

# Japanese Companies Face Growing Anti-Corruption Enforcement Risk

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When companies talk about compliance risk in East Asia, China often dominates the discussion. Japan, on the other hand, is rarely the center of the conversation. Unlike China, which has routinely been involved in headline-making anti-bribery enforcement actions, Japan, with its mature economy and well-established corporate institutions, has never been the locus of an enforcement action under the FCPA. Moreover, a notable settlement between a Japanese engineering company and the Securities and Exchange Commission notwithstanding, Japan did not even make the latest list of countries with current FCPA corporate investigations.<sup>[1]</sup>

However, history alone may be a poor guide when assessing anti-corruption enforcement risk for Japanese multinational companies. First, the risk of domestic enforcement action may be higher than commonly perceived. In recent years, Japan has come under increasing pressure from the international community to step up enforcement of its own anti-bribery laws, and the high-profile conviction of several Japanese executives in connection with an infrastructure project in Vietnam<sup>[2]</sup> indicates that these laws are not mere window dressing.

Second, Japanese MNCs are heavily invested in countries that do make the corporate investigations list. The high cost of domestic production and years of low economic growth have turned Japanese companies to emerging markets in search of opportunity. This globalization brings both bigger economic returns as well as greater exposure to anti-bribery laws of other jurisdictions.

Thus, the hands-off approach many Japanese conglomerates have employed regarding compliance in their overseas subsidiaries may be decreasingly viable. Instead, in the current enforcement climate, Japanese

MNCs should proactively address the anti-corruption risks in markets and industries in which they operate, and preemptively form strategies to address them.

## *Outside Pressure: Reform and Enforcement of Japanese Anti-Bribery Law*

### *Updated Anti-Corruption Laws*

Over the past two decades, Japan has made significant changes to its anti-bribery laws, in no small part due to pressure from the international community to bring its regime in line with evolving international standards. Following its ratification of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (the Convention) in 1998, Japan amended its Unfair Competition Prevention Law (UCPL)<sup>[3]</sup> to criminalize bribing “foreign” (i.e., non-Japanese) public officials within its territorial boundaries.<sup>[4]</sup>

Article 18 of the UCPL provides that:

No person shall give, or offer or promise to give, any money or other benefits to a [non-Japanese] officer for the purpose of having the foreign public officer act or refrain from acting in a particular way in relation to his/her duties, or having the foreign public officer use his/her position to influence another foreign public officer to act or refrain from acting in a particular way in relation to that officer’s duties, in order to obtain illicit gains in business with regard to international commercial transactions.

Individual penalties for foreign bribery offenses include up to five years’ imprisonment and/or a fine of no more than JPY5 million.<sup>[5]</sup> Corporate entities may be fined up to JPY300 million for violations.<sup>[6]</sup>

In 2004, the UCPL was given extraterritorial effect through the revision of Article 18, an amendment that criminalized the payment of bribes to non-Japanese public officials by Japanese corporate entities or citizens.<sup>[7]</sup>

### ***First Foreign Bribery Prosecutions***

Japan brought its first foreign bribery prosecution in 2007. The case involved payments made by employees of a Japanese electrical engineering company's Philippines subsidiary to local government officials in connection with a government contract. The defendants were charged with providing improper travel and JPY800,000 (~\$6,818 in 2007 terms) in gifts to Philippine officials.<sup>[8]</sup> On March 16, 2007 the defendants were convicted with violating the UCPL and fined JPY500,000 (~\$4,260 in 2007 terms) and JPY200,000 (~\$1,700 in 2007 terms), respectively.<sup>[9]</sup> The Japanese government has since brought three additional enforcement actions<sup>[10]</sup> and has initiated two additional foreign bribery investigations under Article 18.<sup>[11]</sup>

### ***Criticism of Japanese Enforcement***

Despite these efforts, in February 2014 the OECD Working Group on Bribery criticized Japan's track record, expressing "significant concerns about the low level of foreign bribery enforcement in Japan," particularly in light of the "numerous allegations involving Japanese companies" reported in the media.<sup>[12]</sup> The Working Group concluded that "implementation of the Convention is not given adequate priority by the Japanese authorities," and underlined the "lack of targeted resources for the purpose of detecting, investigating and prosecuting foreign bribery cases."<sup>[13]</sup> In its most recent progress report, Transparency International echoed the Working Group's concerns, noting that Japan, with nearly four percent of global exports, had "little or no enforcement."

In response to such criticism, Japan has reiterated its commitment to step up investigation and prosecution of foreign bribery cases under the UCPL by, for example,

strengthening coordination among law-enforcement authorities and increasing resources for anti-bribery detection, investigation and prosecution.<sup>[14]</sup>

Japanese enforcement efforts continue to be sporadic. However, the February 4, 2015, conviction by the Tokyo District Court of three former top executives of Japan Transport Consulting Corporation, for bribery in connection with Japanese government-funded railway projects in Vietnam,<sup>[15]</sup> is precisely the sort of concrete evidence of progress Japan's critics are seeking. In Japan's effort to shed its reputation as a country that does not take a strong stance against bribery, it would not be surprising to see more such cases follow.

### ***Internal Pressure: Japanese Directors Now Liable for the Illegal Actions of Foreign Subsidiaries***

International calls to increase enforcement efforts are not the only driving force behind Japanese anti-bribery trends. Under a June 2014 amendment to the Japanese Companies Act that came into effect May 1, 2015 (the Amendment)<sup>[16]</sup> and the Japanese Civil Code,<sup>[17]</sup> the director of a parent company may be liable for damages caused by a subsidiary's non-compliant activity when such activity results from a director's failure to satisfy his or her duty of diligence. Japanese courts have interpreted this duty to obligate a director who becomes aware of a foreign subsidiary's non-compliance to: (i) fully investigate the non-compliant behavior,<sup>[18]</sup> (ii) take corrective measures,<sup>[19]</sup> and (iii) enhance internal controls to prevent future misconduct.<sup>[20]</sup>

While Japanese companies have yet to be the target of the sort of shareholder suits frequently brought against U.S. companies by their shareholders in connection with FCPA enforcement actions, such legal principles provide support for derivative actions. In addition, the Amendment also provides a new "double-derivative" cause of action by shareholders in a parent company against the directors of the parent's major subsidiaries for a breach of directors' duties.<sup>[21]</sup>

### ***Internationalization Raises Anti-Corruption Enforcement Risk***

Expanding into new markets can bring Japanese companies formerly subject only to domestic anti-bribery law within the ambit of new regulatory schemes. To understand how Japanese companies' international growth raises the level of anti-corruption enforcement risk, one need only look as far as the healthcare industry. Japan's top five pharmaceutical companies derive approximately half their revenue from foreign markets<sup>[22]</sup> and foreign sales represent 47% of total revenue.<sup>[23]</sup> In the \$18 billion medical device manufacturing industry, exports account for roughly 26.5% of total sales.<sup>[24]</sup> Mergers and acquisitions have driven much of this growth. For example, between 2007 and 2012, Japanese pharmaceutical companies made no fewer than 33 major acquisitions.<sup>[25]</sup> See also *"Guarding Against Bribery When Conducting Clinical Trials Overseas"* (Aug. 19, 2015).

Such growth dovetails with another trend: the dramatic increase in global FCPA enforcement in the life sciences sector, which has seen nearly 30 enforcement actions in the last decade. Roughly 40% of those cases have originated in China, where Japanese pharmaceutical and medical device companies are particularly active.<sup>[26]</sup> Additionally, the Chinese government has, in recent years, begun aggressively enforcing its own anti-bribery laws against multinational targets.

Entry into new markets brings companies into contact with third-party intermediaries that frequently feature in FCPA enforcement actions, such as consultants who help navigate regulatory checkpoints like licensing and registration requirements. Further, as MNCs move into new markets where they lack the infrastructure and personnel to operate independently, they must rely on third-party sales and marketing agents.

Accordingly, as Japanese healthcare companies pursue new opportunities abroad, anti-corruption risk, as well as the likelihood of enforcement actions by domestic and foreign regulators, increases significantly. This holds true not only for the life sciences industry, but for sectors

like engineering, manufacturing, telecommunications and banking – all of which have recently been subject to heightened enforcement activity from U.S. and global regulators.

See *"Ten Steps A Company Can Take to Mitigate Corruption Risk When Entering a New Market (Part One of Two)"* (Jun. 24, 2015); *Part Two* (Jul. 8, 2015).

### ***The High Cost of Noncompliance***

To date, enforcement actions against Japanese companies and individuals, while relatively few in number, have netted over \$380 million in civil and criminal penalties. In 2011, JGC Corporation entered into a deferred prosecution agreement and agreed to pay \$218.8 million for its role in connection with a four-company joint venture to design and construct a liquefied natural gas plant on Bonny Island, Nigeria. The settlement represents the ninth largest in FCPA enforcement history. Another joint venture partner, Marubeni Corporation, paid \$56.4 million. In March 2014, Marubeni came under fire a second time, this time pleading guilty and paying \$88 million for making improper payments to Indonesian officials in an energy services deal in Indonesia.<sup>[27]</sup>

In response to the increased exposure of Japanese MNCs to foreign bribery risk, in July 2015 the Japanese Ministry of Economy, Trade and Industry (METI) revised its Guideline to Prevent Bribery of Foreign Officials (the Guideline)<sup>[28]</sup> to make clear that a parent company is obliged to establish internal compliance measures to prevent corruption in its overseas subsidiaries. The revised Guideline introduces a set of best practices, such as conducting adequate due diligence on third-party agents and establishing an internal reporting mechanism,<sup>[29]</sup> that resonates with guidance provided by U.S. and U.K. regulators.

### ***A Growing Awareness of Risk at Home and Abroad***

Considering Japan's prominent role in the global economy, Japanese companies have featured less prominently in recent anti-bribery enforcement

cases than one might expect. But Japan's evolving domestic anti-corruption regime and mounting international pressure to proactively implement it, combined with new tools for shareholders to hold directors accountable for the actions of foreign subsidiaries, may change that. At the same time, Japanese MNCs' continued investment in growing economies, particularly those in Japan's own backyard like China and Vietnam, expose them to increased risk of regulatory action from foreign regulators.

Given these changes in Japan's risk profile and the steep legal and financial penalties associated with violations, it is not surprising that simply laying low and following local customs is a strategy that is beginning to fall out of favor. Whether evaluating the risk posed by a state-owned partner in an overseas joint venture, or assessing the qualifications of a regulatory consultant in a foreign market, Japanese companies' perception of corruption-related legal risks is growing. Much work – and education – remains to be done. METI has issued a warning that “quite a few overseas subsidiaries of Japanese companies haven't taken effective measures against foreign bribery.”<sup>[30]</sup> The question is whether they will heed it in time.

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- [1] See *Country Count for the Corporate Investigations List* (October 2015).
- [2] See 鉄道コンサル: O D A 贈賄 前社長に有罪判決 (Railway Consulting: ODA Paying Bribery, Former CEO Convicted), Mainichi (February 5, 2015).
- [3] Unfair Competition Prevention Act (Act No.47 of 1993).
- [4] See 国際商取引における外国公務員に対する贈賄の防止に関する条約(OECD外国公務員贈賄防止条約)の概要 (Overview of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions)) (May 2010). Bribery of domestic officials (inside or outside of the territory of Japan) is criminalized by the Japanese Penal Code (Act 45 of 1907). Article 3(1) of the National Public Official Ethics Act of 1999 addresses the receipt by Japanese public officials of improper payments.
- [5] UCPL, Article 21(2).
- [6] UCPL, Article 22.
- [7] See *OECD, Japan: Phase 2 – Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions* (March 7, 2005); and Ministry of Economy, Trade and Industry, 外国公務員贈賄防止指針 (Guideline for Preventing the Bribery of Foreign Public Officials) (May 10, 2004).
- [8] See 九電工の不祥事で九電本体にも波紋広がる (Ripples from Kyudenko Scandal Spread to Kyushu Electric), NetIB (March 30, 2007).
- [9] See 九電工社員 2 人を略式起訴-外国公務員への贈賄初適用 (Summary Prosecution of Two Kyudenko Employees – First Application of the Bribery of Foreign Public Officials), Kyōdōtsūshin (March 16, 2007).
- [10] The second enforcement action, which concluded in 2009, involved bribery of a Vietnamese official by three Japanese executives of a major Japanese construction consulting company in connection with a highway construction project. See O D A 贈賄で P C I 元役員ら有罪-東京地裁判決 (Tokyo District Court Convicts Former Officers of PCI in ODA Bribery), Kyōdōtsūshin (January 29, 2009). The executives were sentenced to terms of imprisonment ranging between one and a half to two years, following a three-year suspension. The company was fined JPY70 million. *Id.* The third action, brought in 2013, involved the bribery of Chinese customs officials by a senior executive of a Japanese automotive parts manufacturer. The Japanese executive reportedly provided more than JPY50 million in improper payments, while the court imposed a fine of only JPY500,000. See 元専務に罰金50万円略式命令 フタバ産業贈賄事件 (Former Official Issued JPY500,000 Penalty in Futaba Industries Bribery Incident) Nikkei Online (October 4, 2013). The fourth enforcement action, which concluded in 2015, involved bribery of a Vietnamese official by three Japanese executives of a major Japanese railway consulting company in connection with a railway construction project. See note 2. The executives were sentenced to terms of imprisonment ranging between two to three years, following a two-year/ three-year suspension. The company was fined JPY90 million.
- [11] *OECD, Japan: Follow-Up to the Phase 3 Report & Recommendations* (February 2014) at 4 (Follow-Up Report).
- [12] *Id.*
- [13] *Id.* Among the recommendations for further action was an update on the effectiveness of Japan's Whistleblower Protection Act (Act No. 122 of 2004) (Act) to protect public and private sector employees from retaliation by their employers for raising or reporting certain violations or matters considered to be of public interest under the law. *Id.* at 21. While the Act imposes an obligation on employers and government agencies to investigate and respond to whistleblower report, the law fails to specify any criminal penalties for violating its protections. Instead, whistleblowers whose rights have been violated can seek remediation. OECD Working Group on Bribery, Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Japan (December 2011) at 38. Similarly, the Act offers no incentives for providing information regarding violations of anti-bribery law, limiting its usefulness as a deterrent.
- [14] See Follow-Up Report at 7-16.
- [15] See note 2.
- [16] The Companies Act (Act 86 of 2005, as amended by Act 42 and Act 90 of 2014), Articles 330, 362(4)(vi), 362(5), 423(1) and 429(1) .
- [17] Civil Code (Act 89 of 1896), Article 644.
- [18] See 福岡魚市場株主代表訴訟事件 (Fukuoka Fish Market Shareholder Litigation), Supreme Court of Fukuoka, April 13, 2012 (holding that a director's duty of diligence includes the obligation to fully investigate the subsidiary's non-compliant behavior).
- [19] See ダスキン株主代表訴訟 (Dasukin Shareholder Litigation), Supreme Court of Osaka, June 9, 2006 (holding that a director who becomes aware of a subsidiary's non-compliant activity must take corrective measures to mitigate damages).

[20] See 日本システム技術事件 (Japan System Technology), Supreme Court, July 9, 2009 (finding that, where a director has a duty to establish an internal control system that fails to prevent non-compliant activity, such duty includes the obligation to enhance internal controls to prevent future misconduct).

[21] The new “shareholders’ double-derivative suit” allows shareholders holding 1% or more of outstanding shares in a parent company to bring an action against directors of its major direct or indirect wholly owned subsidiaries for any breach of directors’ duties. (The Companies Act, Article 847.3)

[22] See 日本製薬工業協会Data Book 2015 (Japan Pharmaceutical Manufacturers Association Data Book 2015) at 16. See also 武田薬品工業株式会社・セグメント情報 (Takeda Pharmaceutical Company Limited Segment Information); and 第一三共株式会社財務ハイライト (Daiichi Sankyo Company, Limited Financial Highlight).

[23] See note 22.

[24] See Japanese Ministry of Health, Labor and Welfare, 医療機器産業ビジョン2013資料編 (Medical Device Industry Vision 2013 Data Book) (2013) at 2.

[25] See Japanese Ministry of Health, Labor and Welfare, 医薬品産業ビジョン2013資料編 (Pharmaceutical Industry Vision 2013 Data Book) (2013) at 39.

[26] In 2013, 47 Japanese pharmaceutical companies had subsidiaries in China. See Japan Pharmaceutical Manufacturers Association Data Book 2015 (note 22) at 23.

[27] In addition to the fine, Marubeni signed a plea agreement in which it admitted its criminal conduct, agreed to maintain and implement an enhanced global anti-corruption compliance program and to cooperate with the department’s ongoing investigation. See *“Weak FCPA Compliance Program and Lack of Cooperation Cited in Marubeni’s \$88 Million Guilty Plea”* (Apr. 2, 2014).

[28] METI, 外国公務員贈賄防止指針, 平成 27 年 7 月 30 日改訂 (Guideline to Prevent Bribery of Foreign Public Officials, July 30, 2015 Revision).

[29] See Article 2.2 of the Guideline.

[30] METI announcement regarding the issuance of the revised Guideline (July 30, 2015).