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Herbalife Poised To Resolve Bribery Allegations Involving Chinese Subsidiaries

Herbalife Nutrition Ltd., the dietary supplement marketing company, reportedly is close to a final resolution with the SEC and DOJ related to investigations into the company's Chinese subsidiaries.[1] According to its 10-Q filing last month, Herbalife reached "an understanding in principle" with both the SEC and DOJ to resolve inquiries into the company's external affairs expenses in China. The matter involves "alleged activities that took place in 2006 through 2016"[2] in connection with efforts

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1. Herbalife has at least four Chinese subsidiaries (Herbalife (China) Health Products Ltd., Herbalife NatSource (Hunan) Natural Products Co., Ltd., Herbalife (Jiangsu) Health Products Ltd., and Herbalife (Shanghai) Management Co., Ltd.), but it is unclear whether all of its Chinese subsidiaries are involved or if its Delaware-registered "Herbalife China, LLC" played any role. *See* Herbalife Nutrition Ltd., Exhibit 21.1 to Form 10-K for the fiscal year ended Dec. 31, 2019 (filed Feb. 18, 2020), https://www.sec.gov/Archives/edgar/data/1180262/000156459020005039/hlf-ex211_111.htm.
2. Herbalife Nutrition Ltd., Form 10-Q for the fiscal quarter ended March 31, 2020 at 21 (filed May 7, 2020), https://www.sec.gov/ix?doc=/Archives/edgar/data/1180262/000156459020022907/hlf-10q_20200331.htm ("Herbalife Q1 2020 10-Q").

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to obtain sales licenses and influence investigations and news reports about the company. This resolution follows charges filed by the SEC and DOJ last November against the former head of Herbalife's Chinese operations, Yanliang Li, and DOJ's charges against the former head of Herbalife's external affairs department, Hongwei Yang.[3] Those charges illustrate challenges that companies may encounter when conducting business abroad, including similar marketing companies in China, and in particular the potential exposure of U.S. issuers under the FCPA's accounting provisions.

The Allegations

Filings in the individuals' cases allege that employees of Herbalife's Chinese subsidiaries bribed Chinese officials, primarily at the provincial level, and employees of a Chinese state-owned media company.[4] Herbalife is a multi-level marketing company, often referred to as network marketing or pyramid selling. Although multi-level marketing is illegal in China, China permits a similar form of "direct selling," which requires the company to obtain direct selling licenses and to use independent sales representatives.[5] Employees of Herbalife's Chinese subsidiaries allegedly paid bribes to government officials in order to obtain these direct sales permits, to influence government investigations into the company's compliance with Chinese laws, and to suppress negative news reports about the company.[6] Gifts to the government officials allegedly amounted to $25 million, provided between approximately 2006 and 2016. These benefits apparently included cash, airline tickets, a shopping trip and spa visit, hundreds of meals, hotel stays, and a college reference for an allegedly fictitious internship for the son of a State Administration for Industry and Commerce official.[7]

Interestingly, the Li indictment noted expressly that Herbalife (identified as "Company-1") had a well-documented compliance program and provided routine in-person and online trainings. Li and Yang allegedly knowingly circumvented Herbalife's internal controls, lied to its auditors, and certified that they would

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3. U.S. Dep't of Justice, "Two Former Executives of the China Subsidiary of a Multi-Level Marketing Company Charged for Scheme to Pay Foreign Bribes and Circumvent Internal Accounting Controls," Press Rel. 19-1,249 (Nov. 14, 2019), www.justice.gov/opa/pr/two-former-executives-china-subsidiary-multi-level-marketing-company-charged-scheme-pay; Securities and Exchange Comm'n v. Jerry Li, Complaint, Case 1:19-cv-10568, Doc. 1 (S.D.N.Y. Nov. 14, 2019) (hereinafter "Li Complaint").
4. *See* Philip Rohlik, "Individual Accountability and Extraterritorial Jurisdiction: DOJ and SEC Charge Employees of Chinese Subsidiary of U.S. Issuer," FCPA Update, Vol. 11, No. 4 (Nov. 2019), https://www.debevoise.com/insights/publications/2019/11/fcpa-update-november-2019.
5. *Id.*
6. *Id.*
7. *U.S. v. Yanliang Li and Hongwei Yang*, Sealed Indictment, No. 19-Crim-760, ¶¶ 5, 15, 18, 20-25 (S.D.N.Y. Oct. 22, 2019) (hereinafter "Li Indictment"); *see also* Philip Rohlik, "Individual Accountability and Extraterritorial Jurisdiction: DOJ and SEC Charge Employees of Chinese Subsidiary of U.S. Issuer," *supra* note 4.

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adhere to Herbalife's compliance code.[8] In other cases, DOJ has declined to pursue enforcement actions against companies in light of considerations such as having a robust compliance program. For example, in 2012, when charging a former executive of Morgan Stanley but not the company itself, DOJ noted the extent of Morgan Stanley's compliance program, including having "trained [the employee] on the FCPA seven times and reminded him to comply with the FCPA at least 35 times."[9] Apparently, Herbalife will not be so lucky in avoiding charges, though it remains to be seen how the SEC and DOJ will characterize Herbalife's compliance program and its role in the scheme in the pending settlements.

"Herbalife's case is another example of DOJ's use of the FCPA's accounting provisions to prosecute wholly foreign cases of bribery involving conduct by the foreign subsidiary of a U.S. company."

The Proposed Company Settlements

Herbalife indicated that it is setting aside $123 million to cover "SEC and DOJ aggregate penalties, disgorgement and prejudgment interest,"[10] a significant increase from the $40 million the company previously set aside, as disclosed in a February filing.[11] Pending approvals by the Herbalife board of directors, the SEC, DOJ, and the relevant court, the company will enter into an administrative resolution with the SEC regarding alleged violations of the FCPA's accounting provisions and a three-year deferred prosecution agreement ("DPA") with DOJ regarding a conspiracy to violate the FCPA's books and records provisions.[12] The description of the DPA and omission of "alleged violations" suggests that the company may admit to certain criminal conduct underlying the conspiracy to violate the books and records provisions, but that it will not face any charges under the FCPA's anti-bribery provisions.

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8. Li Indictment at ¶ 28.
9. U.S. Dep't of Justice, "Former Morgan Stanley Managing Director Pleads Guilty for Role in Evading Internal Controls Required by FCPA," Press Rel. 12-534 (Apr. 25, 2012) ("Between 2002 and 2008, Morgan Stanley trained various groups of Asia-based personnel on anticorruption policies 54 times. During the same period, Morgan Stanley trained Peterson on the FCPA seven times and reminded him to comply with the FCPA at least 35 times."), www.justice.gov/opa/pr/former-morgan-stanley-managing-director-pleads-guilty-role-evading-internal-controls-required.
10. Herbalife Q1 2020 10-Q at 21, *supra* note 2.
11. Herbalife Nutrition Ltd., Form 10-K for the fiscal year ended December 31, 2019 at 29 (filed Feb. 18, 2020), https://www.sec.gov/ix?doc=/Archives/edgar/data/1180262/000156459020005039/hlf-10k_20191231.htm.
12. Herbalife Q1 2020 10-Q at 21, *supra* note 2.

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Additionally, as part of the DPA, Herbalife will "undertake compliance self-reporting obligations"[13] for the term of the agreement, which suggests that the company will not be subject to an external monitorship. This may be a result of the compliance program Herbalife already has in place, which allegedly was circumvented by Li and Yang.[14] Herbalife reported that it has already completed a lengthy internal investigation and "implemented remedial and improvement measures," including enhancements to internal controls and personnel changes.[15]

FCPA Enforcement for Multi-level Marketing Companies in China

Herbalife's and its former executives' cases are not the only FCPA actions involving marketing challenges and direct selling licenses in China. In 2014, Avon entered into a settlement with the SEC and a three-year DPA with DOJ, in which it admitted to criminal conduct and agreed to pay approximately $135 million in penalties, disgorgement, and prejudgment interest.[16] Avon had to retain a monitor for eighteen months, followed by a self-reporting period of the same length.[17] Although Herbalife set aside an aggregate penalty amount comparable to Avon's, it allegedly spent up to $25 million in improper gifts and expenses, compared to Avon's $8 million.

In 2016, Nu Skin Enterprises entered into a settlement with the SEC to resolve allegations that it made a $1 million donation in order to influence the outcome of a Chinese investigation into its business practices.[18] Nu Skin paid $765,688 to settle the charges that it violated the FCPA's internal controls and books and records provisions, without admitting or denying the findings.[19] The Avon and Nu Skin cases did not lead to charges against any individuals.

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13. *Id.*
14. *See* Philip Rohlik, "Individual Accountability and Extraterritorial Jurisdiction: DOJ and SEC Charge Employees of Chinese Subsidiary of U.S. Issuer," *supra* note 4.
15. Herbalife Q1 2020 10-Q at 21, *supra* note 2.
16. *See* Debevoise & Plimpton LLP, "The Year 2014 in Anti-Bribery Enforcement: New Records, New Trends, and New Complexity as Anti-Bribery Enforcement Truly Goes Global," FCPA Update, Vol. 6, No. 6 (Jan. 2015), https://www.debevoise.com/insights/publications/2015/01/fcpa-update-january-2015.
17. *Id.*
18. *See* Colby A. Smith, Andrew M. Levine, & Philip Rohlik, "Charitable Donations as FCPA Violations: SEC Settles with Nu Skin Over Donation by Chinese Subsidiary," FCPA Update, Vol. 8, No. 2 (Sept. 2016), https://www.debevoise.com/insights/publications/2016/09/fcpa-update-september-2016.
19. *Id.*

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Additionally, Usana Health Sciences has made disclosures since 2017 about its internal investigation into its Chinese subsidiary, BabyCare Ltd., which engages in direct selling in China.[20] The investigation "focuses on compliance with the FCPA and certain conduct and policies at BabyCare, including BabyCare's expense reimbursement policies."[21] Investigations by the SEC and DOJ appear to be ongoing, and no charges have been brought to date against the company or any individuals.

Conclusion

While not yet finalized, Herbalife's anticipated settlement with the SEC and DOJ continues companies' clear preference to settle FCPA charges rather than proceed to trial. Despite Herbalife's seemingly well-documented compliance program and evidence that employees actively circumvented its internal controls, the SEC and DOJ appear to be resolute on pursuing enforcement in this case. Factual allegations and other terms in the DPA and SEC settlement may provide clarity as to why enforcement was deemed necessary and the extent of the company's role in the scheme.

Moreover, Herbalife's case is another example of DOJ's use of the FCPA's accounting provisions to prosecute wholly foreign cases of bribery involving conduct by the foreign subsidiary of a U.S. company (in this instance with underlying conduct in China and allegedly involving bribes paid in Chinese currency by Chinese nationals).

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20. Usana Health Sciences, Inc., Form 10-K for the fiscal year ended December 28, 2019 at 3, 27, F-25 (filed Feb. 25, 2020), https://www.sec.gov/ix?doc=/Archives/edgar/data/896264/000156276220000071/usna-20191228x10k.htm.

21. *Id.*

German Corporate Criminal Liability Act Heads to Parliament

The draft of Germany's Corporate Sanctions Act ("Draft Act")[1], which aims at replacing the current administrative liability for corporate wrongdoing with a criminal liability regime, has taken another step forward: following consultations with business associations and German states, the Draft Act was recently introduced to the German Parliament for discussion and resolution. Not much was changed, and the main critique of the Draft Act, which we discussed in a previous article, remains.[2]

1. Sanctions No Longer Include Dissolution of Delinquent Companies

The revised Draft Act no longer proposes the dissolution of the company in case of egregious violations. The other sanctions, including monetary fines of up to 10% of the annual turnover in case of companies with revenues exceeding € 100 million, or formal warnings coupled with contingent fines or court-imposed remedial or compliance measures, were left untouched.

Not-for-profit organizations no longer fall under the Draft Act, but they remain responsible under administrative liability rules, which remain in effect.

New language clarifies that publication of sanctions in cases involving a large number of injured persons has informational purposes rather than "naming and shaming" purposes.

2. Mandatory Mitigating Effect of Internal Investigations

The revised Draft Act no longer leaves the mitigating effect on penalties to court discretion, but now mandates a 50% reduction of the maximum fine and the waiver of the sanctions publication for companies that qualify. To earn these mitigating measures, the company must conduct an internal investigation that makes a material contribution to the discovery of both the corporate crime and the corporate responsibility, or to enable effective cooperation with the prosecution by sharing of findings – and the company still has to comply with a number of technical requirements. The revised version requires the company to inform every interviewee, not only the employee, about the potential use of the interview in criminal prosecution and the rights to legal representation and to remain silent.

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1. Entwurf eines Gesetzes zur Stärkung der Integrität in der Wirtschaft," https://www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/Dokumente/RegE_Staerkung_Integritaet_Wirtschaft.pdf;jsessionid=256926471FF5F039611008ABCAED7F51.1_cid289?__blob=publicationFile&v=2.
2. *See* Thomas Schürrle and Friedrich Popp, "Germany Begins Reform of Corporate Criminal Liability," FCPA Update, Vol. 11, No. 5 (Dec. 2019), https://www.debevoise.com/insights/publications/2019/12/fcpa-update-december-2019.

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The court is now required to consider specifically the relevance of the disclosed facts for the state investigation, the timing of the disclosure, and the extent of the cooperation with the public prosecution.

The revised draft now clarifies that cooperation starting only after the opening of the main court proceedings has no mitigating effect.

3. The Fundamental Issues Remain

The Draft Act leaves the main characteristics of the regulation untouched, and doubts persist whether the aim of the new law to assure more compliance at businesses can be achieved with the tools that the Draft Act provides.

The introduction of corporate criminal liability instead of a mere administrative liability conforms now more to international standards, but substantively is not too far away from the current regime.

The now-mandatory prosecution does not conform to the situation in other countries where corporate crime is often prosecuted by one competent authority and with some discretion; in Germany more than one hundred (small) prosecutor offices are already now overburdened with the current law, and the situation is unlikely to improve considering the complexity of business crimes, as well as the severe and nuanced sanctions now provided with little guidance on sanctioning factors, including mitigating effects of compliance measures prior to and after the fact.

Cooperation benefit still attaches only to internal investigations that are not protected by the German law privilege of the defense counsel (and not at all for in-house counsel), despite heavy criticism from German bar associations and industry groups. Without protection of privilege (and with the right of the interviewee not to provide testimony that can burden the interviewee), an internal company investigation is less likely to reveal facts, which not only impedes the aim of the new Act but also exposes witnesses to the risk of a subsequent individual prosecution if they choose to cooperate.

The Draft Act lacks concrete guidelines for preventive measures companies should take to remain free of sanctions. Since there is no system in place to align public enforcement, there is unlikely to be any guidance similar to the U.S. Justice Department's "Evaluation of Corporate Compliance Programs."

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4. Outlook for the Draft Act

In a joint statement, influential economic, compliance and corporate legal associations rejected the Draft Act in its entirety for fundamental shortcomings and false incentives.[3] While providing a long list of proposed improvements, the joint statement criticizes in particular the lack of privilege for investigating counsel, the mandatory cooperation with prosecutors, the increased information rights for injured parties, the disproportionate fines, and the absence of concrete compliance guidelines. The German Government did not spend much time with these concerns, but instead sent the Draft directly to the Parliament.

The discussions will now be continued in the legislature. The Draft Act is meant to come into force two years after promulgation.

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3. "Falsche Anreize zur falschen Zeit," https://www.buj-verband.de/wp-content/uploads/Verbaendebrief-RefE-VerSanG_Juni-2020.pdf.

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