

Can the Hong Kong ICAC Help Reduce Corruption on the Mainland?

by

Bryane Michael

Centre for Comparative and Public Law

Faculty of Law

The University of Hong Kong

Occasional Paper No. 23

February 2013



The Centre for Comparative and Public Law (CCPL) was established in 1995 within the Faculty of Law of the University of Hong Kong. The purposes of the Centre are to promote research and other activities in the field of public and comparative law. The Centre has organised many seminars relating to international law and human rights in Hong Kong, and has active research projects covering such topics as the reform of constitutional law in Hong Kong, the implementation of international human rights standards in Hong Kong law and practice, equality and the law, trafficking of women into Hong Kong, and comparative sexual harassment law.

The Director of the Centre is Professor Simon NM Young and the Deputy Directors are Assistant Professor Kelley Loper, Associate Professor Puja Kapai and Associate Professor Benny Tai. The Research Officer is Sharron Fast, and the Executive Secretary is Flora Leung.

This Occasional Paper is written by Bryane Michael, who is a Visiting Fellow at the Centre. His professional experience includes work as a legal advisor from 2007 to present for the European Union. He has also advised the United Nations Development Programme (UNDP) on legal issues related to the International Anti-Corruption Convention and the World Customs Organisations on legal issues related to fighting corruption in customs. Bryane Michael has done his graduate work at Harvard and Oxford – and has taught at several universities including Oxford University and recently Columbia University.

Further information about CCPL and other occasional papers published by the Centre are available on the Centre's website: www.law.hku.hk/ccpl.

Published by

Centre for Comparative and Public Law
Faculty of Law
Room 921, 9/F, Cheng Yu Tung Tower
Centennial Campus
University of Hong Kong

Tel: (852) 3917 2941
Fax: (852) 2549 8495
Email: fkleung@hku.hk

© 2013 Centre for Comparative and Public Law and Bryane Michael

Suggested Citation: Bryane Michael, "Can the Hong Kong ICAC Help Reduce Corruption on the Mainland?", Centre for Comparative and Public Law Occasional Paper No. 23, Faculty of Law, The University of Hong Kong, February 2013

The contents of this paper may be freely reproduced, provided that appropriate acknowledgements are made of the original source and author. The moral rights of the author are asserted.

Contents

Introduction.....	1
Reducing Hong Kong’s Contribution to Corruption on the Mainland.....	2
<i>Hong Kong: A Likely Vector for corruption in China and other developing markets</i>	<i>3</i>
<i>Criminalising the Bribery of Foreign Officials</i>	<i>8</i>
<i>Cases where foreign bribery may be allowed.....</i>	<i>13</i>
<i>Options for criminalising foreign bribery</i>	<i>21</i>
Allowing for the Prosecution of Corrupt Mainland Officials in Hong Kong	26
<i>What is the extra-territorial application of anti-corruption law – and how would it apply to China?</i>	<i>26</i>
<i>Lessons from the extra-territorial application of anti-corruption law</i>	<i>30</i>
<i>How does extra-territorial application help Hong Kong?</i>	<i>34</i>
<i>Preventing double jeopardy.....</i>	<i>36</i>
<i>Co-operation with Taiwan.....</i>	<i>39</i>
<i>Limits on Extra-territorial application for private-private “corruption”</i>	<i>42</i>
<i>Options for introducing extra-territorial application.....</i>	<i>44</i>
Making Hong Kong’s Companies Liable for Corruption	47
<i>The economic effects of corporate criminalisation.....</i>	<i>47</i>
<i>Overview of the three approaches to corporate criminalisation.....</i>	<i>50</i>
<i>Criminal liability for legal persons</i>	<i>51</i>
<i>Criminal liability by directors and for directors (and other “directing minds”).....</i>	<i>54</i>
<i>Doctrinal approaches to corporate liability.....</i>	<i>55</i>
<i>Vicarious Liability in Joint Ventures, along the Supply Chain and M&A activity.....</i>	<i>58</i>
<i>Deferred and Non-Prosecution Agreements.....</i>	<i>62</i>
<i>Fines and non-conviction based prosecutions.....</i>	<i>69</i>
<i>Options for introducing corporate criminalisation</i>	<i>71</i>
<i>Building political will for reform.....</i>	<i>77</i>
Bringing the Money Back Home – A New Recovery Structure	79
<i>Recovering the proceeds of crime and civil recoveries</i>	<i>79</i>
<i>Getting money back from foreign public officials</i>	<i>84</i>

<i>Options to introduce foreign recoveries</i>	89
<i>Effects on the ICAC's organisational structure and operations</i>	92
<i>Changes to organic legislation and overview of several new departments</i>	93
<i>Conducting corruption assessments on Mainland institutions</i>	95
<i>Receiving complaints from abroad</i>	97
<i>Legislative and regulatory harmonisation across the pan-China region</i>	100
<i>Public relations with the Mainland</i>	102
<i>Conclusions</i>	103
<i>Appendix I: Media Statements Supporting Extent of Corruption on the Mainland</i>	106
<i>Appendix II: Regulatory Impact Assessment and Reform Design</i>	107
<i>Financial Cost-Benefit Calculations</i>	107
<i>Ex-Ante Political Incentive-Compatibility Estimates</i>	109
<i>Optimal Reform Path</i>	115
<i>Appendix III: Specification of Models for Economic Impacts on Hong Kong and Political Incentives</i>	122
<i>The Model of ICAC's work on Hong Kong tax revenue</i>	122

Abstract

Hong Kong's Independent Commission Against Corruption (ICAC) serves as the example *par excellence* of a successful anti-corruption agency. Yet, the Agency works in one of the more corrupt jurisdictions world-wide (the People's Republic of China). To what extent can the ICAC – and the Prevention of Bribery Ordinance (POBO) which regulates its work – contribute to reductions in corruption on the Mainland? In this paper, we look at the ways in which the ICAC – technically a Chinese agency (albeit operating in a legally independent jurisdiction) – can help to reduce and prevent corruption on the Mainland. We find that with the proper modifications to the POBO, the Agency can reduce the value of corruption on the Mainland between \$5-\$20 billion. Through the right regulatory design, these amendments can help actually increase tax revenue by about \$200 million per year. We also analyse the political-economy aspects of the reform – and present an example of an optimal reform path. Using economic analysis to assess the costs and benefits of reform – as well as the winners as well as losers of reform – this paper provides an illustration of evidence-based legislative analysis.

Disclaimer: This Working Paper comes from work done as a Visiting Fellow to the Centre for Comparative and Public Law at the University of Hong Kong's Faculty of Law. The materials and opinions in this paper reflect the views of the author and do not attribute in any way to the University of Hong Kong, the UK Crown Prosecution Service, or any organisation to which the author are affiliated. This paper represents a liberal contribution to the marketplace of ideas and all materials in this paper are based exclusively on publicly available information.

Can the Hong Kong ICAC Help Reduce Corruption on the Mainland?

Introduction

Hong Kong exports roughly HK\$30 billion each year in corruption to developing countries – particularly China. Such exports occur through Hong Kong’s exporters’ and investors’ likely bribery of foreign officials abroad. Such bribery occurs outside of the view (and jurisdiction) of the Independent Commission Against Corruption (ICAC). The ICAC’s mandate to control corruption in Hong Kong has made the archipelago one of the most corruption-free areas in the world. Yet, limits on the Agency’s ability to investigate individuals and companies abroad, have made Hong Kong a net exporter of corruption – particularly to China. As Hong Kong and China draw closer politically, economically and administratively, both governments will come under greater pressure to close large gaps in Hong Kong’s treatment of transnational corruption (particularly by Hong Kong’s companies).

This paper argues that changes to Hong Kong’s anti-corruption law can help the ICAC to reduce corruption on the Mainland. We draw on recent innovations in anti-corruption law – particularly in the European Union – to show how cross-border assistance on anti-corruption cases serves as an important method in helping highly corrupt jurisdictions to reduce corruption. We find that with the proper modifications of the Prevention of Bribery Ordinance (POBO), the ICAC can contribute to reducing the value of corruption on the Mainland by HK\$5-\$20 billion. Through the right regulatory design, these amendments can help actually increase tax revenue in Hong Kong by about HK\$200 million per year. We also analyse the political-economy aspects of the reform – and present an example of an optimal reform path. We show that with the right sequencing of legislative reforms, the Hong Kong Legislative Council (LegCo) can adopt political unpalatable reforms.

The reader should keep several caveats in mind as they read the paper. First, as scholars, we seek to imagine legislative reform and mutual legal assistance in an ideal

world. Our recommendations for reform seek to add to the marketplace of ideas – and not militate for any particular position. Second, we analysed Hong Kong law and administrative institutions without any feedback from the ICAC or Hong Kong’s authorities. We have tried to keep a Chinese Wall (pardon the pun) between our work and the authorities to avoid the appearance that our work reflects any views from outside sources. Third, we base our analysis on publicly available information. Many of the estimates we arrive at come from crude data – making our economic and econometric work imprecise. Moreover, corruption represents a sensitive area of law enforcement – with much information protected by confidentiality. We do not wish to harm any sensitive diplomatic interests through our analysis. Our affiliation with the University of Hong Kong is coincidental – and we could have just as easily analysed the law governing the prosecution of corrupt Kazakh officials in Moscow.

Reducing Hong Kong’s Contribution to Corruption on the Mainland

Hong Kong’s companies likely contribute to corruption abroad – and particularly on the Mainland. Strictly enforced anti-corruption laws in Hong Kong, combined with lax enforcement on the Mainland, have led to a situation where companies seeking to engage in bribery can relatively easily do so on the Mainland. In this section, we estimate the value of such bribery at around HK\$30 billion. We also argue for the explicit criminalisation of bribery abroad. In upcoming sections, we show how increased ICAC work in preventing and investigating corruption abroad can help reduce the value of those bribes by about \$5 billion (and possible much more).

Hong Kong: A Likely Vector for corruption in China and other developing markets

Hong Kong trades almost HK\$6 trillion worth of goods with some highly corrupt foreign partners. Figure 1 shows Hong Kong’s top trading partners, their relative weight in Hong Kong’s total trade, the value of that trade, and a commonly used measure of the

extent to which these trading partners control corruption.¹ China far and away eclipses Hong Kong's other trading partners – representing roughly half of all of the city-state's trade. Yet, such large amounts of trade come from, go to, and pass through traders who most likely pay large amounts of bribes on the Mainland. According to the World Bank's control of corruption indicator, China controls corruption only about 30% as well as Hong Kong. According to Transparency International's 2010 *Corruption Barometer*, roughly 8% of Chinese respondents who had contact with tax and customs authorities admit to paying a bribe in 2010.² Even if only 1% of Hong Kong's foreign trade was exposed to bribery or other forms of corruption, the value of such corruption on the Mainland would amount to **HKD\$34 billion**.³

¹ The control of corruption figures come from the World Bank's *Governance Indicators*. We have rescaled the indicator to show each country's control of corruption as a percent of Hong Kong's control of corruption score. For example, Singapore controls corruption 7% better (as measured by the World Bank indicator). Such a score means that Singapore's raw score divided by Hong Kong's raw score equals 1.07. Chinese authorities control of corruption roughly only 31% as well as Hong Kong's authorities.

² Transparency International, *2010 Global Corruption Barometer Report*, 2011, available [online](#).

³ Our estimate of the value of corruption represents an extremely conservative estimate of the value of corruption. Most enterprise surveys, conducted by the World Bank, which ask businesses to estimate the value of turn-over paid out in bribes tends to amount to about 5% in countries far less corrupt than China. Our estimate does not even take into account the bribes paid to other Chinese government agencies (such as politicians, land and utilities authorities, and others).

Figure 1: High Probability that Hong Kong Companies Pay Bribes Abroad
(control of corruption figures expressed as a percent of Hong Kong's)

Trading Partner	Percent of overall trade	Value of trade (in bill HKD)	Control of Corruption
China	48%	\$3,444	31%
USA	8%	\$ 542	81%
Japan	6%	\$453	89%
Taiwan	5%	\$326	67%
Singapore	5%	\$310	107%
South Korea	3%	\$211	59%
India	3%	\$180	33%
Germany	2%	\$154	93%
Thailand	2%	\$119	38%
Malaysia	2%	\$117	51%
UK	2%	\$107	87%
Switzerland	2%	\$104	103%
France	1%	\$81	85%
Italy	1%	\$75	46%
Vietnam	1%	\$65	31%

Source: Trade and Industry Department (2012) and World Bank (2012).

Notes: The figure shows total trade (as the sum of the value of imports, exports and re-exports in 2011). Shares of trade have been rounded to the nearest full percentage point. See footnote of accompanying text for the calculation of the control of corruption figures.

Hong Kong companies also trade with partners in other high corruption-risk jurisdictions. Taiwan – with its traders' close and often corrupt relations with provinces like Fujian – represents Hong Kong's fourth largest trading partner. Taiwanese authorities also have far less control over corruption than the ICAC – with a control of corruption score only 67% as large as Hong Kong's. South Korea represents Hong Kong's sixth largest trading partner – with a control of corruption score only 60% of Hong Kong's. India – while trading far less with Hong Kong than China – has a control of corruption score only 30% the size of Hong Kong's. Thailand – also a relatively minor trading partner – controls corruption poorly. We can not automatically assume that all Hong Kong companies pay bribes abroad because they operate in high corruption-risk jurisdictions. Yet, from a strictly risk-based analysis of international business, we can deduce that at least some of Hong Kong's companies probably participate in corruption abroad.

The pattern of Hong Kong's foreign direct investment also suggests that Hong Kong's trade with China represents part of a larger system of corrupt payments and money laundering. Figure 2 shows foreign direct investment coming into and out of Hong Kong. China represents Hong Kong's largest investment partner – with roughly HK\$8 trillion in outward investment (to China) and about HK\$3 trillion (from China). However, the next two investment partners – the British Virgin Islands and Bermuda – both represent international tax and money laundering havens.⁴ Such data provide macroeconomic evidence for commonly perceived patterns of investment in Hong Kong. Corrupt Chinese businessmen and officials use Hong Kong to bring money into China and take money out.⁵

Figure 2: China and Tax Havens are Hong Kong's Largest Investment Partners

Outward Direct Investment Positions	billions HK dollars	Inward Direct Investment Positions	billions HK dollars
China	\$8,072	China	\$2,907
British Virgin Islands	\$2,844	British Virgin Islands	\$2,529
Bermuda	\$249	Netherlands	\$1,007
United Kingdom	\$120	Bermuda	\$525
Hungary	\$85	United States	\$644
Luxembourg	\$82	United Kingdom	\$460
Other Countries Confidential	\$74	Japan	\$291
Singapore	\$70	Cayman Islands	\$150
		Singapore	\$111

Source: IMF's Coordinated Foreign Direct Investment Survey for 2010. Numbers have been rounded down (fractions have been truncated).

Academic studies also provide some evidence that Hong Kong serves as an important vector for bringing bribery and corruption to China.⁶ Zhu provides a recent econometric study looking at the relationship between foreign investment in China's provinces by source (with Hong Kong comprising a major source for many provinces)

⁴ For a list of these tax havens, the criteria used to establish their status as tax havens and so forth, see James R. Hines Jr., *Treasure Islands*, 24 J. OF ECON. PERSPECTIVES 4, 2006.

⁵ Jeffrey Hays, *Large Scale Corruption in China: Millions and Billions Stolen by Officials, Bankers and Businessmen*, 2008, available [online](#). Independently verified from original sources.

⁶ Hong Kong's stringent anti-corruption policies (in comparison with China) also have led to criminals avoiding Hong Kong. We do not discuss the displacement of corruption and crime to the Mainland which the ICAC's policies have engendered. For a fuller discussion, see Roderic Broadhurst and Lee King Wa, *The Transformation of Triad 'Dark Societies' in Hong Kong: The Impact of Law Enforcement, Socio-Economic and Political Change*, 5 SECURITY CHALLENGES 4, 2009: 1-38.

and corruption.⁷ The Zhu study – and studies like it – use macro-level aggregate-level data to identify trends which individual case studies can not. Zhu finds that both foreign direct investment and foreign trade strongly and positively correlate with corruption (as measured by prosecutions reported at the province level). He also notes that the most likely explanation for such a positive relationship comes from the use of bribery to avoid the many regulations and *ad hoc* taxes imposed by Chinese national and regional authorities. Baughn *et al.* specifically (though implicitly) single out Hong Kong for bribing foreign officials abroad.⁸ Their study looks at the extent to which firms from 30 different countries engage in international bribery. They find (unsurprisingly) that companies paid fewer bribes abroad when their home countries had ratified the OECD Anti-Bribery Convention. While such trends reflect the criminalisation of bribery at home, they also find that restrictions against the bribery of foreign officials have a statistically significant negative correlation with bribe-paying behaviour abroad. To the extent their finding extrapolate to Hong Kong, they specifically find that Hong Kong companies pay far more bribes abroad than what one would expect given the low level of corruption in Hong Kong itself. Jurisdictions which criminalise foreign bribery pay fewer bribes abroad.

Other evidence directly corroborates the use of bribery by Hong Kong's trading partners in China. Professors Fisman and Wei specifically look at the correlation between corruption on the Mainland and trade with Hong Kong.⁹ In their study, they proxy corruption as the difference between export values declared by Hong Kong Customs & Excise and import values declared by the Chinese Customs Service at the macro-level. They find significant under-declaration and mis-classification of imports into China (as determined by using export values from Hong Kong). Much of this under-declaration may represent simple fraud by Chinese importers. However, given the magnitude of

⁷ Boliang Zhu, *Economic Integration and Corruption: The Case of China*, Paper presented at the International Political Economy Society, 2009, available [online](#).

⁸ Christopher Baughn, Nancy Bodie, Mark Buchanan and Michael Bixby, *Bribery in International Business Transactions*, 92 J. OF BUS. ETHICS 1, 15-32.

⁹ Raymond Fisman and Shang-Jin Wei, *Tax Rates and Tax Evasion: Evidence from "Missing Imports" in China*, 112 J. OF POL. ECON. 2, 2004, available [online](#).

under-declaration on the Chinese side of trade, some corruption must be involved as well. They find a statistically significant positive relationship between undervaluation and tax rates – providing further support that Chinese importers deliberately and illegally influence customs valuations.

Media reports also provide a glimpse at the extent to which Chinese officials use Hong Kong as part of a wider money laundering net to clean the proceeds of crime. Recently, Gu Wangjiang and Bo Xiyong (both relatives of former Chongqing mayor Bo Xi-Lai) came under suspicion for using criminal proceeds from China to operate businesses in Hong Kong.¹⁰ In the mid-1990s, several government officials in Hainan stole more than \$1 billion from the government (through various schemes). They used these criminal proceeds to buy cars and consumer goods from Hong Kong. Many were resold on the black market back in China. In the 1990s hundreds of officials were believed to be involved in a \$6 billion oil, car, firearms and cigarette smuggling operation that worked out of the port city of Xiamen (in southern China). Many of the smuggled goods came in from Taiwan and Hong Kong by ships using import licenses obtained from party officials given huge bribes. When smuggled goods were accidentally seized by customs, the bribed officials jumped in, retrieved the goods and allegedly beat up the customs officers.

These data and examples provide limited empirical evidence that Hong Kong serves as an important facilitator of corruption on the Mainland. As shown by the Baughn *et al.* study, the explicit criminalisation of foreign bribery can help contribute to staunching part of this corruption. A recent Court of Final Appeal case has helped set a precedent for the criminalisation of foreign corruption. However, Hong Kong still has not directly and explicitly outlawed bribing foreign officials. The ICAC will need to anticipate this change in law – and make provisions for deeper work on fighting corruption abroad.

¹⁰ Telegraph, *Neil Heywood death: China 'probes Bo Xilai family's Hong Kong investments*, 23 April 2012, available [online](#).

Criminalising the Bribery of Foreign Officials

In most countries, the direct criminalisation of the bribery of foreign officials has become commonplace. The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, the Convention on the Fight Against Corruption Involving Officials of the European Communities or Officials of Member States of the European Union, and the African Union Convention on Preventing and Combating Corruption – all helped set the precedent for criminalising the payment of bribes to foreign public officials. More recently, the *UN Convention Against Corruption* requires parties to criminalise the bribery of foreign public officials. Hong Kong is a party to the UN Convention.

By international standards and particularly in relation to countries which trade less than Hong Kong, Hong Kong does not deal very well in curbing transnational bribery. The Prevention of Corruption Ordinance (POBO) does not explicitly forbid the bribery of foreign officials. The POBO does forbid bribery “whether in Hong Kong *or elsewhere*” (italics ours).¹¹ However, the Justice Department has yet to bring a prosecution under art. 4(1) for bribery committed “elsewhere.” No publicly recorded cases exist (that we know of) of the ICAC engaging in investigation work under the authority of this provision.

Recent media reports suggest that a recent Court of Final Appeal case may change the way the Hong Kong authorities deal with bribery abroad. A recent Baker & McKinzie brief sensationalistically (and incorrectly we might add) argues that, “bribes offered in Hong Kong to a foreign public official for acts or forbearance outside Hong Kong are liable to be prosecuted under Hong Kong law and the ICAC will have jurisdiction to investigate.”¹² Another brief – by Norton Rose --- argues more accurately that “the Hong Kong Court of Final Appeal has confirmed that it is an offence for a foreign public official to solicit or accept an ‘advantage’ in Hong Kong...in that place outside Hong

¹¹ Prevention of Bribery Ordinance, at art. 4(1), [hereinafter POBO].

¹² Baker & McKinzie, Court of Final Appeal gives Hong Kong anticorruption legislation extra-territorial flavour, 2010, available [online](#).

Kong.”¹³ The case -- a 2010 decision by the Hong Kong Court of Final Appeal – involved the bribery of a Chinese government official visiting Hong Kong.¹⁴ However, the court’s reasoning and the precedent itself make for the very uncertain treatment of future cases.

The Court of Final Appeal had to resort to legal slight-of-hand in order to apply international best practice (criminalising transnational corruption) in recent case law. In *B v. ICAC*, the Chief Justices refuse to overturn the conviction of a person who bribed “a public official *of a place outside Hong Kong*” (italics ours).¹⁵ In other words, an official from the Mainland clearly represent persons “of a place outside Hong Kong.” If any Hong Kong persons pay a bribe to these persons in Hong Kong, they commit an offence. However, their ruling raises four questions which the ruling unsatisfactorily answers.

Would the POBO’s framers have wanted the Ordinance to apply to persons “of a place outside of Hong Kong?” The Chief Justices note that the “possibility of a bribe being offered in Hong Kong to a public official of a place outside Hong Kong existed at the time when the legislation in question was enacted. I see no basis for saying that such a possibility was unforeseen at the time of enactment.”¹⁶ The Ordinance’s drafters clearly foresaw such a possibility. However, we offer two reasons against the Court’s reasoning in this case. First, the mischief that the POBO of the 1970s addresses differs completely from the mischief addressed today. In the 1970s, bribery and corruption in Hong Kong itself represented the core mischief tackled. At the time the POBO was passed, the main threat involved law enforcement itself (namely the police). Second, under colonial rule, the use of bribery abroad served as an important diplomatic and commercial tool.¹⁷ Bribery at home constituted an evil – though bribery abroad could help facilitate trade, secure information about a foreign government’s interests, and so forth. Moreover, the

¹³ Norton Rose, ANTI-CORRUPTION LAWS IN ASIA PACIFIC, 2012 at 30.

¹⁴ For specifics, see *B v The Commissioner of the Independent Commission Against Corruption*, see [online](#).

¹⁵ *Id.* at 8(1).

¹⁶ *Id.* at 13.

¹⁷ Numerous academic sources note the use of bribery in achieving the foreign policy objectives of the Crown. For one example, see Christopher Munn, ANGLO-CHINA: CHINESE PEOPLE AND BRITISH RULE IN HONG KONG, 1841-1880, 2008.

government passing the POBO in the mid-1970s could not have possibly foreseen Hong Kong's rise in international trade, current relations with China or the OECD and UN treaties which encourage countries to criminalise the bribery of foreign public officials. We are not as sure as the Chief Justices that the legislators of time wanted to allow for the use the POBO to prosecute transnational corruption.

Foreseeing this difficulty, the Court argues that adding a new interpretation to the POBO could well be allowed. The Court notes, “[i]t is not an extension of a penal law to apply its principle to circumstances unforeseen at the time of its enactment, so long as the case is fairly brought within its language.”¹⁸ At first glance, foreign bribery seems easy to reconcile with the Ordinance's language – especially nowadays. Almost all jurisdictions have (at least in theory) criminalised the bribery of domestic as well as foreign officials – due to their adoption of the UNCAC. However, bringing *B v. ICAC* into the language of the Ordinance in practice poses more difficulties than at first apparent. Bringing transnational bribery within the Ordinance's language would require a role of the ICAC (as the Ordinance clearly gives a central role to the Commission in preventing and investigating corruption). If the ICAC has jurisdiction to investigate the bribery of persons “of a place outside of Hong Kong,” then what powers does the ICAC have to investigate such bribery – especially abroad?

What powers does *B v. ICAC* imply for the ICAC to investigate bribery of persons “of a place outside of Hong Kong”? Under the current POBO, the ICAC either has jurisdiction to investigate a case – or it does not. However, if the ICAC has the jurisdiction to investigate cases of persons “of a place outside of Hong Kong,” the ICAC would necessarily need to collect evidence and conduct other activities abroad. Yet, nothing in the POBO or ICAC Ordinance gives the ICAC these powers (explicitly at least). The POBO already outlaws bribery committed “in Hong Kong *or elsewhere*.”

¹⁸ *Id* at 13, citing Lord Jowitt in *Joyce v. Director of Public Prosecutions* [1946] AC 347 at p.366.

However, the ICAC has shown great reluctance to engage in activities abroad.¹⁹ At present, the ICAC does not seem to see a strong role for itself in policing bribery abroad.

This begs the question – what kinds of persons “of a place outside of Hong Kong” does the POBO apply to? The Justices note that, “a public official of a place outside Hong Kong comes within the phrase ‘any person employed by or acting for another’ in the definition of ‘agent’ provided by s.2(1) of the POBO...his public duties in that place come within the phrase ‘in relation to his principal’s affairs’ to be found in s.9(2) of the POBO.”²⁰ Clearly, such a definition includes everyone. From the most senior politician to the lowest street cleaner, everyone acts (at least at some point) for another. Such a definition thus results in an absurdity – as such a definition does not exclude anyone. As the POBO provides specific lists of persons covered, the legislative intent clearly aimed at creating two classes of persons -- ones who comprise public officials and another which does not.

The appellant – in their case – argued that application of the POBO to this case would “(i) have absurd implications, [and] (ii) create uncertainty.”²¹ We must admit that such a universal application of the POBO to persons “of a place outside of Hong Kong” seems to fit the bill on both counts. The absurd implications include making all persons potentially “public officials.” As we have previously noted, the other absurd implication derives in giving the ICAC jurisdiction over corruption committed by these persons of a foreign place. Clearly, if the POBO applies to these persons, then the ICAC would have jurisdiction (at least as the POBO currently reads). Such ambiguity clearly “create[s] uncertainty” (as the appellant claimed).

What about the various hyperbolic claims made by Hong Kong’s law firms’ that the case opens the door to the prosecution of bribery abroad and/or the POBO’s extra-

¹⁹ In the ICAC’s 2011 Annual Report, the Commission repeatedly highlighted the presentations it gave to the International Association of Anti-Corruption Authorities (IAACA). The report mentions a few examples of speeches given abroad – though nothing on the scale of other far-less famous anti-corruption agencies. See ICAC Annual Report 2011, available [online](#).

²⁰ *Id* at 19.

²¹ *Id* at 20.

territorial application? The Court could not be more plain, “the contention that the presumption against extra-territorial effect is applicable in the present case is highly questionable... [The offence] occurred in Hong Kong and the offence was therefore allegedly completed here. The fact that the desired conduct was intended eventually to take place abroad does not affect this.”²² The court never intended to create a precedent allowing for the POBO’s extra-territorial application. The court explicitly stated that if the LegCo wanted the Ordinance to apply extra-territorially, it would have so decreed.²³ The case of *B v. ICAC* does nothing more than illustrate the need to explicitly outlaw transnational bribery and define a position on the Ordinance’s extra-territorial application.

Detractors might erroneously claim that foreign law enforcement efforts mitigate the need to explicitly criminalise foreign bribery. Any Hong Kong person or company who pays a bribe these days abroad will almost certainly commit a crime in that foreign jurisdiction.²⁴ In theory, Hong Kong authorities can simply rely on foreign law enforcement. Mutual legal assistance seemingly provides an easy way for Hong Kong policymakers (and the ICAC) to avoid dealing with foreign elements of corruption-related cases. For elements of an offence which happened abroad, the ICAC might want to rely on foreign investigators and prosecutors. However, such an approach could increase the amount of corruption abroad (particularly in jurisdictions like Taiwan, India, China and Thailand).

The Hong Kong government’s failure to criminalise transnational bribery – and consider the extra-territorial application of the POBO at least to the Mainland – may well actually contribute to corruption abroad. Perpetrators bribe foreign police, prosecutors

²² *Id* at 21.4.

²³ As the Chief Justices noted, “in any event, the presumption [that the Ordinance should not apply extra-territorially] does not preclude the creation of an offence having an extra-territorial effect being legislated for in plain terms. And the legislation concerned is plain enough” (*Id.* at 21.3). In other words, if legislators wanted the Ordinance to apply extra-territorially, it would have put such provisions in black-letter law.

²⁴ Only 20 countries – as of December 2012 – have not adopted the UNCAC. The more notable countries include Germany, Japan, and the Czech Republic. See UNCAC signatories, available [online](#).

and judges to avoid indictment and trial.²⁵ Particularly in areas like China and Taiwan (where Hong Kong's administrative relations wax and wane), transmitting requests for evidence on cases where the ICAC is less than 100% sure the offence happened will be difficult. Third, if Hong Kong legislators criminalised foreign bribery, such lawmaking may help make foreign officials think twice before taking bribes at home and abroad.²⁶ When foreign officials commit a crime back at home (in China or Thailand for example), they may feel comfortable. When they know they might be prosecuted someday in Hong Kong, they might think twice before accepting a bribe (even if their country has a strong system of sovereign immunity).²⁷

Cases where foreign bribery may be allowed

Raison d'état represents one defence for transnational bribery. Countries have used the bribery of foreign officials as a legitimate tool of national security and foreign diplomacy for centuries.²⁸ *Raison d'état* (national interest) comprises the guiding principle of international relations and always take precedence over liberal-minded international law. In the US and UK, high-profile prosecutions have fallen by the waist-side based on national security (or interest) concerns.²⁹ Even in rulings by US courts, they found that – in dealing with the FCPA – the Department of Justice and SEC (who share competence for the enforcement of the Act) must consult with the Department of State who attends to the “exigencies of foreign affairs.”³⁰ Where private parties are

²⁵ For an example and supporting data, see Kathleen Barrett, 2010, *Corrupted Courts: A Cross-National Perceptual Analysis of Judicial Corruption*, Political Science Theses, available [online](#).

²⁶ For the way that foreign officials may fall afoul of a foreign jurisdiction's anti-corruption laws, see Paul Carrington, *Enforcing International Corrupt Practices Law*, 32 MICH. J. INT'L L. 129, 2010.

²⁷ For an analysis of the way that foreign and extra-territorial application of anti-corruption law may bread about the administrative “clans” that can protect each other from prosecution in highly corrupt jurisdictions, see Blake Puckett, *Clans and the Foreign Corrupt Practices Act: Individualized Corruption Prosecution in Situations of Systemic Corruption*, 41 GEO. J. OF INT'L LAW 4.

²⁸ For some historical examples of the ways governments have used bribery as an instrument of foreign policy, see Philip Nichols, *Are Extraterritorial Restrictions on Bribery a Viable and Desirable International Policy Goal under the Global Conditions of the Late Twentieth Century - Increasing Global Security by Controlling Transnational Bribery*; 20 MICH. J. INT'L L. 451, 1999.

²⁹ Carrington, in his discussion of the FCPA, refers to the Giffen case (dealing with the bribery of President Nazerbaev of Kazakhstan) and later the BAE case dealing with British bribery of Saudi officials. See Carrington, *supra* note 26.

³⁰ *Id.* at 409.

concerned, the court would not countenance lawsuits based on payments to foreign governments, as such suits could affect the “proper conduct of national foreign policy.”³¹

The UK Bribery Act of 2010 (UKBA) serves as an example of an anti-corruption act which providing one of the most explicit terms defining the use of such bribery. The Act allows for “a) the proper exercise of any function of an intelligence service, or (b) the proper exercise of any function of the armed forces when engaged on active service.”³² Under the Act, the “head of each intelligence service must ensure that [bribery] is necessary.”³³ The Secretary of State should ensure that each intelligence service has procedures in place designating when bribes may be offered.³⁴ The FCPA (in contrast) has had a much weaker national security exemption. The exemption notes that “with respect to matters concerning the national security of the United States, no duty or liability [to keep accurate accounts] shall be imposed upon any person acting in cooperation with the head of any Federal department or agency responsible for such matters.”³⁵ However, unlike in the UK case, the FCPA does not provide a list of circumstances in which US officials and/or companies may legally offer bribes abroad.

In Hong Kong, such issues present complications which do not appear at first glance. In theory, foreign bribery conducted reasons of *raison d’etat* should not concern the authorities – as they do not engage in foreign diplomacy. The Basic Law specifically stipulates that “the Central People's Government shall be responsible for the foreign affairs relating to the Hong Kong Special Administrative Region.”³⁶ However, in practice, Chinese security agencies do not need to (and probably will not) inform the ICAC in cases where members of Chinese security agencies engage in bribery abroad. The Mainland authorities maintain an office in Hong Kong (as per art. 13.2 of the Basic

³¹ *Id.*

³² *UK Bribery Act of 2010* at art. 13(1) [hereinafter UKBA].

³³ *Id.* at art. 13(2).

³⁴ *Id.* at art. 13(4).

³⁵ 15 U.S.C. § 78m(b.3).

³⁶ Basic Law of Hong Kong at art. 13(1).

Law). However, one could imagine situations where the ICAC engages in investigations of corruption sanctioned by the Chinese government.³⁷

The facilitation payments defence represents a far more popular and widespread issue. Most countries tend to criminalise facilitation payments – though exceptions exist on pragmatic grounds. The UN Convention against Corruption provides no defence or exception for facilitation payments.³⁸ The OECD has traditionally taken an ambiguous position on such payments. Its 2009 Recommendation “urges” public officials to stop seeking facilitation payments.³⁹ However, the Recommendation does not require signatories to outlaw the giving of these payments. The Recommendation, instead, requires signatories to “periodically review their policies and approach on small facilitation payments in order to effectively combat the phenomenon.”⁴⁰ The Recommendation seems to place the onus on companies – by “encouraging companies to prohibit or discourage the use of small facilitation payments.”⁴¹ In cases where companies make such payments, they should be “accurately accounted for in such companies’ books and financial records.”⁴²

³⁷ Given China’s relations with several highly corrupt jurisdictions – particularly in Africa – one could imagine situations where Mainland officials offer bribes based on orders from their superiors. In theory, the POBO would exempt such bribery as the Ordinance exempts from prosecution bribery offered (or accepted) with “lawful authority or reasonable excuse” (POBO at art. 4(1)). One could also imagine theoretical cases where Hong Kong officials may consider bribing Mainland officials to secure particular aspects of the security of the Special Administrative Region. As the bare mention of such a possibility would likely cause a stir, we discuss this no further.

³⁸ Many commentators – and the UN itself -- see the omission of a defence for facilitation payments as an outright ban on such payments. For example, in a recent UN produced document, they note explicitly that “The United Nations Convention against Corruption prohibits facilitation payments.” See UNODC, *Anti-Corruption Policies and Measures of the Fortune Global 500*, 2009, at 2, available [online](#).

³⁹ OECD, *Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, 26 November 2009, at VII.

⁴⁰ *Id.* at VIa.

⁴¹ *Id.* at IVb

⁴² *Id.* Prof. Jordan notes that such an approach to the facilitation defence poses a criminal quandary for companies. The accounting provisions still apply in most jurisdictions (requiring that companies account for bribes paid). Companies must still record facilitation payments as such. However, such facilitation payments are still illegal in the jurisdiction in which they are paid. See Jon Jordan, *The OECD’s Call for an End to “Corrosive” Facilitation Payments and the International Focus on the Facilitation Payments Exception under the Foreign Corrupt Practices Act*, 13 U. OF PENN. J. OF BUS. LAW 4, 2011.

Three common law jurisdictions (UK, US and Australia) take very different positions with respect to such facilitation payments – though are converging toward disallowing such payments as a legitimate defence. The UK Bribery Act (and related guidance) explicitly prohibits (in no uncertain terms) such facilitation payments.⁴³ Australian law allows for a facilitation payments defence.⁴⁴ However, recent calls to disallow the defence will likely lead to legislative changes in Australia.⁴⁵ The US FCPA has traditionally allowed for a facilitation payments defence. However, the defence has become narrower over time.⁴⁶

While the long-run trend clearly points to disallowing facilitation payments, most legal systems recognise the need for these payments. FCPA anti-bribery provisions permit so-called facilitation (or grease) payments to foreign officials for the purposes of expediting or securing the performance of a routine governmental action.⁴⁷ Such a defence allows for “obtaining permits, licenses...processing governmental papers...providing police protection...providing phone service... and actions of a similar nature.”⁴⁸ However, the FCPA clearly intends to exclude non-coercive action such as “any decision by a foreign official whether, or on what terms.” In general, the FCPA allows a defence for coercion, but not for bribes paid to obtain an advantage.

⁴³ The Serious Fraud Office (SFO) expresses the general tenor of UK legislation clearly, as “a facilitation payment is a type of bribe and should be seen as such.” A Full Code Test exists to determine if the SFO will proceed with a prosecution (as outlined in the Code for Crown Prosecutors and the Joint Prosecution Guidance of the Director of the SFO and the Director of Public Prosecutions). The SFO may also apply the Joint Guidance on Corporate Prosecutions.

⁴⁴ Australian Criminal Code Act 1995 at s70.4. The section provides a four part inclusive test to assess whether the defendant qualifies for the defence. Specifically, the defendant must demonstrate the “minor nature” of the benefit given, that the dominant purpose consisted of expediting or securing the performance of a routine government action of a minor nature, and that the defendant recorded the conduct.

⁴⁵ The Attorney General’s Office has led a public consultation looking into removing the facilitation payments defence. See Australian Attorney General, *Divisions 70 and 141 of the Criminal Code Act 1995: Assessing the ‘facilitation payments’ defence to the Foreign Bribery offence and other measures*, 15 November 2011, available [online](#).

⁴⁶ See Jordan, *supra* note 42. Part of the narrowing of the defence stems from Department of Justice’s interpretation of the provision, which has becoming increasing strict over time. For a discussion of DoJ treatment, see Richard Grime and Sara Zdeb, *The Illusory Facilitating Payments Exception: Risks Posed By Ongoing FCPA Enforcement Actions and The U.K. Bribery Act*, SEC. L. PRACTICE WORKING PAPER 5, 2011, available [online](#).

⁴⁷ 15 U.S.C. § 78dd (various sub-points).

⁴⁸ The original provides a non-exhaustive list.

The UK Government also “recognise[s] the problems that commercial organisations face in some parts of the world and in certain sectors.”⁴⁹ In general, the SFO and UK prosecutors allow facilitation payments if the company has a policy on facilitation payments, if such payments are made under duress and if recorded as facilitation payments.⁵⁰ Such derogations suggest that national authorities recognise the need for these payments in many parts of the world. The UK Government is not alone. Several government in the Asian region allow facilitation payments. Figure 3 compares these jurisdictions.⁵¹

Figure 3: Facilitation Payments in Perspective

Jurisdiction	Allowed?	Details
Australia	Yes	See main text for discussion
China	No	Chinese law specifically prohibits any consideration which might be deemed a facilitation payment
Hong Kong*	Yes	Under Chief Executive’s Permission Notice if not over €175.
Indonesia	Yes	The law does not mention such payments. However, a special Commission pay approve these payments.
Japan	Yes	No expressly prohibited (though generally accepted as not allowed).
Malaysia	Yes	If agreed by the person’s superiour
Philippines	Yes	Provides specific exemption for gifts
Singapore	No	Not allowed
South Korea	Yes	Allows small gifts and favours
Taiwan	Yes	Sets monetary limits on favours and gifts allowed
Thailand	Yes	Sets limits and conditions for accepting payments and gifts
Vietnam	Yes	Gifts under a certain limit allowed

Source: Rose Norton (2011).

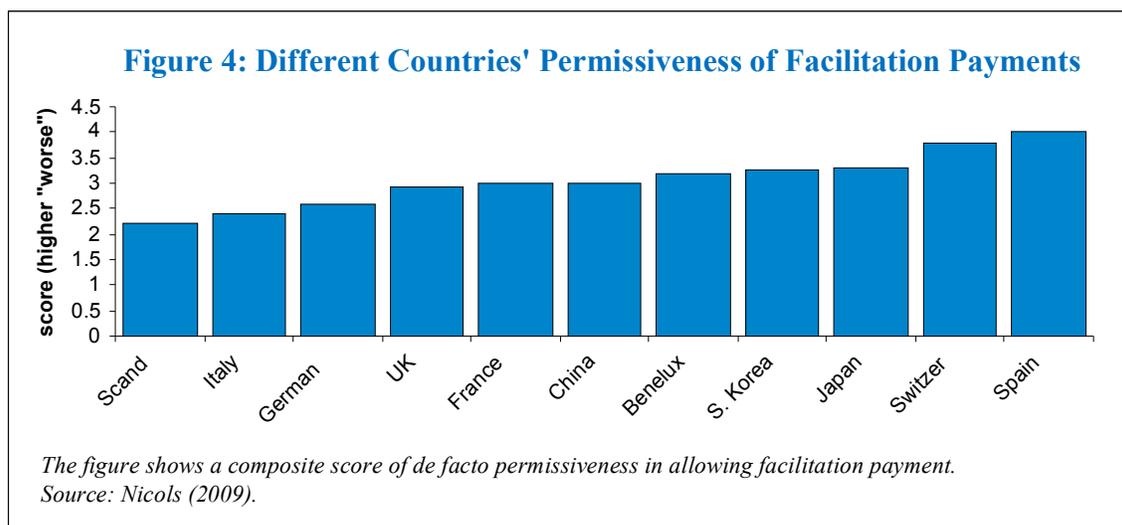
* Like many of these law reviews, this is only partially right. The Chief Executive’s Permission Note does not grant a blanket exemption and none of the examples given in the Note would fall under any reasonable definition of a “facilitating payment” (such as the ones provided under Australian and/or US law).

⁴⁹ UK Ministry of Justice, *The Bribery Act 2010 – Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing*, 2010, at 46 [hereinafter *Guidance*].

⁵⁰ Id at 48-51. For a popular press account of these defences, see Michelle Witton, *Anti-Corruption Views - Facilitation payments – Combating bribery in the front line*, available [online](#).

⁵¹ Norton Rose, *ANTI-CORRUPTION LAWS IN ASIA PACIFIC*, 2011, available [online](#).

The data suggest that companies working in developing markets still need a facilitation payments defence (whether they legally have one or not). Figure 4 shows the extent to which companies in a number of jurisdictions make allowance for facilitation payments **despite the criminalisation of such payments in their own domestic legislation**. On a 1-5 point scale, Spanish, Swiss and Japanese companies' rules make the greatest allowance for facilitation payments.⁵² Despite the criminalisation of such facilitation payments in the UK, many UK companies still provide guidance to employees for offering these payments. Such data do not suggest these companies ignore the law. Instead, they respond to real needs in some of the markets they serve.

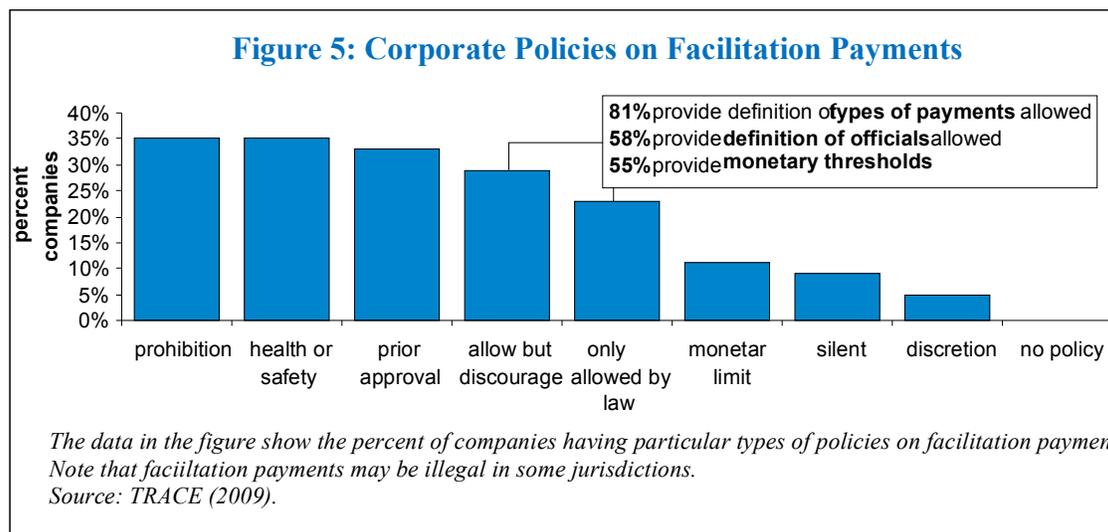


Other data suggest that companies world-wide use facilitation payments to react to problems – rather than seek commercial advantage.⁵³ Figure 5 shows the extent to which various companies in a range of countries have policies with regard to facilitation payments. Of the companies surveyed, less than 40% had policies prohibiting facilitation payments. Remembering that many of these companies operate in countries which completely criminalise these payments, over 80% of companies with policies on facilitation payments provide guidance on the types of payments allowed. Even among companies with facilitation payments-related guidance, about 55% provide monetary

⁵² Philip Nichols, *Who Allows Facilitating Payments?* AGORA WITHOUT FRONTIERS 14, 303, 323, 2009.

⁵³ TRACE, *Facilitation Payments Benchmarking Survey*, 2009, available [online](#).

thresholds about the amount of money which agents can offer to facilitate government action. Such data show that companies have adapted to a pragmatic need. In many developing countries, companies still need to make facilitation payments. Most commentators (like TRACE) see corporate policies allowing for facilitation payments as a sign of avarice – as companies seek to exploit the potential gains from bribery. We would argue that at least some of this bribery comes from need rather than want.



If the POBO criminalises transnational bribery, Hong Kong legislators will need to think hard about defences involving bribery linked to facilitation payments. Hong Kong legislators will have strong incentives to provide some flexibility in the current regime – especially for companies operating in much more corrupt business environments than those in Hong Kong, the US, UK and other upper-income jurisdictions. Hong Kong legislators will hear about the risks to Hong Kong’s competitiveness without a facilitation payments defence.⁵⁴ Hong Kong legislators will also hear that local businesses must trade with one of the most notoriously corrupt jurisdictions in the world. The Chinese Criminal Code prohibits the payment (or

⁵⁴ Both UK and US legislators faced serious calls for a facilitation payments defence on the grounds that local business would lose out to bribe-paying foreign competitors. Even recent analysis suggests this is still the case in the US. See New York City Bar, *The FCPA and its Impact on International Business Transactions— Should Anything Be Done to Minimize the Consequences of the U.S.’s Unique Position on Combating Offshore Corruption?*, 2011, available [online](#).

acceptance) of bribes.⁵⁵ However, the Criminal Code has far less to say about rent-seeking.⁵⁶ The regulations that provide these civil servants with rent-seeking power (and the rents actually paid in the form of bribes) are ruled as legal by corrupt judges who rule on administrative, civil and criminal cases. Faced with a far less reliable executive and judiciary on the Mainland, many Hong Kong companies will continue to feel pressure to pay bribes.

Yet, even the UK – with its clear prohibition on facilitation payments – shows how a workable system can function in Hong Kong. UK law explicitly outlaws facilitation payments. However, as we have previously noted, recent *Guidance* defines several cases under which companies may have an excuse for paying bribes. Such an approach seems relevantly familiar in the Hong Kong context (which currently criminalises all facilitation payments).⁵⁷ Hong Kong – like the UK – provides the same kinds of guidance to prosecutors (in the form of an indigenous Full Code Test). Unlike the case in the UK and the US when the FCPA was adopted, Hong Kong’s largest trading partner is also one of the more corrupt jurisdictions. Complete criminalisation of facilitation payments represents (of course) the best option. In the shorter-term (as we describe later), the practical application of facilitation payments-like defences can help the ICAC (and the Chinese authorities) collect information on corrupt institutions and individuals on the Mainland. Such information can serve to root out corruption more effectively than a blanket (and possibly ineffective) ban on all facilitation payments.⁵⁸

⁵⁵ Chinese Criminal Code, 1997 (8th Session), c. 9, at art. 385.

⁵⁶ Economists also refer to a special case of this phenomenon as regulatory or state capture. Such capture occurs when corrupt regulators or public officials legalise unethical or formerly illegal activities in order to receive personal profits from such activities. For a discussion in the Chinese context, see Nanping Liu, *Trick or Treat: Legal Reasoning in the Shadow of Corruption in the People’s Republic of China*, N.C. J. INT’L L. & COM. REG., available [online](#).

⁵⁷ Following the US, the UK has also recently encouraged self-reporting by bribe payers (in exchange for prosecutorial leniency). Called the “Self-Reporting Initiative for Businesses,” the initiative allows companies to settle in a civil case instead. In practice, courts have tended to ignore prosecutors’ suggestions for leniency. See Crown Prosecution Office, available [online](#).

⁵⁸ To provide a sneak peak at our argument later in the paper, we argue that wide-spread reports from Hong Kong companies who have been the victims of bribe-related extortion on the Mainland can provide the ICAC with valuable information on the extent and types of bribes solicited. The sharing of such information between the ICAC and its Mainland counterparts far more effectively serve of reducing corruption on the Mainland.

Options for criminalising foreign bribery

Given the structure of the current Ordinance, law drafters will have two options in following international practice regarding the criminalisation of the bribery of foreign officials. A *marginalist approach* would seek to preserve the current structure of the Ordinance – attempting to graft new provisions outlawing foreign bribery onto the existing Ordinance structure. The *OECD/UN-based approach* would follow the same drafting strategy adopted by roughly 50 countries world-wide – rescinding previous legislation and adopting a new bill which provides for general definitions and provisions consistent with the OECD Convention and the UN Convention. We include the UK in this approach – as the UK engaged in a wholesale overhaul of its anti-corruption legislation in 2010. Both options would remove the extremely limiting definitions of public officials provided in Schedules 1 and 2 of the POBO. Specific lists of institutions covered inefficiently require constant revision. Enough case law has now been accumulated to know what a broader “public power” might be – making these kinds of lists obsolete.

a) marginalist approach – a revised POBO may change the definition of a “public body,” “prescribed officer” and “public servant” (under Section 2(1) of the POBO) to explicitly include foreign public bodies and officers. Such an approach would either add elements to each definition to include foreign bodies and public officials – or create the three new legal terms of “foreign public body,” “foreign prescribed officer” and “foreign public servant”). The approach would be clunky and leaves a relatively inefficient (from a drafting point of view) ordinance structure intact.⁵⁹ First, the definitions used in the POBO – while revolutionary for the 1970s – do not match many of the definitions adopted in the UN Convention (and thus in other jurisdictions). The definition of “public official” represents the most obvious example. Such definition “mismatch” can cause problems later when Hong Kong or a foreign jurisdiction seeks to engage in mutual legal assistance based on principles like dual criminality. Second, from

⁵⁹ Even in the Court of Final Appeal’s response in *B vs. ICAC*, the Court had to refer to these definitions and “recreate” the meaning of the POBO before addressing the points of law in the case.

a political economy point of view, a marginalist approach to POBO reform allows constituencies against reform several opportunities to block reforms adopted in most of the world. As the folk wisdom goes, “better to cut the diseased tail off the dog once, rather than in small pieces many times.”

b) OECD/UN-based approach – such an approach would transpose the wording from the UN Convention (already ratified by Hong Kong) into the POBO. We call this approach an OECD/UN-based approach because the UN Convention uses the wording from the older OECD Convention. The OECD Convention still remains the model used by organisations like the Council of Europe’s GRECO and technical assistance teams working in countries like Turkey, Azerbaijan and Montenegro as they work on harmonisation with the Convention. However, such an approach would require an almost complete rewrite of the POBO to remove the clunky wording and the list of covered organisations in the two Ordinance Schedules.

Hong Kong should adopt such an OECD/UN-based approach for three reasons. First, trying to keep the current POBO structure intact will likely create loopholes as the ICAC tries to proceed with foreign prosecutions. Questions about whether a particular organisation or bribee is covered under a revised list of regulated organisations would create legal uncertainty and encourage Hong Kong companies to “game” the Ordinance.⁶⁰ In our opinion, *B v. ICAC* represents an early case where such uncertainty has come to the fore. Second, the OECD/UN approach has already generated thousands of pages of legal analysis, commentary and implementation lessons. The results of OECD Member States’ experiences with implementation (and other third-party countries like Council of Europe GRECO members) are easily available from reports generated during peer review and monitoring meetings.⁶¹ Hong Kong can well learn from others’ experiences. Third, China already participates in the OECD Working Group on Bribery as an observer. With

⁶⁰ Gaming the Ordinance refers to strategic actions taken by Hong Kong companies working with parties not covered by the revised Ordinance in order to bribe public officials abroad legally.

⁶¹ Monitoring of the OECD Anti-Bribery Convention already has proceeded to the third-round. For monitoring results, lessons learned and other analytic materials, see OECD, *Phase 3 country monitoring of the OECD Anti-Bribery Convention*, available [online](#).

continued economic and political integration between Hong Kong and the Mainland, Hong Kong law should anticipate closer harmonisation with Mainland law. With Hong Kong law looking more like Chinese law (and both laws looking more like OECD Member States' law), such legislation will provide a "common language" (and indeed a common forum in the OECD Working Group) for working together on fighting corruption. Such an approach also provides the ICAC and LegCo's supporters for reform with political cover – as they can "blame" the OECD for changes by saying basically "we agreed to follow OECD guidelines and now the guidelines are X, Y and Z."

The OECD-UN based approach has its downsides however. First, the cost of political consultations, internal analysis and so forth can easily top HK\$50 million. The ICAC, DoJ, Hong Kong's legislators, and other interested parties would spend all that money – only to arrive (in the best case) at a law already in use.⁶² Given Hong Kong's size, it's government should simply copy best practice in this area rather than try to reinvent the wheel. Second, each potentially divisive issue could derail the entire project of reforming the POBO. To continue with our dog-tail analogy, "better not to cut at all if we can not decide where to cut." Arguing over a one-shot set of anti-corruption provisions might derail POBO reform in general. Contributions to foreign political campaigns comprise one such issue. Many OECD Member States have left political corruption completely untouched – as reform would be too difficult and could derail reform in general. As Carrington notes, "one substantive difference between the OECD Convention and the FCPA is that the Convention does not forbid campaign contributions to foreign candidates for public office, as the FCPA does. And the Convention does not obligate signatory nations to enact accounting and recordkeeping standards corresponding to those enforced in the United States by its Securities Exchange Commission."⁶³ Clearly, not all countries could adopt FCPA-style anti-corruption legislation. In China, the issues become even more murky. For example, do expenses

⁶² The sums of public funds used for such consultations can well exceed this figure for a large country like the US. We calculated HK\$50 million by estimating the number of UK public consultations (roughly 100) and the various costs associated with those meetings – including transportation costs, venue costs, lost wages and productivity and so forth.

⁶³ Carrington, *supra* note 26 at pp. 18-19.

helping a local political mandarin gain support within the Communist Party constitute a “campaign expense” in a country without official campaigns?

c) mixed approach – In practice, we expect Hong Kong’s legislators to use a OECD-UN style reform.. with the flavour of a gradualist reform. As we describe in more detail in Appendix II (using the example of a previous LegCo composition to illustrate the issues involved), a one-shot reform would not garner enough votes. A staged approach to a one-shot reform (on the other hand) would shift political incentives enough to encourage full adoption of reform.⁶⁴ The main reforms in 2015 would serve as a focal point for the other ancillary reforms. The other reforms would centre on preparing for the overhaul of the Ordinance (in 2014) and implementing reforms enabled by a new POBO (in 2016-2017).

Hong Kong’s companies (as described in Appendix II) would likely resist such a large-scale overhaul of the POBO. Hong Kong’s companies operate in a region where the bribery of foreign officials has traditionally received far less attention than in Europe and the Americas (though this has changed after the recent elections to the National People’s Congress elections). Hong Kong ranks first on Bloomberg’s index of *Ease of Doing Business* – and policymakers will hesitate in passing laws which make doing business harder. We describe later some of the other elements which companies will object to most – corporate criminalisation of corruption, non-prosecution agreements and the other “baggage” which has come with anti-corruption law reform (particularly in the UK).

What about the diplomatic aspects of transnational application of the POBO? The issues are even more acute for Hong Kong – as the ICAC’s enforcement actions will have consequences on the diplomatic relations with/of the entire People’s Republic of China. Simple regulation could encourage the ICAC to meeting with the Commissioner's Office of China’s Foreign Ministry in Hong Kong in order to develop a procedure for informing

⁶⁴ For more on models of policy reform (including the best way to divide policies, delay certain parts of legislative reform and so forth), see Anders Olofsgard, *The Political Economy of Reform: Institutional Change as a Tool for Political Credibility*, paper prepared for the World Bank, WORLD DEVELOPMENT REPORT, 2005, available [online](#).

the Ministry (and obtaining approval for) enforcement actions involving the POBO affecting foreign nationals. The working procedures used may be similar to those already used when informing the Chinese government about mutual legal assistance actions.⁶⁵

Future treatment of facilitation payments best describes how such a pragmatic mixed approach to reform. The only realistic option for Hong Kong would consist of outlawing facilitating payments. However, Hong Kong companies making illegal payments to Chinese (and other) officials abroad should be allowed and/or required to self-declare to the ICAC these payments in order to qualify for prosecutorial leniency (to the extent such leniency might be given in the future).⁶⁶ Such an exemption from full prosecution serves three broader public policy objectives. First, such self-declaration will allow the ICAC to receive regular reports about bribe-seeking behaviour on the Mainland. The ICAC can use these data in its discussions with its Chinese counterparts at the National Bureau of Corruption Prevention as they consider the epidemiological evolution of corruption in particular regions. Second, self-reporting will provide information useful for detecting corruption. Imagine that two companies work with the same Chinese official in the same province. Company A self-declares that a bribe was paid, and Company B does not. Obviously, the ICAC should suspect Company B for paying bribes if the Commission has other evidence (or at least change its risk profile about Company B). Third, after 3-5 years of receiving self-declarations, the ICAC can issue revised regulations on the legitimacy of certain kinds of defences. For example, payments to court clerks may be legal in certain Chinese provinces. But the ICAC can decide that such payments will from a certain date (2020 for example) be illegal and unavailable as a defensible payment under the new POBO law.

⁶⁵ Chief Executive to give notice to Central People's Government in relation to Hong Kong requests and external requests, available [online](#).

⁶⁶ Both the US and UK have had significant teething problems in granting prosecutorial leniency for self-reporting. In both cases, courts have tended to reject prosecutor's attempts to ask for reduced sentences – encouraging the use of administrative plea bargains (called non and deferred prosecution agreements which we describe later in this paper).

Allowing for the Prosecution of Corrupt Mainland Officials in Hong Kong

The extra-territorial application of anti-corruption law in general poses two interesting questions for Hong Kong. First, should Hong Kong law be extra-territorial in nature? Because of its extremely close economic relationship with China, the extra-territorial application of Hong Kong anti-corruption law may (unlike in the US or UK examples) provide very real and tangible benefits to Hong Kong. Second, how should Hong Kong authorities respond to extra-territorial application of foreign law in Hong Kong? The extra-territorial application of the FCPA and the UKBA aims to bolster weak government's efforts to fight corruption. However, as a strong government, to what extent do these developments pose a risk to Hong Kong?

What is the extra-territorial application of anti-corruption law – and how would it apply to China?

The US – and now the UK – have decided to impose their laws (and views of those laws) on the rest of the world. At least, you would believe so reading a number of recent analyst's comments about the FCPA and UKBA. Professor Ross recently asked the question – in response to the prosecution of the Japanese construction and engineering company JGC Corporation -- “how was a Japanese company haled into court in Texas for conduct—bribing foreign officials to obtain business—that was initiated in Europe, the effects of which were felt in Africa, and that had only a tangential connection to the United States?”⁶⁷ Professor Davis – in seeking to unravel the motivations for US prosecutors to chase companies around the world for crimes committed outside the US – asks succinctly “Why does the United States regulate bribery of foreign public officials? Don't U.S. authorities have more than enough corruption to tackle at home without worrying about the misdeeds of public officials in far-off lands?”⁶⁸

⁶⁷ Lauren Ross, *Using Foreign Relations Law to Limit Extraterritorial Application of the Foreign Corrupt Practices Act*, 62 DUKE L.J. 445, 2012, at 447.

⁶⁸ Kevin Davis, *Why Does the United States Regulate Foreign Bribery: Moralism, Self-Interest, or Altruism?* NYU SCHOOL OF LAW, PUB. L. RES. PAPER 12-51, 2012.

On paper – and in practice – US and UK authorities do seem to have these powers. The US legislation covers cases where US persons and businesses engages in corruption anywhere in the world as well as where US issuers or others use US mail and or “instrumentality of US interstate commerce” for corruption.⁶⁹ The DoJ and US courts have interpreted many of the provisions broadly – leading to a recent expansion of prosecutions on rather precarious jurisdictional claims. The UKBA establishes jurisdiction over corruption committed outside the UK for “person[s] ha[ving] a close connection with the United Kingdom.”⁷⁰ The Act explicitly covers nine types of persons which may face prosecution for corruption committed outside the UK – including British citizens, subjects and residents as well as citizens of British overseas territories. Given the newness of the new Act, few extra-territorial prosecutions have emerged from the UKBA. However, most commentators note that a similar wave of extra-territorial prosecutions under the UKBA will come sometime soon.

Yet, extra-territorial application does not give US (or any other prosecutors) *carte blanche* to prosecute anyone anywhere. A number of legal instruments, treaties and agreement underpin the application of such extra-territoriality. The US has standing arrangements in a wide number of jurisdictions for mutual legal assistance. Given the special nature of US security and criminal law enforcement arrangements world-wide, the US possesses a unique position for enforcing extra-territorial legislation.⁷¹ Agencies like FBI liaison offices abroad and other DoJ agencies working abroad do much of the ground-work in international investigations and in preparing the ground of evidence collection, extradition, and other aspects of mutual legal assistance in the extra-territorial application of the FCPA. Given the specificities of these US arrangements, they do not provide suitable lessons for jurisdictions like Hong Kong. However, the UK experience

⁶⁹ 15 U.S.C. § 78dd-3. Literally, hundreds of articles review the legal basis for the extra-territorial application of the FCPA. Rather than repeat this over-written about subject, we refer the reader to Ashe. See Daniel Ashe,

Lengthening Anti-Bribery Lasso of the United States: The Recent Extraterritorial Application of the U.S. Foreign Corrupt Practices Act, 73 *FORDHAM L. REV.* 2897, 2005.

⁷⁰ UKBA at s. 12(4).

⁷¹ For a vade mecum of these law enforcement arrangements, and an analysis of their role in global governance, see Allegra McLeod, *Exporting U.S. Criminal Justice*, 29 *YALE L. & POL. REV.* 83, 2010.

does provide useful lessons. UK mutual legal assistance on the extra-territorial application of the UBKA outside the EU benefits from a number of international instruments and agreements.⁷² First, the Council of Europe Convention on Mutual Legal Assistance in Criminal Matters (and related protocols) provides for limited support in areas like extradition, the conduct of joint investigation teams and so forth.⁷³ Forty-seven countries belong to the Council of Europe and include countries like the Ukraine, Azerbaijan, Russia, Moldova and other high-corruption risk jurisdictions. Second, the OECD Convention encourages signatories to allow for some measure of mutual legal assistance. According to article 9(1), “each Party shall, to the fullest extent possible under its laws and relevant treaties and arrangements, provide prompt and effective legal assistance to another Party for the purpose of criminal investigations and proceedings brought by a Party concerning offences within the scope of this Convention.”⁷⁴ Third, the UN Convention Against Corruption (UNCAC) contains provisions related to mutual legal assistance which all signatories should incorporate into their domestic legislation. The Convention does not specifically ask signatories to help enforce extra-territorial provisions of other signatories’ anti-corruption law. Yet, the Convention does encourage, “States Parties...[to] afford one another the widest measure of mutual legal assistance in investigations, prosecutions and judicial proceedings in relation to the offences covered by this Convention.”⁷⁵

If the POBO applies abroad, Hong Kong legislators would need to decide on the rationale for such extra-territorial application – and where such application suited the Hong Kong public interest. From a strictly practical point of view, Hong Kong’s authorities have a strong interest in **partial extra-territorial application** (focused on the

⁷² We discuss mutual legal assistance outside the EU as the new Treaty on the Functioning of the European Union has created close-knit law enforcement (Justice and Home Affairs) space within the EU.

⁷³ See European Convention on Mutual Assistance in Criminal Matters, ETS 30. The Second Protocol in particular defines many of the practical measures law enforcement agencies may rely on. See Second Additional Protocol to the European Convention on Mutual Assistance in Criminal Matters, ETS 182.

⁷⁴ OECD Anti-Bribery Convention, at art. 9(1).

⁷⁵ UNCAC at art. 46.1. The Convention in article 46 provides a list of the types of mutual legal assistance signatories should provide.

Mainland and the Greater Chinese region which includes Taiwan).⁷⁶ First, the Mainland and Taiwan represent Hong Kong's largest trading and investment partners. The economic crime of corruption has important impacts on Hong Kong trade – militating for a stronger role in Hong Kong's enforcement over corruption abroad.⁷⁷ Second, Hong Kong and the Mainland form one territory (albeit with two different and independent legal systems). Such a territoriality principal of jurisdiction clearly would not extend to Taiwan. However, to the extent that Hong Kong and China form a single territory – and particularly nationality – then the principles of nationality and territoriality might clearly encourage Hong Kong authorities to settle extra-territorial application of a revised POBO at least on the Mainland. Third, corruption in Taiwan and the Mainland largely affects Hong Kong citizens. Bribes paid on Mainland distort trade decisions, hurt relatives living on the Mainland, and affects the share prices of companies in Taiwan and the Mainland which Hong Kong citizens have invested in. Hong Kong authorities clearly have an interest in preventing harms to Hong Kong's business and other interests arising from such corruption in its own neighbourhood.⁷⁸ In practice, Hong Kong's legislation would not define specific application in the Greater China region anymore than the US's or UK's might focus on their major commercial partners. However, like the US and UK, enforcement actions would focus on national interest and the costs and benefits of enforcement.⁷⁹

⁷⁶ We argue that extra-territorial application would apply globally – allowing litigants to use Hong Kong's courts in private action cases. However, the ICAC would not become involved in these cases (other than perhaps help parties obtain evidence through official requests and so forth).

⁷⁷ Several commentators have argued for the directed application of the US FCPA based on such an “effects doctrine” view of jurisdiction. For a fuller discussion, see Christopher Duncan, *1998 Foreign Corrupt Practices Act Amendments: Moral Empiricism or Moral Imperialism*, 1 ASIAN-PAC. L. & POL. J. ., 2000, at 31.

⁷⁸ Klaw makes reference to the legitimate use of such a passive personality principle for the extra-territorial application of the FCPA. See Bruce Klaw, *A New Strategy for Preventing Bribery and Extortion in International Business Transactions*, 49 HARV. J. ON LEG. 370, 2012, 384.

⁷⁹ We have restated the Full Code Test which guides prosecutions in the UK (Hong Kong uses similar principles in deciding on prosecutions).

Lessons from the extra-territorial application of anti-corruption law

As a portent for Hong Kong, the extra-territorial application of US anti-corruption law appears to have yielded few – if any – positive benefits for the US. Spalding (2010) finds – using a correlation analysis of FCPA enforcement actions and investment decisions in foreign markets -- that the FCPA currently dissuades US trade with developing (and highly corrupt) countries.⁸⁰ Such work follows up on previous studies from authors -- like Cuervo-Cazurra -- who find statistically significantly reduced foreign direct investment in highly corrupt countries after a country adopted the OECD anti-corruption convention.⁸¹

More nefariously, the FCPA appears to hinder business – without necessarily fighting corruption abroad. Koehler refers to the “façade of FCPA enforcement.”⁸² Such a façade consists of Department of Justice actions aimed at giving the appearance of enforcement. Such enforcement actions often involve rather tenuous evidence (certainly nothing that would serve as the basis for a prosecution in most jurisdictions) and a quick non-prosecution agreement.⁸³ Koehler reviews many of the higher-profile FCPA cases (particularly those settled through deferred and/or non-prosecution agreements). He finds that – despite flimsy evidence -- many of these settlements occurred because a long, drawn-out fight with the US Department of Justice would cost more than settlement.

Prof. Sykes analyses the economic effects of the Alien Tort Statute – and the extra-territorial vicarious liability of employers for the corrupt and criminal deeds of their employees.⁸⁴ His long and detailed analysis of the theoretical economic and social costs and benefits of extra-territorial application lead him to a fair amount of scepticism. He

⁸⁰ Andrew Spalding, *Unwitting Sanctions: Understanding Anti-bribery Legislation as Economic Sanctions Against Emerging Markets*, 62 FLOR. L. REV., 2010.

⁸¹ Alvaro Cuervo-Cazurra *The Effectiveness of Laws Against Bribery Abroad*, 39 J. OF INT’L BUS. STUD. 4, 2008: 634-651.

⁸² Mike Koehler, *The Façade of FCPA Enforcement*, 41 GEO. J. INT’L L. 907, 2010.

⁸³ We discuss non and deferred prosecution agreements later in this paper. In brief, these agreements allow the Department of Justice to punish companies and individuals for engaging in corruption before having sufficient evidence which would stand in a court of law.

⁸⁴ Alan Sykes, *Corporate Liability for Extraterritorial Torts under the Alien Tort Statute and Beyond: An Economic Analysis*, STANFORD L. & ECON. OLIN WORKING PAPER 420.

generally finds two problems with the extra-territorial application of law. First, these laws generally include extensive reporting and other costs that companies operating abroad must bear. They also expose these companies to the risk of enforcement actions which can be more severe than in the foreign jurisdiction. Second, foreign law enforcement agencies “free ride” on US law enforcement actions. As the US polices key anti-corruption, anti-competition and other policies, foreign governments need to invest less in these public services. Figure 6 provides a summary of these (and other) welfare losses.

Figure 6: Extra-territorial application of anti-corruption law generally leads to negative welfare effects globally

Group	General Effect
Consumer welfare overall	Falls. Consumer welfare falls as the price of products rises and quantities provided falls – as companies scale back to pay for compliance with extra-territorial laws.
Producer welfare overall	Falls. Producers’ costs rise, causing decreased profits.
Government welfare	Falls. The effect on government welfare depends on whether fines exceed the cost of enforcement. In most cases, the cost of enforcement exceeds the gain in fines.
Third-party social welfare	Rises. Third parties can seek recourse in foreign fora – improving welfare.

Source: Based on Stykes (2012).

All the conditions which led the US to exercise extra-territorial standing exist in Hong Kong. McLean uses econometric methods to help explain (or at least predict) when courts would take standing under the FCPA.⁸⁵ In his study, he looks at the effect on FCPA enforcement of foreign direct investment, experiences with corruption abroad, similarity of legal systems and other factors. He finds that the level of foreign investment in a country (holding other factors constant) statistically significantly explains FCPA enforcement actions. He also finds that the amount of corruption in the foreign jurisdiction also helps to explain (with a 99% level of confidence) FCPA enforcement actions. If the US results shed light on the underlying preferences for extra-territorial application of Hong Kong law, then China represents an important area for possible enforcement of the POBO.

⁸⁵ Nicholas McLean, *Cross-National Patterns in FCPA Enforcement*, 121 YALE L. J. 1040, 2012, available [online](#).

Other econometric studies suggest that Hong Kong policymakers may follow US policymakers in extending extra-territorial application of the POBO (particularly to China). Putnam looks at several predictors for US courts exercising extra-territorial jurisdiction.⁸⁶ She finds – in her sample of 438 cases – that US courts tend to take standing only when the case involved some *real politik* element of a “threat to the integrity of domestic rule.” She finds no impact of the ideological reasons that one would expect of judges to uphold – such as considerations of human rights as well as the complementarity and adequacy of the foreign country’s legal system.

In the final plot twist of the extra-territoriality story, the harms associated with extra-territorial effect probably do not apply to China. The reader will recall that many authors have found that extra-territorial enforcement can make investment returns unpredictable and deter foreign investor. Hines notes that this does not apply to China.⁸⁷ She cites numerous cases where the US companies fined under FCPA have not in any way deterred other companies from competing in China. She (like most commentators) point to large market sizes and the importance of *guanxi*. Pedersen finds that – even though the FCPA puts US companies at a competitive disadvantage vis-à-vis other countries competitors -- such a disadvantage does not stop US companies from coming to China.⁸⁸ Such effects are interesting – particularly for Hong Kong – because Hong Kong’s economy depends much more on the Chinese economy than the US’s.

Yet, we know that revisions to the POBO to explicitly outlaw foreign bribery will lead to an important reorientation of Hong Kong’s trade away from China, India, Thailand and Taiwan -- and toward to the US and UK. D'Souza uses econometric analysis to assess the extent to which ratification of the OECD Convention led to

⁸⁶ Tonya Putnam, *Courts Without Borders: Domestic Sources of US Extraterritoriality in the Regulatory Sphere*, 63 INT’L ORG. 3, 2009: 459-490.

⁸⁷ Nicole Hines, *Cultural Due Diligence: The Lost Diligence That Must be Found by U.S. Corporations Conducting M&A Deals in China to Prevent Foreign Corrupt Practices Act Violations*, 9 DUQ. BUS. L.J. 19, 56 (2007).

⁸⁸ Eric Pedersen, *The Foreign Corrupt Practices Act and its Application to U.S. Business Operations in China*, 7 J. OF INT’L BUS. & LAW 1, 2008.

distortions in trade.⁸⁹ She found that ratification of the OECD Convention lead to statistically significant changes in a country's direction of trade – particularly away from trading partners with high levels of corruption. She also finds that countries with lower levels of corruption before implementing the OECD Convention did not experience the same levels of trade distortion (such as Sweden) than those with relatively higher levels of corruption (like Portugal). Thus, Hong Kong companies might simply reduce or alter their trade to other countries (like the UK and US) with lower levels of corruption.

Ironically, the criminalisation of foreign bribery – particularly when criminalising foreign bribery committed in China – could actually increase disguised trade with China. d'Sousa also speculates that highly corrupt countries step in to replace trade that OECD signatories formerly had with more corrupt countries. Traders use third-party intermediaries in these corrupt countries to export to other corruption jurisdictions – rather than trading directly themselves.⁹⁰ Such a result obviously suggests that Hong Kong companies might increase their use of Chinese partners to export to highly corrupt jurisdictions like India and Malaysia. **Such a reorientation will at least equal the amount exposed to corruption – or \$34 billion Hong Kong dollars.**⁹¹

The explicit criminalisation of foreign bribery would likely also change the composition of Hong Kong's trade (namely the types of products these companies sell). D'Sousa finds that after the adoption of the OECD Convention, countries preferred to trade in differentiated rather than relative homogeneous (commodity) goods. First, she argues that such trade distortion occurs because bribes influence demand for differentiated goods less. Governments purchasing a commodity are more likely to pick a

⁸⁹ See Anna D'Souza, *The OECD Anti-Bribery Convention: Changing the Currents of Trade*, Online Working Paper Series, California Center for Population Research, UC Los Angeles, available [online](#).

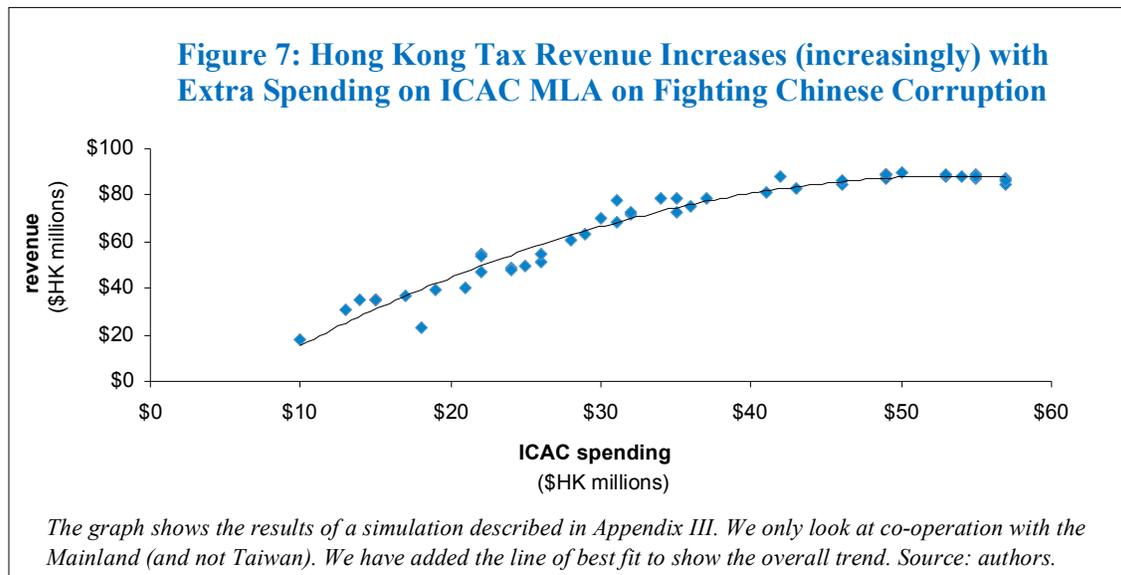
⁹⁰ Klaw goes so far as to suggest that the decriminalisation of giving bribes to foreign officials. He argues that reporting of these bribe payments to the DoJ and SEC (and other agencies) should “bring corruption out of the shadows.” We later argue in our own analysis that Hong Kong law may wish to do something similar (at least in the short to medium term) vis-à-vis China. See Klaw at *supra* note 77.

⁹¹ Later in this section, we show – using an economic model – that the effect consists of two parts. On the one hand, Chinese traders avoid doing business with Hong Kong related traders because of fear of breaking anti-corruption laws. On the other hand, less corruption encourages economic growth – creating more opportunities (and trade) for Hong Kong companies' Chinese partners.

supplier based on bribes and kick-backs rather than on product quality and other attributes. Second, prices of commodities are easier to establish than for differentiated goods. Thus, any price increase (which covers the costs of bribes paid) would likely be more easily detected. Hong Kong's exports consist of largely refinished branded (but otherwise relatively homogeneous) exports which would likely suffer from the criminalisation of foreign corruption. These exports include electrical machinery and appliances, textiles and apparel, footwear, watches and clocks, toys, and precious stones. Hong Kong exporters likely need to pay bribes (particularly in China) to ensure that Chinese authorities do not let illegal Chinese competitors compete with them. They also need to pay bribes to overcome administrative obstacles.

How does extra-territorial application help Hong Kong?

We have constructed an economic model looking at the effects of the extra-territorial application of the POBO on the economy (and specifically tax revenues). We want specifically to know if such a policy would help or hurt the voters (overall) who would be voting for or against such a policy. We find that such extra-territorial application could have significant and positive influences for trade and investment by Hong Kong traders on the Mainland. Figure 7 answers the key question – what kind of return (in terms of extra taxes collected in Hong Kong) comes from paying for the ICAC's extra-territorial application of the POBO in China? We find that a 10% increase in the ICAC's budget (which would cover part of the costs of extra-territorial application on the Mainland) would increase tax revenue by US\$18 million. Such growth represents an 80% rate of return on the extra expenditure. A 50% increase in the ICAC's budget would generate US\$80 million in extra tax revenue.



Hong Kong taxpayers would benefit from providing the ICAC with extra resources in order to enforce the POBO in the Greater China region. The bribery of foreign officials (in this case, Mainland officials) pulls money away from the pockets of Hong Kong businessmen. Such bribery also distorts trade and investment decisions on the Mainland – clearly affecting the Hong Kong economy. In some cases, Hong Kong businessmen may profit from such bribery. However, as we argue later in this paper, the application of the POBO on the Mainland provides these Hong Kong companies with one set of anti-corruption rules – facilitating investment and trade decisions. The general economic evidence suggests that fighting corruption generally increases trade, investment, and economic welfare. Thus, the extra-territorial application of the POBO represents a win-win situation for Hong Kong and the Mainland.⁹²

⁹² We discuss Taiwan in a subsequent section. Law enforcement co-operation with Taiwan likely represents a more complicated issue than co-operation with the Mainland. However, we would imagine that the gains from applying the POBO extra-territorially to Taiwan would also create a similar win-win situation for both jurisdictions.

Preventing double jeopardy

Hong Kong is locked in a web of over-lapping extra-jurisdictional anti-corruption law. Figure 9 shows the Hong Kong's top 5 trading partners (by value of overall trade) and the applicability of their anti-corruption law abroad. All five of Hong Kong's trading partners have extra-territorial application of their anti-corruption law. Such application means that if a Wal-Mart executive paid bribes in Hong Kong for preferential lawmaking – in theory – all five of these jurisdictions could bring criminal charges against the company. In practice, officials from various countries reach compromises about jurisdiction in multi-jurisdictional claims (because of Wal-Mart's operations in these other countries and the operations of its partners). However, the business uncertainty associated with such extra-territorial claims makes them particularly potentially bad for Hong Kong business.

Figure 8: Hong Kong's Major Trading Partners' Anti-Corruption Laws Apply while in Hong Kong

Country	Percent trade	Territoriality of Anti-Corruption Law
China	48%	Extra-territorial application of Chinese law means that Chinese can find Hong Kong participants guilty.
USA	8%	Extra-territorial application of law represents risk to business world-wide.
Japan	6%	Extra-territorial application so far extremely limited.
Taiwan	5%	Extra-territorial application so far extremely limited.
Singapore	5%	Extra-territorial application so far extremely limited.

Source: Herbert Smith (2011).

Potential enforcement of new extra-territorial anti-corruption law poses a rather large business risk to Hong Kong business through double jeopardy style enforcement actions. The TSKJ case shows how such double jeopardy can increase uncertainty around the application of penalties. In 2010, the US Department of Justice (DoJ) agreed with a consortium of 4 oil companies exploiting a gas reserve in Nigeria to drop criminal charges for bribery in exchange for a \$240 million settlement.⁹³ However,

⁹³ Catherine Dunn, *Double Jeopardy and the New World of Antibribery Laws*, CORPORATE COUNSEL, March 12, 2012, available [online](#).

the case did not stop there. Nigeria also imposed fines on all the members of the consortium and the UK and Italy have pursued enforcement actions against various partners. Similarly, the US DoJ does not recognise international double jeopardy – and may bring charges against persons or companies already under trial abroad.⁹⁴ Such a situation can add large-scale uncertainty for Hong Kong companies with a “touch” in the UK or the US who do business in China.

Figure 9: Double Jeopardy Could Serve as a Drag on Hong Kong’s Economy

Factor	Description
Decreased investment	Companies will avoid jurisdictions where the threat of enforcement for crimes committed elsewhere seems high. The ICAC’s reputation makes Hong Kong a high risk jurisdiction for enforcement actions for corruption in China.
Increased compliance costs	Companies in Hong Kong will engage in possible excessive internal monitoring – resulting in lost resources.
Double (or more) fines	Companies who pay out in fines more than they receive in profits will impoverish themselves and the local economies in which they work.
ICAC costs	The ICAC spends money dealing with MLA requests of partners like the US, UK and eventually China.
HK-DoJ costs	Dealing with extradition claims and claims by foreign courts on Hong Kong companies (and even possibly officials) costs money and time.

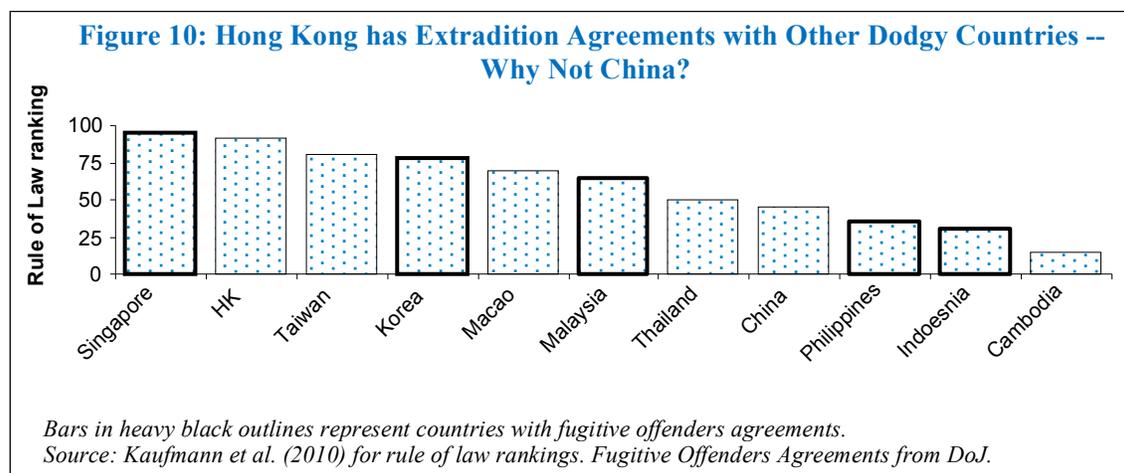
Source: authors.

The extra-territorial application of China’s anti-corruption law also poses a threat to business in the region. In February 2011, China’s parliament passed Amendment No. 8 of the Criminal Law. The Amendment criminalizes the payment of bribes to foreign government officials, Chinese companies or individuals living abroad, and non-Chinese companies working in China or with Chinese partners abroad.⁹⁵ In theory, China could claim jurisdiction over a US company in the case where a US company enters into a joint venture with a Chinese company and subsequently bribes a Kenyan official in exchange for a government contract. Because China recognises Hong Kong, Macau, and Taiwan as parts of China, corruption in these jurisdictions may be treated as Chinese corruption (!!!).

⁹⁴ In *Jeong*, the US court found that double jeopardy does “not attach when separate sovereigns prosecute the same offense.” See *US v Jeong*, 624 F3d 706 (5th Cir 2010).

⁹⁵ Thebriberyact.com, *From May 1st New China Anti-Corruption Laws Follows Long Arm Jurisdiction Trend*, 30 May 2011

Scarily, China (and other countries) could use the extra-territorial application of anti-corruption law for political or commercial ends. Anti-corruption campaigns often serve in China as politics by other means.⁹⁶ China's rule of law rankings – as shown in Figure 11 – reflect such trends.⁹⁷ China's rule of law ranks roughly half of Hong Kong's – suggesting the possibility of wide-spread use of court orders for the arrest of individuals suspected of corruption (who may or may not have committed any crime). The figure also shows rule of law scores for other countries in the region. In the case of the Philippines and Indonesia, Hong Kong allows for extradition – even though their legal systems rank lower than China's for rule of law. So, why not have an extradition treaty with China? Fear of capricious Chinese enforcement of Chinese law in Hong Kong naturally represents one reason.



While such low rule of law scores represents a possible threat to Hong Kong business interests – they also represent an opportunity for the ICAC to provide technical assistance and training. So far, ICAC activities abroad have almost exclusively consisted

⁹⁶ For examples of the use of China's anti-corruption laws in intra-Party political competition, see David Barboza, *Politics Permeates Anti-Corruption Drive in China*, NEW YORK TIMES, September 3, 2009, available [online](#).

⁹⁷ These rankings, provided by the World Bank, show the relative rankings of countries across the world (where 100 represents the score of the country with the highest rule of law ranking). See Worldwide Governance indicators, available [online](#).

of participation at international conferences and other general events.⁹⁸ The ICAC has a unique set of skills and competencies which other anti-corruption agencies in the region could benefit from. If extra-territorial application will apply in the Greater China Region, the ICAC can only benefit by engaging in staff exchanges, EU-style Twinning Agreements, and support missions to anti-corruption agencies in poor, neighbouring provinces.⁹⁹

Hong Kong may send individuals suspected of corruption for trial and/or prosecution abroad under a limited set of treaties and laws. Hong Kong has dealt with the issues of mutual legal assistance the same way most developing countries have – by giving direct effect to the UN Convention Against Corruption. Hong Kong has ratified the Convention through two legislative articles. First, under the Fugitive Offenders Ordinance, Hong Kong may co-operate with foreign law enforcement agencies who are party to the Convention.¹⁰⁰ Second, the Mutual Legal Assistance in Criminal Matters (Corruption) Order also gives direct effect to the UN Convention (and provides a copy of the Convention as a Schedule).¹⁰¹ However, the number of countries with which Hong Kong has mutual assistance agreements is so limited, that such agreements provide little actual support.

Co-operation with Taiwan

Taiwan represents a large corruption risk for Hong Kong. Taiwan is the city-state's fourth largest trading partner – with annual trade amounting to HK\$326 billion. Even if only 1% of such trade involved corruption (either as payments or as diversion of resources because of corrupt transactions not measured in the trade figures), the value of

⁹⁸ We could find no evidence of the deeper exchanges of technical assistance, “twinning” and other exchanges conducted by other anti-corruption agencies. See *Hong Kong Budget for 2012*, available [online](#).

⁹⁹ Logistical issues accompanying such exchanges include the treatment of confidential information and teaching foreign officers about methods which might one day expose corrupt anti-corruption investigators (like investigative techniques used in an internal affairs department). Co-operation with Mainland authorities will help reduce corruption as well as provide valuable technical assistance in fighting corruption on the Mainland.

¹⁰⁰ Fugitive Offenders (Corruption) Order, Chapter 503AB, available [online](#).

¹⁰¹ available [online](#).

such corruption would come to HK\$3 billion. Given Taiwan's control of corruption score (which is only 66% as high as Hong Kong's), the extent of financial transactions involved in corruption is likely to be higher. As such, Hong Kong businesses (as natural and legal persons established in Hong Kong) are likely to be paying bribes in Taiwan.¹⁰²

Hong Kong government officials (and the ICAC) can not rely on mutual legal assistance (MLA) in Taiwan due to lack of political will to fight corruption. Quah (2010) cites serious institutional deficits in Taiwan's anti-corruption effort. Specifically, he notes that "Taiwan also suffers from the same disadvantages of lack of coordination, overlapping of functions, competition for resources, and dilution of the country's anti-corruption efforts [as India and the Philippines]."¹⁰³ Quah attributes such an institutional structure directly to a lack of political will to fight corruption at the highest levels of the Taiwanese government. The *Economist* makes a trenchant observation about how the flawed design of the new anti-corruption commission in 2010 reflects the lack of political will. They note specifically that "the Taiwanese [anti-corruption] commission will not report directly to the president, but only to the justice ministry, where tangled bureaucracy and civil servants who are deferential to their political bosses could limit action."¹⁰⁴

Hong Kong's only hope of enforcing restrictions on transnational bribery in Taiwan consists of extra-territorial enforcement of the POBO and creating its own cross-straits anti-corruption agreement with the Taiwanese Anti-Corruption Agency. In 2009, China and Taiwan signed a mutual legal assistance agreement aimed at promoting co-operation on criminal matters.¹⁰⁵ The Agreement has two elements which makes it a

¹⁰² Informal evidence suggests that Taiwan also serves as an important hub for potentially corrupt Hong Kong investment in China – and particularly the Taiwanese-influenced province of Fujian. China Knowledge Online cites statistics that "Hong Kong is the largest source of FDI at US\$1.32 billion, accounting for 41% of Fujian's total utilized FDI, while the U.S. was the second largest source of utilized FDI at US\$281 million." available [online](#).

¹⁰³ Jon S.T. Quah, *Curbing Corruption in Asian Countries: The Difference between Success and Failure*, The 4th International Conference on Public Management in the 21st Century: Opportunities and Challenges 29, available [online](#).

¹⁰⁴ *Economist*, *Corruption in Taiwan: Confirming the worst suspicions*, Jul 22nd 2010, available [online](#).

¹⁰⁵ *Cross-Strait Joint Crime-Fighting and Judicial Mutual Assistance Agreement*, available [online](#).

useful model for similar potential co-operation with Hong Kong. First, informal NGOs signed the Agreement with unknown authority from their respective governments. Such an arrangement allowed the Parties to avoid the diplomatic issues involved with a government-to-government agreement. Second, the Agreement relies more on informal agreement and good-will among specific individuals rather than legal authority. As Hong Kong's authority to deal with foreign governments is diminished by Chinese authority to deal with international relations, such informality will provide a positive feature.

Hong Kong's legal and political principles allow for such an agreement – providing it falls into certain parameters.¹⁰⁶ First, the provisions of the Basic Law must (and do) apply.¹⁰⁷ From China's perspective, article 95 applies – allowing for mutual legal assistance between Chinese provinces (and from China's perspective, Hong Kong and Taiwan are both provinces). From Taiwan's perspective, article 96 applies (which allows for Hong Kong's ability to enter into MLA arrangements with foreign jurisdictions). Hong Kong's authorities can cite both articles when referring to the legal authority under which any co-operative agreement is made. In that way, Hong Kong takes no position about Taiwan's status. Second, President Hu Jintao has set forth his four-point guideline and “three favourables doctrine” for dealing with Taiwan. Under this doctrine, the Chinese government shall “spare no efforts in promoting economic and cultural exchanges across the Taiwan Strait” and undertake “anything beneficial to the Taiwan compatriots, conducive to the peaceful reunification of the motherland and to the great rejuvenation of the Chinese nation.” Joint work on fighting corruption with Taiwan certainly qualifies on all counts.

Three other developments set the precedent for making an agreement with Taiwan like the Cross-Straits Agreement. First, Qian's seven measures (again Party doctrine)

¹⁰⁶ *Status and Development of Mutual Legal Assistance among Hong Kong Special Administrative Region, the Mainland, Macao and Taiwan*, Speech by the Secretary for Justice, Ms Elsie Leung at the Seminar on Inter-regional Legal Issues of China in Beijing on 4 September 2005, available [online](#).

¹⁰⁷ We refer to articles 95 and 96 of the Basic Law. Article 95 allows Hong Kong to maintain relations with the judicial and law enforcement bodies of “other parts of the country” (of which the Chinese recognise Taiwan as just another part of the country). Article 96 allows the Government to make (after consulting with Beijing), agreements dealing with mutual legal assistance. In practice, article 96 appears function more effectively than article 95.

allows specifically for the interaction between economic and cultural agents which led to the Cross-Straits Agreement mentioned previously.¹⁰⁸ Second, according to then Secretary of Justice Elsie Leung, the Wang-Gu Talks (held in Singapore in 1993) serve as a model for creating agreements with Taiwan like the talks that led to mutual recognition of civil verdicts. In theory, future talks – using non-governmental channels – could lead to an agreement on a very specialised area of public law (like anti-corruption) about whose principles Hong Kong and Taiwan are in complete agreement.¹⁰⁹ Third, in theory, the Cross-Straits Agreement always encompasses mutual assistance on fighting corruption.¹¹⁰ Article 4(c) of the Nanjing Agreement (which led to the Cross-Straits Agreement) specifically mentions the fight against corruption as a core area of mutual legal assistance.

Limits on Extra-territorial application for private-private “corruption”

Hong Kong’s definition of corruption remains one of the most wide-reaching – and potentially contentious – definitions of corruption world-wide. One contentious issue involves the enforcement of Hong Kong’s private-to-private definition of corruption abroad. The ICAC enforces the POBO when both parties belong to the private sector – an area usually tackled under fraud and embezzlement provisions in other countries.¹¹¹ Under Hong Kong’s rules, any person exercising a public function may be charged with corruption – not just public officials. Enforcement of such private-to-private corruption represented about 64% of the ICAC’s total case volume in 2010 – with 106 persons charged with corrupt transactions in the private sector.¹¹²

¹⁰⁸ *Basic Principles and Policies of the Central People’s Government in handling Hong Kong affairs involving Taiwan after 1997*, promulgated by the State Council on 22 June 1995.

¹⁰⁹ At least in theory. Large differences in the enforcement of anti-corruption law (and greater protection given to lower ranking officials in Taiwan than in Hong Kong) still mean that particular requests for MLA could go unanswered. Reassuringly, both jurisdictions seem to protect their most senior political officials equally (if the recent scandals in Hong Kong serve as any guide)!

¹¹⁰ Yu-Kuang Tung, *A Study of the Consequences of the Agreement on Cross-Straits Cooperation in Combating Crimes and Mutual Legal Assistance between Taiwan and China*, 2010, available [online](#).

¹¹¹ For more on this distinction, see Antonio Argandoña, *Private-to-private Corruption*, 47 J. OF BUS. ETHICS 3, 2003, 253-267.

¹¹² ICAC, *Annual Report for 2010*, 2011.

The extra-territorial applicability of Hong Kong’s definition may encourage some foreign litigants to use Hong Kong as the venue of choice. Hong Kong has a common law system – which encourages civil action against corruption (see our discussion above). Such civil action can result in much more enforcement (albeit private enforcement) of anti-corruption law than public enforcement.¹¹³ However, except in the case of China (as we have already shown), the costs of enforcing Hong Kong’s POBO abroad could well exceed the benefits. Indeed, the US has seen decrease in forum shopping behaviour – as *forum non conveniens* rulings have increased over time (as a result of political as well as economic factors).¹¹⁴ We show some of the associated costs and benefits of such enforcement in Figure 11.

Figure 11: The Balance of Pros and Cons Militates for Private Non-Criminal Extra-Territorial Application of the POBO Outside of China

	Pros	Cons
Economic Issues	Encourages foreign private parties to involve some aspect of their work in Hong Kong (to obtain extra-territorial treatment).	Will dissuade some parties who might otherwise want to contract with Hong Kong parties because of fear of over-enforcement.
Political Issues	Continues ICAC positive reputation	Abuse of forum could lead to negative perceptions at home and abroad (like current use of UK divorce law).
Social Issues	Encourages solidarity among people.	May lead to resentment of ICAC

Source: authors – based on framework, empirical results and analysis by Judge et al. (2010).¹¹⁵

When legislating on extra-territorial application of the POBO, the LegCo should exclude criminal ICAC investigation and prosecution in private-to-private cases (except in China), but allow for civil standing in Hong Kong’s courts. **In other words, the ICAC should investigate criminal cases only in China. In all other jurisdictions, Hong**

¹¹³ Moohr finds, in his review of US anti-corruption law, that enforcement has become skewed toward criminal enforcement and away from private action – leading to inconsistent and under-application. See Geraldine Moohr, *The Balance Among Corporate Criminal Liability, Private Civil Suits, and Regulatory Enforcement*, 46 AMER. CRIM. L. REV. 4, 2010.

¹¹⁴ Christopher Whytock, *The Evolving Forum Shopping System*, 96 CORNELL L. REV., 2010-2011.

¹¹⁵ William Judge, Brian McNatt, and Wei-chu Xu, *The antecedents and effects of national corruption: A meta-analysis*, 46 J. OF WORLD BUS. 1, 2011: 93-103.

Kong’s law enforcement bodies would not take an interest. Yet, litigants can still use Hong Kong’s civil courts to seek damages (thanks to the broad extra-territorial application of the POBO world-wide). Given estimated corruption abroad and case loads, we estimate total demand for civil damages in Hong Kong’s courts at about 250 cases per year. Such an amount is insignificant compared with the roughly 7,400 cases handled in 2010. However, because the harms occurred abroad, trial in Hong Kong would represent only economic gain. With an average case preparation time of 30 days, each trial would generate about HK\$200,000 in lawyer fees as well as hotel and personal payments. The total estimated revenue brought to Hong Kong’s economy would equal HK\$50 million -- generating roughly HK\$7.5 million (roughly the cost to set up a small health clinic). Most of those cases are likely to come from Thailand (where courts are worst and the advantages of common law jurisdiction provide the greatest attraction). Such a “Hong Kong effect” is likely to move Thailand up 1-2 places on the Transparency International Index.¹¹⁶

Options for introducing extra-territorial application

When (and if) the Legislative Council agrees to explicitly outlaw the bribery of foreign government officials, the question of extra-territorial application will simultaneously arise. Hong Kong legislators have traditionally resisted the extra-territorial application of Hong Kong law. However, recently in Hong Kong’s Competition Bill, law drafters have recognised the need to introduce extra-territorial application.¹¹⁷ Irregardless of whether legislators decide to reform the POBO marginally or adopt the OECD approach (as we have described above), extra-territorial application would allow for prosecutorial action with any “touch” to Hong Kong jurisdiction (such as having a Hong Kong bank account, travelling to Hong Kong and so forth).¹¹⁸

¹¹⁶ The estimate comes from correlating the number of corruption-related actions with various countries’ Transparency International rankings.

¹¹⁷ Christopher Hooley, *Hong Kong’s Competition Bill*, available [online](#).

¹¹⁸ By “touch” we refer to any element of nationality, territoriality, or effect. Under the FCPA, “provisions apply to any American citizen, national, resident, or person within the United States; or a business either organized in the United States or that issues securities under U.S. law; or any employee, officer or any

Hong Kong's legislators have a number of options for dealing with the potential extra-territorial application of the POBO:

a) explicit extra-territorial application with own enforcement – the LegCo can introduce US-UK style extra-territorial application with the “touch to Hong Kong” philosophy. Any foreign national with personal or business interests in Hong Kong can be prosecuted (or sued for civil damages) in Hong Kong for violations of a revised POBO occurring anywhere in the world. Such a policy would have two benefits in terms of shaping Hong Kong's global leadership on the issue. First, (and important politically), the policy would attract even more favourable attention to the archipelago – with articles in the usual global media like the *Financial Times* and on CNN. Second, the law would assist Hong Kong to develop closer links with the Mainland and other jurisdictions. Chinese officials have made public pledges about fighting corruption. Chinese anti-corruption institutions are widely seen as highly ineffective. ICAC co-operation on corruption cases could strengthen diplomatic (and working level) ties with many of these very corrupt jurisdictions. As Mainland law already allows for extra-territorial application, the extra-territorial application of Hong Kong law does not represent an unusual feature in Chinese law.

The obvious risk for such a policy option involves disputes with Mainland government officials and agencies. Under such a regime, the ICAC could call for the extradition of government officials from across China. Such extradition requests are likely to escalate up the administrative chain of command -- as local party chiefs use their relationships with senior officials in Beijing to seek protection from ICAC enforcement orders. Such a situation places the ICAC in a no-win situation. If senior officials in Beijing oppose the extradition, the ICAC's authority will be undermined (both in reality and in public opinion). If the extradition succeeds, officials in Beijing will lobby against further ICAC enforcement on the Mainland.

other agent of the above. It may be enforced against anyone inside the United States or against any U.S. person or entity outside the United States.” See 15 U.S.C. §§ 78dd-1(a) -3(a).

b) extra-territorial application relying on MLA – such an option would basically turn the ICAC into an international anti-corruption watchdog. Under such an arrangement, the ICAC would not have the explicit authority to engage in investigations or prosecutorial work outside of Hong Kong. However, the ICAC would rely on informal law enforcement co-operation with the Mainland (and hopefully work on more formal arrangements in the future). Such an approach basically replicates the existing treatment of cross-jurisdictional work on anti-corruption. Most of the world’s largest economies belong to treaty zones that give international effect to national anti-corruption investigations and prosecutions. These “zones” include the membership of the OECD Convention, the Council of Europe conventions, and the EU. These zones – particularly the EU with its common internal security policies – basically give extra-territorial application to EU anti-corruption law.¹¹⁹ However, members in these areas tend to work on a national basis – on the basis of mutual assistance rather than trying to apply domestic law internationally.

Hong Kong enforcement based on MLA is unlikely to be very successful – as Hong Kong does not have in place MLA arrangements with many of the partners where most corruption occurs. This includes (de facto) the Mainland, Thailand, India, Taiwan, Korea and Malaysia. MLA requests are likely to remain unanswered (or poorly answered). Any serious cases may also require diplomatic contacts between Beijing and the other country concerned (as Chinese foreign policy interests may be involved). The result being that supposed extra-territorial enforcement of the POBO would be like that of the FCPA during its first 20 years...moribund.

c) explicit and deliberate omission of extra-territorial application – the LegCo could decide that Hong Kong is too small to bring the fight against corruption to the developing world (including and especially China). Because the US and UK (two of the world’s largest economies) have extra-territorial application of their anti-corruption laws,

¹¹⁹ Such internal security policies comprise what were known in the pre-Lisbon Treaty era as third-pillar policy. In the common European law enforcement space, arrest warrants and court decisions may be enforced across the EU. Joint investigations and co-operation on prosecutions through Eurojust are now commonplace.

policymakers might ask why Hong Kong also needs to seek the extra-territorial application of its law. The explicit ruling-out of extra-territorial application would also comprise an important policy decision which would affect future legislation in areas such as competition law, criminal law, and Hong Kong's role in wider Chinese foreign policy issues.

On its own merits, the LegCo would probably not ratify the extra-territorial application of the POBO. However, as we show in this working paper, the gains of extra-territorial application exceed the losses. Thus (in theory at least), the policymakers' task consists of allocating these gains to the right people and at the right time – so they support reform. Given the right legislative strategy, the LegCo might adopt the POBO's extra-territorial application. As we describe in Appendix II, the LegCo should table consideration of the extra-territorial application of the POBO at the same time as amendments to the ICACO and other reforms. We calculate that a vote – using a previous LegCo composition – would result in passage of extra-territorial application. In the meantime, the ICAC and Department of Justice should consider MLA agreements with the relevant jurisdictions in Greater China (Macao, Taiwan and the Mainland) to prepare for extra-territorial application. In practice, such application would comprise as much a diplomatic as administrative action.

Making Hong Kong's Companies Liable for Corruption

The economic effects of corporate criminalisation

A series of studies of Hong Kong (and several of its largest trading partners) highlight the importance of company law, policies and regulations in affecting corruption. Laws which affect corporate anti-corruption policies matter in the fight against corruption. Wu conducts a recent study of anti-corruption policies in companies working in China and Taiwan – and their effect on reducing bribe paying behaviour.¹²⁰

¹²⁰ Chen-Fong Wu, *The Relationship between Corruptive Contexts, Organizational Ethics Practices, and Anti-Corruption, Performance on the Two Sides of the Taiwan Strait*, 46 ISSUES AND STUDIES 1, 2010, available [online](#).

He concludes, from his statistical analysis, that companies which implemented strong ethics and anti-corruption programmes participate less in corruption – irrespective of the level of corruption in the country overall.¹²¹ Company policies “explain” (in the statistical sense of the word) roughly 70% of corrupt practices in the companies Wu studied. The overall level of corruption in the country only “explains” about 20% of company-specific corruption. Legislation (or lack of legislation), which allows for the prosecution of companies as legal persons and encourages companies to have strong internal anti-corruption laws, will have important impacts on corruption at home and abroad.

Corporate policies related to owner/manager liability and accounting policies also have important impacts on corruption. Wu used regression analysis to assess the extent to which corporate policies (as measured by the accounting firm PwC, the consulting company McKinsey & Co. and the brokerage house CLSA) affected the level of corruption in a country.¹²² His study included Hong Kong, as well as China, Taiwan, Thailand, India, and Hong Kong’s other major trading and investment partners. He finds that corporate policies which do not protect or represent the interests of management have a strong negative (and statistically significant) relationship with corruption. Such findings show that when senior managers and directors do not have strong vested-interests in the company’s bribery, the amount of corruption decreases.

Other studies suggest that if Hong Kong passes an OECD-style criminalisation of corruption abroad (and increases corporate liability for such corruption), such policies would help reduce corruption by Hong Kong’s trading partners. Baughn and co-authors conduct an innovative cross-country study -- which includes Hong Kong – looking at the extent to which criminalising corporate bribery abroad helped reduce countries’ bribery

¹²¹ In the study, the author conducted a survey of businessmen from Beijing and Taichung. He asked three sets of questions – about the overall nature of corruption in the country, policies in the respondents’ organisations related to preventing corruption and perceptions about corruption in their company. The Method of Moments analysis the author uses is basically a complicated form of correlation analysis. We do not go into the specifics of the statistical methods used because they are boring and detract from our overall discussion.

¹²² Xun Wu, *Corporate Governance and Corruption: A Cross-Country Analysis*, 18 GOVERNANCE 2, 2005: 151–170.

abroad.¹²³ Specifically, they compare the country's Corruption Perceptions Index (which measures the extent to which businesspersons think a country is corrupt) with the Bribe Payers Index (which measures the extent to which individuals from particular countries pay bribes in other countries). They use the ratification of the OECD and UN conventions to assess the effects of the criminalisation of corporate bribery abroad. They find a statistically significant relationship between the criminalisation of corporate bribery abroad and bribe-paying abroad – holding constant a country's level of domestic corruption. Such results strongly suggest that introducing criminal liability for corruption abroad would reduce Hong Kong's negative influence on some of its most vulnerable trading partners.

Even among countries which have criminalised foreign bribery, more bribery occurs in poorer countries than in richer countries. D'Souza finds – again using econometric methods – that firms (from OECD countries which have signed the OECD Convention) offer statistically significantly more bribes in low-income countries than in other OECD countries.¹²⁴ Such a finding implies that Hong Kong's companies likely pay significantly more bribes in places like Thailand and China than in Singapore and Japan (even with strong laws against corruption at home). If anything, legal changes like corporate criminal liability represent only the first step on a much longer road toward legislating against corporate corruption.

Company policies aimed at reducing corruption in Hong Kong, China and Asia (like elsewhere) have an important impact on corruption. Government policies which reward corruption-prevention and punish laxity have important effects on fighting corruption. In a landmark study, Fan *et al.* look at the value of companies who used corruption to secure high-level government contacts (and thus profitable business).¹²⁵ Two out of the 23 cases they analysed involved corruption by Hong Kong related parties.

¹²³ Christopher Baughn, Nancy Bodie, Mark Buchanan and Michael Bixby, *Bribery in International Business Transactions*, 92 J. OF BUS. ETHICS 1, 2010: 15-32.

¹²⁴ Anna D'Souza, *The OECD Anti-Bribery Convention: Changing the Currents of Trade*, Online Working Paper Series, California Center for Population Research, UC Los Angeles, available [online](#).

¹²⁵ Joseph Fan, Oliver Rui, and Mengxin Zhao, *Rent Seeking and Corporate Finance: Evidence from Corruption Cases*, 36 J. OF COMP. ECON. 3, 2008.

They find that corruption of public officials in China accounts for roughly 8% of company value. Firms also went into increased debt to pay for the favours given to Chinese Communist Party members. They specifically find that roughly 10% of companies' long-term debt went to bribes. Clearly, company law that restricts Hong Kong corruption on the Mainland will have positive economic effects – both on the Mainland and around Victoria Harbour.

Overview of the three approaches to corporate criminalisation

Hong Kong anti-corruption law places responsibility for corruption with a company's natural persons (as agents). The Prevention of Bribery Ordinance -- specifically in section 9 -- outlines the liability of the agents of legal persons engaged in corruption as agents of companies or incorporated bodies.¹²⁶ In the case law, the prosecutions brought before Hong Kong courts have always focused on the agents of companies, their conspirators, accomplices and other natural persons.¹²⁷ Such an approach – while revolutionary when the POBO was passed – now generally runs counter to international law and best practice in the fight against corruption. The trend in international law – particularly in the UN Convention Against Corruption (which Hong Kong has ratified) – encourages corporate liability as a legal person (and increased liability for accomplices, principals and others who make up a criminal “enterprise.”)

Most jurisdictions have relied on doctrines of strict liability, the vicarious liability of principals (and others) for the corruption of agents, and the use of already existing legal doctrines (like implied consent) to prosecute legal persons for corruption. Figure 12 shows the difference between these approaches in comparative law.¹²⁸ In the strict liability approach, companies whose managers, employees, representatives or related parties engage in corruption may be convicted of corruption as legal persons. For these offences, proving *mens rea* becomes irrelevant. An action violating the law comprises

¹²⁶ POBO, Sect. 201(9), available [online](#).

¹²⁷ For a list of cases, see HKLII Databases, Court of First Instance, available [online](#).

¹²⁸ Mark Pieth and Radha Ivory, *Corporate Criminal Liability*, In K.Brown and D. Snyder (eds.), GENERAL REPORTS OF THE XVIIITH CONGRESS OF THE INTERNATIONAL ACADEMY OF COMPARATIVE LAW, 2012.

adequate grounds for a criminal conviction.¹²⁹ We discuss each of these approaches in the following sections.

Figure 12: Three approaches toward establishing corporate liability for corruption

Approach	Description	Example countries
Strict liability	Removes <i>mens rea</i> requirement by criminalising action – irregardless of intent.	UK (for corporate liability and directors’ liability to limited extent), Switzerland, US (to limited extent)
Vicarious liability of principals	Senior level managers and directors bear responsibility – under a <i>respondeat superior</i> doctrine – irregardless of whether they knew about (or wanted) their subordinates’ participation in bribery.	UK, US, Switzerland
Replicating intent through doctrine	Using doctrines like implied consent and malignant corporate culture as “proxies” for the <i>mens rea</i> of a legal person.	Australia, Canada, New Zealand, US (to limited extent)

Source: adapted from Pieth and Ivory (2012).

Criminal liability for legal persons

Establishing criminal liability for corruption for legal persons has generally been easier in civil law jurisdictions than common law jurisdictions. Professors Pieth and Ivory (2012) tend to classify countries into three groups – depending on their approach to criminalising corporate corruption.¹³⁰ Figure 13 shows the three groups. An all-crimes approach would tend to apply criminal liability (and sanctions) to natural and legal persons equally. A listed offenses approach would directly offer criminal sanctions to prosecutors specifically aimed at legal persons. An administrative approach would allow the Hong Kong Department of Justice (if it selected such an approach) to basically “replicate” the criminal punishments used in other countries with fines, disgorgement orders, and engage in injunctive or specific performance orders.

¹²⁹ We refer to this approach as the strict liability method of criminalising corporate corruption because the closest analogy for outright legislation allowing for criminal treatment of corporate persons comes from the common law doctrine of strict liability.

¹³⁰ Pieth and Ivory, *see supra* note 128 at 634.

Figure 13: Corporate criminalisation now the standard world-wide

Approach	Definition	Example countries
All-crimes approach	Legislature defines crimes committed by “persons” – irregardless of whether these persons are legal or natural	France, Netherlands, Belgium, Hungary and Germany
Listed offenses approach	Restricts corporate criminal and quasi-criminal liability by reference to lists contained in legislation.	Czech Rep., Italy, Poland, Portugal, and Spain
Administrative approach*	“Administrative” sanctions are handed down by criminal judges and they are considered “criminal” for the purpose of mutual legal assistance. They may result in the corporation being ordered to pay considerable sums of money, cease operations, or undergo deregistration.	Chile, Russia, and (to a more limited extent) Brazil

* The administrative approach represents a compromise in legal systems which do not recognise criminal offences against corporations.

Source: Pieth and Ivory (2012).

In the US and UK, their legislators have imposed -- by legislative fiat -- liability for corporate persons (albeit using different legal theories). Section 14 of the UKBA refers to corruption by “bodies corporate.” The section basically repeats article 19 of the UN Convention Against Corruption – by making company directors responsible for corruption.¹³¹ However, the legal person may be found guilty of corruption under the Act for failing to prevent bribery. We argue that such an approach basically grafts the traditional elements of the UK’s tort law onto the emerging international anti-corruption *jus cogens*. We discuss these elements of UK law in Figure 14. The US – in contrast – maintains its 1970s disco-era approach to corporate criminalisation. Such an approach finds guilty US corporations based on vicarious liability and *respondeat superior*. The corporate person itself, may be found guilty of the tax and accounting irregularities which accompany corruption. More recently (as we discuss later), the corporate person may also be fined, restricted in action and even executed through deregistration.

¹³¹ The UK Fraud Act of 2006 also provides for the corporate prosecution of corruption. Under the Act, a corporate body can be convicted, as can company officers, for the actions committed by the company. Section 12(2) states that a director, manager or secretary, or a person purporting to act in such a capacity can be found guilty (and punished) if the officer provided “consent or connivance.”

Figure 14: Making Legal Persons Vicariously Liable for Their Agents' Negligence in Fighting Corruption

The UKBA uses a tried-and-true approach to criminal liability in the common law system – criminal negligence. Under the negligence doctrine, persons (usually natural but increasingly legal) possess a duty of care -- as previously defined under the UK's increasingly complex tort law. Now, the UKBA directly defines such a duty of care. Failure to exercise sufficient care (in foreseeing and forestalling potential harms for example) results in negligence – and criminal negligence if prosecutors can show intent and action (or failure of action).¹³² The UKBA basically grafts already existing tort concepts onto the criminalisation of corporate corruption in order to make such criminalisation “in accordance with the fundamental principles of its legal system” (as required by the UN Convention Against Corruption).

The UKBA (section 7) imposes criminal liability on commercial organisations – basically for negligence – in failing to prevent the bribery of its agents. The section also applies a duty of care (by requiring adequate procedures to prevent associated persons from committing such conduct) and basically establishes a Hand rule for establishing negligence (in section 7(2)).¹³³ The Ministry of Justice provides prosecutors with a principles-based test, in order to decide whether a company has engaged in criminal negligence, when deciding on corporate negligence in corruption cases.¹³⁴

A company exercises a reasonable standard of care when the company implements: 1. proportionate procedures (to detect and prevent corruption), 2. top-level oversight and review of anti-corruption procedures and practices, 3. risk assessment in its operations and among personnel, 4. conducts due diligence on partners, 5. communication practices (including training) about the firm's anti-corruption practices, and 6. monitoring and review practices.¹³⁵

The Guidance uses a principles-based test (and not a list test) – requiring both companies and prosecutors to engage in the risk assessments we describe later when they decide how much work constitutes a “reasonable standard of care.” Hong Kong law has not yet developed the same traditions of using principles-based regulation of its private sector. As such, the challenge for legislators (and legal experts which propose rule-making) consists of finding a way to import the legal obligation to engage in nuanced risk assessments without the over-prosecution seen in the US.

In theory, Hong Kong (with its common law tradition) can opt for the same method of criminalisation chosen by the US and UK – clear and direct legislation. In both countries, rather than wait for the courts to develop a doctrine which allowed for

¹³² For a fuller exposition of the way that common law jurisdictions have used tort law to develop anti-corruption law, see Bryane Michael, *Drafting Implementing Regulations for International Anti-Corruption Conventions*, QEH WORKING PAPER NUMBER 150, available [online](#).

¹³³ The Hand Rule (also known as the calculus of negligence) comes from Judge Learned Hand and describes a process for determining whether a legal duty of care has been breached – as established in *U.S. v. Carroll Towing*.

¹³⁴ Ministry of Justice, *The Bribery Act 2010: Guidance about Relevant Procedures Which Commercial Organisations Can Put into Place to Prevent Persons Associated with Them from Bribing*, available [online](#).

¹³⁵ We have paraphrased the guidance to make their abstract principles a bit clearer. See *Id.*

corporate criminalisation of corruption, their legislatures acted to criminalise corruption by corporations and other legal persons. In typical American style, Congress tackled the issue of corporate liability by focusing on the accounting and tax side of the crime rather than the crime itself (though the DoJ became much more vigorous in enforcing the FCPA recently). Congress decided to leave in place the current system revolving around natural persons for the criminal offence itself – but tackled the issue of corporate liability “through the back door” by criminalising related accounting and tax violations which accompany corruption committed by corporate agents.¹³⁶ The British have adopted a more direct approach – by directly applying corporate liability for the corruption of the company’s officers. The UKBA basically follows the UNCAC. The UN Convention Against Corruption requires signatories to establish criminal responsibility of legal persons: when committed in the name of, on behalf of, or for the benefit of a legal person (sec. 19.1(a)) and when committed by any natural person...who has management or supervisory position within the legal person (sec. 19.1(b)). The following article establishes responsibility when lack of supervision has made corruption possible (sec. 19.2). Yet, the UN Convention also encourages national legislation to make directors liable as well.

Criminal liability by directors and for directors (and other “directing minds”)

In many respects, both the UN Convention and UKBA reflect the older OECD approach to tackling corporate liability for corruption. In this approach, companies could face liability for corruption if their directors or other leading members engage in bribery and/or other forms of corruption. Figure 15 shows the OECD’s litmus test for triggering corporate liability.¹³⁷ In the OECD approach, corporate liability occurs as a function of the organisational position of the agent involved in corruption. Simply put, a company is guilty if one or more of its senior managers are guilty of corruption. Both the UK and US

¹³⁶ For more on the way the DoJ and SEC work together to cover the various aspects of the US’s anti-corruption legislation, see Barbara George and Kathleen Lacey, *Federal Intrusion into Internal Corporate Governance: The Accounting Provisions of the Foreign Corrupt Practices Act Two Decades After its Initial Passage*, J. OF TRANSNAT’ L. & POL., 1998.

¹³⁷ OECD, *Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, November 26, 2009 at Annex I, para. B.

have relied only partially on such advice. Other OECD Member States have directly criminalised corporate corruption – rather than rely on the OECD’s guilt-by-proxy method. Even the OECD itself has half-heartedly promoted the 2009 Recommendation – which does not enter into its regular evaluation rounds and does not appear in much of its subsequent advice on the Anti-Bribery Convention and associated Recommendations.

Figure 15: OECD’s Leading Persons’ Approach to Corporate Liability for Corruption

Member countries’ systems for establishing the liability of legal persons for the bribery of foreign public officials in international business transactions should take one of the following approaches:

- a) the level of authority of the person whose conduct triggers the liability of the legal person is flexible and reflects the wide variety of decision-making systems in legal persons; or
- b) the approach is functionally equivalent to the foregoing even though it is only triggered by acts of persons with the highest level managerial authority, because the following cases are covered:
- A person with the highest level managerial authority offers, promises or gives a bribe to a foreign public official;
 - A person with the highest level managerial authority directs or authorises a lower level person to offer, promise or give a bribe to a foreign public official; and
 - A person with the highest level managerial authority fails to prevent a lower level person from bribing a foreign public official, including through a failure to supervise him or her or through a failure to implement adequate internal controls, ethics and compliance programmes or measures.

Source: OECD (2009).

Doctrinal approaches to corporate liability

Establishing intent (or *mens rea*) has been one of the great stumbling blocks to treating corporations like people during criminal prosecutions. Sociologists have long argued that organisations and groups of people possess a will and intent different to (and not attributable to) an individual. However, proving that groups of people and organisations act with a particular intent attributable to a legal person poses numerous difficulties. Two recent developments in comparative law have brought prosecutors one step closer toward the criminal conviction of legal persons. The first approach – implied consent (through the alignment of interests) – argues that corporate objectives, practices and decisions which provide strong incentives to agents to engage in corruption represent

a “corporate will.” The second approach – relying on the culture of the organisation – argues that prosecutors can know corporate intent by the values broadly held by members of the organisation (or its corporate culture).

The alignment of interests approach has support in the US and Australia. Pieth and Ivory refer to several examples where the incentive structure given by corporations represent the implied consent of the corporation (as a legal person) in corruption.¹³⁸ Such consent extends the already existing law of agency in most common law jurisdictions in which the implied wishes of a principal serve as adequate defence for the malfeasance of agents. *Tesco Supermarkets Ltd. v. Natrass* establishes the motive based approach to corporate liability (in the UK at least). In the case, a store manager deceptively advertised prices. In the House of Lords, each of the law lords found that the store manager was not the corporation’s “directing mind and will” and so didn’t represent the company *per se*. Readers will find this case hard to interpret – because the judges found the store manager did not act on behalf of the store. The principle (and precedent) though remains – that the implied wishes and will of a company’s directors can represent the will of the company itself.

All in all, UK law remains relatively schizophrenic as to whether companies possess their own intent and will. On the one hand, laws like the *Corporate Manslaughter Act* create the offense of “corporate manslaughter” – instructing the jury to consider “the extent to which ... there were attitudes, policies, systems or accepted practices within the organisation that were likely to have encouraged [a breach of the Act] ...or to have produced tolerance of it.”¹³⁹ On the other hand, even the *Corporate Manslaughter Act* requires that senior managers commit acts (or omissions) which result in a crime. In *HM Coroner for East Kent*, the presiding judges explicitly refused to accept any doctrine which required individuals’ actions and intentions to represent a broader corporate culture. They ruled that the aggregation of individual acts and states of mind

¹³⁸ Pieth and Ivory, *supra* note 128.

¹³⁹ *Corporate Manslaughter and Corporate Homicide Act of 2007*, at sec. 8(3).

could not comprise some inchoate third will in the guise of a corporate culture.¹⁴⁰ As we shall show below, events have raced past the British judiciary (like usual).

The Netherlands and Belgium represent two examples where a legal person may possess its own intent and bear responsibility for the actions of its agents.¹⁴¹ In the **Netherlands**, prosecutors may find a legal person guilty of an offence when agents acting on its behalf would find such actions “reasonable” and “within the scope” of an entity in light of its “guiding principles.” Judges may find a legal person guilty if the entity’s staff regularly employed criminal methods and if the entity benefitted from their action, and condones such action when/if found. In **Belgium**, judges may also condemn companies for criminal offences.¹⁴² Pieth and Ivory note that because no particular person’s actions may specifically attribute to the company (like in the case of the OECD recommendation we discussed previously), Belgian legislators specifically wanted to leave the question of *mens rea* in a corporate context relatively vague.

Australian law provides the first – and most important – example of a Criminal Code which explicitly acknowledges a culture of compliance.¹⁴³ Under Australian law (according to Pieth and Ivory), “intention, knowledge, or recklessness must be attributed to a body corporate that expressly, tacitly, or impliedly authorized or permitted them...If the prosecution relies on corporate culture, it will look more broadly for evidence of attitudes, policies, rules, general, or localized patterns of behaviour or practices.”¹⁴⁴

The US approach to criminalisation relies in part on a theory of *mens reus* where corporate ethics serves as the company’s “intent.” The Organizational Guidelines’ Effective Compliance and Ethics Programs (Section 8B2.1) – as shown in Figure 16 – specifically instructs US prosecutors to consider various aspects of a company’s

¹⁴⁰ *R. v. HM Coroner for East Kent; Ex parte Spooner* (1989) 88 Cr. App. R. 10; *R. v. P & O European Ferries (Dover) Ltd.* [1991]

¹⁴¹ We unabashedly pilfer this section from Pieth and Ivory (2012).

¹⁴² Art. 5(1) of the Belgium Criminal Code stipulates that legal persons may be “criminally liable for offenses that are intrinsically connected with the attainment of their purpose or the defence of their interests or for offenses that concrete evidence shows to have been committed on their behalf.”

¹⁴³ Section 12.2 Criminal Code Act 1995 Criminal Code Act 1995.

¹⁴⁴ Pieth and Ivory, *see supra* note 128 at 637.

corporate culture when deciding on a prosecution. As we discussed previously, the UK Ministry of Justice guidance provides the same admonitions to UK prosecutors.

Figure 16: Test for Compliance Programme under Point 5 of the US U.S. Attorney's Manual Guidelines

1. Standards and procedures to prevent and detect criminal conduct.
2. High-level “buy in” to the compliance program
3. Avoiding placing known criminals or unethical people in positions of power
4. Dissemination of compliance/ethics standards and procedures and conducting effective training programs
5. monitoring of programme to detect criminal conduct and protect whistle-blowers
6. Enforcement of compliance/ethics program through incentives and discipline.
7. Adaptation of programme when criminal conduct detected

Source: US U.S. Attorney's Manual Guidelines. Paraphrased to promote readability.

Vicarious Liability in Joint Ventures, along the Supply Chain and M&A activity

Both the FCPA and UKBA allow for vicarious liability of foreign affiliates and partners – making these laws self-enforcing. Both pieces of legislation provide for “strict liability” – in the sense that the company’s directors and staff do not even need to know about corruption for them to be guilty.¹⁴⁵ Strict liability provides strong incentives for companies to police these laws themselves, rather than face prosecution for the corruption of their business partners. Corporate managers engage in such policing partly through risk assessments (often with the results of due diligence investigations to guide them).¹⁴⁶ Figure 17 shows other ways that the FCPA encourages self-enforcement (from other companies rather than from government oversight). Companies engage in contractual representations, warranties and introduce contractual provisions for indemnification in case the company faces prosecution for the corruption of foreign partners. Lenders can introduce oversights to make sure that borrowers do not dissipate its capital in illegal payments to foreign officials. More insidiously, the DoJ provides

¹⁴⁵ See H.R. Conf. Rep. No. 100-576, at 920 (1988).

¹⁴⁶ For a discussion of these types of investigations and more generally how companies can comply with the FCPA, see Clinton Long, *When ‘Not Getting Caught’ Is Not Enough: Preventing Foreign Corrupt Practices Act Violations and Liability in International Project Finance*, PACE INT’L L. REV., 2012: 111

number mechanisms for encouraging companies to seek legal opinions about potentially corrupt activities and regularly solicits feedback from industry officials about corruption in their industry. Such mechanisms cast a light on high-risk companies -- decreasing the amount of resources the DoJ needs to use to identify bribe-payers.

Figure 17: Self-Enforcement of FCPA Arising from Vicarious Liability Doctrine
(or how vicarious liability can help the ICAC reduce corruption)

Potential party to vicarious liability	Defensive actions engendered
Businesses with partners in highly corrupt countries (like Thailand and China) Local agents, partners, and counsel Contractors and sub-contractors	Risk assessment of foreign government agencies and agents to minimise probability of bribe payments. If companies share such risk assessments with their partners, these risk assessments help decrease the costs of enforcement (because a larger and richer partner has paid for a risk assessment). Due diligence and corporate investigations can help screen partners likely to bribe. Contractual representations, covenants, and termination clauses. Contracts can serve as a firewall – terminating legal relations (and thus possible liability) in case partners engage in actions violating the FCPA. Foreign contractors will prefer (in theory) to avoid bribery rather than lose significant business. Contracts can also allow the US partner to sue the foreign sub-contractor in case they are fined or penalised by the DoJ. Sponsors can engage in more day-to-day management of partners. Increased participation in management can increase a company’s potential liability. But increased supervision provides for greater control over access to financial records and key relationships with government officials.
Majority and minority shareholders in special purpose vehicles	A creditor can be considered a principal if there is enough control over the actions of the debtor , and control can be a factor in determining vicarious liability.
Lenders and providers of capital	Companies can insist on anti-corruption provisions as foreigners negotiate terms of letters of intent, MoUs, concession agreements, approval of political risk insurance, waivers of sovereign immunities, and other agreements.
Host governments	When a corruption risk arises, the company can ask the DoJ for an opinion .

Source: based on Long (2012).

The US experience shows that working with companies – by providing opinions and restructuring plans when problems arise – can significantly help with enforcement. In the US, companies may protect themselves from liability if they ask the DoJ for an opinion about the legality of a transaction abroad. Such a policy serves as another example of a self-enforcement mechanism.¹⁴⁷ On the one hand, the policy offers companies protection against future prosecution. On the other hand, the policy

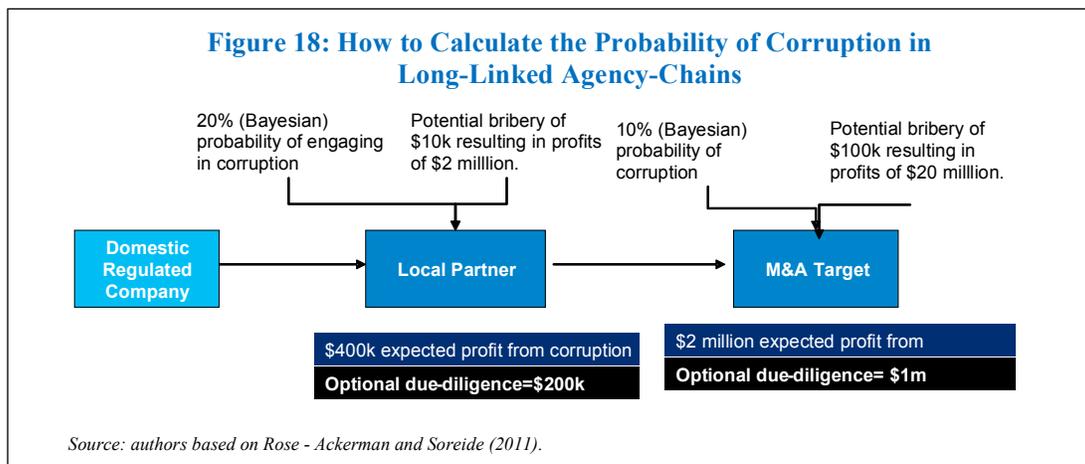
¹⁴⁷ Foreign Corrupt Practices Act Opinion Procedure, 28 C.F.R. § 80.1 (2010).

encourages a steady-stream of information back to the DoJ – which their analysts can use to assess potential corruption risks abroad.

A bit of simple economics can help the ICAC use the same methods other law enforcement agencies use when they assess the extent to which a company exercises a reasonable standard of care in preventing corruption. Figure 18 presents an example based on the 2011 merger between the construction company Kellogg (a subsidiary of Dresser Industries) and Halliburton’s construction subsidiary Brown & Root.¹⁴⁸ The problem with the merger stemmed from Brown & Root’s alleged payments of \$182 million in bribes to Nigerian officials for more than \$6 billion in construction contracts. In the figure, we show a simplified example (to make the calculations easy and to explain the underlying principles). Imagine the ICAC worked according the same principles governing US and UK prosecutors trying to assess whether a company exercised a “reasonable standard of care” (as measured by due diligence expenses). Imagine the Hong Kong company regulated by such a standard works through a local intermediary to acquire a foreign partner. Imagine (as discovered in internal communications later) that the Hong Kong regulated company thought there existed a 10% probability that the final target of the acquisition engaged in bribery in its local, foreign market. Imagine further that the “clean” Hong Kong company thought that if corruption was occurring, the company was paying \$100,000 to obtain profits of \$20 million.¹⁴⁹ If such corruption was occurring, the local partner the Hong Kong company works with has a 20% probability of engaging in bribery of its own (in order to get the authorisations needed to bring the deal to the Hong Kong company). The local partner may earn a \$2 million “cut” of the \$20 million in revenues from the M&A target.

¹⁴⁸ For more on the acquisition, see Joseph Spinelli, Steven Feldman, and Jacquelyne Garfield, *Foreign Corrupt Practices Act Due Diligence in Mergers and Acquisitions Deals*, N.Y. L. J., 2011, available [online](#).

¹⁴⁹ Economists refer to these probabilities (which represent the best guesses of experts) as Bayesian probabilities. We use the formal jargon in case the reader wishes to read more about making these assessments. For more on these methodologies, see Susan Rose-Ackerman and Tina Soreide, *INTERNATIONAL HANDBOOK ON THE ECONOMICS OF CORRUPTION*. Edward Elgar, 2011



How much due diligence would be reasonable if the ICAC used criteria similar to that used in the UK and USA? Under this hypothetical scenario, the expected profit to the intermediary would equal \$2 million for the target of the acquisition and \$400,000 in residual profits for the local partner. Of course, the Hong Kong company could not be expected to dissipate all its expected profits in due diligence (in case the partners involved turned out not to pay bribes). We can therefore expect the regulated company to pay about half of the proceeds arising only from corruption in due diligence (to make sure the profits are “clean”). In this example, the hypothetically regulated Hong Kong company would pay out about \$1.2 million in due diligence services.

The clearer the guidance given to Hong Kong companies about the standards used to assess “reasonable care,” the fewer resources wasted in unproductive monitoring.¹⁵⁰ The FCPA – and particularly its capricious and unpredictable enforcement regime --- has been heavily criticised as costing US businesses anywhere from hundreds of millions to trillions of dollars.¹⁵¹ Partly reflecting better guidance and partly reflecting the effects of the US law already in force for over 30 years, the UKBA has had an extremely marginal

¹⁵⁰ From the ICAC’s perspective, such company monitoring may be considered beneficial. From an economist’s point of view, due diligence and monitoring expenses represent a regulatory burden and dead-weight loss. These expenses do not contribute to productive economic activity (like inventing new technologies or providing fresh fruit to mango-loving consumers).

¹⁵¹ New York City Bar, *The FCPA and its Impact on International Business Transactions— Should Anything Be Done To Minimize the Consequences of the U.S.’S Unique Position on Combating Offshore Corruption?*, 2011, available [online](#).

impact on UK business.¹⁵² After the LegCo allows for the corporate criminalisation of corruption, **the Hong Kong DoJ guidance to the Hong Kong private sector should be very specific – so that the results mirror the UK experience more closely than the US experience.**

Deferred and Non-Prosecution Agreements

The ICAC will need to rely more on the self-reporting concomitant with what the Americans call “pre-trial diversion.” Hong Kong basically represents a single city, sitting on an area of 1,092 square kilometres. The possibility of any corporate principal not knowing what their agents are doing is less likely than in a country spanning 6 time zones (namely the USA). However, if the LegCo ratifies changes to the POBO to allow for the prosecution for foreign bribery, then one could imagine a situation where the principals in Hong Kong do not immediately know what their agents do in Fujing or Bangkok. Once they find out, they would need a mechanism to “come clean” as a way of lowering the costs of enforcement. Such a mechanism (as we previously explained) also reduces ICAC’s surveillance and enforcement costs – because companies have incentives to self-report their own corruption abroad.

The mechanism of Non-Prosecution Agreements and Deferred Prosecution Agreements (which we call NDPAs) has led to a large number of prosecutions which might not have come to light without such an arrangement.¹⁵³ Figure 19 shows the agreements which, since August 2007, U.S. Attorney offices have filed concerning allegations of FCPA violations. These agreements represent only a fraction of the 112 agreements that Finder and colleagues found.¹⁵⁴ Moreover, the UK government has

¹⁵² Only 6% of businesses in a recent *FT* survey claimed that the UKBA has had an effect on the way they conduct business. See Jonathan Moules, ‘Little impact’ of Bribery Act, *FINANCIAL TIMES*, December 9, 2011, available [online](#).

¹⁵³ We lump the two together – based on Finder *et al.*’s observation – that both non-prosecution and deferred prosecution result in the same thing – non-prosecution. US government agencies refer to both as “pre-trial diversion.”

¹⁵⁴ Lawrence Finder, Ryan McConnell & Scott Mitchell, *Betting The Corporation: Compliance or Defiance? Compliance Programs in the Context of Deferred and Non-Prosecution Agreements*, 28 *CORP. COUNSEL REV.* 1, 2008.

already announced its intention to establish a similar programme of NDPA's.¹⁵⁵ Their role in promoting self-enforcement and yielding the mouth-watering fines these agreements generate will prove strong temptations -- too strong for Hong Kong legislators to resist. **The LegCo should provide the ICAC (with DoJ oversight) with the authority to enter into NDPA's – and the ICAC should promulgate guidelines for their use which avoid the mistakes the Americans have made with the FCPA.**

Figure 19: Over HK\$1 billion Collected in Corruption-Related Fines

Company	Date	Amount (in millions HK dollars)
Faro Technologies, Inc.	June 2008	\$22.9
AGA Medical Corp.	June 2008	\$15.5
Willbros Group, Inc.	May 2008	\$250.3
AB Volvo	Mar. 2008	\$151.9
Flowserve Corp.	Feb. 2008	\$81.4
Westinghouse Air Brake Tech. Corp.	Feb. 2008	\$5.2
Lucent Technologies	Dec. 2007	\$150.3
Akzo Nobel N.V.	Dec. 2007	\$225.5
Chevron Corp.	Nov. 2007	\$209.3
Ingersoll-Rand	Oct. 2007	\$54.3
York International Corp.	Oct. 2007	\$170.5
Paradigm B.V.	Sept. 2007	\$7.75
Textron	Aug. 2007	\$36
TOTAL		\$1,053

Amounts converted at 27th April exchange rate of 7.75. Total may not add up to the sum of the individual items as we converted the total in US dollars separately from the items to prevent rounding errors from distorting the total value.

Source: Schmidt (2009).

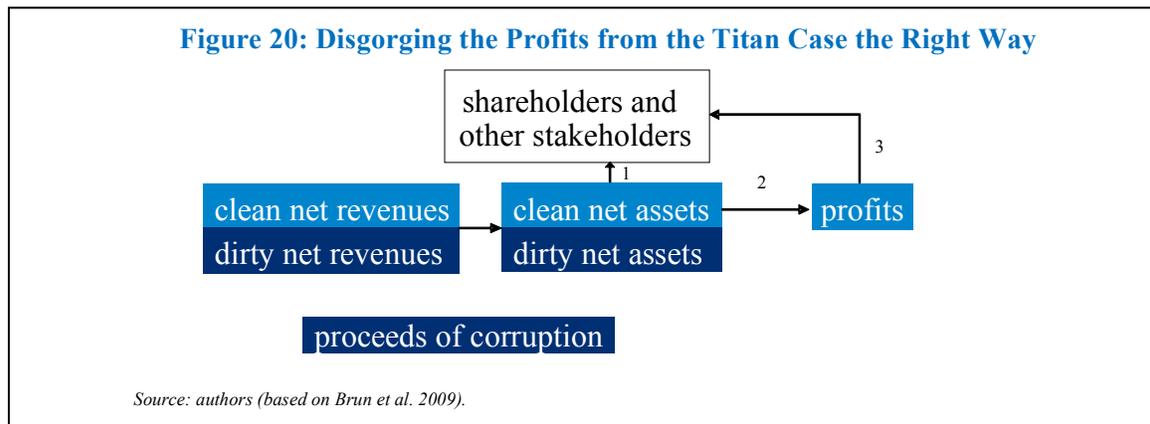
One increasingly important remedy in FCPA enforcement relates to the disgorgement of profits. Under US law, the disgorgement of profits arising from corruption comes from equity and Sarbanes-Oxley – combined with SEC jurisdiction over both anti-corruption and other types of offences.¹⁵⁶ Warin *et al.* (2011) refer to numerous disgorgement agreements – including Siemens AG and Daimler AG disgorging

¹⁵⁵ Outlaw, *Deferred prosecution agreement legislation to be introduced, Solicitor General says*, available [online](#).

¹⁵⁶ David Weiss, *The Foreign Corrupt Practices Act, Sec Disgorgement of Profits, and the Evolving International Bribery Regime: Weighing Proportionality, Retribution, and Deterrence*, MICHIGAN J. OF INT'L LAW, 2011.

\$350 million and \$91.4 million respectively. Innospec ended up paying \$60 million without admitting to any wrong-doing. Technip and other companies have made similar disgorgement payments. The problem with disgorgement comes from the basic problem in recovering any proceeds of crime – commingling and the rights of innocent third parties.

The basic lessons of illicit asset recovery show how the DoJ and Hong Kong courts might order disgorgements more sensibly than its US counterparts. Figure 20 shows the basic model of the corporation – like in the Titan case.¹⁵⁷ US prosecutors found Titan had earned \$25 million from contracts the company secured from Benin president Mathieu Kerekou in exchange for campaign contributions. The company had to disgorge \$15.5 million in profits. A one-time fine of \$15.5 million means that the company must sell assets, stop other legal and profitable investments and reduce profit payments to shareholders and other corporate stakeholders. As shown in the Figure, the fine comes from point (1) in the figure – from net assets. Such a fine penalises investors and other innocent parties.



Leaving the assets in place and slowly taking the proceeds from profits represents best practice. In this case (as shown in the figure), prosecutors allow the assets to remain in place. Instead, deductions from profits arising from some of these “tainted” assets slowly repay for the damage caused by corruption (a slow disgorgement). A government

¹⁵⁷ *Sec. & Exch. Comm’n v. Titan Corp.*, SEC Litigation Release No. 19,107, 84 SEC Docket 3413 (2005).

appointed asset manager can oversee the management of the assets (just like in other asset recovery cases) to preserve their value. The goal focuses on maximising the value of assets (and thus their pay-out). Such an approach guarantees that shareholders and other innocent parties do not pay for the crimes of senior management. The Hong Kong ICAC with DoJ oversight (if eventually given authority to engage in these types of work-outs) can implement such a system to allay fears that disgorgement would penalise innocent third-parties.

For all their appeal, the US experience shows significant and serious problems with NDPAs. First, in the US, these agreements do not qualify for judicial oversight. One obvious problem with the lack of such oversight resulted in exchanges of leniency for waiving attorney–client privilege and releasing protected legal “work products.” Finder *et al.* find, in their study, that more than 66% of DPAs between 2003 and 2006 required privilege waivers.¹⁵⁸ In other cases, prosecutors required that the offending company make charitable contributions to the district attorney’s *alma mater*, and hired former judges and prosecutors as monitors for companies found in breach of the FCPA. In a rather famous case, the DoJ appointed a monitor (as part of an NPA) on the Board of Bristol-Myers-Squibb who found evidence of anti-competitive behaviour and other violations which would have violated the company’s Fourth Amendment rights if investigators had come to search the company’s premises. Numerous interviews with company executives have found that executives have admitted to their company’s guilt in order to receive lenient treatment for their own private persons – in violation of their fourth, sixth and seventh amendment rights. Yet, faced with the DoJ’s extensive powers – a slap on the wrist for a crime they did not commit pales in comparison with years of potential jail time for a crime their colleagues might have committed. **Legislators should thus insist on judicial oversight of any future NDPA scheme used in the future.**

Second, the variability in prosecutions suggests serious flaws with the US DoJ’s discretionary power to use NDPAs. The US DoJ’s discretionary power in applying the

¹⁵⁸ Finder et al., *supra* note 154.

FCPA has led some commentators to note that the DoJ has engaged in “lawmaking through enforcement.”¹⁵⁹ Warin and Boutros show very serious differences in which companies – in identical positions – received very different treatment.¹⁶⁰ Only a handful of DoJ offices deal with NDPA’s. In a comparison of New York and New Jersey agreements, Spivack and Raman find that the New York office almost always chose a non-prosecution agreement whereas their colleagues (literally separated by only a river) chose almost always deferred prosecution agreements.¹⁶¹ Deferred agreements are “better” than non-prosecution agreements because they give prosecutors more control over the regulated company. Yet, such control does not always ensure less corruption. Warin and Boutros’ proposal for reform includes creating strict guidelines on the type of treatment the DoJ offers to companies.¹⁶² The DoJ already offers guidance through charging guidelines – albeit much less precise than needed.¹⁶³

In contrast, the UK Department of Public Prosecutions (DPP) offers their own guidance to prosecutors.¹⁶⁴ The difference in the guidelines reflects the deep fundamental difference in legal traditions between the two jurisdictions. The US Attorney Manual guidelines focus on the contrition and justice of prosecuting that particular individual. The DPP guidance highlights the balance of the prosecution decision between the need to enforce the law and the need to uphold the public interest. Unlike in US law, the “public interest” has much greater expression in UK law. Given the even larger role of the public interest in Hong Kong’s political context (and sensitivities involving the prosecution of China-related companies), **the ICAC should adopt anti-corruption specific prosecutorial guidelines much closer to the UK than the US.**¹⁶⁵

¹⁵⁹ Amy Westbrook, *Enthusiastic Enforcement, Informal Legislation: The Unruly Expansion of the Foreign Corrupt Practices Act*, 45 GEO. L. REV. 2, 2011.

¹⁶⁰ Joseph Warin and Andrew Boutros, *Deferred Prosecution Agreements: A View From The Trenches And A Proposal For Reform*, 93 VIRGINIA L. REV., 2007: 121–134.

¹⁶¹ Peter Spivack and Sujit Raman, *Regulating the 'New Regulators': Current Trends in Deferred Prosecution Agreements*, 45 AMER. CRIM. L. REV., 2008

¹⁶² Warin and Boutros, *supra* note 160.

¹⁶³ USAM 9-28.000, *Principles of Prosecution of Business Organizations*, available [online](#).

¹⁶⁴ Bribery Act 2010: Joint Prosecution Guidance of The Director of the Serious Fraud Office and the Director Of Public Prosecutions, available [online](#).

¹⁶⁵ At the time of this writing, the US DoJ and SEC issued their own specific guidelines related to the enforcement of the FCPA. As these emerged just as we finished this paper, we could not incorporate an

**Figure 21: Charging a Corporation:
A Comparison of US and UK Prosecutorial Guidance**

US U.S. Attorney's Manual Guidelines	UK DPP Guidelines
<ol style="list-style-type: none"> 1. nature and seriousness of the offense 2. pervasiveness of wrongdoing 3. company's history of similar conduct 4. company's timely and voluntary disclosure; 5. existence and effectiveness of a pre-existing compliance program 6. company's remedial actions; 7. collateral consequences (including harm to shareholders) of a conviction 8. adequacy of prosecution of individuals; and 9. adequacy of civil or regulatory remedies. 	<p>Factors tending in favour of prosecution:</p> <ol style="list-style-type: none"> 1. Large or repeated payments are more likely to attract a significant sentence, 2. Bribe was probably planned because local practices strongly encourage bribery, 3. Payments actively helped to corrupt the official, 4. When internal policies against bribery have not been followed 5. When company did not self-report and/or try to remedy the problem,

Sources: see footnotes. We have paraphrased the UK recommendations to put them into plain English and to remove repetition.

A third drawback of NDPA's revolves around prosecutors' (the US DoJ's) negative foreign bias. Professor Garrett, in a sweeping econometric review of FCPA prosecutions, found that a foreign firm is statistically significantly more likely to receive an FCPA conviction than a domestic firm.¹⁶⁶ Foreign firms plead guilty often and early – rather than opting (or having the option for) a Non-Prosecution Agreement or a Deferred Prosecution Agreement. He finds specifically that foreign firms are only 20% as likely to enter into a NDPA as its domestic counterpart. Part of the reason involves fear of the US's *respondeat superior* rules – such that a corporate CEO in Munich or Mumbai may find themselves convicted of a crime in a country they never visited (the USA). Garrett also finds that foreign firms pay fines that are 22 times higher (than means 2200% times higher) than their US counterparts. Unlike other authors such as Warin and Boutros, they do not attribute these biases to capricious or arbitrary prosecutorial discretion. Instead they blame the economics of prosecution. These foreign firms tend to be larger, easier to identify and cheaper to prosecute (due to economies of scale for these large prosecutions).

extensive analysis of this guidance. See Criminal Division of the U.S. Department of Justice and the Enforcement Division of the U.S. Securities and Exchange Commission, FCPA: A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT, available [online](#), [hereinafter *Resource Guide*].

¹⁶⁶ Brandon L. Garrett, *Globalized Corporate Prosecutions*, 97 VIRGINIA L. REV. 8, 2011.

Fourth – most interestingly from both legal theory and practice – relates to the use of the corporate death sentence. NDPAs can – without judicial oversight – often result in disbarment, deregistration or bankruptcy. Such actions equal, in actual fact, a corporate death sentence.¹⁶⁷ Economists, legal scholars and public policy experts can agree – unlike in the case of a death sentence for natural persons – that corporate death sentences are never efficient.¹⁶⁸ Some reasons for the lack of such efficiency include harm to third-parties, increased unpredictability of investment, and the availability of reorganisation options not available to natural persons.¹⁶⁹ **A revised POBO should not give the Hong Kong authorities the power to impose capital punishment on companies (through actions such as deregistration and forced bankruptcy).**

Instead, business reorganisation and monitorships can help address the underlying failures leading to criminal corporate *mens reus*. Monitorships are often used with NDPAs to ensure that companies fix the problems leading to DoJ action.¹⁷⁰ As shown in Figure 22, business reforms and monitorships made up about a bit more than half of all NDPAs. By 2008, both elements made up almost 70% of NDPAs. As Warin and colleagues note, “companies with a more entrenched culture of corruption and those lacking effective compliance programs seem most likely to receive FCPA monitors, while the nature of the actual underlying offenses appears to be a less important consideration.”¹⁷¹

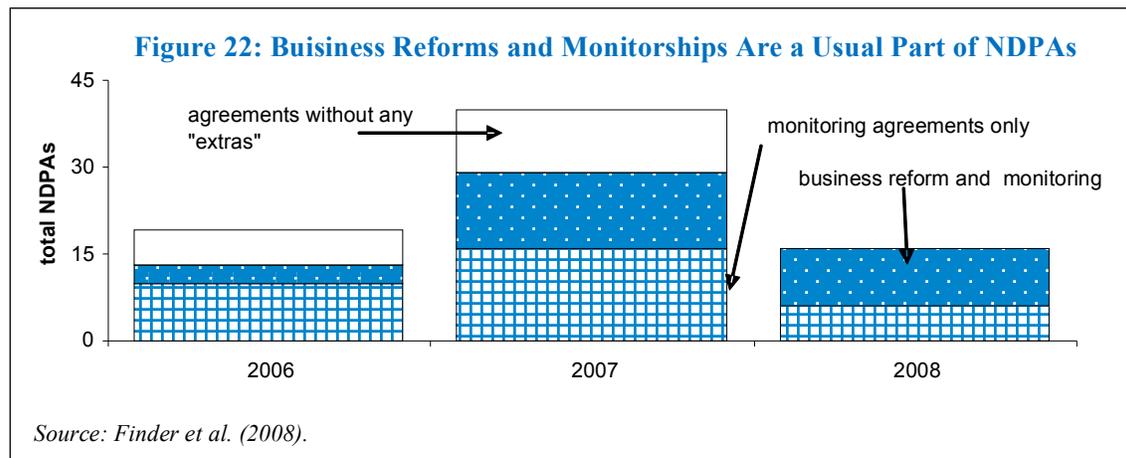
¹⁶⁷ Weiss refers to the key corporate death sentence – the Arthur Andersen prosecution – which destroyed over \$9 billion in value. *See supra* note 156 at 512.

¹⁶⁸ As the exception which proves the point, Stevenson and Wagoner fall into the typical trap by claiming that debarment of foreign contractors can increase welfare. They claim that a corporate death sentence imposed on foreigners can only help US competitiveness. Such an argument (besides being ethnocentric) ignores the residual positive welfare impacts of increased trade with foreign markets. *See* Drury Stevenson and Nicholas Wagoner, *FCPA Sanctions: Too Big to Debar?*, 80 FORDHAM L. REV. 775, 2011, available [online](#).

¹⁶⁹ USAM 9-28.1000 specifically notes that DNPAs should be used when potential harm to third-parties exists.

¹⁷⁰ Section 163 of the DOJ Criminal Resources Manual.

¹⁷¹ Joseph Warin, Michael Diamant and Veronica Root, *Somebody’s Watching Me: FCPA Monitorships and How They Can Work Better*, 13 U. OF PENN. J. OF BUS. LAW 2, at 17.



Monitorships – besides establishing and helping to change the corporate *mens rea* – also have other positive attributes. First, such monitorships encourage companies to hasten their internal reforms. Monitorships are paid for by the company and are extremely expensive – ranging from \$28 million to \$52 million for three years of former Attorney General John Ashcroft’s monitorship time. Second, company officials can use these monitorships as scapegoats when requested to pay bribes. When corrupt foreign officials approach company managers in the future, they can argue that US government appointed monitors closely monitor their actions – decreasing the likelihood that foreign officials will ask for bribes in the first place. Third, monitorships serve as a “Scarlett letter” – ensuring that the public sees the important role prosecutors play in helping the company to reform. **The HK authorities (the ICAC, DoJ and courts) should encourage the use monitorships as a way to reform companies who often engage in corruption (if and when give such powers by a revised POBO).**

Fines and non-conviction based prosecutions

Fines represent a core way that UK and US law deters (and recovers the proceeds of) corruption. Moving to a system where fines can be used to deter corruption serves as the basis of US and UK prevention. Figure 23 shows the logic for using fines. We show the cost-benefit calculus of a businessman thinking to pay a bribe to a government official. In the first case – with criminal prosecution only – we assume the person may

have only a 5% probability of detection. Imposing fines for negligence (like in the US or UK approaches) has three effects. First, these fines cause the probability of detection to rise – because the list of fined companies serves as a high-risk group of companies to anti-corruption agencies like the ICAC. A company fined for not having adequate systems in place to detect and/or prevent corruption clearly represents a higher risk than a company with adequate procedures in place. Second, because the probability of detection increases – the expected profit from corruption falls. In our example, the corrupt manager only has an 80% probability of receiving the \$50 million pay-off from corruption when the probability of detection increases. Third, the fine serves to reduce the expected gain from corruption. Corporate management can avoid implementing internal procedures designed to detect corruption – and pay the fine to the regulatory (or prosecutorial agency). The fine decreases the amount of the potential benefit – in our example by \$10 million. Clearly, the fine must serve as an adequate deterrent (as required under the UN Convention Against Corruption).

Figure 23: The Calculus of Consent and the Need for Fines

The following table shows a hypothetical cost-benefit calculation of a potentially corrupt manager in two different jurisdictions. In the first jurisdiction, prosecutors apply only criminal sanctions. In the second jurisdiction, the preventive or repressive anti-corruption agency may apply fines to companies which fail to implement adequate systems to detect and prevent corruption. We show the “disutility” of jail time (as economists call it) by the amount of money a person would pay to avoid prison. If such a disutility argument seems too difficult or implausible, then imagine this sum represents the financial equivalent value of the unhappiness the person would experience in prison.

	Criminal Only	With fines
Amount at risk	\$50 million	\$50 million
Probability of detection	5%	20%
Expected gain	\$47.5	\$40 million
Fine	\$0	\$10 million
Expected gain	\$47.5 million	\$30 million
Payment to avoid prison	\$40 million	\$40 million
Final gain/loss	\$7.5 million gain	-\$10 million loss
Engage in corruption?	Yes	No

Source: authors, based on Aidt (2003).¹⁷²

¹⁷² Toke Aidt, *Economic Analysis of Corruption: A Survey*, 113 ECON. J. 3, 2003.

Hong Kong imposes fines as a way to recover the proceeds of corruption – but not to deter corruption (that we know of). **Revised legislation should clearly impose the same type of negligence fines used in the US and UK.** As we discuss in Appendix II, an addition to the Company Law (rather than the POBO) would probably serve as the politically most convenient avenue for obtaining adoption. Assuming that HKD\$34 billion of foreign trade with China is exposed to corruption – and assuming that Hong Kong’s courts (with the ICAC’s and DoJ’s help) can recover even 5% of that amount in fines, **the total revenue collected from fines would equal HK\$1.7 billion.**

Options for introducing corporate criminalisation

If Hong Kong’s experience reflects that of the US and UK, the LegCo will need to (and eventually want to) criminalise corruption by companies and other legal persons. We discussed three approaches to corporate criminalisation from the OECD – strict liability approach, the vicarious liability of principals approach and a doctrinal approach which seeks to create a definite *mens rea*. In theory, the LegCo could choose any of these approaches, as none of these approaches run diametrically counter to Hong Kong’s jurisprudential tradition. In practice, Hong Kong legislators really have only one option. **Hong Kong’s legislators should include provisions into the Prevention of Bribery Ordinance which explicitly make Hong Kong’s companies criminally liable for the corrupt acts of their agents at home and especially abroad.**

Hong Kong legislators not sit idly by and rely on existing common law remedies – like vicarious liability and the directly minds approach to criminalisation. One or two corrupt managers may not reflect the will of the organisation – or even its managers and Board. Hong Kong legislators would do well to leap-frog past the UN and OECD recommendations on corporate criminalisation (which even these organisations only begrudgingly endorse as a bare minimum political compromise). Instead, Hong Kong legislators should criminalise corporate corruption directly – rather than criminalise through the “leading persons” approach and other approaches. Both the US and UK (with

their common law traditions), have used a similar “leapfrog” approach – by passing legislation which mixes strict liability and a corporate duty of care.

Hong Kong legislators should catch up with this evolving area of comparative law by basing the corporate prosecutions when allowed by law (or at least their risk profiling) on these companies’ negligence (and a dysfunctional corporate *mens rea* as shown by their incentives and corporate culture). The UK and US (two of Hong Kong’s largest trading and investment partners) already use a corporate culture test when deciding on prosecutions. The ICAC should prepare for similar legal innovations in Hong Kong.

The LegCo has three options when deciding on the criminalisation of bribery committed by legal (corporate) persons:

a) revisions to Crimes Ordinance – the DoJ’s legislative drafting experts can propose revisions to the Crimes Ordinance – most likely just an additional article -- to provide for corporate liability for corruption. In this way, the approach taken most closely follows Pieth and Ivory’s “list-based approach” to criminalising corruption (as described previously). The article could explicitly note that criminal liability applies only for corruption (to prevent creating precedents which might create legal doctrines of corporate liability for other crimes). Such a revision basically makes Hong Kong corporations strictly liable for corruption – and dodges the issues of a corporate *mens rea*. However, as the Crimes Ordinance does not already contain offences committed by companies, the introduction of such an offence would represent an innovation into Hong Kong law.

b) inclusion in a revised POBO – the DoJ’s legal eagles could propose a simple modification to the POBO to cover explicitly legal as well as natural persons.¹⁷³ Such an approach follows the Western Continental European approach Pieth and Ivory discuss. Such an approach also keeps all relevant anti-corruption law in one ordinance – a

¹⁷³ We saw “explicitly” because nothing excludes the prosecution of corporate persons in the POBO. The Ordinance makes multiple references to “person(s)” (such as in art. 4.1 for example). Nothing in the Ordinance mandates that these persons be natural rather than legal persons. However, the tenor of the Ordinance’s language clearly focuses on individuals (natural persons).

philosophy Hong Kong’s lawmakers seem to value. Such a strict liability approach – again – dodges the issue of *mens rea*.

c) inclusion in the Companies Ordinance – in this approach, Hong Kong’s legislators could add a provision into the Companies Ordinance to allow for corporate criminal liability for corruption. The Companies Ordinance makes several references to activities which constitute crimes (such as art. 40A which establishes “Criminal liability for misstatements in prospectus”).¹⁷⁴ However, again, the Ordinance does not make reference to crimes committed by bodies-corporate or legal persons. However, the Ordinance does make several references to punishments applies to companies directly in the form of fines. For example, “A listed company shall not send to an entitled person of the company, for the purposes of its general meeting, a copy of a summary financial report in place of a copy of the relevant financial documents from which the report is derived... [otherwise], *the company* and every officer of the company who is in default shall be guilty of an offence and liable to a fine” (italics ours).¹⁷⁵

Corporate criminal liability for legal persons should appear in the Crimes Ordinance strictly for political-tactical reasons rather than deep-seated legal ones. Corporate criminalisation will be extremely politically unpopular -- and so Hong Kong legislators should want create “distance” between revisions to the POBO and these criminal law revisions. Clearly the ICAC will be at the centre of this debate because the UN Convention encourages such corporate liability. As discussed in Appendix II, we recommend putting some time between public discussions about corporate criminalisation and the other reforms. To the extent that any amendments to the Crimes Ordinance address the issue of *mens rea* as a corporate culture and/or internal framework of incentives, the DoJ should consult closely with the ICAC (as the body most likely to consult with the public and issue future guidance about preventing such corporate crime). The ICAC’s experience and daily exposure to corruption makes it uniquely qualified to play such a consultative role.

¹⁷⁴ Companies Ordinance, available [online](#).

¹⁷⁵ *Id* at 141CA. Similar fines appear for breaches of articles 141CB - 141CE.

What about the plea bargains (or non and deferred prosecution agreements) which have grown up around such corporate prosecutions in the US (and increasingly in the UK)? Hong Kong's legal profession has traditionally held plea bargaining in contempt – for the reasons with which the reader will be well-familiar.¹⁷⁶ Foreign experience – and particularly US experience – shows that these plea bargain agreements can lead to improved anti-corruption enforcement. The same experience also shows that prosecutors can abuse such agreements. The question is not whether Hong Kong authorities will use these agreements or not – as the trend in international law appears to favour these agreements. Rather, the question remains how to design the rules governing ICAC and DoJ staff so as to prevent the abuses of the American system?

The authority for such agreements can come from a modifications stemming from two insertions into Hong Kong's law – a one sentence insertion into the POBO creating the legal basis for these agreements (with DoJ oversight) and a one-line insertion into the ICAC Ordinance giving the ICAC the authority to enter into these agreements. These types of plea-bargains represent a very new approach to prosecution in Hong Kong (in the same way they represent a new approach in the UK). The UK has already started formal preparations for introducing pre-trial diversion into its legal system. Hong Kong could well do the same. The ICAC brings prosecutions for corruption to Hong Kong's courts – thus should have the authority to enter into these agreements. The authority to engage in pre-trial diversion could be inserted in Part II of the POBO – thereby allowing for Secretary of Justice oversight of pre-trial arrangements and agreements.¹⁷⁷

Tactically, LegCo and public consultations about these amendments should coincide with changes to the Crimes Ordinance – and not the other POBO revisions. The other revisions to the POBO will be extremely controversial. Any discussion about pre-

¹⁷⁶ For an overview, see Grenville Cross, *Plea Bargaining: The Right to Know?* HONG KONG LAWYER September 2006, available [online](#).

¹⁷⁷ Article 31(1) of the POBO stipulates that “No prosecution for an offence under Part II shall be instituted except with the consent of the Secretary for Justice.” If pre-trial diversion agreements fall into Part II of the Ordinance, then article 31(1) would help ensure adequate review.

trial diversion will detract attention from (and political support for) the broad changes to the POBO. Public discussion of amendments to the ICAC Ordinance should be separated by at least 6 months from changes to POBO. In that way, these extremely controversial changes do not get lumped – either politically or analytically – with the already controversial changes to the POBO. Such a unusual sequencing of reform will maximise the probability of legislative adoption (as we show in Appendix II).

Once the LegCo gives the authority to the ICAC to enter into these agreements, **the ICAC should submit a draft Guidelines Manual for DoJ review.** Because of the serious problems involved in using these agreements in the US, the Hong Kong Law Society and other relevant stakeholders should be consulted about the eventual guidelines governing the ICAC’s use of such agreements.

One related issue which will determine the success or failure of NDPAs in Hong Kong relates to lawyer-client privilege. At present, Hong Kong corporate legal counsel (at least as of 2007) does not enjoy the same privileges as in British and American firms.¹⁷⁸ Such privilege generally encourages companies to find corruption before it happens – and often encourages self-reporting. Over 10 years of US experience shows that privilege remains a cornerstone for the success of these NDPAs. Hong Kong law must adapt in order to encourage companies to self-police (and thus qualify for lenient pre-trial diversion agreements). Part of Hong Kong law already provides such privilege – in the form of section 15(1) of the POBO.¹⁷⁹ However, the various exceptions and cases covered would require further legal analysis – particularly as voluntary disclosure would affect the company and legal counsel alike.¹⁸⁰

¹⁷⁸ Robert Clark & Ming Lai Chung, *In-House Counsel and the Attorney-Client Privilege*, available [online](#).

¹⁷⁹ The section stipulates that “Save as is provided in this section, nothing in this Ordinance shall require the disclosure by a legal adviser.”

of any privileged information, communication, book, document or other article.

¹⁸⁰ The section deals with exceptions under which legal counsel may need to give information – and covers certain types of third-parties.

Lawyer-client privilege also helps promote the culture of compliance required by regulators. Yockey’s study of privilege in an FCPA context is particularly instructive.¹⁸¹ First, lack of privilege (such as in Hong Kong because of national legal tradition or in the US when companies waive such privilege) destroys a culture of compliance. When employees know that corporate counsel will work with them (rather than against them), they are much more willing to produce evidence. Second, and more worryingly, he finds that without the protection of privilege, company staff will have every incentive to cover-up and destroy internal evidence linking them to corruption. Third and most worrying (though not obvious because of the abstract nature of the harm), companies avoid working in industries with higher proportions of FCPA investigations – like extractive industries). Companies avoid these industries, leading to a range of harms (see Figure 24). Thus, helping companies – particularly in high corruption-risk industries – to self police and engage in NDPA’s can help prevent the distortions to investment caused by the criminalisation of transnational bribery which we discussed previously.

Figure 24: How Does Anti-Corruption Law Enforcement Lead to Economic Distortions?

Macroeconomists are very comfortable with the idea of macroeconomic distortions. However, anti-corruption lawmakers may be less familiar with these kinds of abstractions. Consider the following example -- **Hutchison Port Holdings** staff become worried that they might face prosecution under beefed up Hong Kong anti-corruption laws. They thus refuse to bid for port projects in risky jurisdictions and avoid taking legitimate decisions where the ICAC might suspect corruption. Such actions mean fewer ports built – and higher costs per port. These higher costs translate into higher prices of goods shipped through those ports (from iPods to fabrics). Higher prices mean lower real incomes and higher prices (and thus inflation). An anti-corruption law enforcement policy has become a non-tariff barrier to trade (and has made consumers prefer non-traded goods like haircuts and rock concerts). Simple policies – even anti-corruption policies -- can have profound macroeconomic effects.

When drafting the Guidelines, the ICAC should focus on defining a set of materials used in the corporate context which would be “highly unlikely” to be involved in the search (though not in prosecution).¹⁸² The goal of such a policy

¹⁸¹ Joseph Yockey, *FCPA Settlement, Internal Strife, and the “Culture Of Compliance*, WISC. L. REV., 2012.

¹⁸² Because privilege does not exist in Hong Kong, one “work around” would be to define materials that the ICAC would not look at during investigations (thereby replicating lawyer-client privilege). Naturally,

consists of encouraging companies to engage in the “protected” internal communication which facilitates self-policing. Legal advisors to the ICAC already have two sets of guidelines to help them decide what kinds of communication might not attract investigatory and/or prosecutorial interest.¹⁸³ Naturally, these guidelines would not bind the ICAC – as Hong Kong law does not recognise the principle of privilege. However, creating a framework where companies have strong incentives to deter corruption works in the public interest.

Building political will for reform

Revisions to the POBO will generate benefits to the economy as a whole, to the tax base, and to foreign economies like China. However, some interests with important representation in the LegCo will be harmed by these reforms (as shown in Appendix II). Compensation to the losers of policy reform remains a tried-and-true method of ensuring the passage of technocratically advantageous (but politically difficult) reforms.¹⁸⁴ The ICAC does not decide on the allocation of public funds. However, the ICAC can provide analysis to the Financial Secretary – specifically during consultations on the budget.¹⁸⁵ Providing economic incentives for certain beneficiaries of Chinese corruption in Hong Kong represents smart policymaking and smart politics.

In Appendix II, we identify the political interests and groups helped and harmed by the revisions to the POBO we discuss in this paper. We also – by quantifying the harms to these groups – provide the expected costs of government programmes required to compensate these groups for lost revenue (as a result of better anti-corruption

because Hong Kong law does not formally recognise the principle of privilege, the DoJ could subpoena these material at a later date if the ICAC’s investigation reveals evidence of corruption.

¹⁸³ Both the UK *Guidelines* and the recent US *Resource Guide* provide ample examples of the kinds of materials prosecutors take into account when deciding whether to proceed with a case. See Resource Guide, *supra* note 165. See also Guidance, *supra* note 49.

¹⁸⁴ One of the oldest (and most powerful) sets of tools economists have at their disposal are tools that let them calculate the types of redistribution needed to pass policies which will benefit everyone in the long-term, but might harm politically important interests in the short-term. For an example of this type of analysis, see Sanjay Jain and Sharun Mukand, *Economic Policy Reform under Political Constraints: Labor Reallocation and Compensatory Redistribution*, available [online](#).

¹⁸⁵ Comics often represent the best way to absorb complex information. For the easy to understand version of the budget consultation, see [online](#).

enforcement). In Figure 25, we show some of the ways that anti-corruption agencies (especially preventive agencies) can provide advice to a budget-making authority. The ICAC will find some of these tips more or less useful – as we do not have detailed information about the informal politics behind Hong Kong budget making. In some cases, our recommendations may go against established practice (or even administrative law). However, we hope that some of the tips will help in the difficult political game ahead.

Figure 25: The Dos and Don'ts for a Preventive Anti-Corruption Agency's Budget Recommendations

Best Practice for Giving Advice

- provide only recommended budgetary envelopes for particularly adversely affected groups
- give the economic models, assumptions and other supporting materials to the Financial Secretary so their staff can double-check your analysis
- provide only estimates of financial harms (or their financial equivalents)
- obtain information about the impacts of proposed legislation (or recent changes) during community relations activities to identify potential opponents of later reforms
- provide to the public examples of individuals or groups helped by new legislation (to put a human face to your policy reforms)
- do be prepared to adapt or compromise if political pressure from Beijing or powerful local constituencies becomes too great (diplomacy is a game played over centuries, not over months)
- be willing to acknowledge, confirm, or discuss independent experts' and academics' impact estimates (as public understanding of the broader political costs and benefits of reform can only help the ICAC).

Things to Avoid while giving advice

- do not give advice on specific programmes or specific individuals who will receive compensation,
- do not base audits or risk profiles on the recommended allocation of resources (on the theory that less compensated groups might have more incentives to engage in corruption),
- do not seek go around the normal budget process or ask for emergency compensation to a particularly affected group,
- do not hide the Agency's advice from parliament (though the specific allocation recommended should not be publicly disclosed!)
- absolutely do not recommend compensation to groups to “do the right thing” or in exchange for supporting the reforms,
- do not give advice whose main purpose is to increase the ICAC's budget
- do not compensate harmed foreign interests (except on the Mainland who may influence the political process in Hong Kong).

Source: authors (based on work with over 10 preventive anti-corruption agencies world-wide).

Bringing the Money Back Home – A New Recovery Structure

Recovering the proceeds of crime and civil recoveries

Most countries – in line with the criminalisation of corruption-related offences – still (and unfruitfully) rely on the criminal recovery of proceeds related to corruption to “bring the money home.”¹⁸⁶ In Hong Kong, the Organized and Serious Crimes Ordinance provides the legal basis for such recovery.¹⁸⁷ The Ordinance (passed in 2003) represents a relatively recent addition to Hong Kong’s legal framework for fighting corruption. However, recovery – particularly in an international setting – requires three conditions.¹⁸⁸ First, Financial Intelligence Units in the relevant jurisdiction should identify (and possibly restrain) the assets. Second, the relevant law enforcement official(s) should prepare a request for mutual legal assistance. Third, the necessary recovery “infrastructure” must be in place – namely agreements in place so that investigators and/or prosecutors can ask for information from foreign banks, freeze assets and so forth.

Regarding Hong Kong’s recovery infrastructure, the LegCo has adopted mutual legal assistance treaties with 21 countries.¹⁸⁹ However, as shown in Figure 26, the countries which pose the highest risk (in terms of Hong Kong companies participating in bribery abroad) are not represented. China (representing roughly one-third of deposits held by Hong Kong banks) has no MLA agreement with Hong Kong. With poor control

¹⁸⁶ The World Bank (as the main thought-leader on the recovery of corruption-related proceeds) still remains undecided on criminal versus non-conviction based methods of recovery. Brun *et al.* strongly argue for non-conviction based confiscation (as a way to tackle issues like illicit enrichment). Greenberg *et al.* argue strongly against – noting that favoring non-criminal rather than criminal enforcement violates the core principle of promoting the criminal prosecution of corruption. See Theodore Greenberg, Linda Samuel, Wingate Grant and Larissa Gray, *STOLEN ASSET RECOVERY: A GOOD PRACTICES GUIDE FOR NON-CONVICTION BASED ASSET FORFEITURE*, 2009. See also Jean-Pierre Brun, Larissa Gray, Clive Scott, Kevin Stephenson, *ASSET RECOVERY HANDBOOK: A GUIDE FOR PRACTITIONERS*, 2009, at sec. 5.5.1.

¹⁸⁷ *Organized and Serious Crimes Ordinance*, Chap 455, available [online](#).

¹⁸⁸ Wayne Walsh, *Seizure, Confiscation and Repatriation of Assets: Practice in Financial Centres* (Hong Kong), Paper presented at the conference Making international anti-corruption standards operational: Asset Recovery and Mutual Legal Assistance Regional Seminar for Asia-Pacific (5-7 September 2007), available [online](#).

¹⁸⁹ These countries are Australia, Belgium, Canada, Denmark, France, Germany (not yet in force), Ireland (not yet in force), Israel, Italy (not yet in force), Malaysia (not yet in force), Netherlands, New Zealand, Philippines, Poland, Portugal, Singapore, South Korea, Switzerland, Ukraine, United Kingdom, United States of America.

of corruption on the Mainland, lack of formal co-operation between Hong Kong and China remains an Achilles Heel in Hong Kong's international anti-corruption efforts. Hong Kong has MLA agreements with the US and Singapore. However, both of these jurisdictions represent relative insignificant banking counterparties – and have adequate control over corruption (as compared with Hong Kong).

Figure 26: Hong Kong has MLA Agreements with Countries It Does Not Really Need Agreements With (at Least in Anti-Corruption)

	MLA Agreement	Deposits Held in HK	Deposits Held Abroad	Control of Corruption
China	No	33%	28%	31%
USA	Yes	4%	4%	81%
Japan	No	1%	2%	89%
Taiwan	No	N/A	N/A	67%
Singapore	Yes	8%	10%	107%

The Figure shows Hong Kong's 5 largest trading partners, the presence of an MLA agreement, foreign deposits held in Hong Kong by each country's nationals (as a percent of total foreign assets), Hong Kong citizen deposits abroad (expressed as a total of these foreign deposits), and the World Bank's Control of Corruption indicator (expressed as a percent of Hong Kong's control of corruption score). Total foreign assets in Hong Kong totalled HK\$ 489 billion at the end of 2011, and total Hong Konger bank deposits held abroad equalled HK\$ 748 billion.

Source: HKMA (2012), DoJ (2012) and World Bank (2012).

The MLA Ordinance provides for an important exception which seriously compromises Hong Kong's ability to co-operate on anti-corruption with the Mainland. According to Mutual Legal Assistance Ordinance, Hong Kong must refuse a request for assistance with an asset recovery if “acceding to the request would impair the sovereignty, security or public order of the People's Republic of China.”¹⁹⁰ Yet, the Chinese state – a semi-planned economy -- relies on corruption in order to exist.¹⁹¹ In a semi-planned economy with fixed wages and bureaucratic incentives, senior politicians use corruption to provide the only incentive available to party officials and civil servant level bureaucrats. Corruption serves as a useful incentive because if officials' engage in self-dealing or do not follow their superiors' instructions, they can be prosecuted in the

¹⁹⁰ MLAO at sec. 5(1).

¹⁹¹ Tieh-chih Chang, Growth, *Corruption and State Capacity? China in Comparative Perspective*, Paper prepared for presentation to the Mini-APSA, Department of Political Science, Columbia University, April 30, 2004, available [online](#).

next anti-corruption drive. Corruption serves as one of the organising principles of the Chinese system of governance – thus any corruption-related asset recovery touches at the very core organising principle of Chinese public sector administration.¹⁹² We provide recent media statements by senior Chinese officials to support this assertion in Appendix I.¹⁹³

In theory, the UN Convention Against Corruption seemingly provides a promising avenue for asset recovery. In practice, the use of the UN Convention Against Corruption remains an extremely uncertain avenue for such recoveries. All of Hong Kong’s major trading and investment partners (with the exception of Japan) are Parties to the Convention.¹⁹⁴ However, even if the ICAC sends a request for assistance under the UNCAC, the odds are still extremely unlikely that the ICAC will receive much support. Hong Kong’s prospects of MLA with China look slim now – but show great promise of future opening. China does not belong to the Egmont Group of Financial Intelligence Units. However, as Guo Ming-cong of China’s Supreme People’s Procurator’s Office, notes “P.R. China has signed criminal or civil assistance treaties with 57 countries and extradition agreements with 28 nations.”¹⁹⁵ Most work to date though consists of organising high profile conferences of anti-corruption agencies, prosecutors associations and so forth. However, if China co-operates with a jurisdiction that co-operates with Hong Kong, then the possibility of at least indirect cooperation with the Mainland increases.

¹⁹² The reader might find statements like this extremely hyperbolic. However, senior Chinese officials have increasingly confronted this reality in a series of speeches. Moreover, more than 500 studies of planned economies have revealed similar findings. The use of corruption as a “surrogate price mechanism” represents one of the reasons why political scientists moved away from encouraging state planning in the 1990s. See Rasma Karklins, *THE SYSTEM MADE ME DO IT: CORRUPTION IN POST-COMMUNIST SOCIETIES*, ME Sharp, 2005.

¹⁹³ We provide quotes from senior Chinese officials to this effect to show that we do not try to cast aspersions at the Chinese state. We simply describe a well-known result from academic research of planned and semi-planned economies over the last 40 years.

¹⁹⁴ Japan has signed but not ratified the Convention.

¹⁹⁵ Guo Mingcong, *The Status Quo and Challenges the People’s Republic of China Faces in Developing International Cooperation on Asset Recovery*, in *ASSET RECOVERY AND MUTUAL LEGAL ASSISTANCE IN ASIA AND THE PACIFIC*, 2007, available [online](#).

A more likely route for recoveries consists of encouraging victims to use civil law to recover losses stemming from corruption abroad. The ICAC has historically relied on civil recovery – primarily because other methods of recovering assets have been unavailable.¹⁹⁶ In the past, these civil recoveries have often resulted from clever lawyering and the creative interpretation of fiduciary duty. The *Reid* case represents the archetypical case of bending civil law to its limits to recover the proceeds of corruption.¹⁹⁷ Basically, Charles Warwick Reid – a former Hong Kong prosecutor – was convicted of corruption and ordered to repay HK\$12.4 million in restitution. Hong Kong prosecutors found millions of dollars in assets in New Zealand (where Reid was originally from) in property registered under his family’s name. The authorities could not recover the funds through asset recovery orders and mutual legal assistance treaties with New Zealand -- as neither existed at the time. Instead, Hong Kong prosecutors had to argue that the recipient of a bribe (Reid in this case) holds those funds on trust for the victims (and/or the public interest as represented by the Crown). Thus, under this interpretation of equity law, Reid had to repay these funds which he held “on trust.” The common law system, in this case, provided the flexibility to bend a common law principle of equity to serve a public policy objective of recovering stolen assets.

While Hong Kong may have pioneered the use of civil recoveries in corruption cases (like in many other areas of anti-corruption law), such law has subsequently failed to keep up with international best practice. The use of domestic and foreign courts represents the most important area where Hong Kong law could better assist in civil recoveries.¹⁹⁸ In other jurisdictions, plaintiffs and prosecutors have extended the “bribe as a breach of trust” doctrine in three ways (see Figure 27). To date, Hong Kong courts have not needed to try many of these types of cases – partly because of the ICAC’s domestic

¹⁹⁶ The following account comes from legal analyses provided by Norton Rose, Nicholls *et al.*, and the World Bank. See Norton Rose, *An introduction to the law of bribery and corruption*, available [online](#). See also Emile van der Willebois, J.C. Sharman, Robert Harrison, Ji Won Park, Emily Halter, THE PUPPET MASTERS: HOW THE CORRUPT USE LEGAL STRUCTURES TO HIDE STOLEN ASSETS AND WHAT TO DO ABOUT IT, World Bank. See also Colin Nicholls, Timothy Daniel, Alan Bacarese, John Hatchard, CORRUPTION AND MISUSE OF PUBLIC OFFICE, Oxford University Press.

¹⁹⁷ *Attorney General for Hong Kong v. Reid* [1994] 1 AC 324 (PC).

¹⁹⁸ For an overview, critique and possible uses of civil recoveries in Hong Kong, see Simon Young, *Why civil actions against corruption?*, 16 J. OF FIN. CRIME 2, 2009: 144-159.

success. However, if the POBO applies transnationally, Hong Kong courts should (in theory) become available to foreign private litigants.

Figure 27: Hong Kong: The Perfect Venue for Civil Recovery Forum Shopping?

At common law, a company can rely on a number of doctrines in an attempt to recover the proceeds of corruption and/or shield itself from liability imposed by corrupt agents. Some of these doctrines include:

- Trust-based theory: under this theory, the bribee holds the proceeds of the bribe on trust for his principal. The principal (company) can recover the bribe and any gains accruing from the bribe (like returns on investments). The agent may also be liable for damages in tort.
- Tort-based theory: under this theory, the company can sue the briber for corrupting its agent.
- Contract-based theory: under this theory, the company can annul a contract entered into because of corruption. Any consequences arising from the contract can be nullified (and any monies paid can be returned).

Source: Norton Rose (2012).

At present, civil litigants interested in “litigation tourism” in Hong Kong face a number of obstacles. First, as Young notes “Hong Kong does not have civil forfeiture yet.”¹⁹⁹ Such a lacuna is unfortunate – as litigation in the US due to the FCPA has generated at least \$5 billion in fees for private investigators, compliance-related staff, and legal counsel.²⁰⁰ If Hong Kong became a venue-of-choice for such litigation (like the US and a lesser extent the UK), the revenue brought in would amount to a significant proportion of the ICAC’s annual budget. Second, civil courts are not service providers – and so can find for no-cause of actions, *forum non conveniens*, apply limitation periods, require security of costs, and run up costs which well exceed recovered amounts. Thus, there is no reason to think the courts would co-operate in this ambition to make Hong Kong the anti-corruption litigation capital of Asia. Third, as we discuss later, no principle exists in international law to keep plaintiffs from suing in multiple jurisdictions. As a result, both the plaintiff and defendant may well become exposed to a great amount of risk for relatively little reward.

¹⁹⁹ *Id* at 153.

²⁰⁰ For one example which illustrates these costs, see FCPA Blog, *Investigation Costs Keep Climbing*, available [online](#).

Hong Kong courts could provide a useful venue – particularly for litigants from civil law jurisdictions seeking recoveries using common law doctrine. Civil lawsuits by parties aggrieved by corruption from Hong Kong companies (or parties who think they are aggrieved) can bring cases to the ICAC’s attention through filing civil lawsuits in Hong Kong. The ICAC can even help facilitate private action in recovering the damages from corruption abroad (as we discuss later). However, for that to happen, a Hong Kong court must take standing in cases involving foreign corruption. The recent *B v ICAC* case opens the way a little for Hong Kong courts to consider transnational corruption. However, someone must tell potential litigants that Hong Kong’s courts might be “open for business” to consider such civil cases.

Getting money back from foreign public officials

Countries around the world are quickly criminalising illicit enrichment (or the accumulation of unexplained wealth by public officials). The wave of such criminalisation stems in part from almost universal ratification of the UN Convention Against Corruption. Article 20 of the Convention specifically encourages signatories to the Convention to consider criminalising illicit enrichment.²⁰¹ As shown in Figure 28, most countries – at least those studied by a joint World Bank/United Nations study – have legal requirements for declaring public officials’ income. Elected officials and civil servants in roughly 85% of the countries studied in the Bank-UN report had to report their incomes on asset declarations. Yet, far fewer countries have attempted to weave the trap of criminalisation inherent in the use of these asset declarations. Only about 39% of the countries surveyed may impose penal sanctions on members of parliament (elected politicians) for falsifying or not filing an asset declaration. Only in roughly 41% of these countries can impose penal sanctions on civil servants. Such data suggest that even indirect criminalisation has a long way to go before conforming to the spirit of the UNCAC’s article 20.

²⁰¹ Ruxandra Burdescu, Gary Reid, Stuart Gilman and Stephanie Trapnell, *STOLEN ASSET RECOVERY: INCOME AND ASSET DECLARATIONS: TOOLS AND TRADE-OFFS*, 2009.

Figure 28: Hong Kong's Assets in Roughly 40% of Countries Now Available for Recovery

	Members of Parliament	Civil Servants
Percent of countries having an asset declaration law	86%	81%
False filing	72%	79%
Non-filing	89%	89%
Penal (criminal) sanctions	39%	41%

Source: Burdescu et al. (2009). Based on a sample of 89 countries. Percentages may be approximate.

Such a trend toward the international criminalisation of illicit enrichment represents an opportunity for Hong Kong. Foreign prosecutors can seize money stolen by foreign officials from Hong Kong's (and other countries') companies which benefit from such illicit enrichment. If laws against illicit enrichment allow for such seizures abroad, then Hong Kong (and other jurisdictions whose companies have contributed to corruption world-wide) can expect recoveries in the billions, if not trillions.²⁰² These funds represent a "stock" of assets held abroad which asset recovery actions and convictions for illicit enrichment can recover. **Any work the ICAC and DoJ does to help foreign jurisdictions unearth and recover the proceeds of illicit enrichment will likely lead to important financial flows to Hong Kong and other international markets.**

Hong Kong's courts could well serve in all kinds of corruption-related recoveries – if the LegCo passes recovery-friendly legislation. The US and UK have seen a large and profitable area of private litigation develop in FCPA and UKBA recoveries. Extra-territorial application of US and UK anti-corruption law – combined with a legal tradition which has encouraged victims' litigation -- has been the dominant cause in spurring this industry. With their branch offices world-wide, international law firms (like Baker & McKenzie) have started offering clients advisory services for recovering damages from corruption in foreign courts (like Russia). Large international companies – like GE and Cola-Cola – are becoming more sensitive about corruption (and willing to use local courts to defend their financial interests).

²⁰² BBC, *Corruption costs \$1.6tn, UN says*, 9 November 2009, available [online](#).

The ICAC – if empowered by legislation giving it the right to assist with civil recoveries -- should assist in the development of this emerging trend in international law. The Commission has led the way in working with community groups (including professional groups like lawyers). The Commission has also taken a leading role in public education. In highly corrupt jurisdictions, the ICAC will likely have little success in pushing foreign authorities to engage in criminal prosecutions of officials who “hold up” Hong Kong persons and companies. However, the Commission could play a role in helping to use Hong Kong’s courts to recover some of the damages arising from these crimes abroad. The Commission’s staff could engage in two areas of work in order to expedite foreign recoveries:

a) organise regular meetings of law firms and large companies to let them know how the ICAC’s new remit to tackle transnational bribery can help them

In many corruption cases, a criminal prosecution can give rise to civil cases from victims seeking to recover damages. The ICAC’s Community Relations Department already organises meetings of businesses to provide advice. The ICAC’s Community Relations Department could organise similar meetings of law firms -- specifically offering them advice about how the ICAC can assist with foreign civil recoveries. Some of the ICAC’s services could include contacting foreign authorities as they look for evidence about violations of the foreign jurisdiction’s anti-corruption laws, violations of the POBO abroad, and so forth. The evidence and other materials obtained by the ICAC could be used in private litigation by the Hong Kong’s victims of corruption abroad.²⁰³

Such services would need to involve limited interaction between the Operations Department and the Community Relations Department. The ICAC currently (in line with international practice) has a firm Chinese Wall set-up between the Operations

²⁰³ To take a simple case, imagine that a Chinese official on the Mainland holds-up a Hong Kong company for bribes. Imagine further that Chinese prosecutors are unable or unwilling to start a criminal prosecution. In theory, Hong Kong companies could sue for civil damages in a Hong Kong court. At present, the likelihood of a recovery seems remote – as Hong Kong and the Mainland have limited arrangements dealing with civil recoveries and the enforcement of civil recovery orders. However, the Chinese official involved would need to worry about avoiding falling into Hong Kong jurisdiction in the future. Such an arrangement might serve as a limited deterrent for corruption on the Mainland in the future.

Department and other parts of the ICAC. Figure 27 describes how other these countries' security-related agencies manage to provide services to the public while maintaining the confidentiality and security of their operations staff. Only licensed lawyers in Hong Kong might work with the ICAC on these cases – encouraging these types of recoveries.

Figure 29: An Airlock for the ICAC's Chinese Wall?

When dealing with domestic corruption, a strong Chinese Wall between Operations and Community Relations helps keep officers (and their investigations) safe. In a domestic-only system of enforcement, Operations staff has no need to interact as a service provider to the public (on whom they enforce Hong Kong's laws). When providing assistance to Hong Kong companies on civil recoveries for corruption abroad, the Operations Department could become a service provider. The Operations Department could (if empowered by law) provide communication with foreign counterpart law enforcement agencies and sometimes foreign court staff. Only the Operations Department has the competence (and even vocabulary) to deal with foreign law enforcement agencies – through its Mainland and International Liaison.

In the new arrangement, the Mainland and International Liaison could communicate with a member of the Community Relations Department (CRD). The identity of specific operations staff would be kept confidential – and the Liaison could not communicate directly with the public. The Community Relations Department would continue to represent the ICAC to the public – both in Hong Kong and abroad. The “airlock” in the Wall comes because operations staff deals with the Mainland and International Liaison. The Liaison deals with the CRD representative (who does not know which operations officers are working on the case). The CRD representative, in turn, works with the public. The public do not have access to the Liaison – guaranteeing the safety of all involved.

Both the Liaison and CRD representative would have training (and management oversight) to ensure that no sensitive materials leak from Operations.

Source: authors (based on foreign experience).

Similar meetings can be organised directly with the large Hong Kong-based companies working in high-risk jurisdictions (like India, Thailand and Taiwan). These meetings will probably (particularly at first) be more general than the meetings with law firms on specific recovery cases. Community Relations Department staff in these meetings can explain to companies how to file for damages abroad (generally) and share the experiences of using the US and UK as venue-of-choice for civil litigation related to corruption abroad. Companies which wish to work with the ICAC directly – rather than

through a law firm – may also do so (depending on how regulations structure the system). Alternatively, to help preserve the anonymity of ICAC staff and procedures (as well as to discourage frivolous cases), the ICAC may insist that companies wanting its help work with the ICAC only through law firms. The law firms would thus only have direct contact with the ICAC’s staff.

b) work with foreign law enforcement agencies on mutual legal assistance which helps strengthen the civil claims of Hong Kong companies abroad

Criminal and civil cases can often go together – especially in cross-border cases. The ICAC can petition foreign anti-corruption agencies and law enforcement agencies to start criminal proceedings for corruption abroad if it receives information from a Hong Kong company that a foreign official solicited bribes abroad. Having the ICAC’s support might encourage more Hong Kong companies to press criminal charges against officials in foreign jurisdictions for corruption. As a liaison, the ICAC could collect testimonies and collect other documents so Hong Kong-based plaintiffs do not need to travel to the foreign jurisdiction several times while foreign prosecutors prepare their cases. In the way, the ICAC can work almost like an “anti-corruption embassy.”

Some of the information collected for the criminal case may serve during civil litigation. Foreign prosecutors often drop criminal proceedings because they do not think they can win the case. As previously discussed, many jurisdictions have criminalised illicit enrichment (and ironically copied article 10 of the POBO requiring government officials to prove the sources of their wealth).²⁰⁴ The results of searches of foreign bank accounts and so forth may provide information needed for a private plaintiff to prove a civil case of corruption in a foreign court. The ICAC could work with foreign law enforcement agencies – as they inform them of the ICAC’s intention to seek information and/or evidence for use in a civil trial at home as well as obtain the release of such

²⁰⁴ Muzila *et al.* (2012) cites roughly 87 countries with these provisions. See Lindy Muzila, Michelle Morales, Marianne Mathias, and Tammar Berge, *ILLICIT ENRICHMENT*, 2012.

information/evidence in a way which ensures the information's (and/or evidence's) admissibility in the relevant jurisdiction and so forth.

Options to introduce foreign recoveries

As ICAC Commissioner Timothy Tong told an assembled delegation of anti-corruption agencies in 2011, “regrettably, success stories in asset recovery are few and far between.”²⁰⁵ The ICAC could pursue three possible strategies for recovering assets abroad. The first strategy relies on the courts to eventually provide the basis for such recoveries. The second strategy focuses on changes to the POBO. The third strategy revolves around vigorous enforcement of the already existing asset recovery framework. The third strategy seems like the most promising approach to recovering assets held abroad.

a) attempt a *Reid*-like recovery from abroad and hope for a *B v. ICAC* judgment

Under this approach, the ICAC would hope that court decisions gradually set a precedent for allowing the ICAC to work more intensively on asset recovery (like *B v. ICAC* did in setting a precedent for application of the POBO to persons “of a place outside of Hong Kong”). The ICAC could basically wait for a case which involves assets held abroad stemming from (or used in connection with) corruption. The ICAC (using the authority invoked in cases like *Reid*) would then recommend to the DoJ to petition the foreign court for the assets.²⁰⁶ The ICAC would basically cross its fingers and hope that challenges to the ICAC's request would be quashed by the Court of Final Appeal. Specifically, the ICAC would hope that the Court would liberally interpret section 14(c) of the POBO -- allowing for restraining orders from the Court of First Instance against

²⁰⁵ Timothy Tong, *Asset Recovery - A Charted Course*, presentation at the Fifth Annual Conference and General Meeting of the International Association of Anti-Corruption Authorities in Marrakech, Morocco on the 22-23 October 2011, available [online](#).

²⁰⁶ The Hong Kong government's power to petition as a plaintiff in cases like this is less obvious than it seems. In the *Reid* case, the UK Privy Council served as court of final appeal (and held jurisdiction over both Hong Kong and New Zealand at the time). Thus, any judgment by the Privy Council could be enforced in both Hong Kong and New Zealand. Hong Kong prosecutors will be unlikely to appear in a similar court of shared jurisdiction in the future (with the possible exception of China).

the property of persons suspected of corruption – like it did in *B v. ICAC*. As the *B v. ICAC* case already sets the (extremely flimsy) precedent for applying domestic legislation to persons of a place outside of Hong Kong, the ICAC may hope that the legal system itself will resolve the issue of allowing the ICAC to pursue assets vigorously abroad.

Hong Kong’s policymakers should not rely on such an approach. For reasons we have already mentioned, we believe the Court’s judgment in *Reid* provides an extremely flimsy foundation for similar, future judgments. The Court failed to provide a convincing legal doctrine or substantiation for its ruling. The events in *Reid and B. v. ICAC* also physically took place in Hong Kong – allowing future defendants to ask whether these cases really had the transnational nature some commentators claim. Foreign authorities will also ask for the basis for a recovery in Hong Kong’s domestic law. These requests must be drafted simply – and the authority must be clearly stated.²⁰⁷ If a foreign prosecutor or court receives a request based on a tenuous court decision, they will be much less certain to cooperate with the ICAC. Most civil law jurisdictions can not cope with the complex reasoning inherent in our common law systems as a legal basis for legal assistance.

b) amend the POBO to provide specific authorisation to proceed as plaintiff in recoveries abroad

Changes to the POBO could authorise the ICAC to engage in recovery action abroad. The amendment to article 14c would read to the effect that “the Commissioner or an investigating officer may... make an *ex parte* application to the Court of First Instance in chambers or foreign instance for an order under subsection (1).” Such an amendment should provide for the legality and certainty of recovery requests – both at home and when sending a request to a foreign police authority, prosecutor’s office and/or court. Because the amendment appears in the POBO, the authority to request recoveries in corruption-related cases will be easier to find, refer to and use. As the POBO represents

²⁰⁷ For the reader that does not believe our experience, they can see Brun *et al.* for support that these requests need to provide a very clear support in the requesting country’s domestic law. See Brun *et al.*, *supra* note 184.

Hong Kong's anti-corruption law, keeping all anti-corruption related provisions in the same piece of legislation keeps with existing practice.²⁰⁸

However, we oppose such an approach for three reasons. First, we think that – in combination with the other reforms to the POBO we propose – adding these amendments will increase resistance among LegCo members to reforming the POBO overall. As discussed in Appendix II, pro-Beijing parties currently hold the majority of the votes in the current LegCo. As China represents Hong Kong's most important trading partner and investor, most of these recovery requests will touch on important (and highly corrupt) business interests on the Mainland. Packaging these amendments as anti-corruption reforms is likely to galvanize support against the broader anti-corruption legislative reform. Second, the Organised and Serious Crimes Ordinance already provides the authority to confiscate the proceeds of crimes (including corruption). When these amendments come in front of the LegCo (at a different time than the amendments to the POBO), the lawmakers will be looking at provisions for fighting serious crime... and not necessarily corruption. Both Hong Kong and Chinese lawmakers agree much more readily on action to tackle serious crime than on fighting corruption. Thus, giving additional competencies to the ICAC to recover the proceeds of corruption in the OSCO makes more political sense than locating these competencies in a revised POBO. Third, foreign police agencies and prosecutors are more accustomed to seeing the source of domestic law authorising recovery actions as tackling serious crime rather than specifically corruption. In our experience, these foreign authorities (for some reason which we can not explain) tend to see references to national anti-corruption laws as less reliable than legislation aimed at fighting serious crime. In this case, how things are labelled is important.

²⁰⁸ The POBO represents an oddity in comparative anti-corruption law as the Ordinance groups several powers and competencies usually found in various laws dealing with the powers of the police and other government agencies. The legislators' intent during the drafting of the original POBO clearly was to keep provisions related to fighting corruption together in one Ordinance.

c) focus on proceeds of crime and use the Organised and Serious Crimes Ordinance to recover assets

The ICAC should vigorously – and globally – pursue the proceeds of corruption. Following the US and UK examples, the search, seizure (freezing) and confiscation of these proceeds will increase revenue to the Hong Kong budget and deter corruption abroad. Most jurisdictions (even the poorest ones like Albania and Cambodia) have a highly developed legal framework for such recoveries.²⁰⁹ The ICAC – or the relevant legal authority like the Secretary of Justice – should seek recovery of the proceeds of corruption for all foreign cases handled by the ICAC.²¹⁰

Effects on the ICAC's organisational structure and operations

The reforms to the POBO we describe in this working paper will have important effects on the ICAC and her organisational structure. The ICAC will need to implement organisational reforms aimed at meeting the requirements imposed by the new legislation. All countries that have seriously adopted a pro-active legal stance against the bribery of foreign officials have also added investigatory and prosecutorial resources. For example, according to Dr. Schmidt, after the passage of the FCPA in the US, “the SEC hired hundreds of employees to enforce all corporate compliance cases, the DOJ hired two attorneys to focus only on FCPA cases, and the FBI created a new four-person unit that handles only FCPA investigations.”²¹¹ What effect will these new provisions likely have on the ICAC?

²⁰⁹ For the legislation in force in any jurisdiction world-wide, see UNODC, International Money Laundering Information Network, available [online](#).

²¹⁰ We are not clear on the authority for such recovery claims. The OSCO provides the Secretary of Justice with the authority to work with foreign law enforcement agencies on such recoveries (OSCO at cap 455 s 3). However, given the high foreign corruption case load we expect for the ICAC, we clearly want the ICAC to have the authority to proceed with recovery claims on its own (with possible oversight by the Secretary of Justice and the courts). After the LegCo approves (in general terms) the ICAC's mandate to engage in such recoveries, regulation can cover the specifics of recovery management.

²¹¹ Timothy Schmidt, *Sweetening the Deal: Strengthening Transnational Bribery Laws Through Standard International Corporate Auditing Guidelines*, MINNESOTA L. R., available [online](#).

Changes to organic legislation and overview of several new departments

The ICAC Ordinance should be amended to give the Commission an explicit role in working with foreign law enforcement agencies. At present, the Ordinance does not provide such a role, nor deal with issues like evidence, procedures and other details in working on cross-border cases.²¹² The ICAC's role comes from tradition and relatively liberal interpretation of the existing wording. **Hong Kong legislators should insert a section before section 13 providing the legislative mandate for the ICAC's work in foreign jurisdictions.** The section, in some ways, would clarify the broad competencies given to the ICAC under a revised POBO. The section would include authorisations for the ICAC to: a) travel to foreign jurisdictions and discuss MLA issues specifically relevant for anti-corruption, b) create the authorisation for the ICAC to consult local companies on civil recoveries abroad, c) work closely with Chinese authorities on preventive, research and case-specific work, and d) base "reasonable grounds" decisions to investigate on the results of statistical analyses.

Hong Kong law already provides a basis for launching investigations based on the results on the statistical analysis of large datasets. Historically (in the time when the POBO was written), criminal investigations could not be based on suspicions arising from statistical patterns. Common law had little basis for establishing "reasonable suspicion" based only on statistics, and judges could not understand the statistics well enough to issue search orders. However, the passage of anti-money laundering laws and legislation allowing for the identification of the proceeds of crime have provided a basis for using statistical analysis in guiding criminal investigations.²¹³ Only quantitative statistical analysis can help the ICAC find likely corruption abroad (as intelligence-based and informant-based methods are unavailable and/or unreliable).²¹⁴ The ICAC should

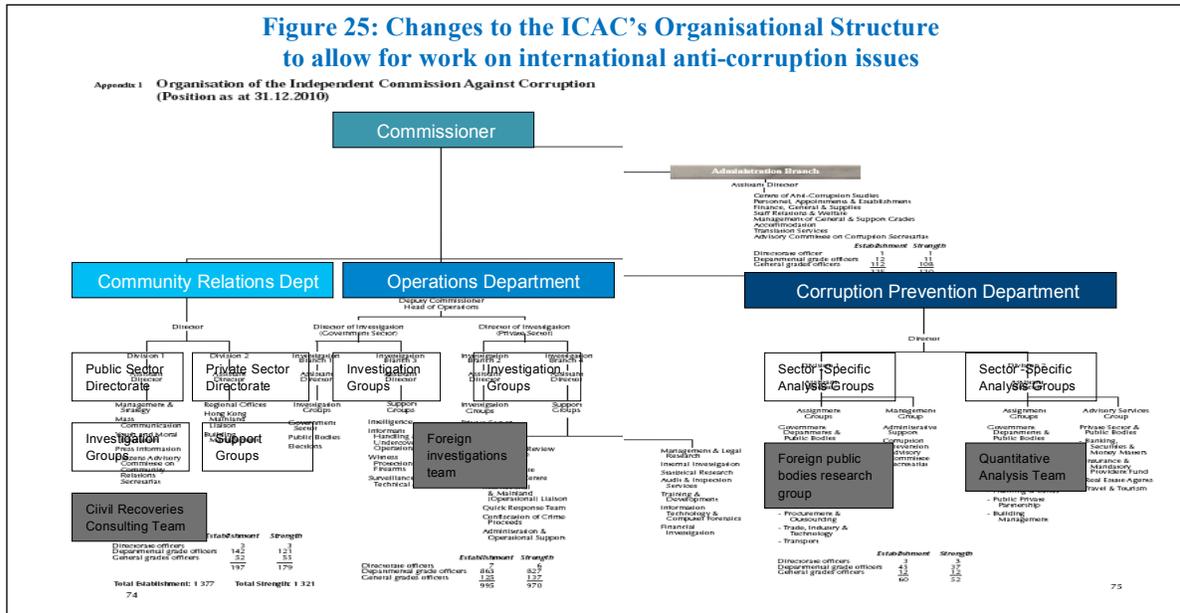
²¹² *Independent Commission Against Corruption Ordinance*, Chapter 204, available [online](#).

²¹³ For more on the current legislation in Hong Kong, see Victor Ho Wai-Kin, *CRIMINAL LAW IN HONG KONG*, Chapter 6 at 233.

²¹⁴ For more on the use of quantitative methods to identify corruption abroad, see Bryane Michael, *Quantitative Methods for Anti-Corruption Agencies and Internal Security Units*, Presentation at the Third Annual OLAF Conference Empowering Anti-Corruption Agencies: Defying Institutional Failure and Strengthening Preventive and Repressive Capacities.

have the specific – and same -- mandate the Financial Intelligence Unit has to use statistics to guide criminal investigations about Hong Kong related corruption abroad.

The mandate to tackle transnational corruption (using statistics or other methods) will require changes to the ICAC's organisational structure. The ICAC Commissioner can structure the Commission anyway that he (or she) sees fit – and thus no changes to the ICAC Ordinance need to be made to provide the authorisation for such changes. Figure 25 shows four specific changes to the ICAC's structure which will help the agency to tackle transnational corruption. First, a small unit or group of specialist lawyers should work in Community Relations Department on assisting with civil recoveries abroad. Second, the Operations Department could create a small (but permanent) special structure to deal with foreign investigations. The foreign investigation teams themselves can be project-based – meaning that the Operations Department can pull investigators into task-specific teams as required by various foreign assignments. However, foreign investigation teams require support – like travel bookings, case management, filing, evidence collection and storage, and so forth. Following standard practice, the Operations Department should have a special unit doing this work so as not to allow the flow of information about movements to the Administrative Department. We deal with the other two changes – the creation of a Foreign Bodies Research Group and a Quantitative Analysis Team -- below.



Conducting corruption assessments on Mainland institutions

If the ICAC has a legislatively mandated role for identifying and working with its Mainland counterparts on investigating corruption on the Mainland, a new department should deal specifically with this obligation. A *Foreign Public Bodies Research Group* in the Corruption Prevention Department would deal with the risk assessment of foreign government agencies and offices. The Group could conduct the same kinds of analysis that this directorate already does for/on Hong Kong government bodies. However, the group would look for specific features of foreign government agencies likely to encourage Hong Kong businesspersons to engage in bribery. An obvious example concerns the way that different province-level regulations encourage (or discourage) corruption across Chinese provinces.²¹⁵ Such analysis will allow the ICAC to gauge the risks of corruption for Hong Kong companies working in various provinces. Detailed knowledge of these regulations will also help the ICAC work with companies who self-declare their bribe payments.

²¹⁵ For a discussion of the reasons why different Chinese provinces engage in differing regulatory approach to fighting corruption, see Elizabeth Sietsema, *The Upside of Corruption: Economic Benefits of Bribery in China*, available [online](#).

The ICAC can also strengthen its ability to detect foreign corruption by Hong Kong companies through a well-trained quantitative-methods team located in the Corruption Prevention Department. Quantitative analysis works by assigning probabilities to specific actors and transactions. For example, quantitative methods can be used to identify the probability that a particular company pays bribes in Thailand. Quantitative methods can also show (with a 99.5% level of confidence or even higher) whether a particular group of companies pays bribes in China. Statistical analysis is often used to make pro-active recommendations for reform – thus making CPD the best fit for this team. Moreover, such analysis should be kept from operations – to keep statisticians away from sensitive case materials.

The ICAC would also need to dedicate more resources to co-operation with Mainland authorities. At present, the organigram of the ICAC's Operations Department provides for an international and Mainland liaison. Given the passive nature of the ICAC's current legal mandate to deal with foreign corruption, a simple liaison to deal with MLA is the "correct" organisational strategy. However, if the LegCo modifies the POBO to give the ICAC a greater mandate for dealing with foreign corruption, then the Operations Department will want to significantly strengthen this office. Groups of virtual teams from the ICAC's various departments could work in connection with this office. Such an arrangement would draw specialists from the current Investigations Group, Intelligence Group, Statistical Research Group, Financial Investigations Group, and Confiscation of Criminal Proceeds Group. In that way, the complex and difficult cases coming from China can receive the attention they deserve.

As we have already mentioned, in the US and UK, high-profile prosecutions have fallen by the waist-side based on national security (or interest) concerns. The issues are even more acute for Hong Kong – as the ICAC's enforcement actions will have consequences on the diplomatic relations with/of the entire People's Republic of

China.²¹⁶ The ICAC may want to consider meeting with the Commissioner's Office of China's Foreign Ministry in Hong Kong in order to develop a procedure for informing the Ministry (and obtaining approval for) enforcement actions involving the POBO affecting foreign nationals. The working procedures used may be similar to those already used when informing the Chinese government about mutual legal assistance actions.²¹⁷

Co-operation with Mainland law enforcement will prove far more challenging. In theory, the ICAC may co-operate fully and relatively freely on corruption-related cases in the Mainland under the Mutual Case Assistance Scheme.²¹⁸ In practice, however, China's police and judges are widely known to be corrupt. Roughly 9% of all Chinese responding to the annual Transparency International Barometer survey admit to having paid a bribe to the police in the preceding 12 months.²¹⁹ Roughly 13% of all participants in the survey report having paid bribes to the judiciary or judges. If these samples even broadly represent the true population estimates for corruption in China, then the total amounts of money paid to judges, prosecutors and the police are staggering. Such data strongly suggest that Mainland counterparts could prove very unreliable partners for the ICAC. The ICAC would need to prioritise its resources – focusing on the cases comprising the highest risk and/or highest value. The ICAC could also work with the Ministry of Supervision where necessary.²²⁰

Receiving complaints from abroad

If revisions to the POBO explicitly criminalise the bribery of foreign officials, then the ICAC should be prepared (and allowed) to receive the same kinds of complaints from foreigners that it receives from Hong Kong nationals. Given the most of the ICAC's 4,000 cases each year come from whistleblowing – and that most of the prosecutions

²¹⁶ Article 150 of the Basic Law stipulates that Hong Kong “may, as members of delegations of the Government of the People's Republic of China, participate in negotiations at the diplomatic level directly affecting the Region conducted by the Central People's Government.”

²¹⁷ Chief Executive to give notice to Central People's Government in relation to Hong Kong requests and external requests, available [online](#).

²¹⁸ ICAC, *ICAC chief leads study delegation to meet Mainland's top procurator*, 2010, available [online](#).

²¹⁹ Transparency International, *2010 Global Corruption Barometer Report*, available [online](#).

²²⁰ Ministry of Supervision, available [online](#).

under the FCPA also come from whistleblowing – then the ICAC should provide an easy-to-use channel for such whistleblowing.²²¹ At present, a whistleblower can visit the ICAC’s offices, call in a complaint, or mail in a complaint.²²² All three options are inconvenient and impractical for a foreign whistleblower.

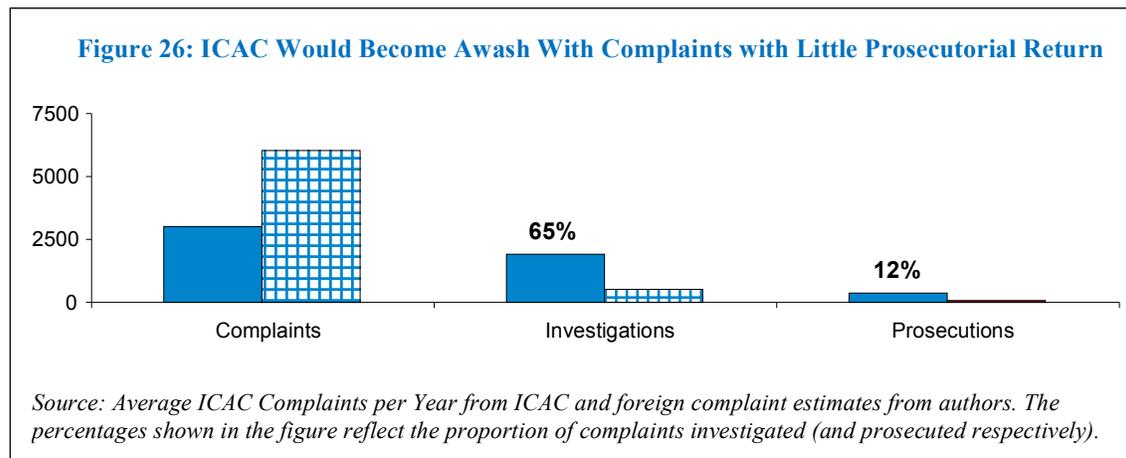
The ICAC could use the same methods used by organisations like the World Bank to collect complaints from abroad. Information on the World Bank website provides answers to questions and advice for whistleblowers. Most importantly, potential whistleblowers can interact by email – an important and basically free option these days. As another innovation, the ICAC could provide a Skype name where individuals abroad can make complaints.

Revisions to the ICAC Ordinance must allow the ICAC to do triage of complaints coming in from abroad. Figure 26 shows the rationale behind giving the ICAC the right to selectively determine which complaints to follow up on (and allow the agency to drop complaints even in cases where bribes are very likely to have been paid). The figure shows that – taking annual averages from data collected since 1974 – the ICAC received an average of about 3,000 complaints per year (and probably many more in recent years).²²³ Over the 36 year period, the ICAC has investigated about 65% of those complaints and prosecuted individuals associated with about 12% of those complaints. Given a much larger number of expected complaints coming from abroad, a 12% prosecution rate would bankrupt the ICAC.

²²¹ See Patrick Delaney, *Transnational corruption: Regulation Across Borders*, 47 VA. J. INT’L L. 413, 34, available [online](#).

²²² ICAC, Report Corruption (website), available [online](#).

²²³ Information Services Department, *Hong Kong The Facts: ICAC*, available [online](#).



The economics of hotline management will require the ICAC to choose selectively which complaints to pursue. As shown in the figure, we anticipate double the average annual amount of domestic complaints coming from abroad (or roughly 6,000 complaints per year). Working with foreign law enforcement agencies abroad (while conducting investigations) requires significantly more time and resources than similar investigations in the tiny area of Hong Kong. We estimate the ICAC will have the capacity to deal with only about 8% of those complaints – requiring triage based on the likely harm the case poses to Hong Kong interests.²²⁴ We estimate that only about 1% of all foreign-sourced complaints would result in prosecutions (particularly given the difficulties posed by cross-jurisdictional prosecution).

Even though the ICAC might not use these complaints in enforcement actions, such complaints would provide useful information for quantitative analysis. The new quantitative analysis teams in the Corruption Prevention Department could use foreign-sourced complaints to engage in various risk assessments of Hong Kong companies doing business abroad. Depending on the nature of the complaints, far more complaints coming from Thailand than India might signal that Hong Kong companies pay more bribes in Thailand than in India (subject to the usual caveats about using complaints in this way

²²⁴ These numbers in part reflect the reason why we encourage the ICAC to pursue a UK-based approach to selecting prosecutions based on the public interest rather than the US-based approach centred around how contrite the company seems.

which the reader probably knows all too well). While not actionable, such complaints might still well be informative.

Legislative and regulatory harmonisation across the pan-China region

An anti-corruption law-drafting working group could form an excellent way to help implement the UNCAC's provisions – both at home and abroad. Hong Kong government agencies have not yet actively engaged with many of the provisions contained in the UNCAC. Normally, after the ratification of the UNCAC, governments engage in two steps to implement the Convention. First, they review and harmonise their domestic legislation with the UNCAC. We have discussed some of the issues in the UNCAC – specifically dealing with the criminalisation of foreign bribery, corporate criminalisation and other topics. However, there are numerous other provisions in the UNCAC untouched by the POBO and other domestic legislation. Second, executive agencies will need to pass regulations implementing the broad legislative provisions contained in legislative amendments. For example, customs agencies tend to require internal regulations governing risk profiling of staff for corruption, the management of asset declarations and conflict of interest declarations and so forth. Such an issue will become more important for Hong Kong as agencies like Hong Kong Customs & Excise engages in broader cross-border initiatives – like co-ordinated border management practices with the Chinese Customs Agency. The nature of closer law enforcement co-operation with China (and Hong Kong's important role in contributing to corruption on the Mainland), will require a rethink of the basic foundations of the POBO.

International best practice for broad-based anti-corruption reform involves the formation of an anti-corruption working group.²²⁵ Such a working group would study the legislative and regulatory changes which need co-ordination in China, Hong Kong and Macao. In this case, National Bureau of Corruption Prevention (NBCP), the ICAC and the Commission against Corruption should establish a working group for legislative

²²⁵ For more on the creation and conduct of these working groups, see UN, *UN Anti-Corruption Toolkit*, available [online](#).

reform aimed at implementing the UNCAC. The working group may meet semi-annually – with the venue rotating between Beijing, Hong Kong and Macau.²²⁶ We do not include a role for such a working group in Figure 25 – as the working group would be independent of the ICAC.

The working group could also work on the broader anti-corruption policy issues stemming from Hong Kong and China’s closer political and economic integration. How the two systems deal with important issues like the death penalty in specific corruption-related prosecutions will have important ramifications on how China and Hong Kong cooperate on corruption-related cases in general. A working group can help find solutions to specific case-related problems and to wider policy issues. An obvious example concerns the extradition of Lai Chang-Xing. Canadian authorities worried about extraditing Lai to a country with the death sentence. Hong Kong could have sought extradition for parts of the offence committed in (or dealing with) Hong Kong. With deepening integration between Hong Kong and the Mainland, corruption will increasingly become a transnational issue. Anti-corruption lawmaking and enforcement also needs to become more transnational.

Another obvious issue would revolve around the sequence and timing of particular prosecutions. The ICAC will certainly in the upcoming years increase its involvement in transnational corruption cases (particularly on the Mainland). Given the widespread nature of corruption in China, indiscriminate prosecutions could lead to resistance by the Communist Party to co-operate with the ICAC. By “choosing their battles wisely”, the ICAC can – in the short-run – ensure that enforcement actions build

²²⁶ As we have argued, such work should cover the Greater China Region (including Taiwan). However, diplomatic tensions continue to wax and wane between the People’s Republic and the Republic of China. If Taiwan becomes part of a common anti-corruption law enforcement space, the Taiwanese Anti-Corruption Commission (ACC) could join this working work. Alternatively, the ACC could participate as an observer (or through an NGO representative which reports back to the ACC).

their relationship with the Government and Party rather than undermine it. Again, such a working group can provide a forum for deciding which prosecutions to undertake.²²⁷

Public relations with the Mainland

The Operations Department already has a liaison office to deal with Mainland and international affairs. However, given the magnitude of corruption on the Mainland and the ICAC's larger mandate, if the LegCo criminalises transnational bribery, the ICAC will need to increase co-operation with the Mainland. The Public Relations Department should get ready to do the same kinds of prevention work on the Mainland that it does at home (if given the legal mandate to do so under the relevant mutual legal assistance agreement). Unlike the Operations Department liaison, this unit's remit would only focus on prevention and facilitating regular co-operation with various branches of the Ministry for Supervision and National Corruption Prevention bureaux. Article 95 of the Basic Law allows Hong Kong to maintain relations with the judicial and law enforcement bodies of "other parts of the country." The ICAC's community relations and public relations efforts have received international accolades. No doubt specific province-level anti-corruption agencies will want to partner with the ICAC's staff on preventive measures aimed at reducing corruption in their jurisdictions. Chinese authorities at various levels of government will find Hong Kong's experience in institutional risk assessment and preventing corruption helpful. The ICAC has a strong interest in preventing corruption on the Mainland rather than deal with the diplomatic and politically problematic issues of operational work on investigations and prosecutions. As the saying goes, "an ounce of prevention beats a pound of cure."

If international anti-corruption technical assistance serves as any guide, the ICAC would spend a fair amount of time doing trainings. In the EU context, Member States have spent the last decade conducting anti-corruption trainings for Eastern European countries – in the guise of an alphabet soup of programmes with names like TACIS,

²²⁷ Eurojust provides an example of a forum in the EU context where national prosecutors can determine jurisdiction for cross-border criminal cases (including those involving corruption). Eurojust's operation has coloured the way we see cross-border co-operation on anti-corruption (and other types of criminal) cases.

PHARE, TAIEX, and so forth. Experts from EU Members' anti-corruption agencies come and provide trainings (lasting from 2 days to 2 years). The ICAC's co-operation with Mainland institutions on training will almost certainly follow such a path. Yet, unlike the EU, the ICAC does not (as an institution) have the decades of experience providing foreign anti-corruption agencies with technical assistance. Thus, as a first step, we propose a standard "syllabus" for preventive anti-corruption organs working in China's provinces (see Figure 27). These issues cover the basics that most preventive agencies now deal with.

Figure 27: Syllabus for Anti-Corruption Prevention Staff

- Week 1: **International and comparative anti-corruption law** – practical skills in legal analysis and drafting (legislative and regulatory), evidence, criminal, civil and administrative law in a civil law system
- Week 2: **Marketing and PR** – practical skills on identifying public sector wants and needs with surveys and interviews, designing posters with Photoshop and Frontpage, working with the media and conducting interviews
- Week 3: **Consulting law enforcement and executive agencies** – practical skills focusing on police investigation, prosecutor procedures, risk assessment in police and customs,
- Week 4: **Economic analysis for anti-corruption** – practical skills on cost-benefit analysis of anti-corruption programmes and social impacts, the budget request to MoF and Parliament.
- Week 5: **Political tactics and bureaucratic politics** – practical skills focus on identifying each politician's interests, designing bureaucratic politics "plays" for anti-corruption policies (like they do in football),
- Week 6: **Advising on Asset Declaration and Conflict of Interest Programmes** – teaching how to find suspicious declarations using Excel, providing advice to staff filling out forms, providing counsel for ethics breaches.

Source: taken from authors' training programme for preventive anti-corruption agencies.

Conclusions

Cross-border work on fighting corruption has taken off in recent years. The US and UK have led the campaign for dealing with transnational bribery – and applied their own laws extra-territorially for particularly egregious corruption abroad. How should Hong Kong – long seen as one of the world's least corrupt and more legally progressive jurisdictions – react to several important topics addressed in the UN Convention Against

Corruption? How should Hong Kong authorities deal with the large corruption risk directly to the North? In this paper, we have looked at several of these topics – namely the criminalisation of transnational corruption, the extra-territorial application of such legislation, corporate criminalisation of corruption and cross-border recovery of the damaging arising from corruption. By analysing these topics, we have addressed an even more interesting question arising in the academic and practitioner anti-corruption literature. How can authorities in one jurisdiction (in our case Hong Kong) prosecute corrupt parties in another jurisdiction. We have focused on China as a case-study, but hope much of our reasoning can apply to other jurisdictions.

Changes to Hong Kong’s anti-corruption law can help reduce corruption on the Mainland. We have shown that Hong Kong likely serves as an important vector for such corruption (though most of the responsibility for such corruption -- of course -- lies with Mainlanders themselves). We have shown that changes to the Prevention of Bribery Ordinance (POBO) can help dissuade corruption, and help the ICAC investigate such corruption when it occurs. We focus on criminalising transnational bribery, allowing for the extra-territorial application of the Ordinance (though only within the Greater China region), making companies criminally liable for corruption and encouraging the recovery of the proceeds of corruption-related crimes abroad. The ICAC’s organisational structure will need to respond to these new competencies and obligations – mostly by creating departments to deal with foreign cases. We have seen that the US (and increasingly the UK) have had important effects on corruption world-wide. We think that Hong Kong could play a similar, progressive role.

Despite our Panglossian recommendations, such reform will not be easy. We have argued for normative changes rather than positive changes (looking at policies as they should be in an ideal world). In practice, only Machiavellian strategies based on the timing and the profitability of legislative reform will likely lead to change. Using tools from political economics, we have shown that only a very particular timing of legislative changes would likely lead to adoption. We illustrated how legislative changes affect each LegCo member’s political costs and benefits. We also showed that even with the best

timing and sequencing of reform, adoption passes (using a previous LegCo composition as an example) by the narrowest of margins. However, as tax revenue would likely increase from these changes (and the net benefits exceed the costs), the executive should support such reform.

Appendix I: Media Statements Supporting Extent of Corruption on the Mainland

The following represents public statements made by senior Chinese officials about the extent of corruption on the Mainland. We provide these quotes only to illustrate internal views about corruption and the administrative role such corruption has played in the past. They also illustrate a likely warming in Chinese mutual legal assistance and co-operation with Hong Kong (and other) anti-corruption bodies.

Media Source and Date	Relevant statement	Link
New York Times (November 19, 2012)	“In recent years, there have been cases of grave violations of disciplinary rules and laws within the party that have been extremely malign in nature and utterly destructive politically, shocking people to the core.” Xi Jinping – Chief of the Communist Party of China	*
The National (2 July 2011)	"The party is soberly aware of the gravity and danger of corruption that have emerged under the conditions of the party being long in power" Hu Jintao – former Chinese President	*
Telegraph (8 November 2012)	[Corruption could] “even cause the collapse of the Party and the fall of the state.”	*
China Daily (14 January 2010)	"The current problem is not that we lack policies or slogans, but how to practice them, making them enforceable for every Party member" - Prof. Lin Zhe of the Central Party School	*
Wall Street Journal Dec 29, 2010	“corruption persists, with some cases even involving huge sums of money. The situation in combating corruption is still very serious, and the tasks are still abundant” - State Council report on corruption	*

Appendix II: Regulatory Impact Assessment and Reform Design

In this Appendix, we discuss our use of regulatory impact assessment and tools which gauge the political palatability of certain kinds of reforms. Regulatory impact assessment attempts to assess the extent to which legislative (and regulatory) proposals create an additional tax or other burden on society. Because of the close links between Hong Kong and China, we have had to consider Chinese economic welfare in our calculations.²²⁸ Political incentive compatibility assesses to what extent legislators would vote for socially advantageous policies – assuming they act only to maximise their own votes. Such an approach assumes that politicians are accountable only to their voting constituency – and will adopt the policies which provide to those constituencies a net positive social or private gain. By calculating the private and social costs and benefits to each voting member’s constituencies, we can calculate the number of votes each legislative amendment to Hong Kong’s current anti-corruption law would likely to receive. Such an approach also allows legislative advisors (like us) to consider the sequencing and policy mix so as to maximise the probability of legislative adoption. **We conduct such an analysis only to illustrate the method – and do not wish to imply that Hong Kong legislators do (or should) engage in such Machiavellian practices!**

Financial Cost-Benefit Calculations

Most OECD member countries require cost-benefit analysis as part of any proposal for lawmaking (at either the legislative or regulatory levels).²²⁹ Because public policy concerns itself with social costs and social benefits – rather than simply effects on tax revenue and expenditure – most estimates express the range of social benefits (from increased happiness of the population to lower costs of living) on a financially-equivalent

²²⁸ For an overview of the types of techniques we use, see Robert Brent, *APPLIED COST-BENEFIT ANALYSIS*, 2006.

²²⁹ We do not know if Hong Kong has the same legal requirements. Nevertheless, we provide cost-benefit analysis as such assessments represent best practice in the area of policy advice. Moreover, we have suppressed and significantly revised many of our recommendations based on the results of our cost-benefit analysis. Legal basis - Impact Assessment Guidelines”, SEC(2005)791, 15 June 2005. For readers wanting to learn how to do similar cost-benefit analyses, see ANDREA RENDA, *Impact Assessment in the EU: The State of The Art and the Art of the State*, available [online](#).

basis. These financial equivalent estimates of costs and benefits (which we provide in Figure 28 below) “jam” all the various benefit and costs of our recommendation in a couple of easy-to-read financial estimates. In that way, the reader can compare very different policies quickly and easily.

The proposals we make in this paper would generate a net financially-equivalent welfare gain of roughly HK\$20 million. As shown below, most of this welfare improvement occurs abroad – and particularly in China. The effect of our key proposals on Chinese welfare equals roughly HK\$210 million – coming mostly from removing distortions which add to the cost of Chinese business. The cost imposed by our advice comes to roughly HK\$100 million – or roughly one-tenth of the ICAC’s current budget.

Figure 28: Financial Costs and Benefits at a Glance
(All values in thousands of Hong Kong dollars)

Legislative Change	Benefits	FE Costs	Net RIA*
1. Outlaw foreign bribery in POBO (with relevant defences)	\$20,000	\$30,000	\$-10,000
2. Reorganise ICAC to work on foreign bribery and PR	\$30,000	\$10,000	\$20,000
3. Allow for extra-territorial application in POBO (including complaints from foreigners)	\$55,000	\$20,000	\$35,000
4. Step-up use of OSCO asset recovery	\$25,000	\$ 5,000	\$20,000
5. Provide advice on civil recoveries	\$45,000	\$ 5,000	\$40,000
6. Deferred Prosecution Agreements	\$60,000	\$10,000	\$50,000
7. Corporate liability for corruption	\$40,000	\$10,000	\$30,000
8. Provide advice to Financial Secretary	-	\$ 5,000	\$-5,000
9. Working Group with China on legislative reform and PRD Mainland China unit	\$25,000	\$ 5,000	\$20,000
Totals	\$300,000	\$100,000	\$200,000

Note: FE stands for financially-equivalent and refers to the monetary equivalent value of welfare impacts within the immediately discountable future (about 3-5 years into the future). These estimates represent only approximations. Providing detailed analysis would require a separate paper in its own right.

Our costs and benefits come from several factors. Costs considered in our analysis include the costs associated with presenting legislation, communicating with the relevant stakeholder groups (as discussed below in the political analysis), additional ICAC operating expenses, and the costs of working with foreign law enforcement agencies. The benefits we considered include the relative increase in producers' profit margins (because less of their profits melt away as bribes), lower transactions costs of business, greater utility from lighter penalties from prosecutions and of course assets, fines and other collections.

The total net welfare benefit of adopting these legislative changes amounts to roughly \$200,000 in the near term. Such an amount equals the tax benefits to complete adoption – as shown in Figure 7. In theory, welfare impacts should exceed tax revenue. The reason why taxes collected so closely reflect tax revenues collected deals with the way we arrived at our estimates. Following a conservative welfare impacts approach, we very heavily discount a very uncertain future in our welfare estimates (thereby lowering our welfare impacts). Moreover, we had to heavily discount Chinese welfare because the “value” of Chinese happiness is less. Such a problem affects cost-benefit analyses in all low wage economies (where the value of labour and the relative they price on amenity far falls behind similar values in advanced economies. We did not correct for this distortion because such a discount serves the dual purpose of our policymakers implicitly discounting the happiness of foreigners in our analysis.

Ex-Ante Political Incentive-Compatibility Estimates

If all the proposed changes we suggest appeared before the previous Legislative Council (LegCo), they would have failed by a vote of 17 yeas versus 40 nays.²³⁰ Such a voting outcome represents the widely dispersed benefits for foreign bribery and corruption among Hong Kong's various constituencies. Figure 29 shows the various interests previously represented in the Legislative Council. As shown, 36 members were

²³⁰ To learn how to do this type of analysis yourself, see Gerard Roland, *TRANSITION AND ECONOMICS: POLITICS, MARKETS, AND FIRMS*, 2004.

pro-Beijing (with another 10 having pro-Beijing tendencies). Such data suggest that the design of any policy must take Beijing's interests closely into account.

Strictly on the underlying economic interests which attach to Hong Kong's political parties, political groups in Hong Kong would have likely voted against the proposed reforms by 45-to-15. The figure shows the estimated position of each of Hong Kong's political parties – as judged by congruence with their party platforms (which we assume reflect economic interests of the members of that group). At the heart of the failure of any lawmaking – when taken as a single package – lies strong entrenched interests in Beijing in favour of corruption. Ironically, the pro-Democracy political groups would not support these reforms because of their positive engagement with business (combined with pay-offs in the form of corrupt companies' social contributions to social welfare programmes). With little direct support from the pro-Beijing parties and little support from the pro-democracy groups, our legislative proposals would not have passed if proposed all at one time.

Looking at geographical constituencies, our proposed reforms would likely have failed if proposed all at the same time. Figure 30 shows the number of votes for a general Bill on Anti-Corruption Reform (which would lump together all our proposed legislative amendments) by Hong Kong's geographical constituencies. **Again, the problem lies in the fact that fighting corruption transnationally generates abstract benefits (such as lower prices and increased competitiveness by players not currently operating in foreign markets).** We assume that interests physically located in these regions will exert more effort in resisting reforms than those potential beneficiaries (who can only be reached with abstract reasoning and appeal to their values).

Figure 29: Estimated Political Positions to Suggested Reforms by Hong Kong’s Political Interests on Purely Ideological Grounds
(uses previous Council composition as an illustration of the political economic technique)

	Estimated Reaction to Proposals	For/Against
Pro-Beijing (37)		
Democratic Alliance for the Betterment and Progress of Hong Kong (10)	This Party would oppose greater enforcement against Mainland interests as well as anything potentially reducing the stability of the status quo.	Against
Federation of Trade Unions (4)	Labour would support policies discouraging the low cost advantage and corruption-driven outsourcing to the Mainland.	For
Professional Forum (4)	A Right Wing party would oppose our basically liberal reforms aimed at introducing international law to HK.	Against
Economic Synergy (4)	As laissez-faire capitalist party, they would oppose increased regulation and interference with free trade.	Against
Liberal Party (3)	Strong pro-Chinese free-market interests in this Party would oppose reforms aimed at undermining its base.	Against
Federation of HK and Kowloon Labour Unions (1)	Labour would support policies discouraging the low cost advantage and corruption-driven outsourcing to the Mainland.	For
New People's Party (1)	This party has strong support by mandarins in administrative class	For
Independent (10)	Given dispersion of benefits and high focus on costs of our reforms, we expect over resistance from this group.	Against
Pan-democracy (23)		
Democratic Party (8)	Our reforms would appeal to its egalitarian constituency who would see corruption as a violation of human rights and economic rights	For
Civic Party (5)	While similar to the Democratic Party, our measures might seem to repressive for this Party.	Against
Labour Party (3)	Mostly indifferent to our reforms, they would lean against the engagement with China and strong engagement with corporations	Against
People Power (2)	As a relatively fringe party, they would see political advantage in opposing these reforms as grandstanding.	Against
League of Social Democrats (1)	As a relatively fringe party, they would see political advantage in opposing these reforms as grandstanding. They would also score by criticising “pro-business” aspects of our strategy in introducing legislation.	Against
Association for Democracy and People's Livelihood (1)	This party is naturally indifferent to our reforms. In political logrolling, we expect other groups who fund social initiatives with their profits could obtain a nay vote from this party.	Against
Neighbourhood and Worker's Service Centre (1)	Pro-labour elements could be convinced that any laws making the corruption on the Mainland which takes jobs away from Hong Kong would be politically useful.	For
Independent (2)	Given dispersion of benefits and high focus on costs of our reforms, we expect over resistance from this group – particularly given our pro-active engagement with Beijing.	Against

** Predicting political party and politician positions on issues carries the same risk as predicting stock market prices. Theory provides illustrations and models – though real-world experience may diverge with the predictions of theory.*

Figure 30: Likely Incentives Based on Geographic Constituencies

	number seats*	Likely impact of reforms on electorate	Votes for
Hong Kong Island	7	Financial sector harmed.	2
Kowloon East	5	Traders harmed, but non-corrupt traders	1
Kowloon West	5	Traders harmed.	1
New Territories East	9	Traders harmed.	4
New Territories West	9	Traders harmed.	3

* Uses seat allocations from the past. Actual votes may differ based on individual personalities, political circumstances and other variables.

By functional constituency, our proposed legislative reforms would fail by a vote of roughly 10 to 5. As shown in Figure 31, we expect votes in favour from the professional services groups who would receive extra business from our proposed rulemaking – such as lawyers and accountants. The other groups which would vote in favour include groups who would receive additional public spending arising because of revenues coming from fighting corruption. These include groups like teachers.

Because of the diffused benefits accruing to groups like wholesales, retailers and other commercial interests, we expect their LegCo representatives would vote against our recommendations. Beneficiaries in this group include companies who have already been excluded from favourable trade in China (and elsewhere) because of competitors paying bribes for market access and SMEs who would see indirect increase in demand for their goods and services (as Chinese firms lose their corruption-based economic advantages). The potential “losers” from our reforms comprise large companies who actively bribe foreign officials – and can lose their companies and freedom if the ICAC’s enforcement efforts increase abroad.

A relatively large number of functional constituencies – which are initially neutral to our recommendations – could be persuaded by the losers from our reforms to vote against any anti-corruption bill. Constituencies like agriculture, culture & the arts, and health care have no natural economic interests arising from corruption abroad (working in

mostly non-tradable sectors).²³¹ However, given the nature of political this-for-that (known as logrolling), losers from the reforms could promise their support on future legislation aimed at these groups in exchange for their resistance to reforming the existing anti-corruption legal framework.

²³¹ Agriculture in Hong Kong comprises about 0.1% of GDP – meaning that little agricultural production occurs on the islands. The main economic interests tied with agriculture focus on local transport, packaging and sale – thus being non-tradable services.

Figure 31: Estimated Support for Reform by Functional Constituency

Constituency	Estimated impact of proposed reforms	For or against?
Heung Yee Kuk (Rural Council)	Rural councils will be agnostic to a Bill aimed at fighting corruption abroad.	Neutral
Agriculture and fisheries	While these interests may benefit from sales abroad, their interests in the short term are not strong-enough to politically mobilise them.	Neutral
Insurance and Financial services and Finance (3 seats)	Outlawing transnational bribery and making companies legally liability would place companies at risk for wide-spread corrupt practices on the Mainland.	Against
Transport	This group is now (or could be) a large beneficiary for foreign bribery abroad.	Against
Accountancy	The additional requirements of our proposals would create extra work for accountants.	For
Education	Our proposals do not impact this group – so their main interest consists of effects on general tax and expenditure.	For
Legal	The additional requirements of our proposals would create extra work for accountants.	For
Information technology	This group is now (or could be) a large beneficiary for foreign bribery abroad.	Against
Medical and Health services (2 seats)	Our proposals only marginally impact this group – so their main interest consists of effects on general tax and expenditure. However, some members can sell goods and services abroad. If true, part of this group is now (or could be) a large beneficiary for foreign bribery abroad.	Neutral
Archi. survey. and planning (2 seats) Real estate and construction	This group is now (or could be) a large beneficiary for foreign bribery abroad.	Against
Social welfare	They would favour the additional revenues (and thus spending) from our proposals.	For
Tourism	This group is now (or could be) a large beneficiary for foreign bribery abroad.	Against
Commercial (2 seats)	This group is now (or could be) a large beneficiary for foreign bribery abroad.	Against
Industrial (2 seats)	This group is now (or could be) a large beneficiary for foreign bribery abroad.	Against
Import and export	This group is now (or could be) a large beneficiary for foreign bribery abroad.	Against
Wholesale and retail	This group is now (or could be) a large beneficiary for foreign bribery abroad.	Against
Textiles and garment	This group is now (or could be) a large beneficiary for foreign bribery abroad.	Against
Sport, perf. arts, culture	Our proposals have no impact on this group.	Neutral
Catering	Our proposals have no impact on this group.	Neutral
District Council	Our proposals have no impact on this group.	Neutral
Labour	They would favour policies which make Hong Kong business more competitive.	For

Source: Authors (based on underlying economic rather than ideological interests of each constituency group).

Optimal Reform Path

The optimal reform path combines groups of recommendation – and leaves enough time between each group – to maximise the probability of legislative adoption (see Figure 32). Groupings take into account three elements for each combination in order to pass in the previous LegCo. First, the package of reforms (in each individual package) must be desirable to pro-Beijing constituencies. Second, because of Hong Kong’s highly fractured political interests, compensation must be widely spread out (in relatively small amounts) to a large number of varied groups. Such compensation packages must compensate each group for lost profits stemming from corruption abroad. We assume that no group will hold-up the reform to seek payments in excess of their losses from the reform. Third, each grouping of policies – and accompanying compensation – should pass by a simple majority vote. As such, we do not group policies together – or plan compensation – in order to achieve anything more than a 51% majority in the Legislative Council. Moreover, we must choose groups of reforms which do not rely on other groups – so that the failure of any one group of reforms to pass does not influence the likelihood that other groups will pass.

Figure 32: Sequencing and Policy Mix of Reforms

	2014 Jan- Jun	2014 Jul- Dec	2015 Jan- Jun	2015 Jul- Dec	2016 Jan- Jun	2016 Jul- Dec	2017 Jan- Jun	2017 Jul- Dec
Outlaw foreign bribery in POBO (with relevant defences)			■	■				
Reorganise ICAC to work on foreign bribery and PR					■	■		
Allow for extra-territorial application in POBO			■	■				
Use OSCO to allow for asset recovery							■	■
Deferred Prosecution					■	■		
Corporate liability for corruption								■
Provide advice to Financial Secretary		■		■		■		■
Working Group with China on legislative reform and MLA	■	■						

Source: authors.

The **first group of reforms** (scheduled in theory in the first half of 2014) focuses on improving law enforcement and co-operation with the Mainland. Such work will build support for the ICAC's work on the Mainland and provide a useful example for the Pro-Beijing political parties in Hong Kong. The ICAC currently possesses the authority to undertake this first group of reforms within legislative mandate (so the ICAC need not wait for – or rely upon -- any lawmaking). Some of the work on anti-corruption co-operation may be used to punish political outcasts (like Bo Xilai) – building political support on the Mainland. Some advantages of starting out the reforms with this approach:

- sends a signal to Hong Kong business that policymakers will be tackling corruption on the Mainland in the future (giving them an unspoken “warning”),
- provides political capital to China's leaders which they will need to use when discontent from enforcement actions starts to undermine their local power bases,
- provides a concrete example to LegCo members of successful co-operation with China,
- helps provide buy-in by technocrats and experts in the legal profession and administrative professions in Hong Kong.

During this stage, the ICAC's optimal strategy consists of increasing the number of Community Relations events and trainings like the ones held in 2011 for companies doing business on the Mainland. To reduce resistance to more stringent enforcement actions later, these seminars will help defray the costs of installing compliance and other safeguards in Hong Kong companies working on the Mainland. Transferring a large part of the cost of adapting to increased ICAC enforcement helps reduce public resistance and serves an important policy purpose -- as these compliance programmes clearly comprise a public good (in the economics sense of the word) which government should pay for.

The first stage also works on flipping interests in each constituency – so that legislative changes for the second group of reforms can be introduced on a platform of **Providing Opportunities for All**. The second set of reforms can not commence until a

likely majority would vote for reforms to the POBO and ICACO. The primary goal also consists of winning pro-Beijing's support for reforms (as pro-Beijing parties control the LegCo).

The goal consists of obtaining a simple majority in each constituency in favour of the new legislation. Figure 33 shows some of the actions that the Hong Kong authorities (including the ICAC) can take to build support for a majority in favour of reform in each constituency. The legal authority to engage in these efforts comes from the same authority that the Corruption Prevention Department relies upon in its prevention work with the private sector.

The goal of these activities consists of pushing sometimes minority interests within each constituency into the majority. In many cases, working with the Mainland authorities on prosecutions of businessmen who extort bribes from Hong Kong businesses working in China (even with their blessing) will result in higher profits for Hong Kong businesses. These higher profits will translate (under the assumptions we use in our political economic analysis) into political support for reform. In other cases, a couple of corrupt companies serve as the cost-leader for the industry. Entering into enforcement actions will scare the others into submission (who will be politically grateful for having not to pay bribes abroad).

Figure 33: ICAC Actions to Align Fractionalised Political Interests with the Broader Public Interest

Constituency	Estimated impact of proposed reforms
Heung Yee Kuk (Rural Council)	No work needed.
Agriculture and fisheries	Work with majority (small firms) to show how corruption by larger interests reduces their markets. Encourage them to help the ICAC find one or two large corrupt companies. Once 1-2 companies lose their corruption-derived economic advantages, the others will support reform.
Insurance and Financial services and Finance (3 seats)	This group is hurt by the corruption in China which restricts their market access. Offer ICAC's link with China (built in the first group of reforms) as a way to help them lobby for anti-corruption on the Mainland.
Transport	Sponsor economic work showing how corruption is rising prices of transport to and on the Mainland.
Accountancy	Encourage this group to show their clients how corruption hurts the majority.
Education	Make emotional appeal about how corruption is preventing education of millions on the Mainland.
Legal	Encourage lawyers to advise clients about Chinese anti-corruption laws. Even small shifts in the proportions in favour of reform in each constituency could change the vote's outcome.
Information technology	Conduct meetings with the smaller IT firms working in China and educate them about the harms larger firms paying bribes inflict on them. Encourage them to write to their LegCo representative.
Medical and Health services (2 seats)	Do nothing. The welfare gains on the Mainland from providing better medical and health (even on a corrupt basis) exceeds the economic distortions from corruption.
Archit. and planning (2 seats) and real estate	Vigorously investigate one of the largest members of this group. Once the clean minority see that the Government is serious about fighting corruption, they will support broader reforms.
Social welfare	No work needed.
Tourism	Try to show the corruption of the larger tour operators. Once the smaller firms see that they can compete in part through denouncements, they will support the broader reform.
Commercial (2 seats)	Work with Beijing to arrange for grandfather clauses for companies sourcing from China (so that their existing relations wont be investigated if they promise their relations in the future will be bribe-free).
Industrial (2 seats)	Work with Beijing to arrange for grandfather clauses for companies sourcing from China (so that their existing relations wont be investigated if they promise their relations in the future will be bribe-free).
Import and export	No change of position possible. Avoid working with Mainland on prosecutions of this group under Chinese law in order to avoid galvanizing this group against the reforms.
Wholesale and retail	Focus work on prosecuting Mainland businesses extorting these groups. They will support reform in Hong Kong if they see it brings them benefits on the Mainland.
Textiles and garment	Share information with the majority that are corrupt --- Focus on the companies most likely benefit
Sport, arts, culture	No work needed.
Catering	No work needed.
District Council	Start PR campaign specifically saying "Don't Bribe on the Mainland" (in both Cantonese and Mandarin) – to raise awareness that closer co-operation with China planned.
Labour	No work needed – they are a natural ally (though PR needed when their employers prosecuted for bribery abroad).

Source: authors. Some actions must run into second stage of reform due to lags. These "recommendations" simply illustrate a principle from political economy. We do not advocate in practice particular policies.

The **second set of reforms** should focus principally on getting reforms to the POBO and ICAC Ordinance passed. These reforms should focus on the explicit criminalisation of foreign bribery and opening a debate on extra-territorial application of anti-corruption law (as well as setting in place system of civil law recoveries). By starting this round with announcing government’s intent to seek the authority to enter into non-prosecution agreements, Hong Kong companies will have fair warning of the reforms coming up. Such agreements will be politically popular – particularly if the ICAC and DoJ vow to exercise restraint at the beginning of the programme. Having a NDPA programme announced – and the changes on the Mainland away from corruption – should help to “flip” many of the long-term interests in Hong Kong tied to corruption.

The public consultation and LegCo debates should focus on the benefits to the (future) electorate of these reforms. The US and UK experiences in ratifying the legislative amendments we have discussed will help. On-going work with the Chinese authorities should also help remove “hidden” resistance from companies currently profiting from corruption on the Mainland. Several prosecutions on the Mainland of companies engaged in bribery and corruption should credibly signal that legislative reform will generate more winners than losers. Again, the ICAC’s role in helping to promote this wave of highly visible prosecutions at the provincial level will depend on its Mainland counterparts. These reforms must be introduced on a platform of **Providing Opportunities for All**.²³²

After work on realigning the underlying economic incentives of the various constituencies sending representatives to the Legislative Council, **we expect a vote of 11 ayes and 8 nays** – providing for a margin of error in the adoption of reforms to the POBO and ICACO. Figure 34 shows the theoretical results of a vote on the legislative reforms if the ICAC and other law enforcement agencies would have followed our advice on political tactics. As shown, many of the interests previously attached to corruption

²³² To be one hundred percent clear, we do not talk about any ICAC public relation work aimed specifically at influencing elected officials or the constituents using political communications. In political economic analysis, the incentives provided by executive agencies “speak for themselves” by allocating the costs and benefits which motivate political and economic behaviour.

would “flip” or support reform. Remember that companies do not yet hold liability for the corrupt acts of their agents – so the most controversial aspects of reform still lie in the future.

Figure 34: Revised Political Positions on Revisions to the POBO and ICACO
(by functional constituency)

Constituency	For or against?	Constituency	For or against?
Heung Yee Kuk (Rural Council)	Neutral	Commercial (2 seats)	1 For and 1 Against
Agriculture and fisheries	For	Industrial (2 seats)	1 For and 1 Against
Insurance and Financial services and Finance (3 seats)	For	Import and export	Against
Transport	Against	Wholesale and retail	For
Accountancy	For	Textiles and garment	Against
Education	For	Sport, performing arts, culture and publication	Neutral
Legal	For	Catering	Neutral
Information technology	Against	District Council	Neutral
Medical and Health services (2 seats)	For	Labour	For
Archit. and real estate (2 seats)	For	Tourism	Against
Social welfare	For		

The voting outcomes shown above represent the equilibrium positions for these groups based only on their economic interests tied mainly to the Mainland. For the policy (legislative changes) we propose, each groups’ vote depends (in the model) only on whether the economic benefits to the constituency exceed the costs imposed by the new policies. We provide these results only to illustrate a particular method from the social sciences. A detailed accounting of the way advocates of policy reform would need to behave to achieve these changes would move our analysis from Machiavellian to Faustian.

The **third group of reforms** should focus on legislative and operational changes to encourage criminal asset recoveries. Showing companies that the ICAC is working with them to recover assets from abroad will build support for the recently passed revisions to the POBO and ICACO. Hong Kong should share recoveries with the Mainland (Chinese) authorities as warranted. Public reporting of these recoveries can also help build popular support for the difficult reforms to take place in the final stage of reform.

These recoveries also help to provide budgetary support for programmes which benefit the “losers” of anti-corruption reform. The extra tax revenue and the proceeds from recoveries abroad (money paid by Hong Kong business to corrupt Chinese officials) can pay for trade missions to the Mainland, job retraining, extra commercial real estate which lowers rents and other programmes aimed at benefiting the traders who currently pay bribes in China for market access.

The **fourth (and last) group of reforms** focuses on corporate liability for corruption and asset recoveries. Given reform fatigue, **the reform strategy should centre on allowing corporate liability to shield personal liability in the short-term.** Moreover, focusing corporate criminalisation on the Crimes Ordinance avoids reopening the issue of POBO reform. If the LegCo does not adopt the corporate criminalisation of corruption, the authorities lodged in the POBO and ICACO naturally do not take effect in practice. By now, roughly 4-5 years will have passed since reforms began. While extra revenues have helped to compensate some of the losers of reform, the ICAC will have started prosecutions which touch on deep entrenched economic interests. Some of these interests represent natural persons with very close links to senior members of Hong Kong’s government. These persons will resist, with all their resources, the work which places their freedom at risk. ICAC work focusing on prosecuting the legal person – rather than the natural person – will help defray some of this important antagonism to reform.

Appendix III: Specification of Models for Economic Impacts on Hong Kong and Political Incentives

The Model of ICAC's work on Hong Kong tax revenue

In the limited confines of the political economy model, Hong Kong policymakers will not want to contribute to the fight against corruption on the Mainland unless such work benefits Hong Kong taxpayers. Self-interest – whether for individuals or for countries -- generally serves as a pretty good guide for predicting future behaviour and actions. In Figure 7, we presented a simulation of tax revenue earned from the ICAC's anti-corruption effort in collaboration with its Mainland Chinese partners. The model relies on four effects – that the application of the POBO has an effect on reducing corruption in China, reductions in corruption will lead (overall) to an increase in trade and investment with Hong Kong, that such increases have an impact on incomes in Hong Kong and finally that these increases in incomes lead to higher tax collections.

We constructed our model using an Excel spreadsheet – taking relationships between our variables from previous studies and regression analysis of past data. To construct our model, we used World Bank data for Hong Kong's and China's GDP, trade, investment, and tax collections. Such regression analysis provided estimated impacts of the economic growth in China on trade and investment in Hong Kong (and most academic observers note that China accounts for about half of Hong Kong's growth).²³³ Finding estimates for the effect of increased anti-corruption enforcement in Mainland on local trade and investment proved a bit more difficult. We consulted the literature and arrived at the most reasonable estimates we could find.²³⁴

²³³ For previous studies, see Vivek Arora and Athanasios Vamvakidis, *China's Economic Growth: International Spillovers*, IMF WORKING PAPER 10/165, available [online](#).

²³⁴ See Alvaro Cuervo-Cazurra, *supra* note 81, available [online](#). See also Paivi Karhunen and Svetlana Ledyeva, *Corruption Distance, Anti-corruption Laws and International Ownership Strategies in Russia*, J. OF INT'L MANAGE. 2011. See also Matthew Cole, Robert Elliott and Jing Zhang, *Corruption, Governance and FDI Location in China: A Province-level Analysis*, University of Birmingham Discussion Papers 08-06, 2008.

We start our model by specifying how changes in GDP affect tax revenues in Hong Kong. We assume that we have i number of corrupt Chinese provinces with a GDP (Y_i) – which we treated as basically one single variable for our spreadsheet to keep the model simple. We assume that corruption has a growth reducing effect represented by the Greek letter α -- added as an exponential argument because GDP's magnitude will likely influence this effect. The fight against corruption must increase economic growth (otherwise little policy reason exists to fight corruption). We model the pro-growth effect of the ICAC's work on the Mainland by the effect β -- which remains constantly proportional across all provinces. We assume that ICAC spending I (expressed in currency units) on investigations and prosecutions affect the overall harm of corruption.²³⁵

We must assume that some amount of foreign GDP passes into Hong Kong (through the trade or investment channel). For our purposes, we do not care how exactly foreign GDP affects Hong Kong's GDP – only that a relatively stable relationship exists between these two variables. We model such a pass-through through the parameter γ . Finally, we assume that part of Hong Kong's tax revenue comes from incomes earned exclusively at home φY_{HK} and part earned only as a result of foreign growth $(1-\varphi)$. Our model basically “decomposes” Hong Kong growth into two parts, the part attributable to growth in China and a completely “domestic” part which is completely unrelated to growth in China.

The countervailing effects of the ICAC's work at home and abroad serve as the heart of our model. Hong Kong's taxpayers feel ambivalent about paying taxes to fund the ICAC's work in our model. On the one hand, they benefit from the ICAC's work on the Mainland through pro-trade and pro-investment creating effects reflected in β . On the other hand, they must pay taxes to fund the ICAC's work – and these taxes drag down Hong Kong's economy by the coefficient ρ . In words, we are simulating the

²³⁵ The reader can remember I as the investment made by the Hong Kong authorities in its own growth by helping the Mainland to fight corruption.

circumstances under which the effect from extra growth on the Mainland ($Y_i^{1-\alpha+\beta I}$) exceeds the dead-weight loss imposed by extra taxes at home ($Y_{HK}^{1-\rho I}$). Tax revenues for Hong Kong (T) in light of the ICAC's additional work abroad equals (for China's 22 provinces):

$$T = t[\varphi Y_{HK}^{1-\rho I} + (1-\varphi) \sum_{i=1}^{22} \gamma_i Y_i^{1-\alpha+\beta I}] \quad (1)$$

We want to know the effect of changes in ICAC spending on law enforcement in China I on tax revenues T in Hong Kong. In order to assess the effects of changing enforcement spending on tax revenue, we rearrange the equation so as to “pull down” the exponents and prepare the equation for our analysis – as shown in equation 2. Dealing with natural logs also helps avoid statistical errors and problems too complicated to discuss here,

$$\ln T = \ln t + \ln \varphi + (1-\rho I) \ln Y_{HK} + 22 \ln(1-\varphi) + \sum_{i=1}^{22} [\ln \gamma_i + (1+\alpha) \ln Y_i - (\beta I) \ln Y_i] \quad (2)$$

Doing a bit of calculus, we arrive at the core logic of the model. As shown in equation 3, tax revenue increases with increased GDP in China resulting from fighting corruption – and decreases from reduced economic activity in Hong Kong which the extra taxes used to pay for ICAC work causes. We use such a result to check our graph in Figure 7 – just to make sure our simulation results follow the logic laid out in the model.

$$\frac{\partial \ln T}{\partial I} = -Y_{HK}^{\rho I} \ln Y_{HK} + 22 Y^{-\beta I} \ln Y_i \quad (3)$$

In order to run our simulation, we had to replicate the uncertainty we have of life in the real world. We wouldn't know what the exact effect of the ICAC's work on domestic output would be, the pass-through between foreign GDP and domestic investment/trade, and the effect on foreign corruption. Therefore we added error terms (basically a randomly distributed variable). These random variables allowed us to simulate what our the effects might be under a range of possible scenarios (namely if the

ICAC's effect on Chinese corruption was relatively low or high, whether increased enforcement decreased business effort in Hong Kong by a little or a lot, and so forth). With these error terms, equation 1 becomes equation 4.

$$T = t[\varphi Y_{HK}^{1-(\rho+\varepsilon_1)I} + (1-\varphi) \sum_{i=1}^{22} (\gamma_i + \varepsilon_2) Y_i^{1+\alpha-(\beta+\varepsilon_3)(I)}] \quad (4)$$

In simulating in Excel, we set up the model shown above – with the error terms added with a 10% variance in either direction. The result – shown in Figure 7 (which of course should be seen as an illustration rather than a rigorous empirical study) – shows the results of a series of about 25 simulations we ran (known as Monte-Carlo simulation). In each run, we randomly selected an ICAC spending level between HK\$10 million and HK\$100 million. We recorded the resulting estimated tax revenue on the graph. The graph shows the nice properties of diminishing returns to ICAC spending (because of the exponential variables in the equation). Practically speaking, we do not anticipate increases in the ICAC's budget of more than maybe \$10 million-\$30 million.