



CHINA REGULATORY ENFORCEMENT QUARTERLY

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Q3 – 2015 | www.dlapiper.com

EXECUTIVE SUMMARY

On August 12, a series of explosions in the northern port-city of Tianjin killed over one hundred people and injured hundreds of others. The explosions were allegedly caused by hazardous chemical materials in shipping containers stored at a warehouse owned by Tianjin Ruihai International Logistics Co. Ltd. ("**Ruihai Logistics**"), a firm which specializes in importing hazardous materials into China. The fires and subsequent damage caused by the explosions continued to rock the Binhai New Area of Tianjin for several days, including eight additional explosions occurring on August 15. Hundreds of residents of the Binhai New Area are still homeless, and many more are mourning over loved ones.

China's state media reported that Ruihai Logistics had used the political connections of its owners to circumvent safety regulations and inspections. For example, fire safety documents stated that the warehouse was a safe distance of 1,000 meters away from public buildings, when in fact it was less than 600 meters from a residential apartment complex. Various other allegations have been raised including potential violations of land, environmental, and safety certifications.

A formal investigation was launched by the Ministry of Public Security, directly reporting to Premier Li Keqiang at the central government level. 23 business executives, including officials at Tianjin's port and other local government authorities, had been arrested for their roles in the blasts.

In situations such as the Tianjin explosions, as well as the Chinese stock market meltdown which also occurred in Q3 of this year, the Chinese government has found itself responding to national crisis management issues where a rapid response pattern is beginning to form: 1) active management of public discourse and increased internet content controls, 2) rapid launch of an investigation including the detention and arrest of suspects, and 3) early strategic communications from central leaders regarding the central government's response, including an emphasis on its continued fight against corruption.

The Tianjin incident as well as the Chinese stock market meltdown, which is covered in further detail in this newsletter, are just part of the backdrop to China's regulatory enforcement landscape in Q3 2015. The finance, banking, and media sectors have come under fire as Chinese authorities attempt to restore investor confidence and prop up the sputtering Chinese economy. Additionally, we have seen an uptick in Chinese companies "self-reporting" bribery and corruption issues to authorities. This, along with President Xi Jinping's recent speech to U.S. technology companies in Seattle, emphasizing the government's continued commitment to control domestic internet operations, evidences the increasingly active role the Chinese government is playing, both proactively and reactively in order to deal with the significant regulatory challenges it is facing.

WHAT TO EXPECT IN Q4 2015 AND BEYOND

The Ninth Amendment to the PRC Criminal Law, which came into effect on November 1, 2015, is another strong indication that the central government will continue its push to crackdown on corruption.

The Central Commission for Discipline Inspection's Central Inspection Team ("**CI Team**") has recently completed its second round of inspections targeting nine central units and 17 central state-owned enterprises ("**SOEs**") in various industries including transportation, energy, aerospace, publication and travel. The CI Team will shortly commence its third round of inspections against another 31 SOEs and various government bureaus and agencies, targeting principally those bureaus and SOEs in the financial and insurance sectors.

We have highlighted in this newsletter several other new regulations and enforcement trends, including those relevant to the life sciences, food and beverage, internet, and advertising sectors. We hope you enjoy this edition of the China regulatory enforcement quarterly.



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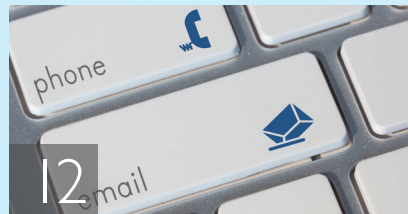
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PRC LEGAL AND REGULATORY UPDATES

China-France Extradition Treaty came into effect strengthening cooperation on fugitive repatriation

July 17 – The China-France Extradition Treaty (“**China-France Treaty**”) was ratified by the French Parliament and came into effect on July 17, 2015. The China-France Treaty now provides the legal basis for Chinese and French authorities to obtain mutual assistance in tracking down and extraditing fugitive suspects. While the China-France Treaty carves out several exceptions, its focus is on Chinese-nationals residing in France who have committed crimes in China.

First Amendment to the PRC Advertising Law focuses on pharmaceutical and medical devices companies

September 1 – The First Amendment to the PRC *Advertising Law* (“**First Amendment**”) came into effect, aiming to strengthen consumer protection and crackdown on fraudulent advertisements. There is a notable focus on pharmaceutical and medical devices companies including:

1. Prohibition against advertising for certain drugs, devices, medical treatment methods, etc. Additionally, certain prescription drugs are only allowed to be advertised on professional medical and/or pharmaceutical journals designated by authorized governmental departments.
2. Further guidance on language which may not appear in a drug or medical device advertisement including absolute assurances or guarantees of the product’s safety and efficacy, demonstration of its cure rate or efficacy, comparison of safety and efficacy with other competitors, and other information prohibited by law or regulation.
3. Prohibition against using a spokesperson (e.g. celebrity, doctor, sports star, etc.) to recommend and/or certify the product in advertisements.

4. Mass media (including broadcasting, TV, newspaper, audio and internet) cannot feature drug/device/medical service and health supplements in disguised forms, such as health-related education programs. Certain additional restrictions pertaining to advertisements directed towards minors are also outlined.

5. Wider range of sanctions and penalties include fines up to CNY 1,000,000 (approx. USD 161,000), together with the imposition of criminal liability and revocation of business licenses for serious infringements. Advertisement producers, publishers, and/or spokespersons, together with the advertisement owners could be jointly liable for fraudulent advertisement of products and services concerning consumers’ health.

Measures Concerning Unannounced Inspection on Drugs and Medical Devices came into effect in an effort to make inspections more transparent

September 1 – *The Measures Concerning Unannounced Inspection on Drugs and Medical Devices* (“**Inspection Measures**”) issued by the CFDA came into effect to further strengthen the investigatory and oversight process pertaining to safety risks associated with products sold by pharmaceutical and medical devices companies. The Inspection Measures emphasize a more transparent inspection process which include requirements for the government inspectors to present proper certificates and documentation. Any documents obtained during the inspection should also be properly recorded. Under the Inspection Measures, the authority may also publish the inspection results on its website or through the media so that the public is aware of the safety risks identified from its inspection.



A NEW ERA IN NATIONAL SECURITY?

The *National Security Law* (“**Security Law**”) was issued by China’s National People’s Congress Standing Committee on July 1, 2015 and came into effect on the same day. It sets out President Xi’s new national security vision for China. The Security Law is the end product of a series of legislative efforts on national security and is referenced by draft versions of the Counter-terrorism Law, the Foreign Non-governmental Organization Administration Law, the Cyber-security Law, as well as the Counter-espionage Law which was passed on November 1, 2014. The Security Law is a wide-sweeping reform of China’s national security laws and represents an expansion in scope covering more aspects of national and cyber-security than ever before.

Introduction

The Security Law contains 84 provisions covering a wide range of issues from politics, military, economics, natural resources, religion, food security, cyber-security, space exploration, etc. It outlines the obligations and rights of government organs, commercial and social entities as well as individuals in respect of national security matters. It also introduces a series of major measures that the State will take, including risk prevention, assessment and precaution, national security review and supervision, risk control, etc.

In the area of cyber-security and national security review, the Security Law highlights how pervasive state intervention will likely to be. It provides that:

1. The state should develop its ability to protect against cyber and information security risks, and ensure that core cyber information technology, information system and data in important infrastructure are secured and controllable.
2. The state should actively develop independent and controllable technologies in important sectors and key infrastructure. The state should also strengthen the use of intellectual property rights to protect domestic infrastructure and technology.

3. The state should set up a national security review and supervision system. The national security review should include foreign investment, key technologies, internet and information technology products and services, and other important activities that are likely to impact the national security of China.

Potential Impact on Multinational Companies (“MNCs”)

Challenges for technology companies: According to the Security Law, the state will prioritize the development of domestic “secured” and “controllable” technologies. This language may pose a concern to MNCs with foreign-sourced technologies who compete with domestic counterparts who may not have as many regulatory challenges and/or may be perceived as more “secure” or “controllable.” Although no specific rules have been implemented, MNCs in China could also face additional restrictions when their customers in China seek to purchase foreign-sourced technology products and services.

Challenges in the mergers and acquisitions context:

Although a “national security review” is stipulated in the PRC *Anti-Monopoly Law* and several other administrative regulations, the Security Law does not set out further guidelines as to the scope and procedures for such a review. It is likely that the government may issue future guidelines for carrying out the national security review, especially in the mergers and acquisitions context, in light of the broader security concerns raised in the Security Law.

Due to its recent enactment, the actual impact of the Security Law is still unknown at this stage. DLA Piper will continue to monitor the development in this area and update our clients accordingly.



EXPANDING THE SCOPE OF LIABILITY FOR CORRUPT PRACTICES

THE NINTH AMENDMENT TO PRC CRIMINAL LAW

The Ninth Amendment to the Criminal Law of the People's Republic of China ("**Amendment**") came into effect on November 1, 2015. The new revisions extend the scope of criminal liability under the PRC law and address many key issues that have emerged in recent years. Notably, the Amendment revised several anti-bribery provisions, mainly to impose harsher punishment on offenders who provide bribes. The Amendment also added several provisions concerning personal data protection.

The Amendment provides certain key revisions to the current PRC Criminal Law:

1. The Amendment introduces a new offense of offering bribes to the immediate relatives of State Work Personnel ("**SWPs**")¹ or individuals who have close relationship with SWPs. This offense also covers offering bribes to former SWPs, their immediate relatives, or individuals with whom they have close relationships.
2. Before the Amendment, monetary fines were usually imposed on entity offenders. Individual bribe givers would only be fined when they offer a large bribe amount to an employee of a company, a foreign party performing official duties, or an official of an international public organization. However, the Amendment has imposed criminal monetary fines against individual offenders regardless of circumstances. It has also imposed monetary fines on individuals in charge of entities involved in or directly responsible for the corrupt activities.
3. The Amendment has provided a more flexible and general sentencing criteria to replace the former standard of specific monetary amount. The new standards are divided into these categories: "relatively large," "large," or "extremely large" amounts. To date, no guidance or implementation measures explaining how these criteria will be applied have been issued.
4. Existing PRC Criminal Law provides that criminal penalties against bribe givers can be mitigated or exempted as long as the offender self-reports before the commencement of a prosecution. Under the Amendment, an offender who self-reports before the commencement of a prosecution will only be eligible for an exemption of punishment under specific circumstances such as the offense was relatively minor or the accused has provided information to authorities leading to the "successful investigation of a major case." Other than these special circumstances, the criminal penalties to be imposed on offenders who self-report will only be lessened but not eliminated.
5. The Amendment further stipulates certain restrictions on the entitlement to a reduction in sentencing where an individual convicted of embezzlement or accepting bribes is first sentenced to the death penalty.

¹ Chinese law defines SWPs as people who: (i) perform public services in the legislative, administrative, or judicial agencies or the military; (ii) perform public services in SOEs, institutions, or civil organizations; (iii) have been assigned by the government or SOEs to non-state-owned enterprises, institutions, or civil organizations to perform public services (e.g., a deputy general manager of a Sino-foreign joint venture company who has been sent to the JV by the Chinese party which is an SOE); or (iv) perform public services according to law. Public services refer to performing organization, leadership, supervision, management, and similar functions on behalf of state organs, SOEs, public institutions, and civil organizations. These are mainly public affairs functions connected with the authority and duties to supervise and manage state property.

6. Under the Amendment, individuals who commit crimes that take advantage of their professions or violate their professional obligations, may be barred from engaging in such professional activities for a period of between three to five years after the completion of criminal penalties or the expiration of parole.

At this stage, it is not clear as to how the changes brought by the Amendment will be enforced and applied by Chinese authorities. The new offense of offering bribes to individuals who have a close relationship with an SWP or a former SWP, however, does pose further potential compliance issues for companies operating in China. It will almost certainly mean that the scope of any due diligence review of potential transactions, such as the review of potential joint ventures and other business partners, will need to be

updated to take into account of potential risks arising from any relevant "close relationships" with SWPs. Further, given the highly discretionary nature of how the law is interpreted and enforced in China, there is no guarantee that the individuals involved might be exempted from punishment by self-reporting to the authorities before a prosecution commences. Those considering whether or not to take advantage of the newly amended self-report provision should first consider all the factual circumstances of any potential offense – how serious are the circumstances surrounding the case in question? If the facts involved reveal a potentially serious offense, then greater care should be exercised in assessing how useful the information at hand will be to the authorities and whether the facts to be confessed are already known to the authorities.





MAJOR ENFORCEMENT NEWS

Major Chinese commercial real estate conglomerate self-reports potential bribery violation to the judicial department

July 10 – According to media sources, a leading Chinese commercial real estate conglomerate conducted an internal investigation regarding certain bribery allegations. The investigation identified 18 employees who allegedly sought personal benefits by abusing their position of power and authority in the company. Two employees were suspected of receiving an undisclosed large sum of bribes from several construction companies. The real estate company subsequently self-reported to the judicial department relevant authorities regarding the findings and mitigation actions taken by the company.

LING Jihua, aide to former President HU Jintao, arrested and accused of bribery allegations

July 20 – LING Jihua, head of the Communist Party's United Front Work Department and deputy chairman of the Chinese People's Political Consultation Conference was investigated by the Supreme People's Procuratorate (China's top prosecuting body) for multiple allegations, including abusing his position and accepting large sums of bribes either directly or indirectly via his relatives. LING had been expelled from the Communist Party earlier for violating Party discipline, paving the way for the subsequent investigation.

Military procurement continues to be a focus for bribery crackdown with top military officials arrested

July 30 – GUO Boxiong, former vice chairman of China's Central Military Commission, was expelled from the Communist Party and is currently under investigation by the Chinese authorities for bribery allegations. GUO's responsibilities included administering defense expenditures

and assets. Another top military official named GU Junshan, who was the deputy director of the People's Liberation Army General Logistics Department, was found guilty of accepting bribes and was sentenced to death with a two-year suspended sentence. GU was mainly in charge of military procurement and contracts. According to various news articles, GU allegedly accepted 6% kickbacks in the sale of military land totaling CNY 2 billion (approx. USD 330 million) in the Shanghai area. Since GU was tried before the military court, specific facts of the parties involved were not disclosed to the public.

Chairman of a major chemical engineering company was found guilty of offering bribes

August 5 – The chairman of a Hong Kong listed chemical engineering company was found guilty of offering bribes by a Chinese court. The court imposed a fine of CNY 30 million (approx. USD 4.83 million) on the company and the chairman was sentenced to imprisonment for three years. The main customer of the company is one of China's largest state-owned petroleum groups and the investigation into the company was allegedly related to the previous investigation of the state-owned petroleum group. Several reputable Chinese and foreign media sources have speculated that ZHOU Bin, the son of ZHOU Yongkang, may have secretly been a shareholder of the chemical engineering company and the company may have took advantage of ZHOU Yongkang's government connections to gain commercial contracts.

“Sky Net” continues to repatriate top wanted Chinese fugitive officials from overseas

As of September 18, YANG Jinjun, the most wanted fugitive on Sky Net's 100 Most Wanted List and the brother of YANG XiuZhu (former chief of the Zhejiang Province Construction Bureau), was successfully repatriated from the

United States. Chinese media sources reported that YANG was the first wanted fugitive successfully repatriated with assistance from U.S. enforcement authorities.

“Sky Net” is a multi-agency operation involving the collaboration of four Chinese government agencies/organs: Organization Department of the Communist Party of China’s Central Committee, Supreme People’s Procuratorate, Ministry of Public Security, and the People’s Bank of China.

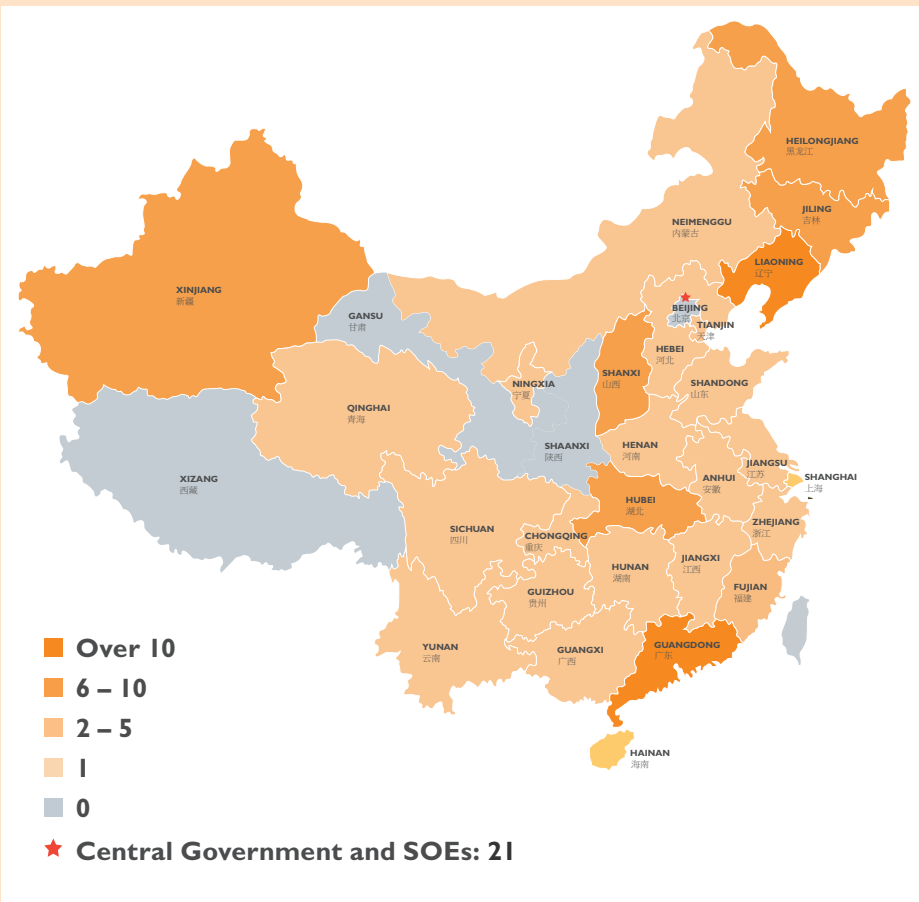
President XI Jinping emphasizes cyber-security during visit to the U.S.

September 23 – During the Eighth Sino-U.S. Internet Industry Forum held in Seattle, U.S., President XI gave a speech to a group of American and Chinese technology

company executives addressing China’s concerns regarding cyber-security and emphasized that China is committed to improving internet security. According to media sources, the China Internet Security Certification Center distributed a document to multiple U.S. technology companies and requested them to comply with Chinese national security regulations. The document also stated that Chinese authorities may request that companies turn over their user data and intellectual property to demonstrate that the company does not and will not in the future possess data that is harmful to China’s national security. For further information on the new National Security Law, please see the “A New Era in National Security?” located in this newsletter.

Chinese government/SOE officials under investigation for Q3 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 third 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.



Notable individuals put under investigation in Q3 include:

- LING Zhengce, Former Vice Chairman of Shanxi People’s Political Consultative Conference;
- ZHOU Benshun, Secretary of Hebei Provincial Party Committee and Chairman of the Standing Committee of Hebei Provincial People’s Congress;
- GU Chunli, Vice-Governor of Jilin;
- DENG Qilin, Former Chairman and Party Committee Secretary of Wuhan Iron and Steel; and
- XI Xiaoming, Vice-President and Party Group Member of the Supreme People’s Court.

OVERSEAS REGULATORS

Manufacturer of infant formula settles FCPA charges with U.S. SEC and agrees to pay USD 12 million for making improper payments to health care professionals at Chinese hospitals

July 28 – One of the world's largest manufacturers of infant formula agreed to pay USD 12 million to settle Foreign Corrupt Practices Act (“**FCPA**”) charges brought by the U.S. Securities and Exchange Commission (“**SEC**”). It was found that the company violated the FCPA by making improper payments through third-party distributors to healthcare professionals at Chinese government-owned hospitals in an effort to recommend the company's infant formula to new or expectant mothers. The investigation also found that the company lacked sufficient internal controls to prevent and detect approximately USD 2 million in improper payments out of its Chinese subsidiary. The company had been using off-the-book slush funds to pay doctors and other healthcare professionals in China for the purpose of retaining business.

U.S. DOJ issues memorandum concerning individual accountability for corporate wrongdoing

September 9 – A memorandum written by the U.S. Department of Justice's (“**DOJ**”) deputy attorney general titled “individual accountability for corporate wrongdoing” (“**Yates Memo**”) shifts DOJ's investigative approach from corporations to individuals. The Yates Memo states that “one of the most effective ways to combat corporate misconduct is by seeking accountability from individuals who perpetrated the wrongdoing.” The Yates Memo indicates six key steps to strengthen the pursuit of individual corporate wrongdoers:

1. in order to qualify for any cooperation credit, corporations must provide to the DOJ all relevant facts relating to the individuals responsible for the misconduct;
2. criminal and civil corporate investigations should focus on individuals from the inception of the investigation;
3. criminal and civil attorneys handling corporate investigations should be in routine communication with one another;

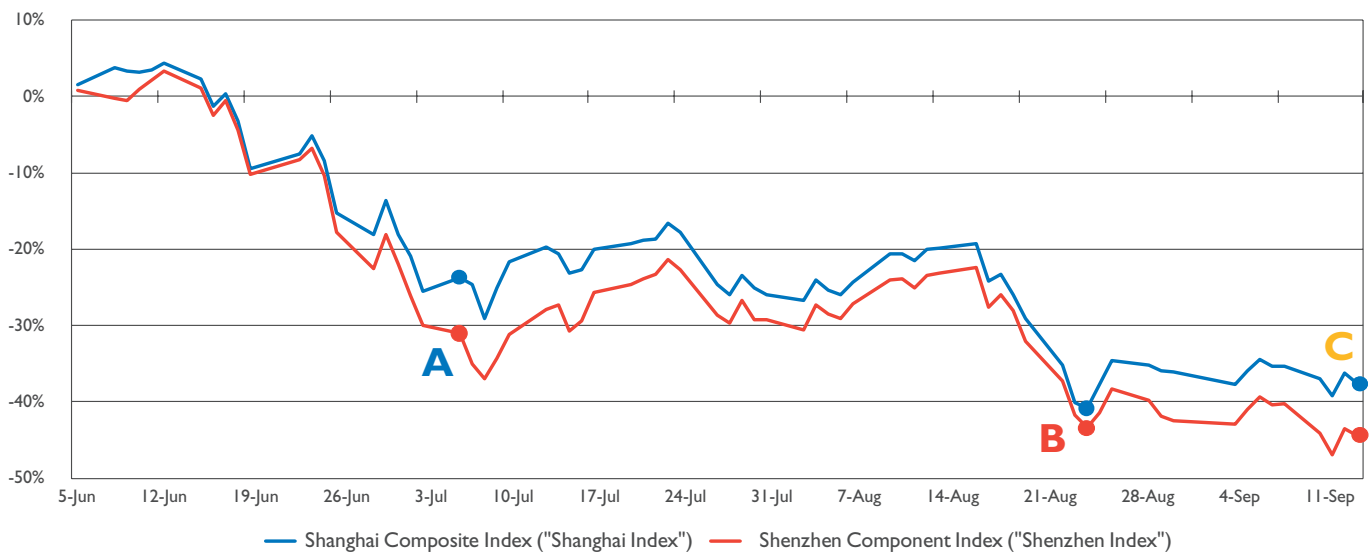
4. absent extraordinary circumstances or approved departmental policy, the DOJ will not release culpable individuals from civil or criminal liability when resolving a matter with a corporation;
5. DOJ attorneys should not resolve matters with a corporation without a clear plan to resolve related individual cases, and should memorialize any declinations as to individuals in such cases; and
6. civil attorneys should consistently focus on individuals as well as the company and evaluate whether to bring suit against an individual based on considerations beyond that individual's ability to pay.

A full version of the Yates Memo could be found at the U.S. DOJ website.

SEC announced fraud charges in cross-border scheme to secretly control and manipulate stock of U.S.-listed Chinese companies

September 10 - The SEC announced fraud charges against a Wall Street CEO and his company, family members, and business associates accused of secretly obtaining control and manipulating the stock of Chinese companies they were purportedly guiding through the process of raising capital and becoming publicly-traded in the United States. The SEC alleged that the individuals involved secretly obtained more than five percent ownership interests of newly U.S.-listed companies for the purpose of manipulating the stock of the Chinese companies and deriving illegal gains. To avoid detection and evade SEC reporting requirements as beneficial owners, they divided their shares among a vast network of foreign accounts and generated tens of millions of dollars in illegal profits as they sold the securities into artificially inflated markets. The SEC's complaint alleged violations of the antifraud provisions and the disclosure and reporting provisions of the U.S. federal securities laws or the aiding and abetting thereof.

REGULATORY TIMELINE OF THE CHINESE STOCK MARKET CRASH



A

July 4 – The China Securities Regulatory Commission (“**CSRC**”) organizes a meeting with 21 major brokerage firms. At the conclusion of the meeting, the 21 major brokerage firms published a joint announcement on the website of the China Securities Association agreeing to the following: 1) to set up a fund worth at least CNY 120 billion (approx. USD 19.4 billion) to purchase shares of large, well-established and financially sound companies (blue-chip shares); 2) cease selling shares from their own companies; and 3) repurchase shares from their own companies. Meanwhile, the Shanghai and Shenzhen stock markets are put on hold regarding all future and pending IPOs in an attempt to stabilize the market.

July 8 – CSRC issued a notice restricting major shareholders, executives and directors from selling their shares in listed companies for six months in order to stabilize the stock market. This notice was effective immediately on the day of the announcement.

July 9 – The Ministry of Public Security (“**MPS**”) and CSRC announced a joint investigation on illegal securities trades and conducted a series of investigations into the stock market crackdown.

B

August 25 – According to media sources, multiple CSRC officials, senior executives of a top-tier Chinese investment bank, and a journalist were arrested for suspected violations in connection with the recent stock market crackdown.

- LIU Shufan, an official within the CSRC, was accused of bribery, fraud, and insider trading.
- Employees of a major Chinese brokerage firm, including the company’s managing director and three other directors were put under investigation.
- A journalist of a well-known Chinese financial magazine was arrested for suspected violations of colluding with other undisclosed persons in fabricating and spreading false information regarding future securities markets.

August 28 – The CSRC reports on its website that 22 suspected criminal cases have been transferred to the MPS for further investigation. These 22 cases are primarily related to criminal offenses such as manipulation of the stock market, insider trading, fabrication and spreading of false information, and other crimes relating to illegal business operations.

C

September 16 – ZHANG Yujun, the former assistant chairman of the CSRC, was put under investigation for suspected serious disciplinary violations.

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