

AMENDMENTS TO CHINA'S ANTI-UNFAIR COMPETITION LAW: STRENGTHENING THE RULE OF LAW IN AN INCREASINGLY COMPLEX MARKETPLACE

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Background

On September 2, 1993, the Third Session of the Standing Committee of the Eighth National People's Congress (NPC) passed the Anti-Unfair Competition Law (AUCL). On November 4, 2017, the Thirtieth Session of the Standing Committee of the Twelfth NPC passed the Amendments to the Anti-Unfair Competition Law (Amended AUCL or New Law), marking the first time that the AUCL underwent a major revision since its enactment 24 years ago. The amendments underscore the government's efforts to strengthen the rule of law in the increasingly complex marketplace that has transcended traditional boundaries to include ecommerce and cyberspace. We discuss the key revisions of the Amended AUCL below (Revision).¹

Comparisons of 1993 AUCL and 2017 Amended AUCL

Topic	1993 AUCL	2017 Amended AUCL
Definition of "Unfair Competition"	A business operator's conduct that violates the provisions of this law, infringes upon the lawful rights and interests of <u>another business operator</u> , and disturbs <u>the socioeconomic order</u> .	A business operator's conduct that violates the provisions of this law, disrupts <u>the order of competition in the marketplace</u> and infringes upon the legitimate rights and interests of <u>another business operator or the consumers</u> .
Recipient of the Bribe (Bribe Receiver)	The organization or the individuals of a counterparty in a transaction	(1) any staff member ² of the counterparty to a transaction; (2) an entity or individual entrusted by the counterparty to a transaction to handle related matters; and (3) an entity or individual that may influence a transaction either by way of exercising authority or influence.
Purpose for the Bribery	For the purpose of selling or purchasing goods	To seek transaction opportunities or competitive advantage
Means of the Bribery	Financial property (e.g., cash, cash equivalents, or material goods ³) or other means, ⁴ including "off-the-book, covert"	Financial property or other means

¹ A recent Morgan Lewis Lawflash, "China Redefines Commercial Bribery and Increases Penalties," published on January 29, 2018, summarizes the new amendments that are analyzed in more depth in this white paper. Read the LawFlash here: <https://www.morganlewis.com/pubs/china-redefines-commercial-bribery-and-increases-penalties>.

² "Staff member" (工作人员) includes but is not limited to employees. It includes those who are affiliated with the counterparty to a transaction in the capacity of an employee but might not have that designation due to their employment arrangement—e.g., dispatch or temporary workers.

³ "Financial property" is defined as "cash or material goods" in the 1996 *Interim Provisions on Prohibition of Commercial Bribery* promulgated by the State Administration for Industry and Commerce (SAIC) of the People's Republic of China (PRC).

⁴ *Id.* "Other means" is defined as "non-cash benefits."

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	payment or receipt of kickbacks	
Regarding Commission and Discounts	Paying and receiving a commission or a discount in <u>selling or purchasing goods</u> must be recorded accurately in the books and records.	Paying and receiving a commission or a discount <u>in a transaction</u> must be recorded accurately in the books and records.
Individual Liability vs. Corporate Liability	Not stipulated.	The bribery conducted by the staff of a business operator is imputed to the corporate entity unless the business operator can prove that the conduct of the individual is unrelated to seeking transaction opportunities or competitive advantages for the business operator.

Analysis and Takeaways

Greater emphasis on consumer protection

The Amended AUCL retains the general principle of promoting order and fairness in the marketplace while adding consumer protection as a focus of the new law. While the Amended AUCL continues to place an emphasis on the overarching principle of upholding order and fairness in the marketplace, Article 2 of the Amended AUCL (the General Provision) stipulates that “unfair competition,” as defined by the new law, encompasses conduct that infringes the legitimate rights and interests of other business operators or the consumers. The Revision reflects the government’s recognition that the ultimate victims of unfair competition are often the general public who end up paying the costs of illegitimate market practices such as commercial bribery.

Although the degree of harm to consumers’ rights and interests has long been a key factor in the regulators’ determination of whether the conduct at issue constitutes unfair competition in practice, the inclusion of consumer protection in the general provision of the Amended AUCL is a notable development that codifies the protection of consumers’ rights and interests alongside that of the business operators who are disadvantaged by unfair competitions. As such, the general provision represents the fundamental precept based on which the legality of conduct in the marketplace will be scrutinized under the Amended AUCL. In other words, any business practice that is construed as disrupting the order of the marketplace will be deemed to violate the AUCL notwithstanding whether all of the elements of the law are met, for the amended statutes, while providing more clarity in some respects, still leave ample room for interpretation and broad discretion by the regulators.

Bribery predicated on the intent to “seek improper business opportunities or competitive advantages”

Article 8 of the 1993 AUCL stipulates that commercial bribery is defined as “bribes given for the purpose of selling or purchasing products.” As the law has not clearly defined what constitutes “bribes,” this provision has historically been interpreted strictly by some regulators who focused on the enumerated elements of the law—e.g., “off the books” rebate or bribes given “for the purpose of selling or purchasing products”—rather than making a determination of commercial bribery based on corrupt intent or the totality of the circumstances surrounding a transaction. As a result, an ordinary sales incentive such as a legitimate discount or a rebate that is a part of a sales transaction but is erroneously recorded or not recorded in a company’s books and records due to clerical errors is often construed as *per se* commercial

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bribery under the 1993 AUCL. Since the 1993 AUCL was enacted, many companies have been swept up over the years by this provision that imposes strict liability on accounting errors that might not have any underlying corrupt intent.

In contrast, Article 7 of the Amended AUCL deleted this language and broadened the applicability of the provision to other contexts by stipulating that commercial bribery is “for the purpose of seeking business opportunities or competitive advantage.” This revision is another defining change in the Amended AUCL that recognizes the variety of transactions that exist in today’s complex business environment in which paying bribes for the purpose of seeking a competitive advantage, even if it is not directly in connection with a transaction, could still disrupt order in the marketplace.

“Bribe Receivers” broadly defined as those who can influence a transaction

Article 7 of the Amended AUCL defines “bribe receivers” as (1) any staff member of the counterparty to a transaction; (2) an entity or individual entrusted by the counterparty to a transaction to handle related matters; and (3) entities or individuals that may influence a transaction either by way of exercising authority or influence. Notably, the amended AUCL carved out the “counterparty of a transaction” from the enumerated list of bribe receivers. At the same time, it also broadened the definition of the “bribe receiver” to include those who can influence a transaction.

Taken together, the amendments adopt the general approach that the government has taken to enact the 2015 Ninth Amendment of the PRC Criminal Law—which is another critical component of the anti-corruption legal regime in China—in recognizing that bribes are often paid to those third parties who have the authority or influence to enable the giving and receiving of improper payments in exchange for transaction opportunities or competitive advantages. The amendments move the Chinese anti-corruption regime closer in line with other international anti-corruption regimes such as the US Foreign Corrupt Practices Act and UK Bribery Act, which have long recognized that bribes given to or through a third-party intermediary can still implicate the bribe giver.

Although the Amended AUCL no longer includes a counterparty to a transaction (counterparty) as a potential bribe receiver, the SAIC⁵ advises that the *de facto* “counterparty to a transaction” might not be the party that enters into the contract directly. Rather, an intermediary might be entrusted to enter into a contract on behalf of the *de facto* counterparty—who bears the consequences of a transaction involving bribes—particularly in industries where the intermediary retains relatively stronger bargaining power due to an asymmetry of information—e.g., a hospital serving as the procurement intermediary between the pharmaceutical companies and the patient population whereby the patients are the *de facto* counterparty. In such a situation, bribes paid to the hospital still constitute commercial bribery. Accordingly, the Revision does not eliminate the possibility that an organization or corporate entity such as a hospital or an educational institution may still be deemed a bribe receiver.

Adequate compliance measures as a defense against corporate vicarious liability

The Amended AUCL espouses an important trend in the developments of anti-corruption laws around the world, which is to recognize that individuals should be held accountable for carrying out the act of bribery, while the corporate entities bear the responsibility of monitoring and supervising their employees to prevent corruption and/or bribery. For example, the UK Bribery Act codifies individual liabilities in both

⁵ Shandong Administration Industry and Commerce, *Compilation of Viewpoints on Commercial Bribery*, Dec. 13, 2017, <http://www.sdaic.gov.cn/sdgsj/xwzx/ztlm/xfbzdzjzfczl/fljd/956691/index.html> (last visited Jan. 28, 2018).

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active and passive bribery and also penalizes a corporate entity's failure to prevent bribery, while the Yates Memo of the US Department of Justice (DOJ) outlines the DOJ's renewed focus on finding individual liabilities in a bribery scheme in order to curb public bribery at its root. With the same enforcement objectives, the Amended AUCL imposes vicarious liability on the corporate entity whose staff member is found to have engaged in bribery, except where the corporate entity is able to avail itself of the statutorily provided defense under the Amended AUCL—to prove that the employee's conduct is not related to seeking transaction opportunities or competitive advantages for the corporate entity.

There is no requirement that the employer needs to expressly authorize or even have knowledge of the staff member's noncompliance. In practice, it would be difficult to separate what the employee does in relation to his or her trying to meet the sales targets or expectations set forth by his/her employer, the fulfilment of which, if done by the employee's paying bribes for the purpose of seeking transaction opportunities or competitive advantages, ultimately benefits the corporate entity. Under the Amended AUCL, as long as the corporate entity is unable to submit sufficient evidence to prove that the staff member's conduct is unrelated to seeking business opportunities or competitive advantage for the corporate entity, the corporate entity will be vicariously liable for the bribery act of the individual.

Although a defense is available under the Amended AUCL, the law does not provide any clear guidance as to how a corporate entity can meet its burden of proof. Recent statement in the media made by Hongcan Yang, Chief of Antitrust and Anti-Unfair Competition Bureau of SAIC, sheds light on the regulator's perspectives and is instructive: To prove that the employee's conduct is unrelated to seeking transaction opportunities or competitive advantages for the corporate entity, the corporate entity has to show that "it has already established compliance measures that are lawful, compliant with rules and regulations, and reasonable; that it has implemented effective measures to monitor noncompliance; and that it has not condoned or acquiesced covertly, in effect, the employee's act of bribery."⁶

The Amended AUCL imposes quasi-strict liability on corporations for failure to prevent bribery, which is a hallmark feature of the UK Bribery Act. The Amended AUCL also imposes vicarious liability and introduces a defense based on the argument that the corporate entity has implemented adequate compliance procedures to detect and prevent bribery, in addition to taking appropriate measures against individuals who commit an act of bribery. In sum, the Amended AUCL aims to incentivize the implementation of a robust compliance program the way that other regulators, e.g., the UK Serious Fraud Office (SFO) and the US DOJ, have also advocated.

While it remains to be seen how Chinese regulators will assess the sufficiency of a business operator's defense against vicarious liability, two immediate implications of this amendment are the need to conduct some or greater due diligence on job candidates to reduce the risk of hiring previously noncompliant individuals because their illegal conduct could trigger corporate liability, and to provide periodic compliance trainings to employees and anyone who acts on behalf of the business entity in a transaction, including but not limited to agents, dispatch workers, temporary workers or any third-party contractor that performs services for or on behalf of the corporate entity.

Book and records violation as an accounting issue as opposed to commercial bribery

Under the 1993 AUCL, a business operator may give the counterparty in a transaction a discount or pay an intermediary a commission in a way that is open and transparent. Both parties in the transaction are

⁶ Wu Nan, *Summary of Press Conference of Chief of Antitrust and Anti-Unfair Competition Bureau of SAIC*, China Industry and Commerce News, Nov. 9, 2017, available at http://www.saic.gov.cn/zw/zcfg/jd/201711/t20171109_270236.html (last visited Jan. 28, 2018).

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required to record the discount or commission accurately in their respective books and records. And any “off-the-books, covert kickback” is considered *per se* commercial bribery.

Under the Amended AUCL, the words “off-the-books, covert kickback” are deleted from the statutory language. While it is no longer considered *per se* commercial bribery, the regulators might still find a corrupt intent behind a rebate, if it is “off-the-books.” The amendment signals a departure from relying on a literal interpretation of the statute whereby a single factor—“off the books”—would often be sufficient for finding commercial bribery. It also reflects the regulators’ intent to adopt a more holistic approach to evaluate the totality of the circumstances surrounding an “off-the-books” transaction or part of a transaction to discern whether it can be attributed to a clerical error—for which the invocation of the accounting rules would be more appropriate than invoking the AUCL to find *per se* commercial bribery.

Enhanced enforcement authority and penalty for obstruction of justice

In the previous version of the AUCL, when investigating any suspected conduct involving unfair competition (including commercial bribery), the competent authority may (1) question the business operator under investigation, any interested parties and witnesses in accordance with the prescribed procedures and require them to provide evidence or other materials in relation to the suspected conduct; and (2) inquire into or make copies of any agreements, books and records, bills and invoices, documents, records, business correspondence, and other materials in relation to the suspected conduct.²

Article 13 of the Amended AUCL provides the government agency with enhanced enforcement authority to investigate any suspected conduct involving unfair competition (including commercial bribery), which includes (1) entering the business premises in relation to the suspected conduct; (2) questioning the business operator under investigation, any interested party, or any other related entity or individual, and requiring them to explain relevant situations or provide other materials in relation to the investigated conduct; (3) inquiring into or making copies of any agreements, books and records, bills and invoices, documents, records, business correspondence, and other materials in relation to the suspected conduct; (4) sealing up and/or seizing the financial property related to the suspected conduct; and (5) inquiring into the banking details of the business operator suspected of engaging in the activities.

Along with enhanced enforcement authority, Article 28 of the Amended AUCL provides the penalties for obstruction of justice in a regulatory investigation—i.e., up to 5,000 remnimbi (\$760) for individuals and up to 50,000 remnimbi (\$7,906) for corporate entities. Further, for the first time in the history of AUCL, the New Law mandates that the public security bureau may also exercise police power by imposing public security penalties on entities or individuals who resist or hinder a competent authority’s investigation, which include but are not limited to warning, fines, and administrative detention.

To ensure that the enhanced enforcement authority does not provide an opportunity for abuse of power, the Amended AUCL also stipulates additional procedural due process. It specifies that a written report must be submitted to the principal of the competent authority and be approved before any of the five measures can be undertaken. It further requires that a written report must be submitted to the district-level or above supervising and inspecting authority for approval before seizure of financial property or inspection of a business operator’s bank accounts can be conducted.

² Article 17(3) of the 1993 AUCL also authorizes the competent authority to inspect the financial property in relation to the suspected conduct of unfair competition provided in Article 5 of the 1993 AUCL (which is related to unfair use of trademark, corporate name, etc.), and, if necessary, order those business operators under investigation to explain the sources and quantities of the commodities concerned, to temporarily stop sales, to wait for inspection and not to transfer, conceal, or destroy such financial property. However, this measure does not apply to other conduct involving unfair competition such as commercial bribery.

Aggravated penalties

1. Increased administrative fines

Article 19 stipulates that the penalty for violation of Article 7 of the Amended AUCL (the Commercial Bribery Clause) could result in a penalty of 100,000 renminbi (\$15,813) to 3 million renminbi (\$474,390), which has been increased from 10,000 renminbi (\$1,581) to 200,000 renminbi (\$31,626), in addition to disgorgement of illegal gains.

2. Suspension or revocation of business license

While suspension of the business license has always been within the scope of the Administration of Industry and Commerce's authority, this is the first time that such penalty is codified in Article 19 of the Amended AUCL to explicitly empower the competent authorities to take such a drastic action against a violator and also put all business operators on notice that the consequences and costs of violation can be severe.

3. Negative impact on corporate entity's credit history and reputation

Article 26 of the Amended AUCL stipulates that business operators that are found to engage in unfair competition in violation of the Amended AUCL shall receive an administrative penalty; the competent authority shall also record the violation in the company's credit history, as well as publishing the violation in accordance with relevant laws and regulations (black list).

In the event that a company is found to have engaged in bribery, the potential penalties are not limited to financial damage. The enforcement action could also result in a disruption of business operations, reputational harm, costs of having to indemnify contractual parties for related damages, and/or triggering parallel enforcement across disciplines in China and in other jurisdictions. These penalties are expected to impact multinational companies that have global operations and may therefore be subject to parallel enforcement actions in other countries more significantly than domestic Chinese companies.

Best Practices in Light of the New Law

In sum, the Amended AUCL empowers the regulators with more enforcement authority and expanded repertoire of penalty measures, all of which augment the costs of noncompliance. Accordingly, multinational companies are advised to take or revisit the following steps to comply with the new requirements:

1. Conduct risk assessment to identify and address any sales practice or business operation that might create legal exposure to the company under the Amended AUCL
2. Consider making compliance inquiries in hiring employees or engaging a third party who is entrusted to act on behalf of the company, and consider reporting the employee's misconduct to the authorities so as to mitigate vicarious liabilities that might be triggered by an individual's noncompliant conduct
3. Strengthen internal controls and compliance program

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- (a) Review and revise corporate policies and procedures to meet both regulatory requirements and international standards
 - (b) Provide whistleblower protection and a reporting mechanism to proactively monitor and detect noncompliance
 - (c) Conduct timely and thorough internal investigations to collect evidence in order to invoke the defense provided by the Amended AUCL to avoid corporate liability
 - (d) Audit the company's accounting procedures and document retention practices to ensure compliance of both accounting and anti-bribery rules
 - (e) Conduct periodic gap analyses of the company's internal controls and third-party risk analyses
 - (f) Impose appropriate disciplinary actions against noncompliant employees to clearly demonstrate that the company does not condone noncompliance
 - (g) Manage third-party compliance risks by conducting due diligence
 - (h) Implement remedial measures to bridge the gaps in the company's policies and procedures and address weaknesses in compliance controls
4. Provide compliance training to management, employees, and third-party business partners
 5. Retain documentation of compliance trainings and other aspects of a robust compliance program

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