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Drug Giant Faced a Reckoning as China Took Aim at Bribery

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China sought to make an example of GlaxoSmithKline in a case that involved bribery of doctors and investigators and ended with guilty pleas and record penalties.

By DAVID BARBOZA NOV. 1, 2016

SHANGHAI — Peter Humphrey was in the bathroom of his Shanghai apartment when the police kicked the door off its hinges and knocked him to the ground. Nearly two dozen officers stormed his home. They confiscated files, laptops and hard drives related to his work as a corporate investigator.

Mr. Humphrey and his wife, Yu Yingzeng, were taken to Building 803, a notoriously bleak criminal investigation center normally reserved for human smugglers, drug traffickers and political activists. Sleep-deprived and hungry, he was transferred later that day to a detention house, placed in a cage and strapped to an iron chair. Outside, three officers sat on a podium and demanded answers.

Mr. Humphrey knew the reason for the harsh interrogation. He and Ms. Yu had been working for GlaxoSmithKline, the British pharmaceutical maker under investigation in China for fraud and bribery.

The Glaxo case, which resulted in record penalties of nearly $500 million and a string of guilty pleas by executives, upended the power dynamic in China, unveiling an increasingly assertive government determined to tighten its grip over multinationals. In the three years since the arrests, the Chinese government, under President Xi Jinping, has unleashed the full force of the country's authoritarian system, as part of a broader agenda of economic nationalism.

Driven by the quest for profits, many multinationals pushed the limits in China, lulled into a sense of complacency by lax officials who eagerly welcomed overseas money. Glaxo took it to the extreme, allowing corruption to fester.

When bribery accusations surfaced, the company followed the old playbook, missing the seismic changes reshaping the Chinese market. Rather than fess up, Glaxo tried to play down the issues and discredit its accusers — figuring officials wouldn't pay attention.

Along the way, there were bribes of iPads, a mysterious sex tape and the corporate investigator, who gave his operations secret code names. The company's missteps are laid bare in emails, confidential corporate documents and other evidence obtained by The New York Times, as well as in interviews with dozens of executives, regulators and lawyers involved in the case.

The aftershocks of the Glaxo case are still rippling through China. The authorities have unleashed a wave of investigations, putting global companies on the defensive. The government has intensified its scrutiny of Microsoft on antitrust matters this year, demanding more details about its business in China. And just two weeks ago, the authorities detained a group of China-based employees, including several Australian citizens, working for the Australian casino operator Crown Resorts, on suspicion of gambling-related crimes.

Companies are racing to find new strategies and avoid getting locked out of China, the world's second-largest economy after the United States. Disney and

Qualcomm are currying favor with Chinese leaders. Apple redid its taxes in China after getting fined. Some multinationals are training employees in how to deal with raids.

The crackdown has prompted a complete rethinking for Glaxo — and for much of the pharmaceutical industry. To appease the government, drug makers have promised to lower prices and overhaul sales practices.

“For a long time, there’d been this policy of going easy on foreign enterprises,” said Jerome A. Cohen, a longtime legal adviser to Western companies. “The government didn’t want to cause embarrassment or give outsiders the impression that China is plagued with corruption. But they’re not thinking like that anymore.”

The Glaxo case was fueled by missed clues, poor communication and a willful avoidance of the facts. For more than a year, the drug maker brushed aside repeated warnings from a whistle-blower about systemic fraud and corruption in its China operations.

The company’s internal controls were not robust enough to prevent the fraud, or even to find it. Internally, the whistle-blower allegations were dismissed as a “smear campaign,” according to a confidential company report obtained by The Times.

Glaxo just wanted to make its problems go away. It offered bribes to regulators. It retaliated against the suspected whistle-blower. It hired Mr. Humphrey and Ms. Yu to dig into the woman’s background, family and government ties, as a way to discredit her. And Glaxo may even have gone after the wrong person, documents and emails obtained by The Times suggest.

None of it mattered. The allegations were true.

Prosecutors charged the global drug giant with giving kickbacks to doctors and hospital workers who prescribed its medicines. In 2014 Glaxo paid a nearly $500 million fine, at the time the largest ever in China for a multinational. Five senior executives in China pleaded guilty, including the head of Glaxo’s Chinese operations, a British national, in a rare prosecution of a Western executive. With Glaxo embroiled in scandal, sales plummeted in China, the company's fastest-growing market.

Glaxo has declined multiple requests for comment, referring instead to earlier statements. Glaxo "fully accepts the facts and evidence of the investigation, and the verdict of the Chinese judicial authorities," one statement read. "GSK P.L.C. sincerely apologizes to the Chinese patients, doctors and hospitals, and to the Chinese government and the Chinese people."

Mr. Humphrey and Ms. Yu, both in their late 50s at the time of their arrests, were punished too. The couple spent two years in prison for illegally obtaining government records on individuals.

Mr. Humphrey was crowded into a cell with a dozen other inmates. There were no beds or other furniture, just an open toilet and a neon light overhead. During his incarceration, Mr. Humphrey said, he suffered back pain, a hernia and a prostate problem that was later diagnosed as cancer.

"I was in a state of complete shock and breakdown," said Mr. Humphrey, who was released along with his wife in July 2015. "I was physically broken down and mentally blown away. I didn't sleep for 45 days."

A Whistle-Blower Emerges

An anonymous 5,200-word email in January 2013 to the Glaxo board laid out a detailed map to a fraud in the Chinese operations.

Written in perfect English, the email was organized like a corporate memo. Under the header "Conference Trip Vacations for Doctors," the whistle-blower wrote that medical professionals received all-expenses-paid trips under the guise of attending international conferences. The company covered the costs of airline tickets and hotel rooms, and handed out cash for meals and sightseeing excursions.

In a section labeled "GSK Falsified Its Books and Records to Conceal Its Illegal Marketing Practices in China," the email explained how Glaxo was pitching drugs for unapproved uses. As an example, the whistle-blower said the drug Lamictal had been aggressively promoted as a treatment for bipolar disorder, even though it had been approved in China only for epilepsy.

Glaxo “almost killed one patient by illegally marketing its drug Lamictal,” said the email, which was obtained by The Times. “GSK China bought the patient’s silence for $9,000.”

The email was one of nearly two dozen that the whistle-blower sent over the course of 17 months to Chinese regulators, Glaxo executives and the company’s auditor, PricewaterhouseCoopers.

When the authorities pressed Glaxo, the company was dismissive. It failed to properly investigate the allegations. It didn’t beef up its internal controls. And it didn’t change its marketing practices.

The decision was calculated. In the decades since China began opening its economy, most multinationals had avoided scrutiny over bribery. China needed overseas companies to help develop its economy, by setting up manufacturing operations and creating jobs. The authorities were reluctant to jeopardize investment, so they took a softer approach to enforcement.

When companies did run into trouble, fines were tiny. The rare cases tended to be colored by politics. Seven years ago, the Chinese authorities detained executives from the global mining giant Rio Tinto on suspicion of stealing state secrets. The charges were eventually downgraded to bribery and theft of commercial secrets, and the company avoided punishment.

By the time Glaxo’s fraud bubbled to the surface, China had changed.

Over the last decade, China has emerged as an economic powerhouse, but it took off even more as the rest of the world slowed after the financial crisis. That gave China the upper hand with overseas companies, which were increasingly dependent on profits from the country’s growing consumer base.

The economic might coincided with the Communist Party’s increasingly nationalistic stance. The authorities in China, already undertaking a severe crackdown on Chinese companies, wanted to show that, like American regulators, they could also penalize and sanction global companies.

And it was no secret that big drug makers were violating the law in China.

Years earlier, the consulting firm Deloitte warned about rampant corruption in China's pharmaceutical market. As Deloitte found, doctors and health care workers were poorly compensated, so they could easily be induced to write more prescriptions with offers of cash, gifts, vacations and other benefits. Big drug makers, eager for growth, willingly obliged.

"The remarkable thing is that China is a more hospitable environment to this type of corruption, because it's a market where doctors and hospitals are heavily reliant on drug sales," said Dali Yang, who teaches at the University of Chicago and has studied the industry. "They were like fish swimming in water."

American investigators had punished several major drug companies for such behavior abroad. In 2012, Eli Lilly agreed to pay $29 million, and Pfizer $45 million, to settle allegations that included employees' bribing doctors in China. In settling the cases, neither company admitted or denied the allegations.

That summer, Glaxo agreed to pay $3 billion in fines and pleaded guilty to criminal charges in the United States for marketing antidepressants for unapproved uses, failing to report safety data on a diabetes drug and paying kickbacks. The case was built off tips from several whistle-blowers.

After that, Glaxo's chief executive, Andrew Witty, pledged, "We're determined this is never going to happen again."

But it did — in China.

Redirecting Bribes

In early 2013, Glaxo realized it couldn't ignore the problems. The authorities were asking questions. The whistle-blower continued to send emails.

So the company tried another common gambit in China: bribing officials.

The company set up a special “crisis management” team in China and began offering money and gifts to regulators.

That strategy had worked in the past. A company, often using a middleman, would try to soothe officials and regulators, offering gifts and favors.

One government agency had received multiple emails from the whistle-blower, and Glaxo targeted multiple branches of the agency, according to state media reports. One executive tried to cozy up to a Shanghai investigator with an iPad and a dinner totaling $1,200, another Glaxo employee said in a statement to the police. When that executive asked for money to bribe the Beijing branch, Mark Reilly, the head of the company’s Chinese operations, gave the “go ahead.”

Another executive with Glaxo’s Chinese operations bribed regulators to focus on “unequal competition,” rather than a more punitive investigation into “commercial bribery.” The goal, that executive admitted in a statement, was to limit any potential fine to about $50,000. It didn’t work.

As pressure mounted, the case took a bizarre turn, setting Glaxo on a collision course with the government.

In March 2013, Glaxo’s chief executive and five other senior executives in the company’s London headquarters received an anonymous email with a media file. In it, a grainy video showed Mr. Reilly, the executive in China, engaged in a sexual act with a young Chinese woman.

The attached email alleged that Mr. Reilly, a British national who had helped manage the company’s China operation for four years, was complicit in a bribery scheme tied to a travel agency called China Comfort Travel, or C.C.T. According to the email, Glaxo funneled money through the travel agency to pay off doctors. The travel agency also supplied Mr. Reilly with women, as a way to secure that business.

“In order to acquire more business, C.C.T. bribed Mark Reilly, the general manager of GSK (China) with sex,” the email said. “Mark Reilly accepted this bribery and made C.C.T. get the maximized benefits in return.”

Glaxo later discovered that the video had been shot clandestinely, in the bedroom of Mr. Reilly's apartment in Shanghai. Analysts working for the company said it had been edited to disguise the location.

Glaxo executives in London were shocked. They deemed the video a serious breach of privacy, involving a possible break-in at the home of a senior executive in China. Mr. Reilly moved to a more secure residence.

Project Scorpion

Like many global companies, Glaxo has a code of conduct that encourages employees to report fraud or wrongdoing without fear of retaliation by the company. In many countries, including China, the rights of whistle-blowers are protected by law.

Glaxo didn't seem to care.

By the time the video surfaced, Glaxo already had its suspicions about the identity of the whistle-blower. Months earlier, the company had fired Vivian Shi, a 47-year-old executive handling government affairs in Glaxo's Shanghai office. The official reason for Ms. Shi's firing was falsifying travel expenses. In fact, she was dismissed because the company believed she was the whistle-blower, according to confidential corporate documents obtained by The Times.

Ms. Shi did not return multiple calls for comment.

After receiving the video, Glaxo took more aggressive action, seeking to discredit Ms. Shi, who had already left the company.

At that point, in the spring of 2013, the company turned to Mr. Humphrey, the investigator. He ran ChinaWhys, a small risk consultancy firm that advised global companies like Dell and Dow Chemical.

His firm was engaged in what he called "discreet investigations," helping multinationals cope with difficult situations like counterfeiting and embezzlement. Short in stature, with a shock of white hair, Mr. Humphrey portrayed himself as a kind of modern-day Sherlock Holmes.

“He likes a good adventure and likes solving cases,” said his friend Stuart Lindley, who runs a financial services company in China. “But he was definitely aware that some of that stuff was risky.”

In April 2013, Mr. Reilly met with Mr. Humphrey at Glaxo’s glass office tower near People’s Square in central Shanghai. According to meeting notes obtained by The Times, they discussed the emails, the sex video and Ms. Shi, the suspected whistle-blower. Mr. Reilly told the investigator that she held a grudge against Glaxo.

At the meeting, Mr. Reilly asked the investigator to look into the break-in at his apartment. But he made clear that he also wanted to assess what power and influence Ms. Shi might have with the government.

Legal experts say Mr. Reilly should not have been put in charge.

“The executive so accused has an obvious conflict of interest in overseeing such an investigation,” said John Coates, a Harvard Law School professor. “Even if the executive were entirely innocent of the whistle-blower’s charge, giving that same executive the role of investigating the whistle-blower smacks of retaliation.”

Efforts to reach Mr. Reilly, who has since left the company, were unsuccessful.

Using the code name Project Scorpion, Mr. Humphrey and his staff spent the next six weeks working undercover, gathering evidence. They visited Lanson Place, the upscale apartment complex where Mr. Reilly lived when the sex tape was made. They created a dossier on the suspected whistle-blower, searching for motives and ties to high-ranking officials or regulators. They interviewed former co-workers, scrutinized her résumé and scoured the web for information about her father, a former health official.

Glaxo may have crossed a line in this regard, putting the company more sharply in the government’s sights.

As part of the investigation, Mr. Humphrey turned to a Chinese detective to acquire a copy of Ms. Shi’s household registration record, or hukou. The official document contained information about her husband and daughter. The authorities had warned private detectives about acquiring confidential government documents.

“This type of household information is supposed to be private,” said John Huang, a former government official who is now managing partner at McDermott, Will & Emery in Shanghai. “But people were buying and selling it.”

Glaxo got little payoff from the investigation.

On June 6, 2013, Mr. Humphrey delivered a 39-page report to Glaxo that said Ms. Shi was probably the whistle-blower and even had a “track record of staging similar attacks” at a previous job. But the report included no evidence linking her to the emails or the sex video, according to a draft obtained by The Times.

Glaxo’s strategy of bribery and discrediting ultimately failed.

With the Chinese government in the midst of a crackdown on corruption, the police carried out a series of raids on June 27, 2013. They seized files and laptops from multiple Glaxo offices and interrogated dozens of employees. In Shanghai, four senior executives were detained. Investigators also raided the offices of several travel agencies that had worked closely with Glaxo, including China Comfort Travel.

A week later, the police stormed Mr. Humphrey’s apartment in Shanghai. He and his wife were charged with violating privacy laws.

Mr. Humphrey declined to comment on the specifics of the Glaxo case. His son defended his work, saying Glaxo engaged him “under false pretenses.” “My father is an honorable and law-abiding man,” said the son, Harvard Humphrey.

When prosecutors announced the case against Glaxo in July 2013, several weeks after arrests began, their allegations closely mirrored those of the whistle-blower. They described an elaborate scheme to bribe doctors and workers at government-owned hospitals using cash that had been funneled through a network of 700 travel agencies and consulting firms.

“It’s like a criminal organization: There’s always a boss, and in this case GSK is the boss,” said Gao Feng, one of the lead investigators.

Glaxo said little about the developments until July 15, when several high-ranking executives confessed from prison on state-run television. After that, the company capitulated, issuing a blanket statement for its misdeeds: “These allegations are shameful and we regret this has occurred.”

Cleaning Up Corruption

Dressed in a dark suit and a blue tie, Mr. Reilly, the Glaxo executive, was led in handcuffs into a small courtroom in the city of Changsha, in central China, in September 2014. With security guards behind him, he stood alongside four other senior Glaxo executives as a judge read the charges.

“The defendant company GSKCI is guilty of bribing nongovernment personnel and will be fined 3 billion yuan,” the judge, Wu Jixiang, said sternly, referring to Glaxo’s Chinese name. The company and the executives, having confessed, were given relatively light sentences, the court said.

Mark Reilly was sentenced to three years in prison and ordered to be expelled from China.

After handing down that sentence, the judge turned to Mr. Reilly.

“Do you obey the court’s verdict? Do you appeal?” he asked.

Mr. Reilly said that he would not challenge the verdict. Because he was swiftly deported, he will not serve prison time in China.

Glaxo is still trying to clean up the mess.

In China, Glaxo has promised to overhaul its operations and has put in place stricter compliance procedures. The company has changed the way its sales force is compensated and has eliminated the use of outside travel agencies.

Glaxo has also tightened oversight of expenses and cash advances, areas central to the case. Employees must now send in photographs of the guests and food, to verify that the meetings took place.

And in August 2015, Glaxo tried to make amends by rehiring Ms. Shi, an acknowledgment that the company had erred in firing an employee suspected of being a whistle-blower.

But the decision also hinted at a more troubling admission — that Glaxo had targeted the wrong person. There are indications that Ms. Shi was not the whistle-blower, and that there may have been more than one person.

The emails sent to regulators were written in fluent English and came mostly from a Gmail account. The email with the sex video came from a local Chinese account and was written in poor English. The only similarity was the anonymity.

The Times sent emails to both accounts and got a response from just one, the person who had written the detailed emails to the Chinese authorities and Glaxo. “You have reached who you are looking for,” the person replied.

In a series of exchanges, the author denied being Ms. Shi, acting in concert with her or sending the video. The person said Glaxo had erroneously blamed Ms. Shi for the emails and never found the actual whistle-blower.

The Times was unable to verify the identity of the person, who described working in Shanghai but declined to come forward for fear of retribution.

“I didn’t reveal to GSK personnel that I was the whistle-blower because doing so would have placed me in potential physical jeopardy,” the whistle-blower wrote in an email to The Times. “You understand that criminals — you know that they were convicted later in Chinese courts — were in charge of GSK China at that time, and I truly believe that they would have harmed me in some fashion had they discovered my identity. ”

Correction: November 4, 2016

An article on Wednesday about a crackdown on corruption in China that ensnared the drug maker GlaxoSmithKline referred incompletely to charges faced by the mining company Rio Tinto seven years ago, when China took a softer approach to enforcement. They were downgraded to bribery and theft of commercial secrets, not bribery alone.

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