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Herbalife Agrees to Pay \$123 Million to Settle Charges Related to 10-Year Bribery Scheme in China

Herbalife Nutrition Ltd.'s ("Herbalife") recent settlement of bribery allegations demonstrates the U.S. government's continuing focus on China and the critical role that board members and senior management of multinationals play in overseeing compliance globally. On August 28, 2020, Herbalife Nutrition Ltd. ("Herbalife") agreed to pay the Securities and Exchange Commission ("SEC") and the Department of Justice ("DOJ") more than \$123 million in penalties and disgorgement to resolve bribery allegations in China. The settlement resolves a long-running probe in which two former executives of Herbalife's Chinese subsidiary were indicted on criminal charges in November 2019. The resolution is one of many recent noteworthy enforcement resolutions targeting the operations of multinationals in China.

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The Findings

According to the facts set out in the SEC's order instituting the Cease-and-Desist proceedings (the "Order"), between 2006 and 2016, Herbalife's Chinese subsidiaries ("Herbalife China") engaged in a scheme in which Herbalife China executives offered improper payments and other benefits to Chinese government officials to obtain direct sales licenses, curtail government investigations of Herbalife China, prevent or reduce fines issued by Chinese authorities, and remove negative media coverage of the company. The SEC reported that, despite receiving reports of high travel and entertainment spending in China as well as violations of Herbalife's internal FCPA policies, senior executives of Herbalife failed to prevent the misconduct that included the provision of improper payments and benefits and falsifications of expense reports.

The Order indicates that Herbalife China's then-Managing Director and Director of External Affairs, along with other Herbalife China employees, provided lavish meals, gifts and other benefits to Chinese government officials in order to obtain its first direct selling license in March 2007. The SEC further stated that Herbalife China employees funded the meals and gifts through falsified expense reimbursements until 2016.

The Order also indicates that employees of Herbalife China provided improper payments to Chinese government officials in order to curb investigations of Herbalife China and to prevent or reduce fines issued to Herbalife China by the Chinese government, and to delete negative media articles involving the company. For example, the SEC described an instance in which senior executives of Herbalife China discussed providing the amount that would have covered a fine to the government official who stopped an investigation in Nanjing involving Herbalife China.

A central finding of the SEC's investigation is that Herbalife executives received audit reports indicating high spending in China and violations of internal policy, but failed to appreciate the severity of the issues, to follow up, or to exercise appropriate oversight over the misconduct. In one example, an audit report covering expenses over a six-month period indicated that the External Affairs department submitted expenses claiming to have treated more than 30,000 Chinese government officials and media members to meals and that it was reimbursed a total of approximately \$3.7 million. Board members of the Company reportedly received the report and questioned the findings on more than one occasion. However, Herbalife employees dismissed the expenses as typical.

In related proceedings, two senior managers of Herbalife China were charged on November 14, 2019 for violating the FCPA, committing perjury, and destroying records in a federal investigation. These charges are pending.

The Resolution

Herbalife was found to have violated the books and records and internal accounting controls provisions of the FCPA. Herbalife's Chinese subsidiary was not named as a respondent and did not consent to the foregoing charges in the

resolution. The Order requires Herbalife to pay approximately \$58.7 million in civil disgorgement and \$8.6 million prejudgment interest to the SEC. The Order also instituted a three-year report period, during which Herbalife must conduct an initial review and two follow-up reviews, promptly report questionable findings, and submit periodic compliance reports.

Additionally, Herbalife entered into a three-year deferred prosecution agreement with the DOJ under which it will pay a criminal fine of approximately \$56 million, reflecting a discount of 25 percent off the bottom of the otherwise applicable Sentencing Guidelines fine range, calculated according to a base fine of approximately \$46.5 million (the “pecuniary gain to Herbalife from the offense”), a total offense level of 30 given that the offense was committed outside the U.S. and exceeds \$25 million, and a culpability score exacerbated by the fact that the company had more than 5,000 employees but mitigated by full cooperation credit.

Key Takeaways

- **Effective Enforcement of Policies and Procedures:** Herbalife’s controls included limiting dinners with any Chinese government official to six dinners per year, and obtaining specific corporate pre-approvals for certain External Affairs expenses. However, these controls were routinely flouted and ignored, at times at the direction of senior company executives, demonstrating the limits of relying on written requirements alone.
- **Compliance and Audit Oversight:** Despite board members questioning the reasonableness of the high marketing expenses, the company’s Internal Audit department claimed that the expenses were “tolerable.” Senior management and board members failed to follow up. That the government highlighted these points demonstrates the government’s view of the critical role that senior managers and board members play in ensuring that companies follow up on red flags. This is particularly true for board members of public companies who, under Sarbanes-Oxley, are subject to heightened requirements to oversee internal controls.
- **Chinese Subsidiary Not Charged:** Herbalife’s main Chinese subsidiary, which directly engaged in the misconduct, was not charged. The agencies instead pursued the U.S. parent company under the books and records and internal accounting controls provisions, relying on findings that executives of Herbalife failed to detect and prevent improper payments in the China subsidiary. The detail distinguishes the Herbalife resolution from certain other recent settlements in which the government targeted local subsidiaries in addition to domestic parents.
- **Value of Cooperation:** Herbalife received a 25% discount off the bottom of the Sentencing Guidelines fine range. In reaching this discount, the DOJ cited factors including Herbalife’s full cooperation, extensive remedial measures and commitment to continuing to enhance its compliance program and internal accounting controls.
- **Calculation of Improper Gains from License Payments:** Because the findings indicate that Herbalife employees made improper payments to obtain licenses to operate in certain provinces, the government may have argued that all gains flowing from those licenses were illicit. Herbalife China generated \$860 million in annual net sales in 2016 alone. That the DOJ calculated Herbalife’s improper gain to be only \$46.5 million suggests a significant degree of negotiation surrounding which gains flowed from improper license payments, and which did not.