

## Section 8: Incentive or Bribe?

### China Cracks Down on Commercial Bribery

Government will focus on corruption in sales incentive programs.

#### Background

The Chinese government has intensified probes into commercial bribery in the private sector, with a particular focus on sales incentive programs, as part of its broader crackdown on corruption, which may result in increased risks for companies doing business in China.

Local bureaus of China's State Administration of Industry and Commerce (SAIC) enforce commercial bribery laws and investigate bribery cases. In recent months, the SAIC, through a series of enforcement actions, has targeted the tire manufacturing industry. Media reports also suggest that there may be some ongoing investigative activity in the healthcare sector.

The SAIC's recent investigations into commercial bribery and the resulting enforcement actions involving the tire manufacturing industry suggest the following:

Any benefits paid to distributors by manufacturers in addition to regular compensation with the intention of increasing sales or reducing competition may constitute commercial bribery under Chinese law.

Illegal "improper benefits" may include reward travel arranged by the manufacturer, incentive credits that can be exchanged for gift cards or other goods, shopping cards tied to a distributor's purchase volume, and direct rebates to distributors in the form of gift cards or gasoline cards.

When calculating illegal gains, Chinese regulators typically take into account sales revenue realised by distributors and retailers under the relevant improper incentive programs.

#### Recent Enforcement Actions

**Michelin (China) Investment Co., Ltd.** was found to have violated Chinese law by implementing a rebate scheme under which third-party distributors were awarded points for facilitating sales of Michelin tires. Distributors could use these points to redeem merchandise, including Amazon gift cards, from the Michelin Distributor Club website. Michelin China recorded the gift cards as "sales expenses" and did not issue any related invoices. The distributors were not required to, and did not, record their receipt of the gift cards in their books and records. Since the third-party distributors typically sold several tire brands other than Michelin, the SAIC found that Michelin China's scheme violated the Chinese Anti-Unfair Competition Law because it was improperly designed to increase sales revenue by squeezing out competitors. Additionally, the government found that the monetary value of the incentives was enough to adversely affect market order, thus constituting commercial bribery. Penalties included disgorgement of CNY18,442,865.44 and a fine of CNY160,000.

**Giti Tire Corporation** was found to have provided improper and illegal sales incentives to retailers in the form of travel tour programs. Giti invited distributors and retailers to participate in tours in Europe and Taiwan and covered all transportation, accommodation, and related travel costs through travel agencies. Government authorities ordered the disgorgement of illegal income in the amount of CNY10,459,508.08 and imposed a fine of CNY130,000.

**Bridgestone (China) Investment Co., Ltd.** was found to have made improper payments to distributors in order to encourage their facilitating tire sales. Bridgestone paid distributors who met or exceeded quarterly purchase targets with gift cards for an online shopping website. Bridgestone also promised to give retailers tour cards if they purchased 500 tires before a certain deadline. The SAIC investigation concluded that Bridgestone's incentive programs constituted commercial bribery in violation of Chinese law, and the SAIC imposed a disgorgement penalty of CNY17,395,026.49 and a fine of CNY150,000.

**Yokohama Tire Corporation** implemented an incentive program by which it agreed to pay distributors "golden tokens" as an award for facilitating sales of Yokohama tires. The distributors could exchange the tokens for online gift cards via the Yokohama website. Yokohama recorded the payments as "promotional and advertising fees." Government regulators imposed disgorgement penalties of CNY5,149,867.57 and a fine of CNY100,000.

**Kumho Tire Co., Ltd.** was found to have provided its distributors with rebates in the form of gas cards and online shopping gift cards. Kumho recorded these rebates as "promotional expenses." The SAIC deemed this practice to be commercial bribery and imposed a disgorgement penalty of CNY7,403,492.83 and a fine of CNY100,000.

#### Ongoing Investigative Activity

Chinese media reports suggest that there may also be some ongoing investigative activity in the healthcare sector. China Central Television reported on December 24, 2016 that there were doctors from Shanghai's Huashan Hospital at the centre of an anti-bribery investigation by government authorities for allegedly receiving monetary rebates from sales representatives of foreign pharmaceutical companies in return for prescribing medicines to boost sales volumes for the companies. On December 26, 2016, the Shanghai Health Bureau announced the results of its preliminary investigation: the misconduct was substantiated and the doctors involved were suspended. To date, the investigation and resulting punishment have focused solely on the physicians. It is still unknown whether the pharmaceutical companies and their representatives are or will be subject to investigation.

Because so many hospitals in China are fully or partially owned by the government, the Chinese authorities' focus on corrupt payments to physicians by foreign entities also raises issues under the US Foreign Corrupt Practices Act.

#### Going Forward

Corruption in China presents high risks for those businesses operating or planning to operate in the country. The Chinese government's anti-corruption initiative initially focused on bribery of public officials, but it has recently expanded to focus on graft in the private sector. In light of the aggressive crackdown on corruption and bribery, and the recent focus on commercial bribery, companies are advised to carefully consider the type and value of any incentives, gifts, or benefits provided to third-party distributors, agents, or consultants. Companies with existing incentive or benefits programs should consider conducting thorough reviews of such, including evaluations of the structure, implementation, and anti-corruption and anti-bribery compliance of such programs.

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