



Antibribery Crackdown Transforms Business Practices in China

Medical device manufacturers in China will benefit from efforts to integrate China into the global legal and business system.

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In China bribes are often offered and accepted for the sale and procurement of medical devices, pharmaceuticals, and other healthcare products. Managers of hospitals or clinics who accept bribes for using specific medical devices typically use them to the exclusion of other products. Doctors who accept bribes to buy, use, or recommend medical devices have been known to prescribe or even over-prescribe procedures using those devices. As a result, products supported by bribery sell more quickly and at a higher price than products for which lower or no bribes are paid, regardless of the devices' inherent value or effectiveness. The overall effect is that prices rise for all medical devices.

Problems such as those cited here are driving the Chinese government to eliminate bribery in relation to *cai wu* (literally, cash and valuables) or bribery by other means (e.g., tourism) by expanding efforts to make it harder to offer and accept bribes. This push is part of a general evolution of China's judicial concepts and legal system. This change is inseparable from China's business, cultural, and economic environment, as privatization and rapid economic growth require new judicial and cultural frameworks. Manufacturers of medical device and diagnostic products need to

become familiar with all the provisions of the new anti-bribery regime, so that they and their sales agents can ensure that their activities in China comply with these complex and demanding regulations and market requirements.

Bribes, Kickbacks, Theft

Bribery is a major worry for all multinational companies, of course. Integrity Interactive, which helps global corporations manage and reduce the risk of compliance failures, recently announced the results of its new annual study of the top 12 corporate compliance concerns expressed by global companies. According to the study, companies are putting greater focus on public compliance concerns in the world at large as they focus on preventing legal problems for themselves. The leading corporate ethics and compliance concern for 2009 was anti-bribery requirements. Understanding these requirements helps companies avoid the difficulties caused by investigation for charges relating to official corruption.¹

Given the growth of multinational business activity in China, it is unfortunate that bribery is pervasive there, and in-



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deed, it is a global problem not limited to China. In 2008 Ernst & Young conducted its 10th global fraud survey and interviewed 1186 business leaders in large organizations across 33 countries. The survey found that 23% of companies admitted their organizations had faced pressure to make illegal payments, while 18% said they had lost business to a competitor as a result of a bribe.² A study by the Carnegie Endowment in 2007 estimated that around 10% of Chinese government spending, contracts, and trans-

actions are used as bribes, kickbacks, or theft. Foreign firms also contribute to the problem.³ In the 2008 Corruption Perception Index by Berlin-based Transparency International, China scored 3.6 on a scale of 10 to 0, with a rating of zero indicating corruption is very intensive and rampant.⁴ The Chinese Communist Party Central Committee issued a 36-page policy paper in 2004 calling corruption "a life-and-death struggle" for the Party.⁵

Some people attribute the existing level of corruption to political reasons. Others take it as a matter of culture. To quote one recent academic study,

“[s]ome people hold the view that China’s corruption problems have their root deep in the Chinese culture. They argue that the Chinese people, as well as most of their counterparts in Asian countries, have a long tradition of placing personal connections above the law, and that this is the real source of corruption.”⁶ No matter what the reasons are, the problem cannot be cured very easily.

Under the crackdown governmental authorities are financially motivated to fight bribery. Each regional office of the Administration for Industry and Commerce (AIC), the central body that administers China’s companies and enterprises, is assigned an annual target for imposing and collecting anti-bribery fines. For example, according to a 2006 news report, Wuxi AIC, Chong’an Branch, has five subsidiaries and one economic examination team, or a total of six investigative units. Each unit was assigned the task of collecting as much as RMB 1 million (\$1460,000) in annual fines while the economic team was to collect as much as RMB 2.5 million in fines. Thus, the annual target totaled RMB 7.5 million for all six units. Chong’an Branch reached that mark in 2004 and exceeded it in 2005 by collecting RMB 8.4 million in fines, according to the report.

The government’s collection efforts continue to grow. In the first six months of 2006 alone Chong’an Branch took in fines totaling RMB 5.8 million.⁷ The financial incentive might give a falsely positive impression of the AIC’s efforts, but it does indicate the Chinese government’s long-standing drive to stamp out bribery.

Definitions Differ

Companies in China, whether foreign or domestic, risk running afoul of anti-bribery and corruption rules, according to a report by KMPG Forensic. “[W]ith the recession companies are having to fight harder than ever to win new contracts, and as a result there could be an increased pressure on those in the front line to override antibribery and corruption laws.”⁸ Adding to the difficulty is the uneven nature of law enforcement in China, as different governmental au-

thorities may have different opinions regarding what is bribery. Some definitions of bribery are either extremely harsh or difficult to understand.

The case of one medical clinic is a good example of this problem. The Yi Chang City Women and Infants Clinic, was investigated and fined for engaging in commercial bribery because of actions that might be allowed for nonprofits in other countries. The clinic, in proportion to the sale price of the pharmaceuticals it purchased from certain suppliers, took some donations of cash and an air conditioner from the suppliers in 1998 and 1999. The clinic accounted for the cash donation under the entry of “other revenue,” and the air conditioner under the entry of “fixed assets.” Yi Chang AIC determined that the clinic took a commercial bribe from the suppliers and fined it accordingly.

The clinic brought an administrative lawsuit against the Yi Chang AIC for its decision, which was upheld by the courts. The AIC and the courts determined that the clinic did not account for the donations appropriately. By entering the donations in their books as “other revenue” and “fixed assets,” the clinic did not account for donations to set off the costs of purchasing pharmaceuticals. To avoid the bribery conviction, the Yi Chang City Women and Infants Clinic should have accounted for the donations as discounts for the goods it purchased, or credited administrative expenses with the donations. Yi Chang AIC and the courts determined that by failing to take either of these actions the clinic was booking the donations “off the accounting book” and “secretly.” Therefore, the clinic should assume an administrative liability for taking a commercial bribe.⁹

Please bear it in mind that law enforcement in China is uneven. The case is just one example that indicates how the Yi Chang AIC and the court treated such a scenario. Regional AICs and courts of some other areas may have different determinations, which makes risk management a tougher job in China.

Differences in interpretation should

also be considered in the following discussion about the specifics of China’s new anti-bribery crackdown.

Centralized Systems Established

As discussed earlier, China’s central government and local governments are taking major steps in their efforts to curb bribery and reduce the prices of certain drugs. These steps include establishing online, centralized procurement systems and procedures in order to blacklist businesses that offer bribes and to punish doctors for taking bribes for purchasing or prescribing healthcare products.

In January 2009, several government agencies, including the Ministry of Health and the State Food and Drug Administration, issued jointly the Opinions on Strengthening the Centralized Procurement of Drugs by Medical Institutions. These rulings, which in practice encompass some medical devices as well, are intended to regulate the procurement processes of medical institutions, control unreasonably high prices, and regulate purchases and sales in order to restrict and prohibit commercial bribery and reduce the high cost of medical supplies. For example, Beijing Health Bureau required that the medical consumables be procured on a concentrated basis.¹⁰

Implementation of centralized, online medical procurement is under the direction of local government at the provincial level. Going forward, all not-for-profit medical institutions under governmental jurisdiction at the county level or above or all state-owned enterprises (including state holding enterprises), must participate in this centralized procurement process that, in principle, will be conducted once a year. All other medical institutions are also encouraged to participate.

The system features a procurement catalogue that will include, with some specified exemptions, almost all drugs and other medical products used by medical institutions. Listings in the catalogue are secured by means of public tendering and bidding, online auction, collective bargaining, and listing online. Medical

purchases that have been made collectively several times at consistent prices may be listed directly online. Products listed in the system will, in principle, be dispatched to medical institutions by manufacturers or trading enterprises, as authorized by manufacturers. Some experts in China estimate that the number of pharmaceutical companies will decrease by one-third as a direct result of the reform.

Bribery Blacklist

According to the “Rules Regarding Maintaining Records of Commercial Bribery in Medical Sales” issued by the Ministry of Health in 2007, each provincial health department must maintain and publish a “bribery blacklist” of manufacturers or traders of healthcare products. By law, medical institutions cannot purchase any medical products from blacklisted companies for two years. Companies are added to the list if they:

- Provide financial or other benefits to medical institutions or their representatives.
- Were convicted of bribery as a criminal offense.
- Were investigated and punished for bribery by the discipline supervision authorities.
- Attracted administrative punishment for bribery from the relevant authorities.
- Fulfilled other criteria as may be stipulated by provincial health administrative departments.

Local governments are implementing the blacklisting rules vigorously. For example, in November 11, 2009, the Fujian Provincial Department of Health published a list of six pharmaceutical and medical device companies from inside and outside the province that engaged in commercial bribery within Fujian. These six companies are restricted from participating in the Fujian bidding and tendering process for two years, and hospitals in the Fujian province may not procure any health care products from the blacklisted companies for two years.¹¹

Plugging Loopholes

Bribery may also expose the parties on both sides of the transaction to criminal liability. There are two categories

of criminal bribery in relation to individuals. Originally, only state employees could be found guilty of having accepted a bribe, but the law has been changed to include individuals not employed by the state. If the recipient of a bribe works for the state (for example, as a public official working in a state-owned enterprise), he or she would commit what is known as the crime of taking a bribe, which domestic Chinese lawyers usually refer as the crime of a state employee taking a bribe. If the recipient of a bribe does not work for the state, he or she would commit what is known as the crime of a nonstate employee taking a bribe. An example of a nonstate employee is a general manager who does not have the status of a public official and works in a privately owned Chinese enterprise or in a business that receives foreign investment. The distinction is significant because the punishment for state employees is much harsher than it is for nonstate workers.

It has long been debated whether a doctor not employed by the state could be criminally liable for committing the crime of a nonstate employee taking a bribe, because a doctor is more of an independent practitioner than an employee of a company or enterprise. In addition, some hospitals are not considered a company or enterprise in China but rather are not-for-profit organizations. To resolve these issues, in November 2008, the Supreme People’s Court and the Supreme People’s Prosecuting Institute jointly issued a judicial interpretation, “Opinions on Several Issues on Application of Laws on Handling Criminal Cases Regarding Commercial Bribery.”

This judicial interpretation holds that a doctor can be subject to criminal liability for taking a bribe for the purpose of prescribing healthcare products. The judicial interpretation also emphasizes that if the recipient of a bribe works in a medical facility that person can also be criminally liable. The specifics of the crime and penalty depend on whether the person charged is an employee of the state. What is clear is that the Chinese government is closing ambiguities in the law, making it increasingly difficult for doctors to accept bribes.

Criminal law prohibits anyone (both state employees and employees of businesses or enterprises) from taking advantage of his position to demand *cai wu* or receive *cai wu* in order to confer illegitimate benefits on the giver. The use of *cai wu* as a bribe is also prohibited under administrative law. *Cai wu* tends to consist of cash or valuables that are usually tangible. Previously, nontangible items, such as entertainment in the form of travel or events, were not considered to be *cai wu* or to be a means of bribery under the criminal law. The judicial interpretation has now changed the definition of what constitutes *cai wu* in this context, as the scope has broadened to cover “gifts” that are financially quantifiable and have rights of property. Such financial interests and rights include improvements to houses and apartments, membership cards with financial value, cash substitutes or coupons, and travel.

If a medical device company, or any other provider of healthcare products, pays for a doctor to take a vacation, that vacation may make both the company and the doctor criminally liable for bribery. Because judicial interpretations are applicable retrospectively, those who have engaged in activities that fall within the new definitions may face criminal investigations for their actions in the past. As a result, the exposure to compliance and risk to reputation has increased for companies and enterprises active in the medical products market in China.

Start of a New Era

Outlawing practices as engrained as *cai wu* and instituting a bribery blacklist mark the start of a new era for doing business in China. These actions indicate that China’s legal and regulatory system is fully capable of conforming and supporting established international norms of doing business. Medical device manufacturers that export to China, as well as their business agents in that country, will ultimately benefit from such efforts to integrate China into the global legal and business system. Any temporary disruptions in business strategies to accommodate such a change will be far outweighed by the positive impact of this integration process.

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