

**SQUIRE  
SANDERS**

LEGAL  
COUNSEL  
WORLDWIDE

**BME China Sourcing Conference 2009  
Best Value China Sourcing-Optimizing Price, Quality and Lead Times**

**Corruption and fraud risk management  
in procurement departments in China**

**Rainer Burkardt  
Squire, Sanders & Dempsey L.L.P.  
Shanghai Office  
September 18, 2009**

# Agenda

---

- **Part I:** Figures and facts - introduction of the 2008 BRIBELine China Report
- **Part II:** Legal implications - anti-corruption laws in China, the US and Europe and legal liabilities for the company and its management
  - Applicable laws in the US (FCPA), Europe (OECD) and China (PRC Anti-bribery law)
  - Actual implementation and enforcement of anti-corruption legislation risks and
  - Consequences in case of violation of anti-corruption legislation
- **Part III:** Practical measures - how to effectively manage corruption risks without running out of business!

## Part I: Figures and facts - Crisis-related factors

---

Experts refer to the so-called **fraud triangle**, a model that requires the presence of **three key factors** in order to trigger an economic crime:

- the assumption that there is an **opportunity** for criminal activity
- **incentive** (or pressure)
- the perpetrator's subjective **justification** for his deed (he portrays it as a mistake or he does not view it as reprehensible because he thinks he is being treated in an unfair manner).

## Part I: Figures and facts - Crisis-related factors

---

- An **economic downturn** influences the lives of many: they lose money or income
- People faced with desperate circumstances are more likely to take risks in order to **recover lost assets or income**
  - a plunge in share prices causes savings to lose value
  - a partner or spouse loses his or her job
- As a consequence honest individuals may turn to bribery or other forms of economic crime

## Part I: Figures and facts - Crisis-related factors

Three key factors make **emerging markets** susceptible to economic crime.

- Firstly, **supply chains are more complex** and subdivided in emerging markets
  - China's size and geographic diversity compound this situation
  - Little takes place in China without sales agents, dealers, representatives and other middlemen
  - It is therefore **difficult to comprehensively monitor** production from raw materials to end product - which increases the opportunities for manipulation
- Secondly, maintaining **close personal relationships is** essential to business life in China
  - a good relationship with customers and suppliers is part and parcel of doing business all over the world.
  - But in China there is the danger that these relationships - known as 'guanxi' - will take precedence over the initial business objective

## Part I: Figures and facts - Crisis-related factors

- Thirdly, China saw a period of enormous economic growth
  - many businesses are extremely sales orientated and set growth targets that could place employees under extremely heavy pressure
  - The growth rate has been so rapid that **effective procedures** and controls could **not be introduced** quickly enough
  - The development of the legal system has not kept up with economic growth, with the result that officials find themselves swamped with cases involving the prosecution of economic crimes

## Part I: Figures and facts - frequent types of economic crime

---

The *Economic Crime Survey 2007* based on a survey of 5,400 businesses in 40 nations, lists the **five most frequent types** of economic crime:

- embezzlement
- falsification of balance sheets
- corruption and bribery
- money laundering
- copyright infringement

These five types of economic crime listed in the previous slide are found in **all** developing countries.

## Part I: Figures and facts - frequent types of economic crime

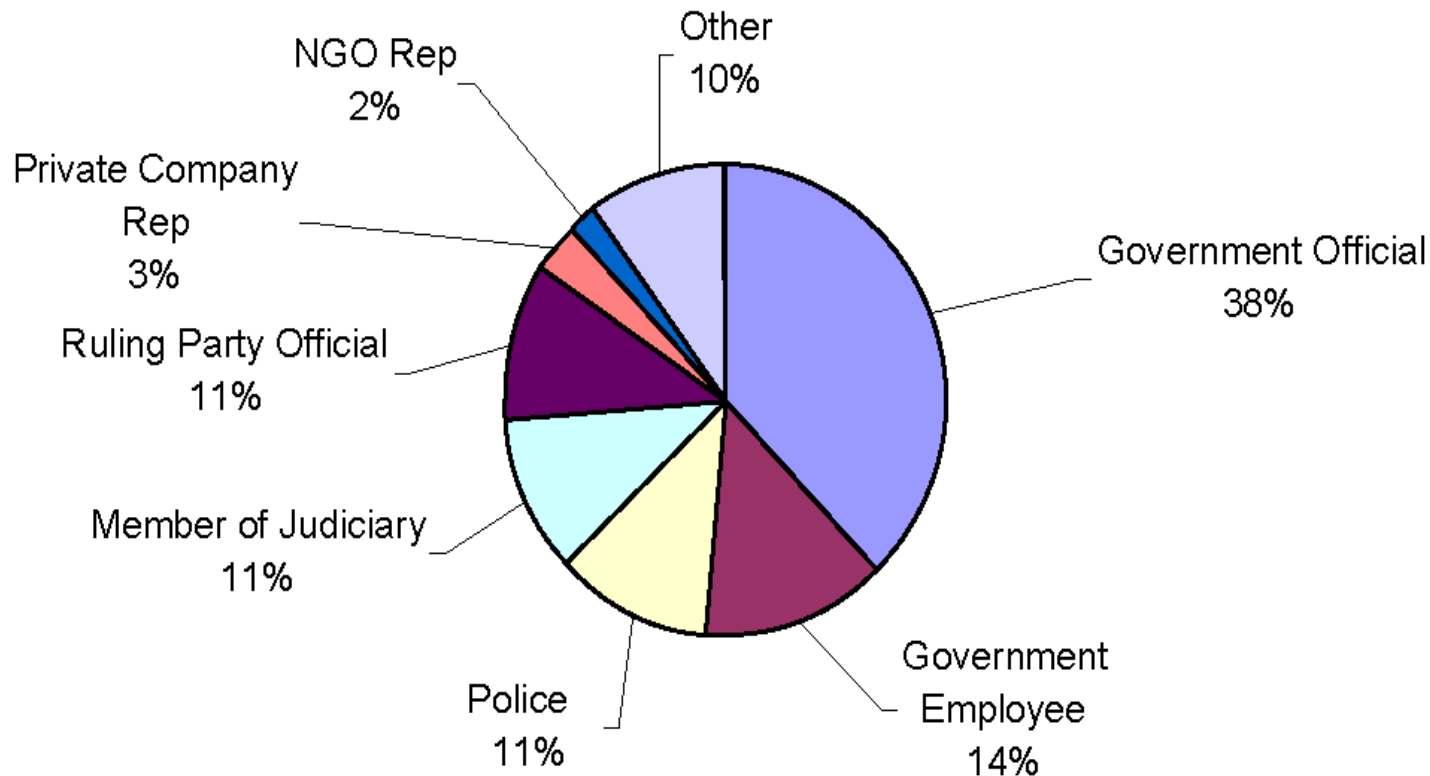
---

**China** in particular is susceptible to the following problems:

- **corruption or bribery** (secret agreements between purchasing departments and suppliers to inflate prices and split profits)
- **improper procurement practices** giving preferential treatment to certain suppliers
- **copyright infringement** and failure to record all licensing fees due
- **money siphoning** (failure to record earnings covered up by falsifying balance sheets)
- bribery and **corrupt practices** in order to obtain orders (including excessive demands made to favour certain suppliers and improper bidding practices)

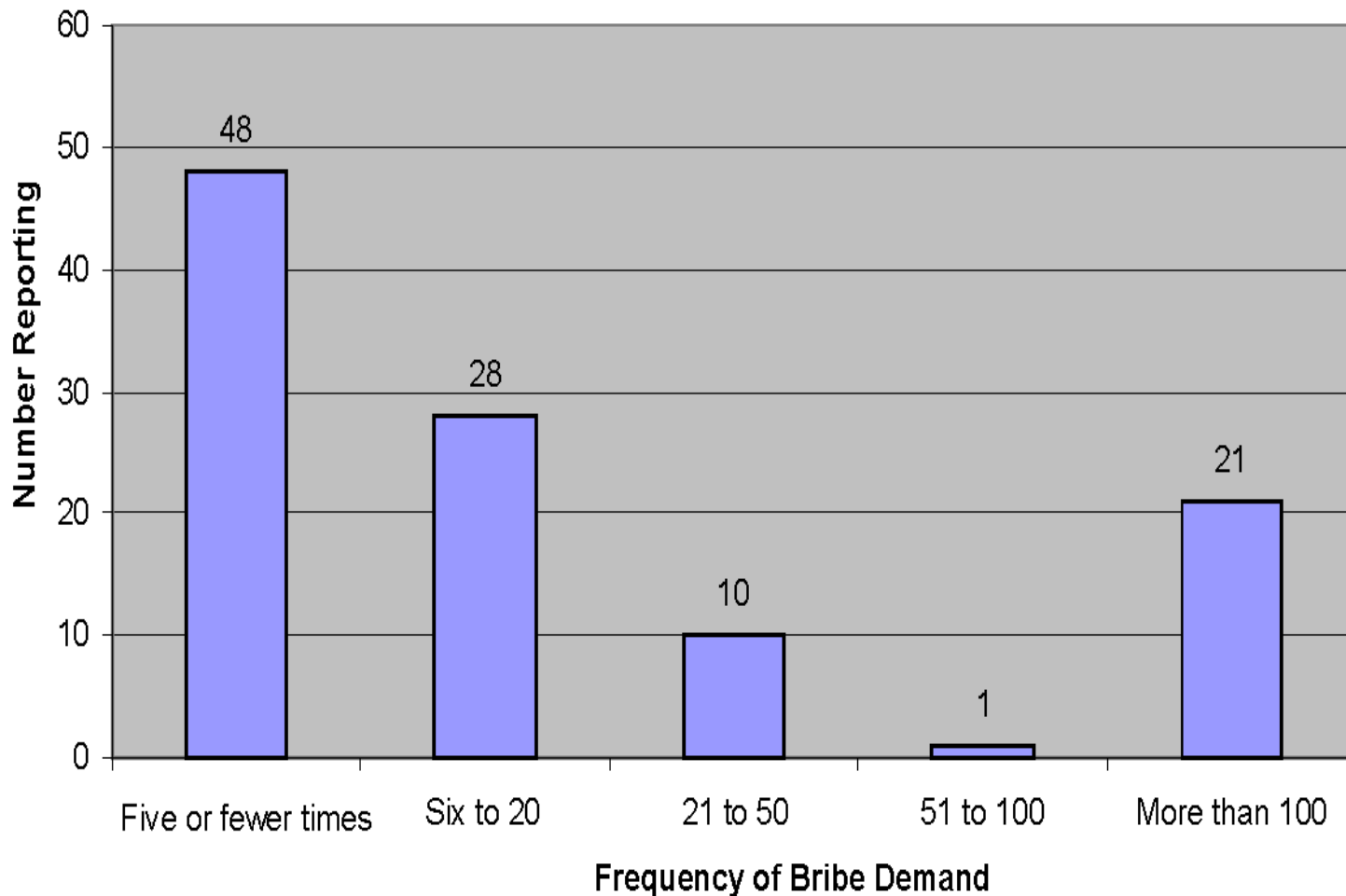
# Part I: Figures and facts - introduction of the 2008 BRIBELine China Report

Chart 1: Who Requested the Bribe? (N = 148)



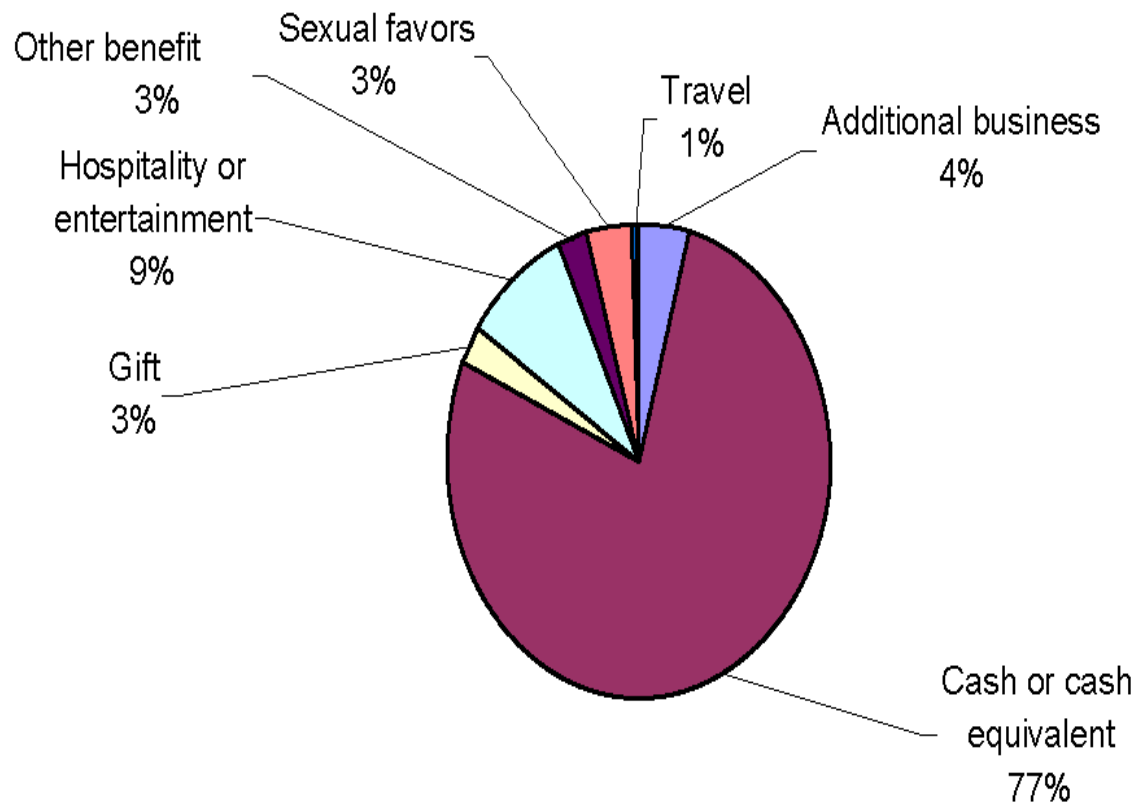
## Part I: Figures and facts - introduction of the 2008 BRIBELine China Report

Chart 2: Frequency of Recurring Bribe Demands (N = 108)



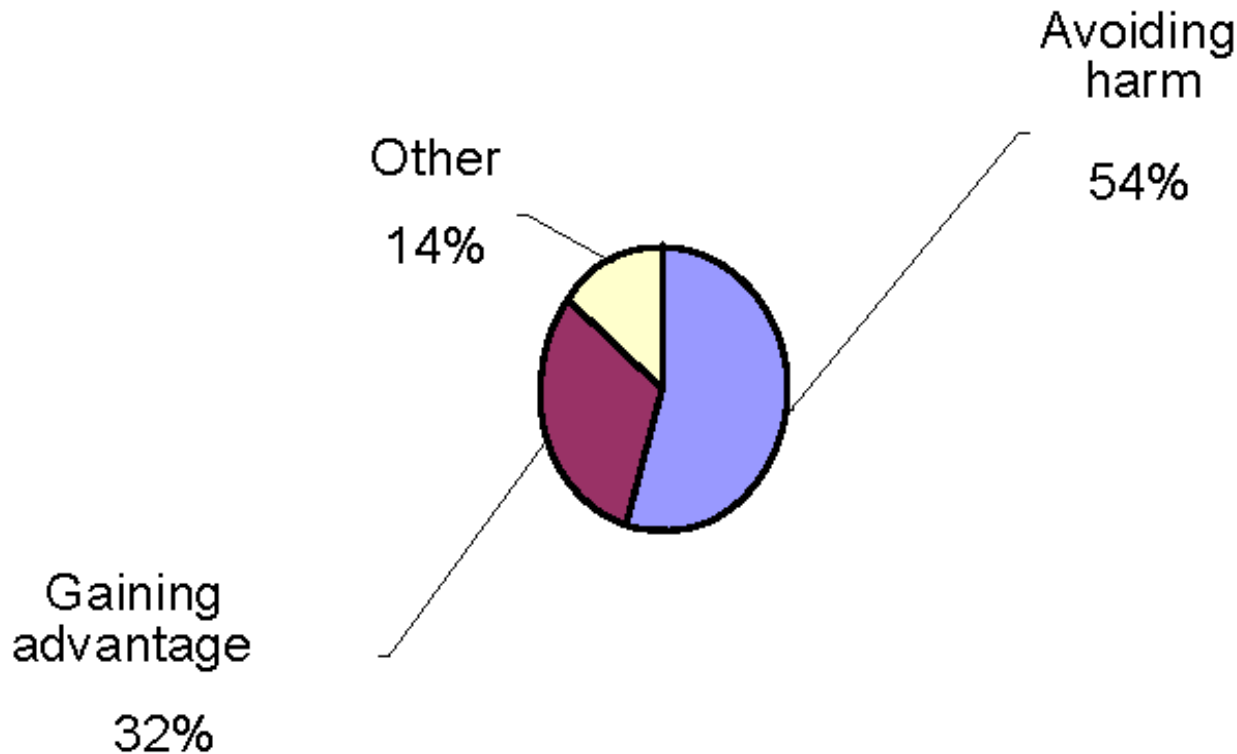
# Part I: Figures and facts - introduction of the 2008 BRIBELine China Report

Chart 3: Primary Form of the Requested Bribe (N = 148)



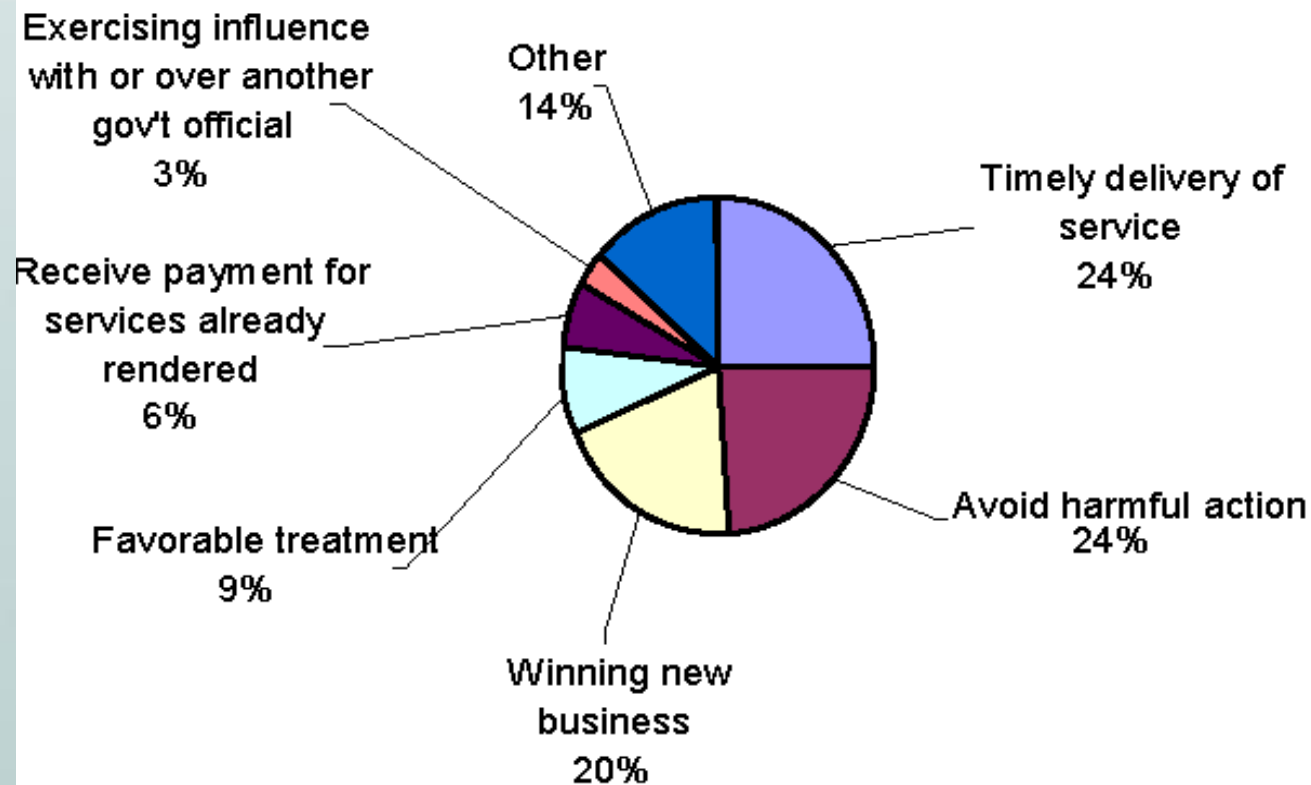
## Part I: Figures and facts - introduction of the 2008 BRIBELINE China Report

### Chart 4: General Nature of Bribe Demands (N = 148)



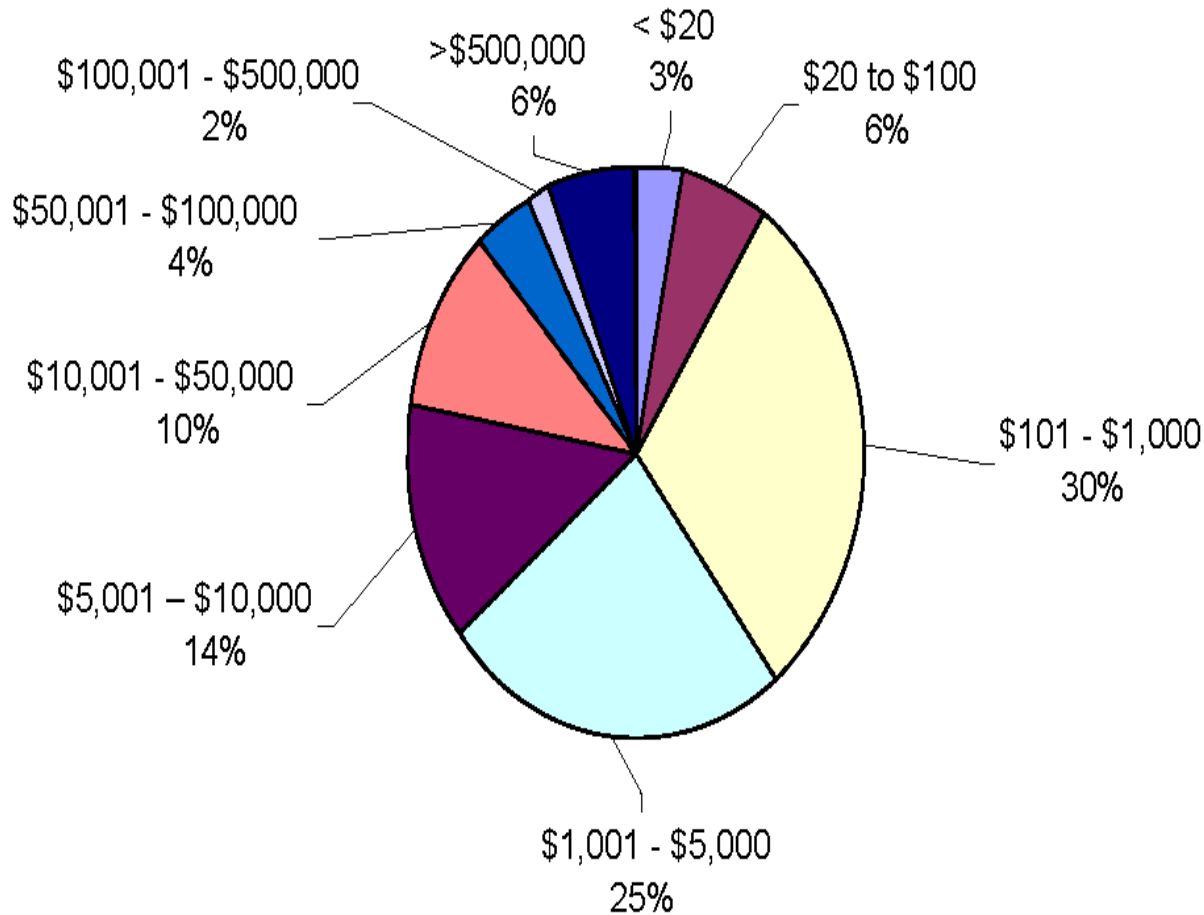
## Part I: Figures and facts - introduction of the 2008 BRIBELINE China Report

### Chart 5: Specific Nature of Bribe Demands (N = 148)



# Part I: Figures and facts - introduction of the 2008 BRIBELine China Report

Chart 6: Amount of Bribe Requested (N = 117)



## Part II: Legal implications - anti-corruption laws in China

---

Anti-corruption laws in China:

- PRC Anti-Unfair Competition Law
- Tentative Provisions for Prohibition of Commercial Bribery
- PRC Criminal Law
- Notice on Issuing Opinions on Issues concerning the Application of Law in the Handling of Criminal Cases of Commercial Briberies

## Part II: Legal implications - anti-corruption laws in China

---

### Article.8 Anti-Unfair Competition Law:

Managers shall not use money or properties or the other methods to bribe to others **in order to sell or purchase commodities.**

- It shall be guilty of giving bribe if managers give a secret commission to the other organisations or individuals without the normal accounting records.
- It shall be guilty of taking bribe, if the organisations or individuals accept the secret discount without normal accounting records.
- Managers may offer a discount to the others in public, or may pay commission to the middle man in selling or purchasing commodities.
- However, managers who give discount to the others or pay commission to the middle man, or the others who take the discount or commission shall make accounting strictly according to the facts.

## Part II: Legal implications - anti-corruption laws in China

---

### Article.2 Tentative Provisions for Prohibition of Commercial Bribery

- Business operators may not commit acts of commercial bribery **in selling or purchasing commodities**, in violation of Article 8 of the Anti-unfair Competition Law.
- “**commercial bribery**” means acts of offering bribes to the other party entity or individual by using property or other methods **in order to sell or purchase commodities**.
- “property” means cash and physical commodities, including any property provided to the other party entity or individual under the pretext of costs for promotion, publicity, sponsorship, research and development, labor, consultancy and commission, or by the method of reimbursing various expenses, in order to sell or purchase commodities.
- “other means” means any method for providing any interests other than property, such as provision of opportunities for domestic or overseas travels and site visits under various names.

## Part II: Legal implications - anti-corruption laws in China

---

### Article. 3 Tentative Provisions for Prohibition of Commercial Bribery

- The acts of using commercial bribery for the product sale or purchase for the business operator that have been taken **by any employees** of a business operator shall be **deemed as the acts of the Business Operator**.

## Part II: Legal implications - anti-corruption laws in China

---

### Article. 4 Tentative Provisions for Prohibition of Commercial Bribery

- No entity or individual may accept or solicit bribes in selling or purchasing commodities. Any Business Operator that **secretly offers a rebate off the book** to the other party entity or individual shall be treated as having offered bribes and be punished accordingly; the other party entity or individual that secretly **accepts** a rebate off the book shall be treated as having accepted bribes and be punished accordingly.
- “rebate” means the act by a business operation of **secretly refunding** a proportion of the commodity prices to the other party entity or individual in cash, kind or other form off the book in selling products.
- “secretly off the book” means the **failure to record any payment truthfully in the account books** that reflect its production and business activities or the receipt and expenditure of administrative fees in accordance with financial and accounting regulations, including failure to record any payment in the financial account book, transfer of any payment to another financial account book or account falsification.

## Part II: Legal implications - anti-corruption laws in China

### Article 6 Tentative Provisions for Prohibition of Commercial Bribery

- A Business Operator that sells or purchases commodities may **offer a discount** to the other party in **an explicit manner**. In the case of offering any discount to the other party, the Business Operator must truthfully record the payment in its account books; in the case of accepting any discount, the Business Operator must truthfully record the receipt in its account books.
- “**discount**” or “preferential price treatment in commodity transactions” means the **preferential prices offered** by a Business Operator to the other party **in an explicit manner** and by means of recording the same in the account truthfully, including the two circumstances in which the total price is reduced in a certain proportion at the time of payment and in which a certain proportion of the total price is refunded after the payment of the total price.
- “in an explicit manner” and “recorded in the account” mean the act of **recording any payment** or receipt **in the account books** that reflect its production and business activities or the receipt and expenditure of administrative fees in accordance with financial and accounting regulations in consideration of the agreed amount and payment method.

## Part II: Legal implications - anti-corruption laws in China

---

### Article 7 Tentative Provisions for Prohibition of Commercial Bribery

- A Business Operator that sells or purchases commodities may **pay commission** to a broker **in an explicit manner**. In the case of paying commission to any broker, the Business Operator must **truthfully record the payment** in its account books; in the case of accepting any commission, the Business Operator must truthfully record the receipt in its account books.
- “commission” means the compensation paid by a Business Operator to any broker that has **legitimate business qualification** and has **provided services** to it **in market transactions**.

## Part II: Legal implications - anti-corruption laws in China

---

### Article 8 Tentative Provisions for Prohibition of Commercial Bribery

- No Business Operator may pay cash or provide physical goods to the other party entity or individual as gift in commodity trading, except for advertised **gifts in nominal value in line with business practices.**

## Part II: Legal implications - anti-corruption laws in China

---

### Article 9 Tentative Provisions for Prohibition of Commercial Bribery

- Where a **Business Operator** commits bribery in order to sell or purchase commodities, the administration for industry and commerce may, pursuant to Article 22 of the Anti-Unfair Competition Law, and depending on the seriousness of the case, impose a **fine not less than RMB 10,000 and below RMB 200,000**, and shall **confiscate the illegal gains**, if any. If the act constitutes a crime, such case shall be transferred to the judicial organ for **criminal prosecution**.
- If any relevant **entity or individual accepts** bribes in purchasing or selling commodities, the administration for industry and commerce shall impose a penalty in accordance with the preceding paragraph. If the act constitutes a crime, such case shall be transferred to the judicial organ for criminal prosecution.

## Part II: Legal implications - anti-corruption laws in China

---

### Criminal Law

- Art.163: **acceptance** of bribes by a **non-state** functionary: imprisonment for less than five years; for cases involving a large amount, with imprisonment of over five years, and may be subject to forfeiture of property.
- Art. 164: **offering** bribes to a **non-state** functionary: imprisonment for less than three years, for cases involving a large amount, with imprisonment of over three years but less than 10 years, and with fine.

Units committing offenses shall be punished with a fine, with **personnel directly in charge** and other **directly responsible personnel being punished** according to provisions of the preceding paragraph.

A briber who confesses his bribery act before prosecution may receive a lighter sentence or a waiver for punishment.

- Art. 385: **acceptance** of bribes (by a **state functionary**) (see Art.163)

## Part II: Legal implications - anti-corruption laws in China

- Art. 387: crime of **acceptance** of bribes by an **entity**: sentenced to a fine if the circumstances are serious.  
**Personnel** who are **directly in charge** and **other personnel** who are **directly held responsible** for the crime are to be sentenced to not more than five years of fixed-term imprisonment.
- Art. 389: **offering** bribes (see Art.164)
- Art. 391: **offering** bribes **to an entity**: entity is to be sentenced to a fine, and the responsible persons who are directly in charge of the unit or other personnel who are held directly responsible for the crime shall be sentenced to not more than three years of fixed-term imprisonment.
- Art. 392: bribing as an **intermediary**: not more than three years of fixed-term imprisonment
- Art. 393: **offering** bribes **by an entity**: sentenced to a fine, and the personnel directly in charge of the unit or other personnel who are directly held responsible for the crime are to be sentenced to not more than five years of fixed- term imprisonment.

## Part II: Legal implications - anti-corruption laws in the US

---

### The Foreign Corrupt Practices Act (FCPA)

- The FCPA prohibits the **bribery of foreign officials** and requires companies to properly record and account for financial transactions.
  - The anti-bribery provisions make it unlawful for certain classes of persons and entities to act corruptly in furtherance of an offer, promise, authorization, or payment of anything of value **to a foreign official**, or foreign political party, official, or candidate for the purposes of securing any improper advantage, or assisting in obtaining or retaining business for, or directing business to any person.
  - The anti-bribery provisions also make it illegal to offer, promise or authorize the payment of anything of value **to anyone** when the payor, promisor or authorizer knows that all or a portion of the thing of value will **pass on to the foreign official**, or foreign political party, party candidate or party official.

## Part II: Legal implications - anti-corruption laws in the US

---

- Activities beyond bribery which constitute a violation of the FCPA include giving **extraordinary nonmonetary gifts** (such as expensive trips) to foreign officials or their associates and employing consultants with connections to foreign officials to exert influence.
- **Twin enforcement** is allowed by both the Department of Justice (DOJ) and the Securities Exchange Commissions (SEC).
  - The DOJ brings **criminal** charges against companies and individuals for violations of the FCPA's anti-corruption and accounting provisions.
  - The SEC, meanwhile, has the power to bring **civil** charges for violation of the accounting standards provisions.

## Part II: Legal implications - anti-corruption laws in the US

---

- The anti-bribery provisions apply to issuers, domestic concerns, certain foreign nationals or businesses, and anyone who commits a proscribed act within the U.S.
  - An issuer is a U.S. or **foreign corporation** that has **issued securities registered in the U.S.** or who is required to **file periodic reports with the SEC.**
  - A domestic concern is anyone who is a U.S. citizen, national, or resident, or any entity with its principal place of business in the U.S. or organized under the laws of a U.S. state, territory, possession or commonwealth.
- In addition, U.S. corporations may be held liable for **acts of foreign subsidiaries** for violations of the anti-bribery provisions where they authorized, directed or controlled the activity in question.

## Part II: Legal implications - anti-corruption laws in the US

---

- Violations of the FCPA carry **substantial penalties**. In respect to violations of the anti-bribery provisions
  - **individuals** face **criminal fines** of up to \$250,000 under the U.S. Code's alternative fines provision, **five years in prison, or both**, while
  - **corporate** entities face criminal penalties of **up to \$2 million** per violation.
- Both the anti-bribery and accounting provisions also carry **civil penalties**. The anti-bribery provisions' civil penalties include **fines of \$10,000 per violation**.
- Companies face additional repercussions upon conviction that include **debarment from federal contracts**.
- Finally, companies may face **asset seizure** and forfeiture and third party lawsuits. The DOJ may seize bank accounts, wherever they may be, if they hold funds that have either passed through or lodged themselves in a U.S. bank. Defendants in such actions have forfeited more than \$100 million since 2007.

## Part II: Legal implications - anti-corruption laws in the US

- Most headline-grabbing was the 2008 Siemens scandal, in which Siemens stood accused of foreign government officials to win infrastructure contracts. In December 2008, Siemens settled charges with the SEC and DOJ, paying \$800 million to U.S. authorities – the largest monetary sanction ever imposed in an FCPA case.
- On July 31, 2009 SEC brought its first FCPA action charging **control person liability**. SEC charged a parent corporation with violating the FCPA’s anti-bribery, books and records, and internal controls provisions and other securities law violations based on **payments allegedly paid by its foreign subsidiary** to customs brokers to facilitate the importation of unregistered products. SEC also charged the parent corporation’s **current executive** as well as its **former executive** with violating the FCPA’s books and records and internal controls provisions based on their position as “control persons,” even though the SEC **did not allege** that the executives had **personal knowledge** of the payments.

## Part II: Legal implications - anti-corruption laws in the US

---

- For an organization to demonstrate it has an effective program, the Guidelines require the organization:
  - to **exercise due diligence** to prevent and detect criminal activity and
  - to promote an organizational culture that encourages ethical behavior and a commitment to lawful conduct.

## Part II: Legal implications - anti-corruption laws in the US

---

The Guidelines provide that a program minimally requires the following **seven characteristics**:

1. The organization must “**establish standards and procedures** to prevent and detect criminal conduct.”
2. The organization’s governing authority (e.g., the board of directors) must be knowledgeable about and reasonably **supervise the program**.
3. The organization must use reasonable efforts to **not empower** substantial authority (i.e., the ability to exercise a substantial measure of discretion in acting on the organization’s behalf) in any **individual** whom it “knew, or should have known...**engaged in illegal activities** or other conduct inconsistent with an effective” program.
4. The organization must “take reasonable steps to **communicate** periodically and in a practical manner **its standards and procedures**” to the governing authority, officers and employees, and, as appropriate, agents and other third parties.

## Part II: Legal implications - anti-corruption laws in the US

---

5. The organization must take **reasonable steps to guarantee that the program is followed**, including monitoring and auditing to discover unlawful behavior, to evaluate from time to time the program's effectiveness, and to publicize a system that may include methods of communication that provide for anonymity or confidentiality, thus enabling employees and third parties to "report or seek guidance regarding potential or actual criminal conduct without fear of retaliation."
6. The organization must **promote and consistently enforce the program** through appropriate performance incentives and commensurate "disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct."
7. "After criminal conduct has been detected," the organization must "**take reasonable steps to respond appropriately**...and to prevent further similar criminal conduct, including making any necessary modifications" to the program.

## Part II: Legal implications - anti-corruption laws in the US

---

- The DOJ and SEC have stressed the **need to conduct due diligence on anyone acting on behalf of an entity** subject to the FCPA. This includes the acts of
  - employees,
  - officers and directors,
  - joint-venture partners,
  - targets acquired in a merger, and
  - third parties, such as agents, consultants, distributors, marketing representatives and freight forwarders.
- Corruption investigations can also impact M&A activity. Any firm targeting a company which conducts business in foreign markets **must include anti-corruption inquiries in their due diligence** or risk successor liability post-closing.

## Part II: Legal implications - anti-corruption laws in the US

---

- There is no one right way to conduct due diligence. Due diligence is a potpourri of tasks that include:
  - FCPA-tailored risk and awareness application materials;
  - interviews, and scrutinizing answers provided thereto;
  - background checks to assess a reputation/history of illegal activity;
  - consulting a third party to provide reliable local information;
  - using a forensic accountant to review books and records to evaluate high risk transactions or suspect patterns of transactions;
  - visiting the office of your third party;
  - documenting the services provided by third parties;
  - targeted review of email, electronic, and hard copy files
- If any red flags appear during the due diligence phase, they must be investigated until you are reasonably satisfied you do not have an FCPA concern.
- Finally, due diligence must be documented.

## Part II: Legal implications - anti-corruption laws in the US

---

Once you have satisfied your due diligence, you need to implement the next **steps in mitigating potential FCPA exposure**, including:

- providing your third party agents with a **copy of your anti-bribery code** of conduct (Be sure it's in their native language and that it references the FCPA)
- Require them to read it and **execute an acknowledgment** that they will abide by it (...include in this acknowledgment FCPA-specific representations and warranties attesting to past compliance and covenants promising future compliance)
- If possible, negotiate as part of your third party contracts the **right to inspect and audit the books** and records of your agent (...be certain to include termination rights).

## Part II: Legal implications - anti-corruption laws in the US

---

### Conclusion:

- FCPA compliance is a must if you engage in international business.
- Operating a compliance and ethics program that meets the Guidelines' expectations should be every organization's baseline objective.
- It's all about mitigating exposure: **Proactively** meeting the Guidelines' mandates and adhering to the due diligence best practices.

## Part II: Legal implications - anti-corruption laws in Europe

---

- In 1997, the member states of the Organization for Economic Cooperation and Development (OECD) adopted the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (Convention).
- The Convention is a collective commitment to ban foreign bribery by the governments of the leading industrialized states.
- The Convention shall overcome damaging effects of foreign bribery on democratic institutions, development programmes and business competition.
- The Convention now has 38 parties.
- The Convention requires its signatories to make it an offence to “intentionally offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.”

## Part II: Legal implications - anti-corruption laws and their Enforcement

---

- The 2009 annual *Progress Report on Enforcement of the OECD Convention (Report)* covers 36 of the 38 *OECD Convention signatories*.
- Beside **foreign** bribery the Report deals i.e with the adequacy of anti-money laundering systems, the need for corporate criminal liability, public access to information and whistleblower protection, cases of **domestic** bribery by foreign companies.
- The *Progress Report* shows that enforcement has been **extremely uneven**: There is active enforcement in only four countries and little or no enforcement in 21 of the parties.

## Part II: Legal implications - anti-corruption laws and their Enforcement

---

- The present situation is dangerous because it is unstable and there are **signs of backsliding**, with some government efforts to curtail the ability of investigative magistrates to bring cases, shorten statutes of limitations, and extend immunities from prosecution.
- The risk of backsliding has grown **more acute during a time of worldwide recession** when competition for decreasing numbers of orders has intensified greatly.
- The **lack of political** will is the major cause of lagging enforcement.
  - An example is the decade-long failure of the UK government to amend its antiquated bribery laws
  - Lack of political will can also take other forms including failure to provide adequate funding and staffing for enforcement.

## Part II: Legal implications - anti-corruption laws and their Enforcement

---

- **Active Enforcement:** 4 countries:  
Germany, Norway, Switzerland, the United States
- **Moderate Enforcement:** 11 countries: Belgium, Denmark, Finland, France, Italy, Japan, Korea (Republic of), the Netherlands, Spain, Sweden, the United Kingdom
- **Little or No Enforcement:** 21 countries:  
Argentina, Australia, Austria, Brazil, Bulgaria, Canada, Chile, Czech Republic, Estonia, Greece, Hungary, Ireland, Israel, Mexico, New Zealand, Poland, Portugal, Slovak Republic, Slovenia, South Africa, Turkey

# Contact Information

---

**Squire, Sanders & Dempsey L.L.P.**

**Shanghai Office**

**Suite 1207, 12th Floor, Shanghai Kerry Center**

**1515 Nanjing Road West, Shanghai, China**

**Tel: +86-21-61036300**

**Fax: +86-21-61036363**



**Rainer Burkardt**

**Partner**

**German lawyer**

**Direct: +86.21.6288.3676**

**[rburkardt@ssd.com](mailto:rburkardt@ssd.com)**