

Integrity and Compliance with the Law

A Guide to the Prevention of Corruption for SME Entrepreneurs Investing in Guangdong and Hong Kong





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Preface

Since China entered the World Trade Organization, the Central People's Government has continued with its policies of economic reform and liberalization. Among the new measures that have been introduced are the "Mainland and Hong Kong Closer Economic Partnership Arrangement" (frequently referred to as "CEPA"), the "Pan-Pearl River Delta Regional Cooperation Framework Agreement", and the 11th Five-year Plan. All of these initiatives have provided an open platform that has promoted greater economic integration between the Mainland and Hong Kong.

Driven by economic globalization, cross-boundary business between Guangdong and Hong Kong is now flourishing, and the Pan-Pearl River Delta and Hong Kong have already become an inseparable economic entity in Southern China. Among the great advantages of this area is the fact that it supports both a strong manufacturing base and an efficient trade and services centre for businesspeople.

The Mainland is one of Hong Kong's largest external investors. Official statistics show that the Mainland's direct investments in Hong Kong now exceed US\$163 billion, and that more than 2,000 Chinese enterprises have elected to operate in Hong Kong in order to forge worldwide links and further develop addressable international markets. At the same time, Hong Kong's enterprises make up the largest group of external investors on the Mainland, with current accumulated investments exceeding US\$273 billion. This in fact accounts for nearly 40 percent of foreign direct investments on the Mainland. Guangdong, especially the Pearl River Delta Region — "the world's factory" — is Hong Kong's closest economic partner. At present, some 80,000 Hong Kong companies — mainly small and medium enterprises (SMEs) — are operating in the Pearl River Delta, and they employ around 11 million local staff.

The three elements that have proved essential in attracting investment are respect for the rule of law, the promotion of integrity, and the maintenance of fair competition. Given the degree of disparity between the legal systems of the Mainland and Hong Kong, the Guangdong Provincial People's Procuratorate (GDPP) and the Independent Commission Against Corruption (ICAC) in Hong Kong joined forces in 1995 and 1998 to publish *Observing the Law: a guide for businessmen in Guangdong and Hong Kong*. This has been very helpful in briefing cross-boundary investors on anti-corruption and anti-bribery laws and has done much to encourage them to comply with these laws.

During the past decade, trade and investments on the Mainland and Hong Kong have repeatedly reached new heights, and the Central People's Government has continued to fight vigorously against corruption and bribery. At the same time, the various regulations related to the crimes of corruption and bribery have been subjected to considerable amendment, and the monitoring of State officials which is enshrined in the *Criminal Law of the People's Republic of China* has been tightened up. There is thus a growing need for Hong Kong's SMEs to understand the very latest developments in anti-corruption laws and related policies in both jurisdictions if they are to avoid breaching these laws. At the same time, Mainland people doing business in Hong Kong also need to understand the *Prevention of Bribery Ordinance* and exactly what it has to say about public servants and employees of private organizations providing, soliciting and accepting advantages. Such an understanding will assist the vast majority of businesspeople to observe the law and also protect their own legitimate rights.

The GDPP and the ICAC have therefore collaborated again in the present publication, *Integrity and Compliance with the Law: a guide to the prevention of corruption for SME entrepreneurs investing in Guangdong and Hong Kong*. The intended readership is SMEs with cross-boundary businesses in Guangdong and Hong Kong.

The scope and nature of business ethics is well understood wherever international businesspeople meet. If SMEs wish to successfully and safely explore the international market, they need to boost their integrity capital and comply with all relevant standards of trade and commerce. It will be seen that the guidelines presented in this new handbook thus include far more information than did the previous guide on how good management practices can help prevent corruption and bribery.

The guide comprises four parts. Part 1 — “Knowing and Abiding by the Law” — briefly explains the provisions and spirit of the anti-corruption laws in Hong Kong and the Mainland. The case studies presented help readers understand the key points of law that are involved. Part 2 — “Knowing Ourselves and Knowing Others” — helps people running cross-boundary businesses assess how effective their enterprises are in lessening the risk of corruption and bribery. It also provides them with a very handy reference on how to apply for licences or approvals from Government departments, as well as charting the principles that lie behind the entering into written agreements with business partners and adopting legal channels to resolve business disputes. Part 3 — “Putting Corruption Prevention into Practice” — again uses case studies to describe the internal management problems faced by many SMEs and provides a wealth of suggestions on how to prevent corruption. Part 4 — “Easy to Know and Easy to Practise” — describes anti-corruption and anti-bribery efforts in Guangdong and Hong Kong, as well as giving contact information about the Hong Kong Government, the Guangdong Provincial Government and related supporting organizations, together with frequently asked questions and answers.

Since 1987, the GDPP and the ICAC have been working together on the operational front under the Mutual Case Assistance Scheme. Their joint compilation of this guide thus marks more than 20 years of close cooperation in combating corruption. It is our earnest hope that the information and guidance that these pages contain will help SMEs who are carrying out or planning cross-boundary business successfully fight corruption and firmly uphold the integrity of all their business operations.

Guangdong Provincial People's Procuratorate
Independent Commission Against Corruption,
Hong Kong Special Administrative Region
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Introduction

Safeguarding stakeholders' interests

This guide provides SMEs engaged in cross-boundary business in Guangdong and Hong Kong with information on how best they can act to prevent corruption and conduct their business affairs with integrity. We trust that this will help businesspeople avoid unnecessary disputes and lawsuits as well as clear breaches of the anti-corruption and anti-bribery laws of both jurisdictions.

Putting integrity management into practice

SMEs can further use the guide to put integrity management proactively into practice. The underlying spirit and concepts include:

- Businesspeople should be fully alert to the prevailing culture and customs of the places where they are investing, complying with local market regulations and operating their businesses strictly according to the law.
- Enterprises should establish a system of integrity governance to win the trust of shareholders, business partners, clients, employees and creditors. This will aid their robust long-term development, and ultimately help them raise capital or go public if that is indeed their intention.
- Companies should establish an integrity based personnel management system for both recruitment and effective team building. This will both boost staff loyalty and also attract superior talents. Training should therefore include education in professional ethics as well as job related knowhow and skills.
- Enterprise leaders should promote a corporate culture of integrity, and should themselves set a good example. They must avoid conflicts of interest, accept responsibilities, improve the company's management system, carry out effective monitoring, and raise the capacity of their early warning systems. Such measures will strengthen the company's reputation by reducing operating costs as well as lessening the risk of corruption and bribery.

Reader friendly style and presentation

This guide uses everyday language and seeks to avoid difficult or complex legal terminology. Extracts from relevant anti-corruption and anti-bribery laws that are mentioned have been placed in appendices for easy reference. While some provisions of the laws and regulations mentioned are not directly related to corruption or bribery, they remain at the heart of all lawful business transactions, and so are briefly introduced with their main clauses highlighted. To enable the reader to track any updates to laws and regulations, Websites where the original and updated text may be found are also cited.

Illustrative case studies

The guide includes specially prepared case studies showing how and why SMEs can become entangled in corruption, bribery or ethical dilemmas. We trust that these studies will be particularly effective in illustrating and explaining legal provisions and in highlighting the importance of managing staff integrity. Most of these studies have been adapted from actual cases, but the names of the individuals involved have been changed. Any use of the given name of an actual person is purely coincidental. Companies are referred to as “Company A”, “Company B”, and so on.

Enhancing management skills

The case studies in Chapter 6 go right to the heart of the management skills involved in detecting signs of corruption and bribery. This chapter details how managers can learn to take appropriate corruption prevention measures and develop the skills needed to manage staff integrity. Such measures are highly likely to prove effective in protecting the legal rights and interests of businesspeople. Furthermore, they will help entrepreneurs control the serious risks likely to arise if the continuous enhancement of management skills is neglected.

The guide as a reference source

This guide sets out to provide general advice only and does not cover all possible scenarios. The legal explanations offered are broad and often in summary form — in no way are they a substitute for the original laws or legal opinions. The reader should further note that no official English translation exists for many of the Mainland laws and statutes referred to. In such cases, we have offered a literal translation which is as accurate as possible, but we strongly recommend the reader to consult the original version in Chinese in order to clarify the intent and force of these provisions. Legal advice should be sought whenever necessary.

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Case Studies

The following case studies are adapted from real cases, but the names of all persons and companies are fictitious. These cases illustrate the major points of law under the PBO and other related regulations and are for reference only.

Case 1

Charlie started a joint venture with three other friends in his early years. Together they set up a chemical engineering company in Hong Kong, and a chemical manufacturing factory in Guangdong. Each of them held 25 percent of the shares in the company in their capacity as company directors.

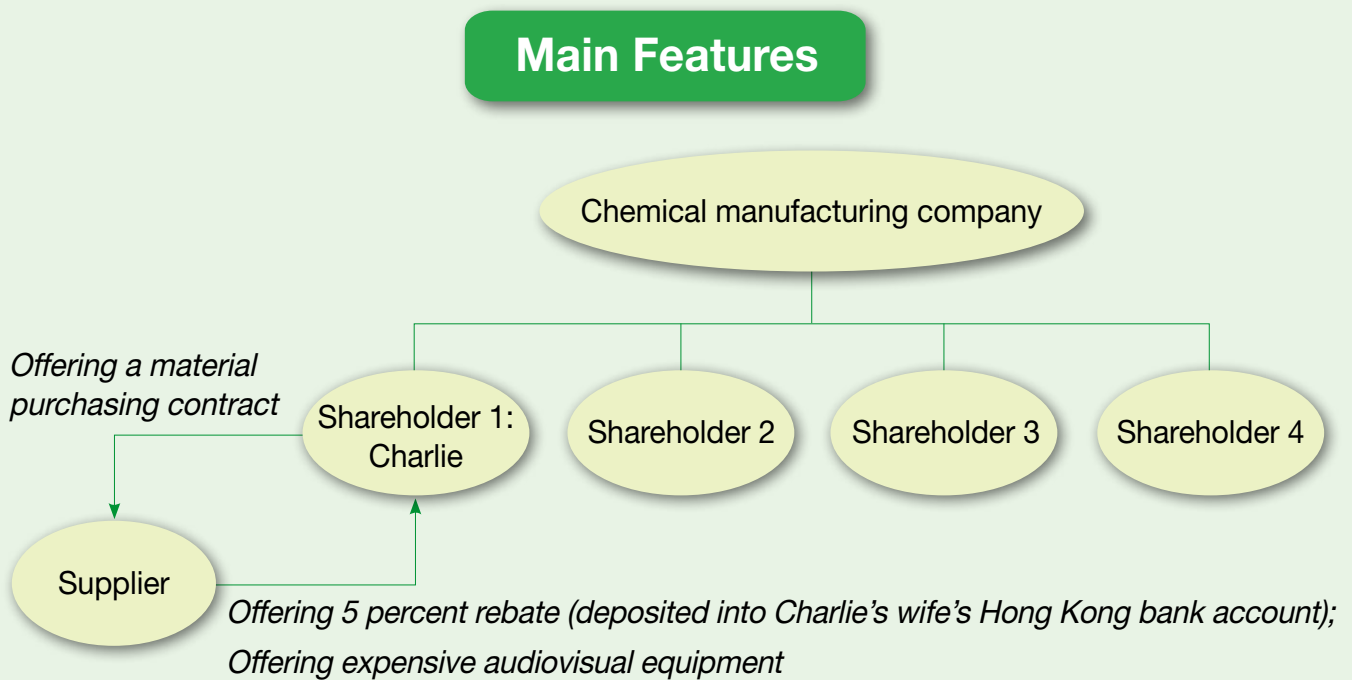
As Charlie had already gained substantial experience in operating Mainland factories and had developed an extensive business network in Hong Kong and the Mainland, especially with Mainland suppliers and Government officials, he offered to manage the Mainland factory. Already a shareholder, he was now receiving a salary as the factory's general manager and manager of Mainland business.

Charlie often boasted that the success of the Mainland factory was due to his networking clout. At the same time, he would frequently grumble to his partners about having to foot so many large entertainment bills at his personal expense.

As the manager of the Mainland factory, Charlie was entrusted with procurement decisions. When one of his Hong Kong suppliers learned that Charlie had recently bought a property on the Mainland, he presented Charlie with an expensive audiovisual set-up, hoping that this gift would secure a contract for the supply of chemical raw materials. This seemingly thoughtful present soon brought its reward in the form of a first order from Charlie. At Charlie's request, the supplier agreed to offer a rebate amounting to 5 percent of the transaction in order to secure future business. Subsequently, the money was deposited into a bank account in Hong Kong in the name of Charlie's wife.

The case was brought to the attention of the ICAC. During the investigation, Charlie claimed that as both a shareholder and the manager of the Mainland factory, he had the right to receive rebates from suppliers. He also stressed that he had verbally notified two of the shareholders that the rebate was to help cover his entertainment expenses on the Mainland. It later transpired that Charlie had merely mentioned his huge entertainment costs during a casual chat with these two shareholders, while the third shareholder had been kept totally uninformed.

The ICAC’s investigation revealed that Charlie had received HK\$50,000 in rebates within just a few months. When delivering his verdict, the judge stated that the defence argument of offsetting entertainment costs by receiving rebates did not constitute reasonable grounds. He added that the defendant was merely using this contention to conceal an offence of bribery. He thus ruled that Charlie had breached Section 9 of the PBO by accepting bribes. The supplier was also convicted of offering bribes.



Analysis and Major Points of Law

Individual shareholders or directors of SMEs are also agents

According to the PBO, the principal of a company is the entire board of directors, while individual shareholders or directors are considered as agents. In this case, Charlie is one of the shareholders and the paid general manager of the factory. He is thus an “agent”. Prior to soliciting or receiving any advantages in the course of business, Charlie should have gained the permission of the board of directors.

The principal’s permission should be definite and given in advance

According to Section 9 of the PBO, an agent must have obtained his principal’s permission before soliciting or receiving any advantages. Otherwise, the agent has to apply for permission as soon as is reasonable after the acceptance. In addition, for such permission to be lawful, the principal must have carefully considered the details of the application before granting permission.

As Charlie's company had not stated clearly in advance whether or not its staff members could accept advantages in relation to their official duties, Charlie was considered not to have obtained the company's permission to accept the rebate. Moreover, since he had not applied for retrospective approval from his company, and since not all the shareholders were aware of his acceptance of the rebate (one of the shareholders learnt about this only during the ICAC investigation and stated that he was actually opposed to Charlie's accepting such a rebate), this acceptance could not be counted as having been permitted by the principal.

During the investigation, Charlie claimed that he had notified other shareholders that the rebate concerned was used to offset his entertainment costs on the Mainland. As noted earlier, he had only brought this matter up casually with just two of the shareholders; the arrangement concerned had not been discussed in any board meetings or formally approved – not to mention the failure to incorporate the matter into any records. As a result, Charlie's claimed defence, i.e. that he had received the permission of the principal, was not substantiated, and the offence of bribery was established.

The lesson to be learned here is that companies should take the initiative to formulate rules and regulations governing acceptance of advantages by board members and staff. They should also state clearly in their documented policy the nature and maximum amount of advantages and on what conditions staff members are permitted to accept such advantages. The procedures for declaring acceptance of advantages and the channels for enquiring about such issues should also be clearly indicated to all staff.

Accepting bribes, whether directly or indirectly, is against the law

Regardless of whether the advantage is directly or indirectly delivered to the taker of the bribe or through a third party, as long as it is proven that the receiving account is under the control of the bribed person, or that he is the ultimate beneficiary, the taker of the bribe can be considered to have accepted the advantage. Charlie must here be considered as the taker of the bribe even though the supplier deposited the unlawful rebate into his wife's Hong Kong bank account.