Tackling corruption: China’s recent investigation into multinational pharmaceutical companies

Over the past month, several large multinational pharmaceutical companies have made headlines in connection with the PRC authorities’ high-profile investigation into alleged corruption and other misconduct in China. The investigation represents the first serious PRC enforcement action involving alleged bribery by senior executives of multinational companies. In this Linklaters Alert, we recap the matters under investigation and explore how multinationals should respond to the increased enforcement environment.

The investigation

The Public Security Bureau in Changsha, Shanghai and Zhengzhou has reportedly been investigating GlaxoSmithKline (“GSK”) in connection with allegations of bribery and tax fraud since June. Certain GSK employees are accused of bribing government officials, pharmaceutical trade associations, hospitals and doctors with cash and gifts in return for favoring GSK products and using travel agencies and consultancies as intermediaries. The payments involved reportedly amount to RMB3 billion (approximately USD490 million). Four senior executives at GSK China (a legal counsel and head of compliance, a vice-president in charge of operations, a general manager in charge of commercial development, and a human resources director) have been detained and a fifth executive was temporarily banned from leaving China.

The PRC authorities’ investigation now appears to have widened to other drug companies operating in China. AstraZeneca has said the police visited its Shanghai office on a matter regarding a sales representative. UCB has also confirmed that its Shanghai office was recently visited by officials from the State Administration for Industry and Commerce (“SAIC”) to collect information on compliance.

Lessons learned

The PRC authorities’ ongoing investigation and actions offer a number of important reminders for multinational companies doing business in China. We examine some of the key lessons learned below.

Regulatory climate

The current investigation illustrates that the PRC government is becoming increasingly serious about anti-corruption and other regulatory enforcement. Since coming into office in November 2012, the nation’s new leadership has vowed to step up efforts to tackle corruption. The new leadership has also continued the country’s transition to a market-oriented economy, resulting in a shift in regulatory focus from “ex ante approvals” to “ex post regulation.” In addition, there have long been complaints and concerns over China’s healthcare sector which is plagued by insufficient capacity and rising medical fees. These factors have clearly contributed to the heightened enforcement environment in the
pharmaceutical industry, and we expect that the healthcare sector will continue to be an enforcement priority for the PRC authorities going forward.

However, the pharmaceutical industry is not the government’s sole focus. In an effort to increase overall regulatory enforcement, the government has targeted a wider range of sectors on a number of fronts. The National Development and Reform Commission (“NDRC”), China’s pricing regulatory agency, recently launched a survey of 60 pharmaceutical companies (including GSK) requesting information in relation to drug production and distribution costs with a view to better regulating drug pricing. The SAIC is currently investigating Tetra Pak for alleged abuse of market dominance. In June, the NDRC also launched an investigation into several international suppliers of infant formula in China in relation to pricing practices. Back in 2010, four employees of Rio Tinto China were arrested on suspicions of espionage and stealing state secrets from Chinese state-owned steel companies and later convicted. These cases send a clear signal to the international business community that the authorities are prepared to take regulatory action across a range of sectors and in relation to a wide variety of enforcement issues (for example, anti-corruption, anti-trust, industry-specific regulation, etc.).

Possible industry sweep

The fact that other international pharmaceutical companies were visited by and received inquiries from the Chinese authorities may suggest that the authorities perceive the alleged practices to be widespread. The current investigation may escalate into an extensive examination of the entire pharmaceutical sector. The likelihood of an industry sweep is increased by the fact that one travel agency apparently used by GSK as a channel for corrupt payments was reportedly also used by other multinational drug companies for event and conference arrangements.

Potential for cross-jurisdiction enforcement

Going forward, regulatory enforcement may be characterized by enhanced interplay and coordination (e.g., information exchange) between enforcement agencies in different jurisdictions. Interestingly, the pharmaceutical sector and health care industry at large have been a target for US regulatory enforcement in recent years. In July 2012, GSK reached a historic USD3 billion settlement with the US Department of Justice (“DOJ”) for health care fraud for which GSK plead guilty. While we are not aware of any regulatory cooperation between the Chinese and US authorities in this case, it appears the DOJ may have inspired the Chinese authorities to launch their own investigation into GSK’s sales practices. Conversely, the US and UK authorities may decide to take further action against GSK and others in light of the ongoing investigation in China. We understand that the Serious Fraud Office (the UK agency responsible for enforcing the Bribery Act) has been briefed on the allegations against GSK. The DOJ and Securities and Exchange Commission could also raise new allegations against GSK under the Foreign Corrupt Practices Act.

New challenges for compliance

Compliance work in China is far from routine. It has become more difficult and challenging as a result of the fast-changing regulatory environment and market dynamics. Unfortunately, GSK appears to have missed red flags despite seemingly vigorous compliance efforts prior to the investigation. GSK reportedly had conducted up to 20 internal audits in China, and just before the opening of the investigation announced that it had found no evidence of corruption or bribery in its China business following allegations raised by a whistleblower. This may indicate that the alleged perpetrators used a sophisticated scheme to conceal their wrongdoing. In any event, the GSK case is an important reminder to multinational companies of the need to guard against increasingly sophisticated forms of corruption and fraud and take steps to enhance their internal compliance procedures.
Conclusion
While China’s rapidly growing market remains an extremely attractive investment destination for multinational companies, the importance of establishing and maintaining an effective compliance system cannot be overstated. The GSK investigation is an important reminder of the need for multinationals to instill a zero tolerance culture in relation to corruption across their global operations and ensure that appropriate internal policies, training and audit procedures are effectively implemented. In an environment of enhanced PRC regulatory enforcement and increasing cooperation between regulatory authorities, compliance failures in one jurisdiction can potentially lead to criminal and civil liability in multiple jurisdictions and significant reputational damage. Establishing a robust compliance programme, including regular and thorough conduct of audits, will therefore be essential in securing long-term success in the Chinese market and beyond.

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