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Internal Controls, Ethics and Operational Compliance in China – The UK Bribery Act

When I first transferred to China from Hong Kong at the end of 1999, there was little or no discussion of compliance issues when dealing with clients who had operations in China. The priority for clients was to develop their business and to find a way through the maze of Chinese foreign investment regulations and laws. As was often the case, laws and regulations would differ from province to province and this made it challenging to provide detailed and accurate legal advice as the laws and regulations and procedures could change overnight. Chinese anti-bribery legislation was non-existent or was certainly not a priority for Chinese regulatory authorities whose mantra was to increase inward investment to China.

However, the last 18 months to 2 years has seen marked changes in the regulatory landscape for foreign invested companies operating here and especially for those investors who have originated from the United States and have head companies there. The FCPA has been around since the 1970's however it has been 2010 in which the activities of the FCPA and the SEC have taken on a new dimension. 2010 saw increased activity in the form of prosecutions and enforcement actions has seen fines totaling US$1.7 billion and an increasing need for companies who are looking to acquire businesses with US parents to engage in detailed FCPA focused M&A due diligence. Significantly, China began to figure more prominently in FCPA investigations as foreign direct investment increased especially in the western provinces.

Also, in 2010 whistleblower legislation was introduced in the United States increasing the need for head offices to conduct on-going corporate compliance audits of their operations in China. The tradition of gift giving, incentive payments and CNY year -end bonuses which are common in China and the use of third party agents means that companies walk a tightrope in balancing compliance and corporate governance obligations with the need to ensure that good governmental relations are maintained for the development of business.

With the advent of the UK equivalent of the FCPA, in 2011 in the form of the UK Bribery Act, the need for a General Manager/Director of local operations with a UK parent company to be pro-active in corporate compliance will also arise. The Bribery Act will come into force on 1st July 2011 which gives a limited time frame for companies to update and audit their present internal controls and compliance procedures.

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This article does not allow for a detailed analysis of the UK Bribery Act, but in summary the UK Act prohibits the giving of bribes or financial inducements to a third party whether a governmental official or a private individual. It also focuses on the act itself by defining an improper action as being the giving of a bribe or the taking of a bribe. The UK act's jurisdiction extends to UK nationals or UK residents and companies or organizations that are established in the UK or conduct some of their business in the UK. What is of more concern is that the UK Bribery Act's jurisdiction would extend to prosecution of the UK Head Company for bribery actions committed by its PRC subsidiaries which will cause sleepless nights for in-house counsel and the head company's board of directors. The penalties under the UK bribery act include up to 10 years imprisonment and potentially unlimited fines.

The UK Act also contains a new corporate offence of failing to prevent bribery by an "associated person" of the company. This could include employees, subsidiaries, agents, contractors and joint venture partners. The only defence in respect of an act of bribery which occurred is for the company to prove that it had "adequate procedures" to prevent the bribery.

The UK Ministry of Justice has published official guidance on the new Act which is divided into 6 principles or preparations that a company should put in place; to ensure compliance with the UK Act.

a) Proportionate Procedures

b) Top Level Statement of Commitment (of bribery prevention)

c) Risk Assessment

d) Due Diligence in respect of Third Parties

e) Communication and Training of Staff

f) Monitoring and Review Procedures

For companies not yet able to demonstrate detailed corporate governance procedures and internal compliance controls are in place for their China operations, time is running out as the UK Bribery Act will come into force in less than 3 months.

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The lesson for all companies conducting operations in China, irrespective of whether they are subsidiaries of US or UK headquartered companies is that a holistic and pre-emptive approach to compliance will need to be instituted as regulatory compliance is here to stay.

This will mean that there will be an increased need for specific on-going employee training to make staff aware what type of conduct is permissible and what is not. Companies will have to ensure that they have included specific terms in employee contracts to cover restraint of trade, trade secrets, bribery and financial inducement issues. Proper financial records will need to be kept detailing expenditure which is related to marketing and business development and internal compliance manuals will need to be updated and prepared which clearly spell out the limits of authority for each management position in an organization and the reporting requirements where suspected breaches of the compliance manuals are discovered.

These steps in the form of notices and signed undertakings should also be obtained from local third party suppliers who deal with the PRC subsidiary, so that they are fully aware of what conduct is not permissible and so that the company concerned can easily demonstrate that corporate governance procedures and record keeping systems are in place and that there is a detailed reporting system in place that can be brought into action to ensure vital documents and email records are kept and preserved if a suspected breach comes to light.

Where companies are also considering entering into joint ventures in China, they will need to spell out compliance obligations to their Chinese partners or insist that the Chinese side give certain specific undertaking in their joint venture agreements.

These compliance obligations will add to the already onerous tax and administrative obligations of a foreign invested enterprise doing business in China however as the recent Rio Tinto case demonstrates and the new US and UK legislation shows, the need for proper compliance training and procedures will only increase for companies doing business here.

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The author welcomes comments and is currently undertaking a number of compliance programs and audit for companies with operations in China. Any requests for further information can be sent to rkimber@rhklegal.cn

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