. An article in the online publication Position and Promotions, reported that the bribery “could trigger a 0.1-0.5 percent increase in the world's second-biggest economy, equivalent to \$70 billion dollars.” This crackdown should also be welcomed by western companies, as “it could also benefit foreign companies operating on the Chinese market, who have experienced the negative effects of the omnipresent palm-greasing, according to Joerg Wuttke, president of European Chamber of Commerce in China.” He was further quoted as saying, “It takes the stress away. You're not afraid that somebody gets an order because he found a better champagne or something like that. It's not Singapore yet, but it's a very positive development”.

As we close this phase of GSK's saga, I think some time for reflection is appropriate. For the compliance practitioner there have been many specific lessons to be learned from GSK's missteps. However I think the clearest lesson is that the only real hope that a company has into today's world is an effective, best practices anti-corruption compliance program. Whether it is designed to help a company comply with the Foreign Corrupt Practices Act (FCPA), UK Bribery Act or other anti-corruption legislation, it really does not matter. It is the only, and I mean only, chance your company will have when an issue in some far-flung part of the world splashes your company's name across the world's press.

But there may also be cause for celebration to those who have long preached against the evils of corruption, whether it is for economic reasons or for those who view the fight against anti-corruption as a part of the fight against terrorism. For if China is attacking domestic corruption, I believe that will lead other countries to do so as well. We are already seeing stirrings in India under new President Modi. So while GSK may well suffer going forward, the fight against global bribery and corruption may just have moved a few feet forward.

## About the Author



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