WHAT'S INSIDE

Executive Summary
PRC Legal and Regulatory Updates
Major Enforcement News
Pharmaceutical Industry Blacklist Update
Central Inspection Teams: What You Should Know Today
In the Numbers
EXECUTIVE SUMMARY

The Chinese regulatory enforcement landscape is still very active for the second quarter of 2015. In the absence of high-profile enforcement actions against Communist Party officials, Chinese authorities appear to be operating along the lines of a “new normal” where police enforcement and deployment of inspection teams by the Central Commission for Discipline Inspection (“CCDI”) are routine, on-going, and appear to be part of a new standard government initiative. The CCDI’s Central Inspection Teams, for example, have been carrying out several rounds of inspections focusing on central state-owned enterprises (“SOEs”). Additionally, based on our research, the CCDI has announced that 192 Chinese government officials were disciplined and/or investigated in this financial quarter alone. Also of significance, Chinese authorities are collaborating with foreign authorities and organizations including the Hong Kong Police, U.S. Federal Bureau of Investigations, International Criminal Police Organization (“INTERPOL”), and many others with increased success at repatriating suspected Chinese targets.

We are now starting to see in the market how this “new normal” is beginning to impact the business environment for companies operating in China both in terms of compliance and operations. Companies are increasingly taking more proactive positions when conducting reviews of business partners, key city or provincial-level contacts, as well as third-party relationships such as agents, suppliers and distributors. The increase in Chinese regulatory investigations is also resulting in increases in the number of whistleblower complaints including those from competitors and anonymous third-party tipsters.

The inspection of SOEs by the CCDI’s Central Inspection Teams is slated to continue as the government appears to be committed to take strengthened measures – whether through inspections, raids, audits, etc. – to protect the financial health of its state-owned assets and reel in waste due to misconduct and abuse of power across various levels of government and private-sectors. This is being seen as a necessity in numerous sectors within the market as many SOEs continued to be saddled with increasing debts and dwindling profits.

WHAT TO EXPECT IN Q3 AND BEYOND

On July 1, 2015, the Standing Committee of the National People’s Congress, China’s top legislature, approved the new national security law. Reaction to the new law from the business community as well as international responses are likely to dominate the third quarter of 2015. The new law covers a wide range of areas including the military, environment, religion, internet, wider social and economic issues, space exploration and more. We will provide an update on the new law in our Q3 2015 edition of the China Regulatory Enforcement Quarterly.

Several other notable developments from Q2 may serve as a prelude for what will come for Q3 and beyond including the launching of a corruption fighting smartphone app, strengthened food safety laws, as well as a major Chinese internet company self-reporting corrupt behavior of its employees to the Chinese police. These and other developments are covered in this edition of the China Regulatory Enforcement Quarterly.
This information is intended as a general overview and discussion of the subjects dealt with and is up-to-date as of July 1, 2015. However, laws and/or updates may have changed since this date. Some information contained in this report is based on media reports and public announcements, some of which may be considered secondary sources. This information is not legal advice, and should not be used as a substitute for taking legal advice in any specific situation. DLA Piper will accept no responsibility for any actions taken or not taken on the basis of this information.
Xi’an Administration for Industry and Commerce ("AIC") issues 2015 plan to fight commercial bribery

April 22 – The Xi’an AIC 2015 plan against commercial bribery requires all district AICs in Xi’an to investigate commercial bribery issues in the local market, especially with respect to construction projects, government procurement, consulting services, the travel industry, as well as the pharmaceuticals industry. At the same time, the Xi’an Bureau of Public Health is carrying out a three-year inspection of hospitals, focusing on commercial bribery, such as red envelopes (which often contain cash or cash-equivalent gift cards), rebates, and excessive prescriptions and/or medical treatment.

Amended food safety laws impose higher standards

April 24 – The amended Food Safety Law ("2015 Food Safety Law") was passed by the National People’s Congress Standing Committee ("NPC") and will come into effect on October 1, 2015. The 2015 Food Safety Law will impose stricter compliance standards and contains a number of new provisions covering online food retailers, special foods such as baby formula and health-related products, food safety examination and insurance, as well as a whistleblower mechanism. There are increased penalties including monetary fines and calculation of damages.

Guangzhou Transportation Commission requires certain third-parties to sign anti-commercial bribery agreement

May 8 – Effective May 8, the Guangzhou Transportation Commission now requires certain third-party contractors and suppliers that the Commission conducts business with to sign its anti-commercial bribery agreement ("AB Agreement"). The aim of the AB Agreement is to deter potential commercial bribery in the procurement of vehicles and parts, vehicle insurance, leases, and transportation-related construction projects. The AB Agreement applies to procurement contracts with a value of over CNY 100,000 (approx. USD 16,000), and in case of breach, a company can be put on a “blacklist” for a period of up to three years, preventing it from participating in future projects or bids.

Jiangsu People’s Procuratorate launches online bribery crime search platform

May 15 – According to the media, the Jiangsu province People’s Procuratorate launched China’s first online bribery crime records search platform. Applicants may submit search queries at the link: http://218.94.117.252:12301/ or via its official Wechat account. Within three business days, applicants will then receive a letter stating the Procuratorate’s search results. The letter will have the same legal effect as an official document issued by the Jiangsu province People’s Procuratorate.

Anti-corruption whistleblower mobile app now available for download

June 19 – The Central Commission for Discipline Inspection ("CCDI") announced two new whistleblower reporting channels -- an online message board and a downloadable mobile app for smartphones. The new whistleblower reporting channels receive tips in connection with corruption and abuse of public funds, particularly relating to the “Four Winds.” The “Four Winds,” as articulated by Xi Jinping, are “formalism, bureaucracy, hedonism, and waste.” Typical violations include using public funds to reimburse personal expenses such as entertainment, travel, personal use of public vehicles, and accepting gifts and cash and/or cash-equivalents in connection with a corrupt intent.
Nanjing mayor sentenced to 15 years for accepting bribes

April 7 – Ji Jianye, the former mayor of Nanjing of the Jiangsu province, was found guilty of accepting CNY 11.32 million (approx. USD 1.8 million) in bribes from 1999 through 2012. Ji was charged with corruption for inappropriately helping seven companies and individuals with obtaining contracts in connection with construction development projects and certain employment opportunities. Ji was sentenced to 15 years along with confiscation of CNY two million (approx. USD 325,000).

China’s “anti-corruption pioneer” jailed for corruption

April 9 – Liao Shaohua, the former party secretary of Zunyi Municipal Committee and member of Guizhou Provincial Standing Committee, was sentenced to 16 years along with confiscation of CNY 1.3 million (approx. USD 209,677) for abuse of power and accepting CNY 13.2 million (approx. USD 2.13 million) in bribes by the Xi’an Intermediate People’s Court. According to multiple sources, Liao’s case shocked the public because Liao used to be widely recognized as an “anti-corruption pioneer” by locals in Xi’an. Liao had been known to arrange anti-corruption campaigns and events including an educational program for prisoners.

Former SASAC director under criminal prosecution for corruption

April 13 – Jiang Jiemin, former director of the State-owned Assets Supervision and Administration Commission of the State Council (“SASAC”), which is responsible for managing and supervising SOEs and state-owned assets, was accused of accepting bribes, owning a large number of properties which were obtained illegally, and abuse of power. Jiang served as a top official in one of China’s largest state-owned petroleum groups before being appointed to SASAC. According to the indictment, Jiang abused his power by receiving bribes in exchange for various construction project contracts, employment opportunities and appointments in connection with his top official status at the state-owned petroleum group from 2004 to 2013. Jiang’s case is being heard by Hanjiang Intermediate Court of the Hubei province.

Major Chinese internet company self-reports to Chinese authorities regarding employee non-compliant behavior including bribes

April 14 – According to media reports, a major Chinese internet company voluntarily self-reported to the police after identifying suspected commercial bribery committed by its employees during an internal investigation. The company also emphasized its priorities for the investigation: commercial bribery, conflicts of interest, competition against the company, and illegal activities. The company further stated that any vendors or distributors who violate any of these four points would be put on the company’s blacklist and barred from any further cooperation.
Nearly 50 officials under investigation for corruption in connection with a major Chinese petroleum SOE

April 22 – According to news from CCDI’s website, the former general manager of a major Chinese petroleum SOE’s Hunan branch is under investigation. On April 13, a former senior executive of the same SOE stood trial at the Zhuhai Intermediate People’s Court on charges of bribery, embezzlement, and causing huge losses of public funds. In total, the media reported that nearly 50 officials from this SOE have been investigated by the CCDI to date.

Ex-security chief of China Zhou Yongkang sentenced to life imprisonment

June 11 – After a lengthy investigation, ex-security chief ZHOU Yongkang was sentenced to life imprisonment along with confiscation of personal property by the First Intermediate People’s Court of Tianjin for accepting bribes, abuse of power, and leaking state secrets. The court stated that ZHOU accepted bribes of around CNY 129 million (approx. USD 20.9 million.) ZHOU plead guilty at the trial and stated that he would not appeal the judgment.

Results of first round of SOE inspections released

June 19 – The central inspection team has completed the first round of inspections for 2015 focusing on 26 SOEs covering various industries including energy, machinery, manufacturing, construction investment, telecommunication, transportation, finance, media and publication. The first round of inspection was conducted from March to May of this year. An official report of the first round of inspections has been released on the CCDI official website. CCDI also announced the list of nine central units and 17 central SOEs which will be investigated during the second round of inspection which began on June 23. For more information about the central inspection team, please see our article “Central Inspections Teams: What You Should Know Today” for further details.

Former president of a major hospital in Yunnan investigated for accepting bribes

June 29 – According to the Yunnan Commission for Discipline Inspection, WANG Tianchao, the former president of the First People’s Hospital of Yunnan, was probed for accepting bribes from third-parties in connection with the hospital’s construction projects, procurement of drug and medical equipment, and nomination of doctors. WANG accepted bribes including cash for a total amount of CNY 45 million (approx. USD 7.3 million) and over 100 properties for a total value of CNY 84 million (approx. USD 13.6 million.) Wang also admitted receiving an additional CNY 1.5 million (approx. USD 243,000) in Cashe-equivalent gifts. The case is now under judicial review.

OVERSEAS REGULATIONS AND CROSS-BORDER COOPERATION

China and the United States strengthen cooperation on fugitive repatriation

April 11 – According to Chinese media, the United States has reached an agreement with China on simplifying the repatriation process of Chinese fugitive officials at large in the U.S. The media stated that U.S. Customs and Border Protection will cooperate with the Chinese Ministry of Public Security to verify the identities of Chinese citizens who apply for travel documents and coordinate charter flights for the transfer of high-level fugitives.

Australian company settles FCPA charges of USD 25 million in connection with 2008 Beijing Olympics

May 20 – An Australian mining company was charged USD 25 million by the U.S. Securities and Exchange Commission (“SEC”) for violating the FCPA when it sponsored the attendance of foreign government officials at the 2008 Beijing Olympics. The SEC investigation found that the company failed to devise and maintain sufficient internal controls over its global hospitality program in relation to the Beijing Olympics. Sponsored officials were primarily from countries in Africa and Asia and were in a position to help the company with its business or regulatory endeavors.

“Sky Net” repatriates top wanted Chinese fugitive officials from overseas

June 25 – Under the “Sky Net” campaign, Chinese authorities are collaborating with INTERPOL’s National Central Bureau for China which issued its top 100 wanted list of suspected fugitive Chinese officials who are at large overseas. As of June 25, the “Sky Net” campaign has successfully repatriated three top wanted Chinese fugitives from abroad. YANG Xiuzhu, who is the former chief of the Zhejiang Provincial Construction Bureau, is the most wanted fugitive on the list. She is currently on trial by the U.S. Immigration Court for visa violations.

Chinese Government/SOE Officials Under Investigation for Q2 2015

Based upon data published by the CCDI, the following visual map of China highlights the provinces which have been targeted the most during the second quarter of 2015. It is important to be aware of the status and trend of China’s anticorruption enforcement activities, especially when companies may have business interests in those targeted areas.
In 2007, the Ministry of Health (now a part of the National Health and Family Planning Commission or “NHFPC”) began documenting pharmaceutical companies that have committed commercial bribery offenses and “blacklisting” them so that their products are barred from entering public medical and/or healthcare institutions. On December 25, 2013, the NHFPC promulgated the “Measures of Recording Commercial Bribery of Pharmaceutical Companies” (“2013 Recording Measures”). After this national-level measure was released, provincial authorities and local governments issued implementation opinions to carry out the 2013 Recording Measures. Pursuant to the 2013 Recording Measures, any pharmaceutical enterprise and its agents who have committed commercial bribery and “other situations” regulated by laws may be put on a “blacklist” issued by the provincial authorities.

“Blacklisted” companies are subject to a number of sanctions. Their products (whether drugs and/or medical devices) could be barred from entering the relevant province’s public medical institutions or the province’s medical healthcare institutions receiving public funds for a period up to two years (essentially all public hospitals in that province.) They could also face reductions in scores when submitting their bids for procurement. If the company commits commercial bribery a second time within five years, its products can be barred for a period of up to two years across the country from entering all public medical institutions or medical healthcare institutions receiving public funds.

In addition to the ten companies on the provincial-level blacklists identified in our Q4 2014 quarterly, we have identified several new additions. For example, in the Hainan Province, the following eight pharmaceutical companies are blacklisted by Hainan HFPC due to commercial bribery:

1. Hainan Perlong Medical Equipment Co., Ltd. (海南普朗医疗器械有限公司)
2. Hainan Hao Jie Medical Equipment Co. Ltd. (海南豪杰医疗器械有限公司)
3. Hainan Sanjing Xinchangsheng Pharmaceutical Co., Ltd. (海南三精欣长盛药业有限公司)
4. Hainan Shuang Ge Medical Equipment Co., Ltd. (海南双鸽医疗器械有限公司)
5. Hainan Feng Yuan Pharmaceutical Co., Ltd. (海南丰元医药有限公司)
6. Hainan Li Qiang Pharmaceutical Co., Ltd. (海南力强医药有限公司)
7. Hainan Fei Li Pharmaceutical Co., Ltd. (海南飞利医药有限公司)
8. Hainan Zhen Yu Pharmaceutical Co., Ltd. (海南振誉药业有限公司)

Eight pharmaceutical companies were also blacklisted by the city of Bengbu HFPC (a city in the province of Anhui) for failure to reduce drug prices by 25% as requested by the government.

For further information regarding these blacklists, please contact DLA Piper.
CENTRAL INSPECTION TEAMS
WHAT YOU SHOULD KNOW TODAY

Recent high-profile anti-corruption cases in the banking, energy and gas, construction, infrastructure, and pharmaceutical sectors have put a spotlight on President Xi Jinping’s enforcement initiatives. At the heart of these concerns, multinational corporations and SOEs often ask the question: “Who is the Central Inspection Team going to investigate next?” This article briefly summarizes key information regarding the Central Inspection Team including recent enforcement news and analysis.

Introduction

While government anti-corruption investigations have been on-going in China since the 1990s, the Central Inspection Team (“CI Team”) as we presently understand it was formed in 2009. The inspection work by the CI Team began as a collaboration between the Organization Department and the Central Commission for Discipline Inspection ("CCDI"), the Chinese Communist Party’s ("CCP") anti-corruption watchdog. The CI Team reports to the Central Leading Group for Inspection Work, a coordination body under the CCP. Since President Xi became the general secretary of the CCP and the President of the country in late 2012, about a dozen inspection teams have been dispatched to various provinces, central government agencies, and SOEs to carry out inspection work.

The CI Team does not actually have the authority to conduct formal investigations or make detentions or arrests. Instead, corruption issues identified by the CI Team are passed on to the Organization Department or the CCDI for further investigation. After the inspection, the CI Team is required to submit an inspection report to the CCP coordination body and provide feedback from their inspection work to the inspected region and target. The CI Team’s feedback is published on the CCDI’s website and is available to the public.

Regulations which govern the way CI Teams conduct their inspection into potential corruption and CCP disciplinary issues may provide some insight:

- Learn from the reports from local party committees;
- Participate in party disciplinary meetings;
- Manage whistleblower letters, phone calls, and visits regarding issues of party members or officials;
- Organize forums to understand public opinions of local leaders;
- Communicate with individuals;
- Review relevant documents and records;
- Conduct surveys and evaluate the opinions of the public;
- Visit the local bureau or individual department; and
- Consult with other government departments to gain better understand of the issues.
**Inspections conducted in 2015**

In the first half of 2015, the CI Team inspected a broad range of targets with a particular focus on SOEs:

- During the first round of inspections, the energy sector which includes oil and gas, electric power, and coal mines attracted the most attention. The inspection period lasted from March to May 2015 and focused on 26 central SOEs.

- Other sectors subject to inspection in 2015 include machinery and manufacturing, construction investment, telecommunications, finance, and the media. Specific targets range from high-level officials, individuals and family members, both Chinese and foreign companies affiliated with the target companies, specific construction projects, and third-party vendors and partners.

- As a result of the inspections conducted to date, nearly 20 senior executives of the target SOEs were placed under investigation.

**Areas of risk**

Based on the inspection feedback provided by the CI Team in 2015 to date, there appears to be two scenarios which commonly give rise to potential corruption risk:

1. **Officials abusing their power in exchange for personal gains**

   Feedback from past inspection work outline instances where government officials would collude with contractors or suppliers in exchange for personal gains. Very few details are offered as to what abusive practices were involved and how these arrangements played out. The feedback only offers general examples of these practices, such as officials approving contracts in favor of specific suppliers or contractors in return for bribes in the form of money, securities, gifts, “red envelopes”, travel and/or entertainment, karaoke, massage, golf, etc. There are also instances of government officials offering up positions and/or certain promotions within the SOE in return for bribes.

2. **Abusive practices in tendering and bidding**

   SOEs are typically required to put certain procurement and construction projects above a certain threshold through a public tendering process. Another practice commonly cited by the CI team is the manipulation of the tendering process and the award of winning bids favored by corrupt officials. As such, public procurement and construction projects undertaken by SOEs are now the key areas of ongoing inspections by the CI Team. For companies that regularly participate in public tendering projects involving SOEs (whether directly or through local agents or distributors), it would be prudent to monitor closely the roles of any agents or distributors engaged to assist with the tendering and bidding process. By doing so, companies can proactively assess potential risks and take appropriate action before being unwittingly drawn into any inspections conducted by the CI Team.

**What’s next**

The second round of inspections began on June 23, 2015 and will continue to focus on central SOEs. The feedback from these inspections will likely be published by the CCDI before the end of the year.
**IN THE NUMBERS**

16
Number of additional companies identified on the HFPC “blacklists” in accordance to the 2013 Recording Measures. See *Pharmaceutical Blacklist Update* in this newsletter for further information.

37
According to media reports, a total of 37 high-level military officials are under investigation for corruption issues this year to date. This includes two former military commanders, KOU Tie and LIU Zhanqi, who were investigated by the military procuratorate for serious violations of discipline.

192
Number of Chinese government officials disciplined and/or investigated by the CCDI in the second quarter of 2015. This number is 12 fewer than the first quarter of 2015.

3,910,000
A food manufacturing company that is a supplier to one of the largest foreign fast food chain stores in China was fined CNY 3.91 million (approx. USD 635,000) for illegally discharging excessive water pollutants. The amount of the fine is the largest monetary penalty the Beijing Municipal Environmental Protection Bureau has ever issued.

256
According to the CCDI, the Ministry of Public Security’s (“MPS”) 2015 “Fox Hunt” operation has thus far been successful. The “Fox Hunt” operation has repatriated 256 fugitive economic crime suspects from over 30 overseas jurisdictions to date. As an example, the MPS Overseas Working Group cooperated with the Indonesian police to successfully repatriate six Chinese economic crime suspects from Indonesia.

11,390,000
SASAC spent CNY 11.39 million (approx. USD 1.85 million) to hire seven independent accounting firms to audit the overseas assets of several central SOEs. These actions may be part of a broader initiative of the Chinese government to strengthen the monitoring of SOE assets both domestically and abroad.

350,000,000
A major foreign automobile manufacturer was fined CNY 350 million (approx. USD 57 million) by the Jiangsu Price Bureau for price fixing in violation of PRC Anti-Monopoly Law. The amount of the fine is equivalent to 7% of the company’s 2014 sales revenue in China.
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