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# FCPA COMPLIANCE IN CHINA

Compliance is difficult in China because of the broad range of persons deemed “foreign officials” under the law, the extensive use of local intermediaries, and social norms requiring lavish business entertainment. To minimize compliance risks, companies need written compliance programs, frequent employee training, whistleblower procedures, rigorous financial controls, and vigorous investigations.

**By Patrick M. Norton\***

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**T**he official statistics are sobering: Chinese authorities report that they have investigated well over one million cases of official corruption in the last eight years. Tens of thousands of officials have been prosecuted. Hundreds of thousands have been dismissed from their positions or have received warnings or lesser punishments.<sup>1</sup> China’s leaders readily acknowledge that government corruption is one of the country’s greatest problems and have announced a broad array of programs and political campaigns designed to fight it. Despite these measures, the number of reported cases has not declined. Few doubt, moreover, that the number of unreported cases is far greater than the number reported.

U.S. companies must enter this environment with caution. The Foreign Corrupt Practices Act (“FCPA”)<sup>2</sup> imposes potentially onerous criminal penalties on “U.S. persons”<sup>3</sup> for the bribery of

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1 Official statistics are announced each January or February by the Communist Party’s Central Commission for Discipline Inspection and are widely reported in the Chinese and Hong Kong press. The data in the text are the author’s calculations based on reports over the last decade.

2 15 U.S.C. §§78m, 78dd, and 78ff.

3 15 U.S.C. §78dd-1 applies to “issuers,” most of which are U.S. corporations. 15 U.S.C. § 78dd-2 applies to “domestic concerns” and officers, directors, employees, and agents thereof, and defines “domestic concern” as any individual who *is* a citizen, national, or resident of the U.S. and any corporation, partnership, *etc.* that is organized under the laws of a state or territory of the U.S. and has its principal place of business in the U.S.

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foreign officials.<sup>4</sup> Although the statute was enacted in 1977, for many years there were no reports of FCPA investigations involving China. That has now changed. Several U.S. companies have paid substantial fines for FCPA violations in their China operations in recent years,<sup>5</sup> and a number of others have announced that they are currently cooperating with U.S. authorities in investigating possible violations.<sup>6</sup> The Department of Justice (“DOJ”) has listed China as a “red flag” country<sup>7</sup>—*i.e.*, a country in which corruption is endemic and U.S. persons are expected to take special precautions against corruption risks. As a result, FCPA compliance has become a significant challenge for U.S. companies doing business in one of the world’s most rapidly growing and promising markets.

Many of the FCPA problems and risks in China are common to those in other developing countries: underpaid bureaucrats who try to supplement meager official incomes with graft; numerous opportunities for official corruption in a rapidly changing and developing economy; longstanding cultural expectations that officials will take advantage of these opportunities; and local anti-corruption laws that are seldom or sporadically enforced for lack of political will or an adequate legal infrastructure. The general requirements that the FCPA imposes on U.S. companies doing business in such countries and measures that U.S. companies may take to comply with those requirements have been discussed elsewhere.<sup>8</sup> This article focuses on several specific

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4 Specifically, the statute prohibits “U.S. persons” from “offering or paying” “anything of value” to “any foreign official” for the “corrupt purpose” of influencing the officials and thereby “obtaining or retaining business” or an “unfair advantage.” 15 U.S.C. §§78dd-1(a), 78dd-2(a), 78dd-3(a).

5 See, U.S. Dep’t of Justice, Press Rel. June 3, 2008, “AGA Medical Corporation Agrees to pay \$2 Million Penalty and Enter Deferred Prosecution Agreement for FCPA Violations”; U.S. Dep’t of Justice, Press Rel. Dec. 21, 2007, “Lucent Technologies Inc. Agrees to Pay \$1 Million Fine to Resolve FCPA Allegations”; U.S. SEC, Litigation Rel. No. 20414, Dec. 21, 2007, “SEC Files Settled Action Against Lucent Technologies in Connection with Payments of Chinese Officials’ Travel and Entertainment Expenses; Company Agrees to Pay \$1.5 Million Civil Penalty”; U.S. Dep’t of Justice, Press Rel. Oct. 16, 2006, “Schnitzer Steel Industries Inc’s Subsidiary Pleads Guilty to Foreign Bribes and Agrees to Pay a \$7.5 Million Criminal Fine”; U.S. Dep’t of Justice, Press Rel. May 20, 2005, “DPC (Tianjin) Ltd. Charged with Violating the Foreign Corrupt Practices Act” (criminal penalty of \$2 million; “disgorgement” of \$2.8 million in profits plus interest).

6 Companies that have announced FCPA problems in recent years involving China also include BearingPoint and Fidelity National Financial Services. Details may be found in their SEC filings.

7 An unintended irony for China, whose own flag is, in fact, red and is commonly referred to in Chinese as the “red flag” (*hongqi*).

8 See, *e.g.*, S. Deming, *The Foreign Corrupt Practices Act and the New International Norms* (ABA 2005); O. Thomas Johnson, Jr., “The Foreign Corrupt Practices Act,” in L. Low, P. Norton & D. Drory (eds.), *International Lawyer’s Deskbook* 251 (ABA, 2d. ed. 2002). See also, Jacqueline C. Wolff & Jessica A. Clarke, *Liability under the Foreign Corrupt Practices Act*, 40 Rev. Sec. & Comm. Reg. 13 (2007).

aspects of FCPA compliance that are particular to China and the ways that U.S. companies are seeking to deal with the problems.

## **A DIFFERENCE OF SCALE**

The FCPA anti-bribery provisions apply only to payments to “foreign officials.”<sup>9</sup> One of the most striking features of the FCPA environment in China is the sheer number of officials to whom these prohibitions apply. There are two reasons for this.

### ***The Ubiquitous Mandarin***

First, China’s bureaucrats are numerous at all levels of government, and governmental licenses, permits, approvals, etc., continue to be required for a broad range of investment and commercial activities. The number and frequency of bureaucratic dealings vary considerably from region to region and industry to industry. Some regions, eager to encourage foreign investment, have simplified investment application procedures by establishing “one-stop shops.” This often streamlines the initial application process, limiting the number of approvals, licenses, etc. that must be obtained. Nevertheless, ongoing relationships with numerous government agencies are both inevitable and desirable for foreign-invested businesses. Prompt access to local officials and a reasonably sympathetic relationship with them are often critical to resolving satisfactorily the problems that arise for any foreign business in China.<sup>10</sup>

In other sectors, interactions with local officials are pervasive and constant. Companies engaged in direct selling operations, for example, require the approval and ongoing cooperation of at least three government agencies (the Ministry of Commerce, the State Administration of Industry and Commerce, and the Public Security Bureau) not only at central, provincial, and city government levels but down to the local district level. Without the support, or at least the benign acquiescence, of hundreds of separate officials in jurisdictions throughout the country, it may not be possible for U.S. companies in this and similar sectors to do business in China at all.

In China, moreover, the “government” is not limited to civil servants in government agencies. There is also a shadow government

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<sup>9</sup> The term “foreign officials” is defined at 15 U.S.C. §§78dd-1(f)(1)(A); 78dd-2(h)(2)(A); 78dd-3(f)(2) (A).

<sup>10</sup> See, Norton, “Informal Dispute Resolution,” in M. Moser (ed.), *Dueling with Dragons: Dispute Resolution in China 19 et seq.* (2007).

of communist party cadres who replicate many official positions and are often more important than their government counterparts. Foreign companies not infrequently must deal with this shadow government too, and for FCPA purposes the party cadres with whom they meet qualify as “foreign officials.”<sup>11</sup>

***He May Not Walk Like a Mandarin or Talk Like a Mandarin, But He’s Still a “Foreign Official”***

Second, and perhaps the most unusual feature of China for these purposes, is the continued prominence of “state-owned enterprises” or “SOEs”—government-owned and -managed companies that, despite years of privatizations, still make up a large part of the economy. The dominant corporate players in many important industries—*e.g.*, banking, steel, telcoms—remain state-owned. More and more of these SOEs are listed on China’s capital markets or in New York, Hong Kong, or London. Nevertheless, the controlling interest in these companies invariably remains in state hands. U.S. authorities consider SOEs and similar parastatal organizations to be state “instrumentalities” for FCPA purposes, and their officers and employees to be “foreign officials.”<sup>12</sup>

It is often difficult for U.S. companies dealing with commercial customers and suppliers in China to remember that the employees of these companies are “government officials” for purposes of U.S. (and Chinese<sup>13</sup>) law. The difficulty is compounded by the ambivalent roles played by the employees as their companies evolve from traditional, state-owned dinosaurs into more modern, internationalized businesses. The typical officer of an SOE today often looks and acts like any other international businessman. He (or she) often thinks of himself as a businessman as well, in part because the government has directed that SOEs be managed on a commercial, profit-making basis. But make no mistake: The Chinese executive flying first class in an Armani suit to a meeting with officers of foreign investment

11 The anti-bribery prohibitions apply directly to any payments to “any foreign political party or official thereof.” 15 U.S.C. §§78dd-1(a)(2); 78dd-2(a)(2); 78dd-3(a)(2).

12 “Foreign official” is defined to include “any officer or employee of a foreign government ... or instrumentality thereof.” 15 U.S.C. §§78dd-1(f)(1)(A); 78dd-2(h)(2)(A); 78dd-3(f)(2)(A). *See also*, U.S. Dep’t of Justice, FCPA Review Procedure Rel. No. 93-1 (Apr. 20, 1993)(quasi-commercial entity “wholly owned and supervised by the government of a former Eastern bloc country ... is an instrumentality of the foreign government for purposes of the FCPA”).

13 Article 93 of the Criminal Law of the People’s Republic of China defines “state functionary” for purposes of the criminal bribery provisions broadly, including “all personnel of state organs” and all personnel at state-owned corporations or other commercial enterprises.

banks at an exclusive restaurant in Hong Kong or New York is, for FCPA purposes, a “foreign official.”

Senior management at all SOEs are appointed by, and answerable to, government and communist party institutions. Any doubt as to the continued applicability of these arrangements was dispelled by the Zhang Enzhao case.<sup>14</sup> Zhang was the Chairman of China Construction Bank (CCB), one of China’s “big four” state-owned banks. In 2004, Grace & Digital Information Technology, a Chinese company, sued Fidelity Information Services, Inc., a U.S. company, in a California state court, alleging that Fidelity had bribed Zhang through an aide to cause CCB to cancel a contract with Grace and switch the business to Fidelity. Grace alleged that Fidelity had violated the FCPA. The California lawsuit was later dismissed. Grace then refiled its claims in March 2006 in a lawsuit in the United States District Court for the Middle District of Florida. Fidelity has acknowledged in public statements that it has discussed these issues with U.S. authorities but has denied any wrongdoing.<sup>15</sup>

An issue that immediately arose was whether the FCPA applied at all, specifically, whether Zhang, as the chairman of a commercial bank soon to be listed on the NYSE, was a “foreign official.” Zhang, by all reports, was the very model of a modern international executive. The alleged bribes included, in addition to cash, such perquisites as golf weekends at Pebble Beach and trips to Europe for family members. Chinese authorities promptly laid this issue to rest by firing and replacing Zhang and then prosecuting him under the anti-bribery laws applicable to government officials in China.

Similar issues arise for many U.S. companies in China doing business with major SOEs. Their counterparts may walk and talk like international businessmen, but for FCPA purposes they are government officials.

### ***Doctors as “Officials”***

China’s healthcare sector presents a similar but distinct problem. China’s hospitals and medical laboratories are nearly all government-

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<sup>14</sup> Zhang’s conviction is reported, and the background of the case described, in *N.Y. Times*, Dec. 1, 2006, Sec. C, p. 6. The Chinese criminal court proceedings named I.B.M., Hitachi, and NCR as having made payments to Zhang through the intermediary. Oddly, the Chinese proceedings did not mention Fidelity even though the case had been widely publicized and apparently precipitated the investigation.

<sup>15</sup> The company that allegedly committed the violations, Fidelity Information Services, Inc., was a subsidiary of Alltel at the time and operated under the name Alltel Information Services. Between the events in question and the filing of the litigation, it was acquired by Fidelity National Financial Services and renamed Fidelity Information Services. Procedural details and developments may be found in Fidelity National Financial Services’ SEC filings.

owned, and the doctors and other healthcare professionals who run these institutions and make most decisions on purchases of pharmaceuticals and medical equipment are government employees.

The healthcare sector in China has long been notoriously underfunded and healthcare professionals notoriously underpaid. One result has been an institutionalization of corruption. For many years, Chinese authorities implicitly condoned a system of kickbacks in the healthcare industry in order to provide medical professionals with supplementary income that served as an inducement for them to remain with public institutions. Companies, domestic and foreign, engaged in the sale of pharmaceuticals or medical equipment frequently encountered demands for kickbacks on product sales, and it was widely understood that government authorities would look the other way.

These practices received extensive publicity in 2005, when Diagnostic Products Corporation (“DPC”), a NYSE-listed company headquartered in California, entered into a deferred prosecution agreement with the DOJ and a related settlement with the SEC. DPC admitted that its wholly owned Chinese subsidiary had paid kickbacks in most of its medical equipment sales in China over a 10-year period. DPC paid nearly \$5 million in fines, including disgorgement of its China profits for the entire 10-year period plus interest.<sup>16</sup> More recently, AGA Medical Corporation was fined \$2 million primarily for similar payments to Chinese doctors to persuade them to purchase AGA products.<sup>17</sup> These cases were widely publicized in both the U.S. and the Chinese press.

Perhaps in part as a result of the negative publicity arising out of these cases, the Chinese government has undertaken a series of aggressive actions to crack down on corruption in this sector.<sup>18</sup> How vigorously these measures will be enforced remains to be seen. Reform of the healthcare sector appears to be a political priority in China and, if effective, would be very popular. It is less clear, however, that Chinese authorities have taken effective measures to remedy the underlying causes of the corruption—the inadequate salaries of government-employed doctors and hospital administrators.

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16 See note 5, *supra*.

17 See note 5, *supra*.

18 See, e.g., Ministry of Health, *Provisions on Establishing Blacklists of Commercial Bribery in Sales and Purchases of Drugs*, Wei Zheng Fa Fa (No. 2007-28)(Jan. 19, 2007); Ministry of Health & State Administration of Traditional Chinese Medicine, *Opinions Guiding Investigation and Punishment of Commercial Bribery in the Public Health Industry* (July 10, 2006).

### ***A Difference of Character as Well as Scale***

Because SOE officers and directors, virtually all medical professionals, and a legion of Chinese bureaucrats qualify as “foreign officials” for FCPA purposes, the entire range of FCPA concerns applies to a much broader range of business contacts in China than elsewhere. A payment in another country with comparable corruption problems, *e.g.*, India, may constitute a commercial bribe with its own legal risks and ethical considerations. The same payment in China is a bribe of a “foreign official”—and hence a *potential criminal violation of U.S. law*. Similarly, entertainment and gift-giving policies that may be appropriate for private business partners in other countries must in China be weighed in the light of the more restrictive FCPA standards applicable to entertainment of and gifts to foreign government officials. In short, the unusual number and frequency of interactions with “officials” in China both magnify and alter the character of FCPA risks there.

### **USE OF INTERMEDIARIES IN CHINA**

Congress was well aware when it enacted the FCPA that companies or individuals might seek to do indirectly what they were prohibited from doing directly. The FCPA therefore proscribes, in addition to direct payments to foreign officials, payments to “any person, while knowing that all or a portion of such [payment] will be ... given, *directly or indirectly*, to any foreign official” (emphasis added) for corrupt purposes.<sup>19</sup> The key, of course, is determining what constitutes “knowing” that an intermediary will make an improper payment to an official. The statute addresses this issue with a lengthy, though still far from clear, definition that includes actual knowledge and further provides that “knowledge is established if a person is aware of a high probability” that the intermediary will make the improper payment.<sup>20</sup>

The use of intermediaries in China poses two specific and distinctive challenges.

#### ***The Need for the Right Guanxi***

Consultants and lobbyists exist in many forms around the world but perform similar functions: obtaining an audience with the right

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<sup>19</sup> 15 U.S.C. §§78dd-1(a)(3); dd-2(a)(3); dd-3(a)(3).

<sup>20</sup> *Id.*, §§ 78dd-1(f)(2); 78dd-2(h)(3); 78dd-3(f)(3).

government decision makers and assisting their client in persuading the decision makers that their client's cause is meritorious. The risk is that this legitimate function can all too easily devolve into serving as a conduit for a payment to the official as part of the necessary "persuasion."

Joint venture partners present similar risks. It is natural for a U.S. company to allow its local partner to handle local government relationships since the partner can be expected to have pre-existing contacts and market knowledge (indeed, these may be important assets that it is bringing to the venture), and language and cultural factors will make it easier for the local partner to deal with officials on common ground. But these relationships present FCPA risks since the local partner will, in effect, be acting as the U.S. company's agent.

The problems associated with the use of intermediaries are particularly acute in China, which has made the use of middlemen a way of life. Thousands of foreign businessmen know only two expressions in Mandarin: *Nin hao?* (Hello, or How are you?) and *guanxi*—"connections." With the right *guanxi* all things are possible; without them, life in China can be difficult indeed. If a foreign company is not already well-established in a locale with direct relationships with the officials in question, the use of local partners or other intermediaries to supply necessary *guanxi* may, therefore, be unavoidable in many circumstances.

The activities of intermediaries are, however, unusually opaque to foreign businessmen in China. Language and cultural differences often make it difficult to be certain of the intermediary's relationships with the officials or to be confident that the U.S. party is able to control the intermediary's actions on its behalf.

### ***Local Distributors: Independent Businessmen or Bagmen?***

Many foreign businesses in China also use local distributors. Until quite recently, this was unavoidable. Chinese law reserved to Chinese companies the rights both to import most foreign goods and to distribute products in the Chinese market. China has recently loosened these restrictions in accordance with its WTO undertakings. Nevertheless, many foreign companies continue to use local distributors in China for the same reasons that distributors are used elsewhere: they have effective commercial networks and logistics resources that are difficult for foreign companies to replicate; and they are prepared to assume the risk of being able to resell the products in the local market and to manage local accounts, including local credit risks.

Many U.S. companies long thought that using distributors, rather than agents, in China also provided an effective insulation from FCPA risks. The distributor, by definition, is an independent third party buying and reselling products for its own account. As a matter of contract law, the U.S. company completes its own sale when the distributor has taken title. Any payments to government end-users to induce them subsequently to purchase the products from the distributor are the distributor's problem. Press accounts suggest that some U.S. companies in China have sought to exploit this situation, in some cases by engaging the distributor for the specific purpose of making payments that would be FCPA violations, in others by turning a blind eye to payments they knew or suspected were being made—the proverbial “head in the sand” approach.

The *InVision Technologies* case disabused U.S. companies of the expectation that the use of independent distributors provided them with insulation from FCPA risks. In late 2004, InVision settled claims by the DOJ and the SEC based in part on claims that InVision had knowledge of a “high probability” that its independent distributors were bribing government officials in China, Thailand, and the Philippines to purchase InVision products.<sup>21</sup> InVision agreed to pay approximately two million dollars in fines.

As a result, U.S. companies using distributors in China now face a quandary. *InVision* makes clear that they can no longer encourage or turn a blind eye to payments by their distributors. At the same time, however, the distributors are independent third parties who are not readily subject to the U.S. suppliers' control and may understandably resist it in many cases.

### ***Due Diligence and Tough Contracts***

Including appropriate FCPA controls in relationships with third parties is particularly difficult in China. The statutory standard is actual knowledge or “knowledge” of a “high probability” that the third party will make improper payments in order to sell the U.S. company's products. Exactly when this “high probability” can be said to exist is, like so many FCPA issues, subject to interpretation and disagreement. Under these circumstances, U.S. companies typically take two basic precautions.

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21 See, SEC Litigation Rel. No. 19078 (Feb. 14, 2005); U.S. Dep't of Justice, Press Rel. 04-780 (Dec. 6, 2004). Most of the payments for which AGA was recently fined were apparently also made by an independent distributor. See, *U.S. vs. AGA Medical Corporation*, U.S.D.C. Minn. (No. CR-08-172JMR), Deferred Prosecution Agreement, June 3, 2008, Att. A, Statement of Facts.

First and foremost is due diligence. “Know your partner” is good advice under all circumstances. Contrary to the expectations of many U.S. companies, it is often—not always, but often—possible to obtain a broad range of information on prospective joint venture partners, consultants, distributors, and other third parties in China. A number of local and foreign-owned companies will provide these investigative services. There is, to be sure, a cost and sometimes a delay, but if a potentially serious problem is uncovered and avoided, the time and expense may be more than justified. Further, if a problem does arise later, having conducted reasonable due diligence may be an important defense against claims that the U.S. company itself should be held liable for its agent’s or distributor’s actions.

Secondly, U.S. companies need to pay close attention to the terms of their agreements with third parties in China. These obviously vary from one context to another. It is typically not difficult, however, to insist that Chinese parties provide contractual undertakings that they will abide by all applicable anti-corruption laws and will not cause the U.S. company to violate the FCPA. (The FCPA does not apply to the Chinese parties themselves, who can be expected to object to any suggestion that they should be contractually required to follow it.) A violation of this undertaking should be a ground for termination. A U.S. company should be highly skeptical of entering into contractual relationships with third parties in China that refuse to provide such undertakings.

In some circumstances, it will also be possible to obtain audit rights as to the third parties’ accounts. Joint venture partners and some distributors, for example, may be willing to provide such rights. In other cases, however, third parties may well resist in principle a foreign company’s attempts to look at its books. In many cases in China, this may not be a realistic safeguard in any event since the accuracy of Chinese companies’ books and records is often doubtful.

## **ENTERTAINING THE BUREAUCRACY**

### ***Shark’s Fin and Bear’s Paw***

The Chinese style of doing business also presents unusual challenges for U.S. companies seeking to comply with FCPA requirements. Entertainment of government officials and business counterparts is common everywhere. But few societies make dining and related social activities such a central feature of doing business. In China, some government officials refuse to meet except over a meal. Others conduct

only the most perfunctory functions in their offices, reserving the real discussions and negotiations for the restaurant. This preference for entertainment is not confined to bureaucrats. Many Chinese businessmen, including employees of SOEs, also seem more comfortable negotiating over *maotai* at the dinner table than in a boardroom with the latest audio-visual aids.

All of this is fair enough. Foreign businessmen in China need to follow Chinese practices. And the FCPA permits “reasonable and bona fide” business-related entertainment.<sup>22</sup> But Chinese social relationships and dining habits present particular challenges.

There is, first, the well-known issue of “face”—the need to recognize in a demonstrable way the other party’s dignity and importance. A cheap meal, however delicious (and many are in China), will not do. “Face” can only be given with some degree of lavishness. Second, and closely related, is the Chinese culinary preference for the indigestible but nevertheless very expensive parts of rare, if not endangered, species. As a result, it is not uncommon for the foreign businessman to find himself giving a Chinese official or SOE employee the necessary “face” by ordering courses of shark’s fin, abalone, bear’s paw, and the like—or, in some cases, finding that the official is ordering such dishes on his own and adding them to the bill.

Similar issues are raised by Chinese gift-giving practices. At Chinese New Year or the Mid-Autumn Festival, tradition requires that businesses present gifts to their business contacts and government officials alike, and the recent prosperity in China has inflated expectations as to what level of gifts is appropriate. Equally challenging are cultural expectations for gifts on the occasion of, for example, the hospitalization of an official, a child’s college graduation, or a child’s wedding. In some cases (*e.g.*, weddings) it is expected that the gift will be made in cash presented in “red envelopes” (*hongbao*). Chinese society finely calibrates the appropriate value or amount of such gifts according to the giver’s status and means. A senior businessman may be expected to provide a gift well outside his company’s normal gift-giving policies.

These widespread local customs and practices in China run headlong into U.S. Government admonitions that entertainment and gifts that are “excessively lavish” will not be deemed to come within the FCPA’s “reasonable and bona fide promotional expenses” defense.

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22 See, 15 U.S.C. §§78dd-1(c)(2), §§78dd-2(c)(2), 78dd-3(c)(2).

Despite repeated requests from U.S. companies and their counsel, U.S. agencies have refused to provide specific guidelines for the level of “lavishness” that will trigger potential criminal liability. U.S. companies are thus left guessing what level of entertainment will be sufficiently lavish for Chinese “face” purposes but not so lavish as to take the expenditure out of the range of the “reasonable and bona fide” promotional expenses defense.

The FCPA’s “local law defense” also offers uncertain protection in China. Under the FCPA it is an affirmative defense to an otherwise improper payment if it can be shown that the payment is lawful under the written laws of the official’s government.<sup>23</sup> In China, government regulations and communist party guidelines prohibit officials from accepting “any gift that might affect [the official’s] impartial exercise of a public function.”<sup>24</sup> These regulations and guidelines also require that officials surrender gifts valued at more than RMB 200 (\$23) each or RMB 600 (\$70) from a single source each year.<sup>25</sup> These criteria may provide a limited FCPA local law safe harbor for gifts, but there are no bright-line Chinese standards for entertainment expenses.

### **“Take Me to Las Vegas!”**

Chinese officials have a healthy appetite for travel as well. In the earlier years of China’s economic development, this reflected the unique travel opportunities that their positions gave them after years of Chinese isolation. Many, too, realized that they and their agencies or companies could benefit from foreign training and meetings, and many foreign governments and companies were happy to oblige, recognizing that a more internationalized Chinese bureaucracy and business community served everyone’s interests.

These legitimate interests in travel have, however, frequently been abused. It has long been common for delegations of Chinese bureaucrats or SOE employees to demand that their travels include side trips, at their hosts’ expense, to major tourist destinations. For many years

23 15 U.S.C. §§ 78dd-1(c)(1), 78dd-2(c)(1), 78dd-3(c)(1).

24 See, *Regulations Prohibiting State Administrative Agencies and Their Personnel from Presenting or Accepting Gifts in Performing Public Functions* (Dec. 1, 1988); *Provisional Regulations regarding Administrative Sanctions for State Administrative Personnel Who Commit Corruption and Bribery* (Sept. 13, 1988); Central Committee of the Communist Party of China, *Provisional Regulations on Internal Supervision* (Dec. 31, 2003), *idem.*, *Regulations on Disciplinary Penalties* (Dec. 31, 2003).

25 State Council Government Offices Administration and Communist Party of China Central Committee Government Offices Administration, *Measures concerning Registration and Disposal of Gifts Accepted or Received from Contacts in China by Personnel of Central Party and Government Agencies* (Sept. 2, 1995).

Disneyland was the destination of choice. More recently, Las Vegas seems to have supplanted Disneyland. Given the opportunity, many officials would, of course, be happy to combine the two. Such trips are plainly something “of value” under the FCPA and, if provided to Chinese officials, may violate the criminal anti-bribery provisions of the Act.

In December 2007, Lucent was fined \$1 million by the U.S. Department of Justice for providing hundreds of such trips to Chinese officials in 2000–03 period. Lucent was also fined \$1.5 million by the SEC for failing to record these payments properly on Lucent’s books.<sup>26</sup>

Chinese authorities have tried to curb these practices. In November 2006, the Ministry of Finance issued *Administrative Measures on Central State Agencies’ and Institutions’ Travel Expenses*.<sup>27</sup> Among other things, the *Measures* prohibit officials at central government ministries and agencies from accepting third-party payments for their official travel and accommodation, and prescribe strict limits for Chinese government reimbursements for travel and accommodation. Provincial and local governments may follow suit. Perhaps these measures are having an effect. One hears reports of officials on recent trips insisting on paying their own transportation and accommodation costs. Nevertheless, the propensity of Chinese officials to seek to add tourist side trips to their business trips is so widespread that it is difficult to imagine the practice going away any time soon.

### **T&E Policies**

U.S. companies spend an inordinate amount of time and anxiety (and often legal fees as well) trying to determine what levels of expenditure in these areas, and what kinds of procedural and approval controls, will effectively limit FCPA risks.

Practice varies considerably on gift and entertainment policies, according to the industry in question and individual companies’ appetite for risk. Most commonly, companies try to identify the likely costs of a “reasonable” meal in major Chinese cities and authorize their management and sales employees to entertain officials up to those limits without further authorization. Bright-line tests like this are easy to administer, provide employees with a range of comfort, and present only limited risks that employees will not follow them. The exact thresholds vary: entertaining the directors of a leading state

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<sup>26</sup> See note 5, *supra*.

<sup>27</sup> Min. of Finance (No. 2006-313), issued Nov. 13, 2006, effective Jan. 1, 2007.

bank, petroleum company, or steel company in Beijing is, after all, quite different from entertaining city officials near a widget factory in Qinghai. “Adult entertainment” is always banned. Most U.S. companies try to limit gift-giving to company products of nominal value or to gifts of nominal value with a company logo. Some also permit reasonably priced traditional local gifts—*e.g.*, the moon cakes that are given at the Mid-Autumn festival. Exceptions to these policies are sometimes authorized, with higher level approval for unusual cases—*e.g.*, the once-in-a-decade visit of a central government minister to a company plant or the expected wedding gift to a senior official’s child.

Travel sponsorships also require strict standards and a high level of vigilance. Local employees can all too easily yield to demands of this kind by officials or state-owned customers whose decisions can make or break their business in China. To guard against these risks, U.S. companies typically: require pre-approval of trip itineraries by senior management or counsel; place strict limitations on the class of travel (economy for all but very senior officials), and standards of accommodation and meals (*e.g.*, three-star not five); and limit tourism to local activities necessary to satisfy requirements of courtesy and hospitality (*e.g.*, a half-day bus or auto tour of nearby attractions rather than the side trip to Las Vegas or Disneyland).

## **THE “BLOWBACK” RISK**

For years Chinese authorities seemed to pay little attention to possible transgressions of China’s anti-bribery laws by foreign companies. There were few, if any, reports of prosecutions. The widespread publicity resulting from U.S. press reports of FCPA violations by U.S. companies in China may have changed this.

Chinese journalists have promptly broadcast throughout China U.S. news reports concerning FCPA violations by foreign companies in China. These reports are frequently followed by editorials asking why their own government is not investigating and prosecuting corrupt acts that, after all, occurred in China and presumably violated Chinese anti-bribery laws as well. The result: U.S. companies that have just negotiated an end to a long, expensive, and troublesome FCPA investigation find themselves confronting possible Chinese investigations of the same offenses—typically under circumstances where the U.S. companies have already effectively acknowledged guilt in their settlements in the U.S.

This was precisely the situation that DPC faced in the wake of its deferred prosecution agreement with the DOJ and its settlement

with the SEC in May 2005.<sup>28</sup> As far as we know, no Chinese agency prosecuted DPC, perhaps feeling that the company had been sufficiently penalized by its own government. The Chinese agencies were interested, rather, in the recipients of DPC's payments. These investigations were both understandable and unobjectionable but were inevitably an intrusion on the company's normal business, as well as a significant additional expense. Other U.S. companies may expect, at the very least, similar problems and costs if their FCPA violations in China become public. If the Chinese authorities decide to pursue them, some may also face the risk of a second round of criminal charges, this time in an inhospitable Chinese legal environment.

## **LIVING WITH THE FCPA IN CHINA**

### ***A Compliance Program***

Some of the measures that U.S. companies adopt in dealing with FCPA problems in China are set out above: active supervision of agents and other intermediaries; aggressive due diligence on agents and partners; appropriate contractual undertakings; and strict travel and entertainment policies. In addition, most U.S. companies apply the elements of their general FCPA compliance programs to China: written guidelines; frequent training; whistleblower procedures; rigorous financial controls to ensure that company policies are being followed and accounts are maintained accurately; and vigorous investigations of credible allegations of violations. Such FCPA compliance measures have been widely discussed in many publications.<sup>29</sup> I will focus here only on specific features of these measures that are unique to China.

### ***Making Sure the Employees "Get It"***

Corporate compliance policies and guidance must be translated into Chinese in order to have an effective compliance program, and care must, of course, be taken that the translator is sufficiently familiar with the subject matter to use accurate terminology. Chinese can present especially difficult translation issues, but there are certainly translation services that can achieve satisfactory results. It is much more difficult, however, to ensure that Chinese employees understand what is actually expected of them.

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<sup>28</sup> See note 5, *supra*.

<sup>29</sup> See, e.g., Deming, *op. cit.*, at 350 *et seq.*

The basic concept—don't pay bribes—is simple enough and readily understood and accepted by Chinese employees. The nuances of FCPA policies, however, are often alien to the Chinese business environment: When are gifts to officials that are generally accepted as appropriate in China inappropriate under the FCPA? Can a quite typical Chinese dinner with an officer at an SOE really result in criminal penalties for the company in the U.S.? How exactly are we supposed to control our local agents and distributors, who are accustomed to doing business in their own way in their own country? What am I supposed to do if a government official implies, but does not clearly state, that he is looking for a kickback? Or if a distributor implies, but does not clearly state, that he is paying kickbacks to sell our products? The answers to these and many similar questions are not always self-evident, and a one-hour lecture by U.S. counsel using a translator will not generally suffice to answer them. The presentation should involve lawyers—U.S. or Chinese—conversant in Mandarin and familiar with both the FCPA's often vague requirements and the Chinese business environment. Ideally, it should also be a two-way discussion, with the employees encouraged to discuss the issues that they encounter in their daily business. Any other approach involves a serious risk that the employees will not act as expected when they are confronted with actual problems.

### ***Investigations***

FCPA investigations everywhere are difficult for the companies concerned. They require sequestration of potentially relevant files, imaging and search of hard drives, interviews of employees and management on many levels, and, as a result, a significant disruption of the company's business. Where the actions of specific managers or employees are called into question, the investigation may also erode the internal trust that is vital to the effective functioning of a business unit.

These problems are typically magnified in China by cultural and language barriers. The logistical problems of searching both hard drives and hard copy files in Chinese can be daunting. Conducting interviews with managers and employees who speak only Chinese or, if they speak English, are understandably uncomfortable being interviewed in English, presents additional challenges. Nuances are often lost in translation—a trite observation but nevertheless important consideration.

The cultural issues may be even more challenging. The company must, of course, pursue the investigation sufficiently vigorously to ensure that any violations have been identified. The allegations or suspicions, however, may be entirely unjustified, and Chinese managers and employees will understandably be upset to have their integrity questioned when they themselves know they have done nothing wrong. Questions and procedures that U.S. employees might find annoying, Chinese employees may find highly insulting. Sometimes, moreover, the principal suspect of any wrongdoing is the head of the China office. That individual's cooperation may be necessary to conduct the investigation effectively. His or her continued employment may also be critical to the company's success in China, at least in the short run. Any investigation must take all of these factors into consideration. There are no easy solutions to the dilemmas they pose.

### **AN UNEVEN AND SHIFTING PLAYING FIELD**

U.S. companies have long complained that the FCPA creates an uneven playing field: U.S. companies must, under threat of U.S. criminal prosecution, refrain from making payments to obtain business abroad that their local or European or Japanese competitors provide without risk and without compunction. Exactly how much business is lost as a result is disputed. Many U.S. companies claim it is substantial.

To some extent this has been and remains the case in China. Many companies report that their local competitors skirt anti-bribery laws and routinely ignore limitations on entertainment of officials that are rarely, if ever, enforced. Foreign competitors too often seem happy to "follow local customs" in the expectation that they face few legal risks either locally or in their home jurisdictions.

This uneven competitive landscape may be changing, though how rapidly is unclear. Reducing corruption is an important goal of China's leadership, and the Chinese government has introduced a number of aggressive measures in recent years intended to achieve this result. Highly publicized arrests and convictions of senior officials, including the communist party secretary of Shanghai and many of his cronies, are undoubtedly intended not only as punishments to the transgressors but as warnings to others. And, after decades of foot dragging, most OECD countries have entered into treaties requiring them to adopt measures similar to those of the FCPA. Recent investigations of Statoil in Norway and Siemens and Daimler-Benz in Germany suggest that at least some of these countries may be taking these obligations seriously.

There is no evidence that any European or Japanese investigations involve activities of their companies in China, but those companies must at least be aware at this point that there is some risk. The playing field, therefore, may still be uneven, but it may no longer be so tilted as in the past.