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## FCPA COMPLIANCE IN CHINA AND THE GIFTS AND HOSPITALITY CHALLENGE

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## INTRODUCTION

ON the fifteenth day of the eighth lunar month (usually around late September or early October), the Chinese celebrate the Moon Festival by exchanging mooncakes.<sup>1</sup> Mooncakes are small, traditional Chinese pastries that can contain a variety of different sweet or savory fillings, anything from red bean paste to duck eggs.<sup>2</sup> But, in twenty-first-century China, virtually no one actually *eats* mooncakes anymore; instead, “[t]he moon cakes’ modern role is to be given away, and not only to your friends.”<sup>3</sup> For this reason, mooncakes may now come in elaborate packaging containing expensive tea leaves, mobile phones, and even gold coins.<sup>4</sup> Businesspeople in China buy hundreds of boxes of mooncakes every year and hand them out as part of the Moon Festival celebration.<sup>5</sup> In doing so, they expose themselves to legal risk—both under local anti-bribery laws and, in the case of many foreign businesspeople, under the U.S. Foreign Corrupt Practices Act (“FCPA”).<sup>6</sup> Just this past year, the head of a construction company in Hong Kong received a two-month prison sentence for violating that city’s strict anti-bribery laws by presenting fifteen boxes of mooncakes to local police

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1. MAY-LEE CHAI & WINBERG CHAI, CHINA A TO Z 93 (2007); Louisa Lim, *Corruption Fears Over China Mooncakes*, BBC NEWS, Sept. 28, 2004, available at <http://news.bbc.co.uk/2/hi/asia-pacific/3695916.stm>. The moon festival (also called the “Mid Autumn Festival”) dates back to the Tang Dynasty, and celebrates the brightest full moon of the year. *Big Trouble in Little China*, BUSINESS TODAY, Oct. 12, 2003.
  2. CHAI & CHAI, *supra* note 1, at 93.
  3. KAI STRITTMATTER, CHINA A TO Z 161 (2006).
  4. *See id.*
  5. WrageBlog: Anti-Bribery Compliance Blog, <http://wrageblog.org/2009/10/07/its-mooncake-time-again> (Oct. 7, 2009, 09:47 EST).
  6. 15 U.S.C. § 78dd-1 et seq. (2006).

officers.<sup>7</sup> It did not matter that the police officers returned the boxes of mooncakes uneaten later that day.<sup>8</sup>

Presenting mooncakes as gifts is just one common facet of a Chinese business culture that values the provision of gifts, meals, and entertainment. In China, building relationships, or *guanxi*, drives successful business development.<sup>9</sup> These necessary relationships grow out of the exchange of favors and gifts, including meals and entertainment.<sup>10</sup> Although not necessarily impermissible, these sorts of benefits, common in Chinese business, pose a serious corruption risk and serve to exacerbate what is already a very challenging anti-corruption compliance environment for foreign businesses in China.<sup>11</sup>

This Article discusses the anti-corruption enforcement trends confronting business practices in China, addresses the legal risks posed by the Chinese gift and hospitality culture, and presents suggestions for structuring corporate anti-corruption compliance programs to mitigate these risks. To contextualize law enforcement's current focus on bribery and other economic crime in China, Part I provides an introduction to the country's pervasive corruption climate, with a brief summary of recent enforcement actions by both Chinese and U.S. authorities. Turning to the problem of business courtesies, Part II provides background on the unique Chinese gift-giving culture and briefly discusses the FCPA, exploring within the statute's anti-bribery framework the issue of business courtesy expenditures. Finally, Part III gives advice on how to tailor the gifts and hospitality component of an organization's compliance program to address this risk in China.

## I. THE UPHILL FIGHT AGAINST CORRUPTION IN CHINA

Before discussing the specific problem of gifts and entertainment in Chinese business culture, it is important to understand the prevalence of

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7. *Id.* Under Hong Kong law, "it is an offense to offer any benefit to an employee of the government . . . where there are 'dealings of any kind', even if the dealings are not ongoing, but only anticipated." *Id.* The prosecution need not prove corrupt intent because intent is presumed if there are dealings and a benefit or gift, of any value, is presented. *Id.*

8. *Id.*

9. CHAI & CHAI, *supra* note 1, at 113–14, 126–27.

10. Nicole Y. 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).

11. See 15 U.S.C. §§ 78m 78dd-1, 78dd-2, 78dd-3, 78ff (2006).

corruption in China and the amplified vigor with which Chinese and U.S. authorities enforce their anti-bribery statutes. It is in this increasingly treacherous environment that multinational corporations must develop policies and procedures to mitigate the risk of becoming ensnared in corruption probes.

In January 2008, Hu Jintao, president of the People's Republic of China, delivered a keynote speech to a meeting of the Chinese Communist Party's Central Commission for Discipline Inspection in which he pledged to step up the country's anti-corruption efforts. "Anti-corruption measures and the upholding of integrity should run thoroughly through the nation's economic, political and cultural makeup and the Party's ideological, organizational, work style and institutional building," Hu said.<sup>12</sup> Hu's comments reflect how corruption has become an issue of increasing concern for the Chinese Communist Party's leadership—corruption has caused public resentment and social unrest, and has been blamed for several of the country's high-profile problems, including poor enforcement of food and product safety standards, as well as lax monitoring of workplace and infrastructure safety regulations.<sup>13</sup> Minxin Pei, a senior associate at the Carnegie Endowment for International Peace has estimated that corruption accounts for approximately 3% of mainland China's gross domestic product.<sup>14</sup> Moreover, China routinely finds itself listed among the world's most challenging business environments. China ranked 79th on Transparency International's 2009 Corruption Perceptions Index, below such countries as Brazil, Colombia, and Ghana.<sup>15</sup>

Unfortunately for the Party leadership, effectively curbing corruption in China is a daunting task, in part because of historical Chinese cultural attitudes toward business relationships, or *guanxi*, and quid pro quo gift

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12. Consulate General of the People's Republic of China in Capetown, President Hu Pledges to Intensify Anti-Graft Battle in China, <http://capetown.china-consulate.org/eng/xwdt/t400372.htm> (last visited Mar. 23, 2010).

13. Ben Blanchard, *China to Target Corrupt Officials' Lovers*, REUTERS, Aug. 26, 2008, <http://uk.reuters.com/article/idUKPEK2013620080826>; see also *Chinese Premier Vows to Fight Corruption of Government Officials*, XINHUA NEWS AGENCY, Mar. 25, 2008 (discussing execution of Zheng Xiaoyu, former head of China's Food and Drug Administration, for accepting bribes to approve medicines that later proved harmful to patients); *Top Officials Charged In Fatal China Mine Accident*, AGENCE FRANCE PRESSE, Jan. 21, 2010 (discussing vice mayor and deputy police chief charged with taking bribes to turn a blind eye to dangerous mine conditions that resulted in an accident that killed 277 people).

14. Bill Salvadore, *Corruption—The Ugly Side of the Economic Reform Boom*, SOUTH CHINA MORNING POST, Dec. 15, 2008, at 8.

15. TRANSPARENCY INTERNATIONAL, 2009 CORRUPTION PERCEPTIONS INDEX, [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2009/cpi\\_2009\\_table](http://www.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table).

giving. The Chinese approach toward business transactions greatly values personal relationships and requires a certain level of gift exchange that may strike many Westerners as inappropriate.<sup>16</sup> Some commentators have suggested that this corruption arose as a result of the transition from communism to capitalism—corruption helped “grease the wheels of commerce.”<sup>17</sup> Further complicating enforcement efforts is the fact that the modern Chinese political infrastructure rests upon a culture of corruption. Beijing has limited ability to crack down on pervasive corruption without losing the support of the police and other lower-level party officials who enforce the central government’s policies and who often regard their positions of limited local power as license to steal.<sup>18</sup> Indeed, despite increased enforcement efforts, the reality is that the Chinese government is losing the battle against corruption.<sup>19</sup>

*Oriental Outlook* magazine vividly illustrated the pervasiveness of China’s culture of public corruption by publishing a diary kept by two Hunan entrepreneurs who attempted to open a fireworks business.<sup>20</sup> The diary chronicles the many payments for gifts, dinners, and entertainment that the two men had to make over eight months in order to secure permits and licenses for their nascent business.<sup>21</sup> In the end, the entrepreneurs had spent over 300,000 yuan (about \$44,000) on gifts and hospitality—nearly every day they treated officials to dinner, paid them cash, or presented gifts such as cigarettes, alcohol, and dried tofu.<sup>22</sup> In March, only four days had no record of gift or entertainment expenses.<sup>23</sup>

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16. Fred Burton & Scott Stewart, *Crossing the Cultural Divide*, BUSINESS SPECTATOR, Jan. 19, 2008, <http://www.businessspectator.com.au/bs.nsf/Article/Crossing-the-cultural-divide-AWUGN?OpenDocument>.
  17. Shaun Rein, *How To Deal With Corruption In China*, FORBES, Oct. 7, 2009, <http://www.forbes.com/2009/10/07/china-corruption-bribes-leadership-managing-rein.html>.
  18. Mark Magnier, *Bribery and Graft Taint Every Facet of Life in China; Those Who Dare to Speak Out Sometimes Pay a Heavy Price*, L.A. TIMES, Dec. 29, 2008, at A1.
  19. See The FCPA Blog, <http://www.fcpablog.com/blog/2010/1/12/china-the-year-in-graft.html> (Jan. 11, 2010, 05:08 EST).
  20. Huang Zhijie, *The Gift Diary of a Small, Private Company*, ORIENTAL OUTLOOK, Nov. 28, 2007, available at [http://www.danwei.org/business/what\\_it\\_takes\\_to\\_register\\_a\\_bu.php](http://www.danwei.org/business/what_it_takes_to_register_a_bu.php).
  21. *Id.*
  22. *Id.* Conversions in this Article were calculated on June 1, 2010 using Google Finance Currency Converter, <http://www.google.com/finance/converter>.
  23. *Id.*

### A. Chinese Efforts to Curb Corruption

Despite these challenges, Chinese authorities are increasingly enforcing laws punishing corruption in business and government. Between 2003 and 2008, China convicted more than 120,000 people for corruption-related crimes.<sup>24</sup> This figure marked a nearly 12% increase from the previous five-year period.<sup>25</sup> Notably, of the 120,000 convicted, 4,525 were government officials above the county level, a 78% increase from the previous five years.<sup>26</sup> The Chinese Communist Party has also ratcheted up disciplinary efforts. Its Central Commission for Discipline Inspection reported that, from July 2003 to December 2008, it punished 2,386 Party officials above the prefectural level.<sup>27</sup> Chinese authorities also aggressively enforce commercial bribery statutes. China prosecuted 6,227 cases of domestic commercial bribery involving 1.65 billion yuan (about \$242 million) in 2008, which marked a small decline from 2007, in which authorities handled 7,450 cases of commercial bribery involving 2.12 billion yuan (about \$310 million).<sup>28</sup> In the largely government-owned banking sector, an extensive audit, completed in January 2008, revealed 445 cases of irregularities or misconduct, involving nearly 860 billion yuan (about \$126 billion), and led to the termination of 177 bank managers.<sup>29</sup>

Whether these eye-popping figures—all released by the government and largely unverifiable—reveal amplified enforcement, increased corruption, stepped-up public relations efforts, or a combination of these is impossible to determine, but it is clear that the Chinese government continues to roll out new initiatives in its fight against corruption. In June 2009, the country launched a new national hotline available to whistleblowers seeking to report corrupt officials anonymously.<sup>30</sup> In July 2009, the Central Party Committee released new regulations intended to strengthen anti-corruption powers and

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24. See Salvadove, *supra* note 14, at 8.

25. *Id.*

26. *Id.*

27. *CPC Releases Officials' Accountability Regulation to Curb Corruption*, XINHUA NEWS AGENCY, July 12, 2009, [http://news.xinhuanet.com/english/2009-07/12/content\\_11696767.htm](http://news.xinhuanet.com/english/2009-07/12/content_11696767.htm).

28. *China Busts 6,200 Briberies*, ASIAONE NEWS, Feb. 23, 2009, <http://www.asiaone.com/News/Latest%2BNews/Asia/Story/A1Story20090223-124030.html>.

29. *China Finds \$118 US Billion in Misconduct at State Banks*, ASSOCIATED PRESS BUS. WIRE, Apr. 19, 2008.

30. *Line Puts Justice Just One Phone Call Away*, FIN. TIMES, June 23, 2009.

to promote the accountability of government officials and state-owned enterprise leaders.<sup>31</sup>

Although these anti-corruption initiatives may impact the largest number of businesses and individuals, the increased prosecution of senior government officials is undeniably the most visible aspect of the Chinese corruption crackdown. In addition to the thousands of low-level officials who have been prosecuted, numerous high-profile officials have faced prosecution, imprisonment, and even execution in recent years. A sampling of these includes the following:

- Zheng Xiaoyu, the former director of China's State Food and Drug Administration, was executed in July 2007 for accepting 6.49 million yuan (about \$951,000) in bribes in return for approving medicines, some of which later proved harmful to patients.<sup>32</sup>
- China's top Internet surveillance tsar, Yu Bing, who directed the Internet monitoring department of Beijing's Public Security Bureau, was arrested in February 2009 on charges that he had accepted 40 million yuan (about \$5.86 million) in bribes in exchange for helping an anti-virus software company frame a rival.<sup>33</sup>
- In August 2008, Tang Ruoxin, the former head of China's credit insurer, the China Export and Credit Insurance Corporation, was arrested for taking bribes in exchange for providing credit guarantees to unfit companies that later defaulted on their loans.<sup>34</sup>
- After his arrest in January 2009, the former vice chairman of China's Securities Regulatory Commission and a former vice president of China Development Bank, Wang Yi, confessed to accepting bribes exceeding 10 million yuan (about \$1.5 million) in exchange for issuing bank loans to entrepreneurs engaged in

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31. See *CPC Releases Officials' Accountability Regulation to Curb Corruption*, *supra* note 27.

32. *Chinese Premier Vows to Fight Corruption of Government Officials*, XINHUA NEWS AGENCY, Mar. 25, 2008, <http://au.china-embassy.org/eng/xw/t418320.htm>.

33. Clifford Coonan, *Chinese Internet Surveillance Tsar Arrested for Graft*, THE IRISH TIMES, Feb. 21, 2009, at 11, available at <http://www.irishtimes.com/newspaper/world/2009/0221/1224241589801.html>.

34. Jaime Florcruz, *Former Top Chinese Official Arrested*, CNN, Feb. 6, 2009, <http://edition.cnn.com/2009/WORLD/asiapcf/02/06/china.corruption/index.html>.

illegal activities. He also admitted that while serving as a securities regulator he offered improper assistance to companies listing themselves on various Chinese mainland securities markets.<sup>35</sup>

- The former chairman of the oil refining giant Sinopec, Chen Tonghai, pleaded guilty in July 2009 to accepting 28.7 million yuan (about \$4.2 million) in bribes in exchange for helping associates with land transfers and the awarding of contracts.<sup>36</sup>
- A top nuclear power official, Kang Rixin, who served as general manager of state-owned China National Nuclear Corporation, was fired in August 2009 after accusations surfaced that he accepted bribes in exchange for granting an eight-billion-euro construction contract to a French nuclear power company.<sup>37</sup>
- Li Peiying, the former chairman of a large state-owned airport holding company, who had been in charge of running thirty of the nation's larger airports—including Beijing's international airport—was executed in August 2009 after being convicted of embezzling \$12.1 million from the company and accepting \$3.9 million in personal bribes.<sup>38</sup>
- The prominent mayor of Shenzhen, Xu Zhongzheng, was arrested in June 2009 for taking numerous bribes and kickbacks in connection with assorted land deals in Shenzhen.<sup>39</sup>

The most high-profile official to be convicted of corruption in recent years is Chen Liangyu, former Communist Party chief of Shanghai, who was also a member of China's powerful twenty-four-seat Politburo. Chen received an eighteen-year prison sentence in April 2008 on charges that he was at the center of a massive scheme that plundered \$400 million from the Shanghai city pension fund. Pilfered funds allegedly went toward real estate

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35. Li Xinran, *Ex-financier Faces Trial Over Bribery Charges*, SHANGHAI DAILY, Feb. 4, 2010, [http://www.shanghaidaily.com/sp/article/2010/201002/20100204/article\\_427868.htm](http://www.shanghaidaily.com/sp/article/2010/201002/20100204/article_427868.htm).

36. Mark McDonald, *Beijing Court Convicts Ex-Sinopec Chief of Bribery*, N.Y. TIMES, July 16, 2009, <http://www.nytimes.com/2009/07/16/business/global/16sinopec.html>.

37. *China Sacks Nuclear Chief Over Grafi Probe*, AGENCE FRANCE PRESSE, Aug. 14, 2009.

38. Michael Wines & Mark McDonald, *China Executes Former Chairman of Airport; Was Convicted of Corruption Charges*, BOSTON GLOBE, Aug. 8, 2009, at 4.

39. *China Names Replacement for Sacked Shenzhen Mayor: Report*, ASIAONE, Jun. 12, 2009, <http://www.asiaone.com/News/Latest%2BNews/Asia/Story/A1Story20090612-148145.html>.

investments, illicit loans, and helping businessmen buy stakes in state-owned companies. More than twenty-five local officials were dismissed or arrested in connection with the scandal.<sup>40</sup> Also ensnared in the pension scandal was Shanghai tycoon Zhang Rongkun, the sixteenth-wealthiest individual in China, who was sentenced to nineteen years in prison for his role in bribery, share price manipulation, financial fraud, and misuse of public funds.<sup>41</sup>

The Shanghai pension fund scandal is an example of how Chinese law enforcement's corruption crackdown is not itself necessarily immune from misuse or favoritism. For instance, several analysts have questioned whether political tensions between Chen and other top party leaders spurred the investigation that ultimately led to Chen's downfall.<sup>42</sup> Further, Chinese authorities unsurprisingly censor stories of corruption that they worry could embarrass the regime. A prominent example of this practice is the corruption scandal involving Nuctech Company Limited, a Chinese technology company until recently headed by Hu Haifeng, the son of President Hu. Namibian authorities accused the company of paying kickbacks to a Namibian front company as part of a deal to supply security checkpoint scanners.<sup>43</sup> Though Hu was not accused of any wrongdoing, Chinese authorities blocked the case from Internet searches in China, and two prominent Chinese news outlets temporarily shut down their news websites after publishing a story on the Nuctech matter.<sup>44</sup> Any discussion of Chinese domestic corruption prosecutions should bear the caveat that it is impossible for outside observers to determine the fairness of the legal proceedings, the existence of selective prosecution, or the possibility that the prosecution was motivated by a need to address a political problem.

Unsurprisingly, Chinese authorities have focused their prosecutorial efforts on China's own public officials, while U.S. prosecutors enforcing the FCPA—discussed at greater length below—concentrate on the supply side by targeting Western companies that offer bribes to government officials. In a handful of instances, however, China has prosecuted foreign nationals and corporations for paying bribes in its country. The most notable example of this is China's recent detention and prosecution of four employees of the

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40. Cara Anna, *Ex-Shanghai Communist Party Boss Gets 18 Years for Corruption Related to City Pension Fund*, ASSOCIATED PRESS FIN. WIRE, Apr. 11, 2008.

41. *Id.*

42. See McDonald, *supra* note 36.

43. Sharon LaFraniere & John Grobler, *Namibians Say Inquiry on China Will Expand*, N.Y. TIMES, Aug. 1, 2009, at A4.

44. Rowan Callick, *Namibia Suspends Credit for Hu Firm*, THE AUSTRALIAN, July 23, 2009, at 8.

Australian mining company Rio Tinto. China originally accused the four Rio Tinto employees of espionage, but those charges were reduced to allegations of commercial bribery and stealing trade secrets stemming from Rio Tinto's negotiations with Chinese officials over iron ore prices.<sup>45</sup> The Rio Tinto employees were tried in Shanghai, pleaded guilty to charges of accepting bribes, and were sentenced to between seven and fourteen years in prison.<sup>46</sup> Although the matter implies a subtext that extends well beyond the claims that Rio Tinto bribed officials at all five of China's large steel companies, the case has worried foreign companies operating in China.<sup>47</sup>

Despite a recent study finding that 64% of the corruption cases investigated by Chinese authorities in the past decade involved foreign companies,<sup>48</sup> actual prosecution of foreign nationals and corporations has been sporadic and politically motivated. In early 2007, a corruption probe in Shanghai implicated employees from several American companies, including McDonald's, McKinsey, and Whirlpool.<sup>49</sup> In April 2009, the chief manager of McDonald's in Hong Kong was convicted of accepting \$323,000 in bribes in exchange for granting a corn supplier preferential treatment.<sup>50</sup> Notably, Chinese authorities did not prosecute McDonald's. Chen Tao, a lawyer on the Criminal Law Committee of the Beijing Bar Association, observed at the time that foreign companies enjoy relaxed corruption oversight: "Authorities appear more cautious and will decline to give harsh punishments, for fear that their international image could be tarnished."<sup>51</sup> Indeed, when a former head of the China Construction Bank received a fifteen-year prison sentence in 2006 for accepting over \$500,000 in bribes, court documents suggested that Hitachi, IBM, and NCR had all paid bribes to the bank through an

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45. David Barboza, *4 on Rio Tinto's China Staff Won't Face Spying Charge*, N.Y. TIMES, Aug. 13, 2009, at A6; David Barboza, *China Indicts Rio Tinto Staff on Bribery Charges*, N.Y. TIMES, Feb. 10, 2010.

46. David Barboza, *At Mining Trial in China, Door Closes Tighter*, N.Y. TIMES, Mar. 24, 2010, at A9; David Barboza, *China Court Hands Down Stiff Sentences to Four Mining Company Employees*, N.Y. TIMES, Mar. 30, 2010, at A4.

47. David Barboza, *Rio Tinto Gave Bribes to Many, China Says*, N.Y. TIMES, July 16, 2009, at A4.

48. See Yu Tianyu, *Multinationals Have Thrived in 'Loose Policy Environments'*, CHINA DAILY, Aug. 20, 2009.

49. David Barboza, *Shanghai Bribery Inquiry Ensnarers Big Firms*, N.Y. TIMES, Jan. 19, 2007, <http://www.nytimes.com/2007/01/19/business/worldbusiness/20bribecnd.html>.

50. Sophie Leung and James Peng, *McDonald's Fires Hong Kong Head After Conviction*, BLOOMBERG, Apr. 16, 2009.

51. Kang Juan, *Harsber Corporate Penalties Urged in Bribery Cases*, GLOBAL TIMES, Aug. 11, 2009, <http://china.globaltimes.cn/diplomacy/2009-08/456252.html>.

intermediary. Chinese authorities did not prosecute these companies.<sup>52</sup> Recently, however, Sinopec, a prominent Chinese oil company, called upon the Chinese government to crack down on multinational corporations paying bribes in China—this came in the wake of the Rio Tinto prosecutions and FCPA actions brought by U.S. regulators against Daimler AG for bribes paid in China (and other countries).<sup>53</sup>

## B. The American Angle

Multinational corporations conducting business in China should take little comfort from any evidence of Beijing's current reluctance to prosecute foreign companies for bribery. Although foreign corporations may not face rigorous scrutiny from Chinese authorities, bribery of non-U.S. government officials places them at great risk under U.S. law. The FCPA, enacted in 1977,<sup>54</sup> prohibits, among other things, corruptly providing money, gifts, or anything else of value to foreign officials for the purpose of obtaining or retaining business.<sup>55</sup> This prohibition applies to all U.S. companies, as well as non-U.S. companies that have securities registered on U.S. exchanges. Considering the pervasiveness of corruption and the degree to which China's business culture accepts some level of gift giving and reciprocal exchange of favors as perfectly acceptable, ensuring that non-Chinese companies operating in China comply with the FCPA requires constant diligence. Exacerbating this anti-corruption compliance challenge is the daily arrival of Western companies, hastily accessing the booming Chinese economy, that are eager to please their new Chinese customers.<sup>56</sup>

The FCPA's anti-bribery provisions only apply to things of value offered or given to "foreign officials." But the definition of "foreign official" is significantly broader than what many would expect. It includes

any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public

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52. See Barboza, *supra* note 49.

53. Patti Waldmeir & Peter Smith, *Sinopec urges curb on "corrupt" foreigners*, FIN. TIMES, Mar. 26, 2010.

54. Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended at 15 U.S.C. §§ 78dd-1 et seq.).

55. 15 U.S.C. § 78dd-1(a) (2006).

56. See David Barboza, *Telecom Company to Pay \$3 Million in China Bribe Case*, N.Y. TIMES, Jan. 2, 2010, at B2.

international organization, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organization.<sup>57</sup>

Recent FCPA enforcement actions in China, discussed in more detail below, show how U.S. authorities have liberally interpreted who qualifies as a foreign official. For example, physicians working at state-owned hospitals qualify as government officials under the FCPA.<sup>58</sup> Recently, AGA Medical was charged with making corrupt payments to physicians at state-owned hospitals in China so that the hospitals would purchase its medical devices.<sup>59</sup> Diagnostic Products Corp. faced FCPA charges for similar conduct.<sup>60</sup> Employees at state-owned oil companies and steel companies also qualify as “foreign officials.” In 2009, Control Components, Inc. (“CCI”) pleaded guilty to violating the FCPA’s anti-bribery provisions by making corrupt payments to employees at the China National Offshore Oil Company.<sup>61</sup> Similarly, Schnitzer Steel Industries and its South Korean subsidiary ran afoul of the FCPA when they made corrupt payments to employees of government-owned steel mills in South Korea and China.<sup>62</sup> Journalists in China may also be considered “foreign officials.” In a 2008 opinion procedure release, the U.S. Department of Justice (“DOJ”) assumed that journalists working for state-run media outlets in China fall under the FCPA’s definition of “foreign official.”<sup>63</sup>

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57. 15 U.S.C. §§ 78dd-1(f)(1)(A), 78dd-2(h)(2)(A), 78dd-3(f)(2)(A) (2006).

58. See *AGA Medical Corporation Agrees to Pay \$2 Million Penalty and Enter Deferred Prosecution Agreement for FCPA Violations*, DOJ Press Release (June 3, 2008), available at <http://www.justice.gov/archive/opa/pr/2008/June/08-crm-491.html>.

59. *Id.*

60. *In re Diagnostic Products Corp.*, Securities Exchange Act of 1934 Release No. 51724 (May 20, 2005), available at <http://www.sec.gov/litigation/admin/34-51724.pdf>; *DPC (Tianjin) Ltd. Charged with Violating the Foreign Corrupt Practices Act*, DOJ Press Release (May 20, 2005), available at [http://www.justice.gov/archive/opa/pr/2005/May/05\\_crm\\_282.htm](http://www.justice.gov/archive/opa/pr/2005/May/05_crm_282.htm).

61. *Control Components Inc. Pleads Guilty to Foreign Bribery Charges and Agrees to Pay \$18.2 Million Criminal Fine*, DOJ Press Release (July 31, 2009), available at <http://www.justice.gov/opa/pr/2009/July/09-crm-754.html>.

62. *In re Schnitzer Steel Indus., Inc.*, Securities Exchange Act of 1934 Release No. 54606 (Oct. 16, 2006), available at <http://www.sec.gov/litigation/admin/2006/34-54606.pdf>; Jaymes Song, *Schnitzer Steel Industries Inc.’s Subsidiary Pleads Guilty to Foreign Bribes, Agrees to \$7.5 Million Criminal Fine; Parent Company Enters into Deferred Prosecution Agreement Following Exceptional Cooperation with Justice Dept.*, U.S. NEWSWIRE, Oct. 16, 2006.

63. U.S. Department of Justice, FCPA Opinion Procedure Release 08-03 (July 11, 2008), available at <http://www.justice.gov/criminal/fraud/fcpa/opinion/2008/0803.html>.

The Chinese government's broad ownership and control of commercial enterprises qualifies a significant percentage of the country's workforce as "foreign officials" under the FCPA, which magnifies U.S. companies' compliance challenges. Indeed, the Chinese government is thought to own more than 70% of the country's productive wealth, and it is the majority shareholder of 31% of publicly listed companies.<sup>64</sup> According to one observer, the Chinese government "wields power through the allocation of massive state resources and effective control of large-scale SOEs (state-owned enterprises), which continue to dominate key sectors of the economy."<sup>65</sup> The state also controls major banks. In total, state-owned and state-held enterprises account for approximately one half of all urban investment in fixed assets.<sup>66</sup> The central government exercises control over these enterprises through the State-Owned Assets Supervision and Administration Commission ("SASAC").<sup>67</sup> SASAC has authority over nearly 150 enterprises, including China's five large electricity conglomerates.<sup>68</sup> In 2007, the SASAC enterprises earned approximately one trillion yuan, which is about 4% of the Chinese GDP.<sup>69</sup>

Companies operating in China can face FCPA liability for more than bribery of those who qualify as "foreign officials." In addition to its anti-bribery provisions, the FCPA contains accounting provisions to ensure that companies keep accurate books and records, and maintain a system of internal controls designed to prevent improper payments.<sup>70</sup> Unlike the anti-bribery provisions, which also apply broadly to individuals and entities doing business in the United States, the accounting provisions apply only to issuers of securities that trade on U.S. exchanges. The books-and-records provision requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions

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64. Zwihiu Chen, *Privatisation Would Enrich China*, FIN. TIMES, Aug. 7, 2008; Lihui Tian & Saul Estrin, *Retained State Shareholding in Chinese PLCs: Does Government Ownership Reduce Corporate Value?*, Institute for the Study of Labor Discussion Paper No. 1493, Feb. 2005, at 1.

65. Lynn Walsh, *China's Hybrid Economy*, SOCIALISM TODAY, Oct. 2008, available at <http://www.socialismtoday.org/122/hybrid.html>.

66. *Id.*

67. *Id.*

68. *See id.*; see also Barry Naughton, *SASAC and Rising Corporate Power In China*, China Leadership Monitor No. 24 (Spring 2008).

69. Barry Naughton, *SASAC and Rising Corporate Power In China*, China Leadership Monitor No. 24 (Spring 2008).

70. 15 U.S.C. § 78m(b)(2)(A)-(B) (2006).

of the assets of the issuer.”<sup>71</sup> The internal controls provision requires issuers to “devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances” that (1) transactions are authorized by management; (2) transactions are recorded in a way that facilitates the preparation of financial statements and that maintains accountability for assets; (3) access to assets is authorized by management; and (4) recorded assets are compared periodically to existing assets and appropriate action is taken with respect to differences.<sup>72</sup>

The accounting provisions allow the government to prosecute companies under the FCPA without having to show actual bribery. For example, as discussed further below, the U.S. Securities and Exchange Commission (“SEC”) brought civil actions against Avery Dennison Corp., ITT Corp., and Lucent Technologies, alleging that these companies violated the books-and-records and internal controls provisions in relation to their business in China.<sup>73</sup> Lucent Technologies was also charged with bribery by the DOJ, but ITT Corp. and Avery Dennison Corp. faced only SEC enforcement actions.<sup>74</sup> Each company paid significant civil penalties in its settlement with the SEC. In addition, the SEC can enforce the FCPA’s accounting provisions against a company engaged in purely commercial bribery, where no “foreign official” is even involved. Schnitzer Steel Industries, Inc., was alleged to have paid bribes to *privately* owned steel mills in China and South Korea to induce the mills to purchase its scrap metal.<sup>75</sup> The SEC alleged that this conduct violated the accounting provisions of the FCPA.<sup>76</sup>

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71. *Id.* § 78m(b)(2)(A).

72. *Id.* § 78m(b)(2)(B).

73. *Lucent Technologies Inc. Agrees to Pay \$1 Million Fine to Resolve FCPA Allegations*, DOJ Press Release (Dec. 21, 2007), available at [http://www.justice.gov/archive/opa/pr/2007/December/07\\_crm\\_1028.html](http://www.justice.gov/archive/opa/pr/2007/December/07_crm_1028.html); *SEC Files Settled Charges Against Avery Dennison Corporation for Violating the Books and Records and Internal Controls Provisions of the Foreign Corrupt Practices Act*, SEC Litigation Release No. 21156 (July 28, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr21156.htm>; *SEC Files Settled Charges Against ITT Corporation for Violations of the Books and Records and Internal Controls Provisions of the Foreign Corrupt Practices Act*, SEC Litigation Release No. 20896 (Feb. 11, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr20896.htm>.

74. *SEC Files Settled Charges Against Avery Dennison Corporation for Violating the Books and Records and Internal Controls Provisions of the Foreign Corrupt Practices Act*, SEC Litigation Release No. 21156 (July 28, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr21156.htm>.

75. *In re Schnitzer Steel Indus., Inc.*, Securities Exchange Act of 1934 Release No. 54606 (Oct. 16, 2006), available at <http://www.sec.gov/litigation/admin/2006/34-54606.pdf>.

76. *Id.* Schnitzer also faced bribery charges stemming from corrupt payments made to government-owned steel mills in the same countries. *Id.*

Additionally, the SEC does not need to show any corrupt intent to bring enforcement actions against companies for violating the books-and-records provision. Although criminal liability can only be imposed on issuers or persons that “knowingly” violate the books-and-records provision,<sup>77</sup> there is no analogous intent requirement for civil enforcement. For example, the SEC asserted that Dow Chemical Co. had violated the books-and-records provision by failing to record accurately improper payments made to foreign officials by its subsidiary, even though the payments were made without knowledge or approval of any Dow employee.<sup>78</sup>

Companies operating in China that are engaged in corruption can also face U.S. criminal liability under other federal statutes, such as the Travel Act.<sup>79</sup> In July 2009, CCI pleaded guilty to violating *both* the FCPA and the Travel Act.<sup>80</sup> The DOJ charged CCI with violating the Travel Act by making corrupt payments totaling \$1.95 million to officers and employees of state-owned *and privately owned* companies in China and other countries.<sup>81</sup> Because the FCPA’s anti-bribery provisions only reach payments made to government officials, the DOJ brought criminal charges for payments made to nongovernmental players by incorporating California’s commercial bribery statute into the Travel Act. The Travel Act makes it unlawful to travel in interstate or foreign commerce or use the mails with the intent to promote or facilitate unlawful activity—here, the unlawful activity was commercial bribery in violation of California state law.<sup>82</sup> In addition, U.S. authorities have brought charges for wire fraud when the facts of a particular case do not involve bribes of actual “foreign officials,” as in the case of several U.N. Oil for Food Program-related prosecutions. In May 2009, healthcare company Novo Nordisk A/S was charged with conspiracy (1) to violate the FCPA’s

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77. 15 U.S.C. § 78m(b)(4)–(5) (2006) (imposing criminal liability for an issuer that “knowingly falsif[ies] any book, record, or account”).

78. *In re Dow Chemical Co.*, Securities Exchange Act of 1934 Release No. 55281 (Feb. 13, 2007), available at <http://www.sec.gov/litigation/admin/2007/34-55281.pdf>.

79. 18 U.S.C. § 1952 (2006).

80. *Control Components Inc. Pleads Guilty to Foreign Bribery Charges and Agrees to Pay \$18.2 Million Criminal Fine*, DOJ Press Release (July 31, 2009), available at <http://www.justice.gov/opa/pr/2009/July/09-crm-754.html>.

81. *Id.*

82. *United States v. Control Components, Inc.*, Criminal Information, No. 09-cr-00162, at 2 (C.D. Cal. July 22, 2009).

books-and-records provision, and (2) to commit wire fraud.<sup>83</sup> Novo Nordisk was accused of making improper payments to the Iraqi government (as opposed to “foreign officials”) to obtain contracts to sell insulin and other medicines to the Iraqi Ministry of Health.<sup>84</sup> Similarly, AGCO Corp. was charged with conspiracy to violate the books-and-records provision of the FCPA and to commit wire fraud based on payments made by its subsidiaries to the Iraqi government to obtain contracts for its agricultural products with the Iraqi Ministry of Agriculture.<sup>85</sup> These cases highlight how U.S. prosecutors have aggressively pursued alternative theories of liability to punish corporate malfeasance when the actual facts of the case do not permit an FCPA anti-bribery prosecution.

### 1. Recent History of FCPA Prosecutions Involving China

The DOJ and SEC have dramatically increased the number of FCPA cases brought in recent years. Whereas in 2004 the DOJ and SEC brought a combined total of only five FCPA actions, they brought thirty-three actions in 2008, and forty actions in 2009.<sup>86</sup> According to Mark Mendelsohn, Deputy Chief of the DOJ’s Criminal Fraud Division, at least 120 companies are under investigation for potential FCPA violations as of November 2009.<sup>87</sup> Since 2002, twenty-seven FCPA actions have involved corporate activities in China; thirteen of these actions targeted individuals. A complete list of the companies and the total penalties incurred is as follows:

<u>InVision Technologies (a subsidiary of General Electric) (2004)</u> .....	\$1,889,000
From 1996 to 2002, InVision’s sales agents and distributors made payments to foreign officials to induce them to purchase InVision’s baggage screening equipment for airports in China, Philippines, and	

83. *Novo Nordisk Agrees to Pay \$9 Million Fine in Connection with Payment of \$1.4 Million in Kickbacks Through the United Nations Oil-For-Food Program*, DOJ Press Release (May 11, 2009), available at [http://www.justice.gov/criminal/pr/press\\_releases/2009/05/05-11-09novo-guilty.pdf](http://www.justice.gov/criminal/pr/press_releases/2009/05/05-11-09novo-guilty.pdf).

84. *Id.*

85. *AGCO Corp. to Pay \$1.6 Million in Connection With Payments to the Former Iraqi Government Under the U.N. Oil-For-Food Program*, DOJ Press Release (Sept. 30, 2009), available at [http://www.justice.gov/criminal/pr/press\\_releases/2009/09/09-30-09agco-penalty.pdf](http://www.justice.gov/criminal/pr/press_releases/2009/09/09-30-09agco-penalty.pdf).

86. Gibson, Dunn & Crutcher, 2009 Year-End FCPA Update (Jan. 4, 2009), <http://www.gibsondunn.com/publications/pages/2009Year-EndFCPAUpdate.aspx>.

87. Dionne Searcey, *U.S. Cracks Down on Corporate Bribes*, WALL ST. J., May 26, 2009, at A1.

Thailand. InVision was charged with violating the anti-bribery, books-and-records, and internal controls provisions of the FCPA. In a non-prosecution agreement, InVision agreed to pay a fine of \$800,000 to the DOJ, and in a settlement agreement with the SEC, it agreed to pay \$559,000 in disgorgement and a \$500,000 civil penalty.<sup>88</sup>

Diagnostic Products Corp. (“DPC”) (2005).....\$4,800,000  
DPC’s Chinese subsidiary made payments to hospital physicians and officials in order to obtain business from the hospitals. DPC pleaded guilty to violating the anti-bribery provisions of the FCPA and agreed to pay a \$2 million fine as part of its plea agreement with the DOJ. The SEC’s cease-and-desist order found that DPC had violated the anti-bribery, books-and-records, and internal controls provisions of the FCPA. In that action, DPC agreed to pay approximately \$2 million in disgorgement and \$800,000 in prejudgment interest.<sup>89</sup>

Schnitzer Steel Industries, Inc. (2006) .....\$15,200,000  
From 1995 to 2004, Schnitzer’s South Korean subsidiary made payments to private companies in South Korea and private companies and government officials in China to induce them to purchase scrap metal. In May 2004, after Schnitzer’s compliance department uncovered the payments, company executives authorized Schnitzer employees to increase the entertainment expenses they paid for the employees of government- and privately owned customers, in lieu of cash payments. According to the SEC order, the gifts that Schnitzer provided included \$10,000 gift certificates and a \$2,400 watch. The Korean subsidiary pleaded guilty to violations of the anti-bribery and books-and-records provisions and paid a \$7.5 million penalty, and Schnitzer entered into a deferred prosecution

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88. *SEC Settles Charges Against InVision Technologies for \$1.1 Million for Violations of the Foreign Corrupt Practices Act*, SEC Litigation Release No. 19078 (Feb. 14, 2005), available at <http://www.sec.gov/litigation/litreleases/lr19078.htm>; *InVision Technologies Inc. Enters into Agreement with the United States*, DOJ Press Release (Dec. 6, 2004), available at [http://www.justice.gov/opa/pr/2004/December/04\\_crm\\_780.htm](http://www.justice.gov/opa/pr/2004/December/04_crm_780.htm).

89. *In re Diagnostic Products Corp.*, Securities Exchange Act of 1934 Release No. 51724 (May 20, 2005), available at <http://www.sec.gov/litigation/admin/34-51724.pdf>; *DPC (Tianjin) Ltd. Charged with Violating the Foreign Corrupt Practices Act*, DOJ Press Release (May 20, 2005), available at [http://www.justice.gov/opa/pr/2005/May/05\\_crm\\_282.htm](http://www.justice.gov/opa/pr/2005/May/05_crm_282.htm).

agreement with the DOJ. In the SEC proceeding, Schnitzer consented to a cease-and-desist order and agreed to pay disgorgement and prejudgment interest totaling \$7.7 million.<sup>90</sup>

Paradigm BV (2007).....\$1,000,000  
Paradigm employees and agents made improper payments to government officials in China, Indonesia, Kazakhstan, Mexico, and Nigeria from 2002 to 2007 to sell geological software to oil and gas companies. In China, Paradigm’s subsidiary used an agent to make payments to a subsidiary of the China National Offshore Oil Company in connection with the sale of software; it also retained oil and gas employees to test its software and paid them in cash for their services, hoping their companies would then purchase the software. Paradigm also paid for sightseeing trips for Chinese state oil and gas company officials. These customer “training” trips included paying for hotels, meals, airfare, sightseeing, and entertainment, as well as providing cash per diems and cash for the officials to shop. Further, Paradigm failed to document these expenses adequately. It was charged with violating the anti-bribery and books-and-records provisions of the FCPA, and it entered into a non-prosecution agreement with the DOJ, agreeing to pay a \$1 million fine.<sup>91</sup>

York International (2007) .....\$22,000,000  
In the criminal action, York was charged with violating the books-and-records provision of the FCPA by paying kickbacks, through its subsidiaries, to the Iraqi government through the Oil for Food Program in connection with contracts for work in Bahrain, Egypt,

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90. *In re Schnitzer Steel Indus., Inc.*, Securities Exchange Act of 1934 Release No. 54606 (Oct. 16, 2006), available at <http://www.sec.gov/litigation/admin/2006/34-54606.pdf>; Jaymes Song, *Schnitzer Steel Industries Inc.’s Subsidiary Pleads Guilty To Foreign Bribes, Agrees to \$7.5 Million Criminal Fine; Parent Company Enters Into Deferred Prosecution Agreement Following Exceptional Cooperation with Justice Dept.*, US NEWSWIRE, Oct. 16, 2006; see also *Schnitzer Steel Indus., Inc., Deferred Prosecution Agreement* (Oct. 16, 2006), available at <http://judiciary.house.gov/hearings/pdf/deferredprosecution/Schnitzer061016.pdf>.

91. Press Release, U.S. Department of Justice, *Paradigm B.V. Agrees to Pay \$1 Million Penalty to Resolve Foreign Bribery Issues in Multiple Countries* (Sept. 24, 2007), available at [http://www.justice.gov/opa/pr/2007/September/07\\_crm\\_751.html](http://www.justice.gov/opa/pr/2007/September/07_crm_751.html); Press Release, U.S. Department of Justice, *Paradigm B.V. Non-Prosecution Agreement* (Sept. 21, 2007), available at [http://www.usdoj.gov/criminal/pr/press\\_releases/2007/09/09-21-07paradigm-agreement\\_0.pdf](http://www.usdoj.gov/criminal/pr/press_releases/2007/09/09-21-07paradigm-agreement_0.pdf).

India, Turkey, and the United Arab Emirates. York entered into a deferred prosecution agreement with the DOJ and agreed to cooperate with the DOJ's Oil for Food investigations and pay a \$10 million penalty.<sup>92</sup> In the SEC action, York consented to the filing of a civil complaint and agreed to pay \$2 million in civil penalties and \$10 million in disgorgement in connection with contracts for which its subsidiaries paid kickbacks to the Iraqi government and made improper payments to government officials in other countries, including China. The SEC alleged that York violated the anti-bribery and books-and-records provisions of the FCPA.<sup>93</sup>

Lucent Technologies (2007) .....\$2,500,000  
 From 2000 to 2003, Lucent paid for expenses (including per diems) for 315 trips to the United States and other benefits for Chinese government officials who were the employees of Chinese state-owned or state-controlled telecommunications enterprises. Some trips were characterized as “factory inspections” or “training” in the contracts with the government customers, although they usually involved little of either, focusing instead on sightseeing in major U.S. cities or at the Grand Canyon, Disneyland, or Universal Studios. Lucent improperly booked these expenses as business trips. It was charged with violating the anti-bribery, books-and-records, and internal controls provisions of the FCPA—it entered into a non-prosecution agreement with the DOJ, agreeing to pay a \$1 million fine. Lucent also consented to a cease-and-desist order in the SEC proceeding and agreed to pay a \$1.5 million civil penalty.<sup>94</sup>

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92. Press Release, U.S. Department of Justice, *Justice Department Agrees to Defer Prosecution of York International Corporation In Connection With Payment of Kickbacks Under the U.N. Oil For Food Program* (Oct. 1, 2007), available at [http://www.usdoj.gov/criminal/pr/press\\_releases/2007/10/10-01-07york-defer.pdf](http://www.usdoj.gov/criminal/pr/press_releases/2007/10/10-01-07york-defer.pdf).
93. Litigation Release, U.S. Securities and Exchange Commission, *SEC Files Settled Foreign Corrupt Practices Act Charges Against York International Corporation For Improper Payments to UAE Officials, to Iraq Under the U.N. Oil for Food Program, and to Others—Company Agrees to Pay Over \$12 Million and to Retain an Independent Compliance Monitor*, No. 20319 (Oct. 1, 2007), available at <http://www.sec.gov/litigation/litreleases/2007/lr20319.htm>.
94. Press Release, U.S. Department of Justice, *Lucent Technologies Inc. Agrees to Pay \$1 Million Fine to Resolve FCPA Allegations* (Dec. 21, 2007), available at [http://www.justice.gov/opa/pr/2007/December/07\\_crm\\_1028.html](http://www.justice.gov/opa/pr/2007/December/07_crm_1028.html); Complaint, *SEC v. Lucent Techs. Inc.* (D.D.C. 2007), available at <http://www.sec.gov/litigation/complaints/2007/comp20414.pdf>.

AGA Medical (2008).....\$2,000,000  
 Between 1997 and 2005, AGA made corrupt payments to physicians at state-owned hospitals in China to induce the purchase of its medical devices. Also, between 2000 and 2002, AGA made payments through a distributor to officials at China's State Intellectual Property Office to obtain patent approvals. The DOJ charged AGA with violating the FCPA's anti-bribery provisions, and AGA entered into a deferred prosecution agreement with the DOJ, agreeing to pay a \$2 million penalty.<sup>95</sup>

Faro Technologies (2008) .....\$2,950,000  
 In 2004 and 2005, Faro's Chinese subsidiary made corrupt payments to Chinese government officials to obtain sales contracts for its portable computerized measurement devices and manufacturing software. The DOJ charged Faro with violating the anti-bribery, books-and-records, and internal controls provisions of the FCPA. Faro entered into a deferred prosecution agreement with the DOJ and agreed to pay a \$1.1 million fine. The SEC entered a cease-and-desist order under which Faro was required to pay disgorgement and prejudgment interest totaling approximately \$1.85 million.<sup>96</sup>

Siemens Aktiengesellschaft (2008) ..... \$800,000,000  
 In the criminal action, Siemens AG and several of its subsidiaries were charged with violating the FCPA's internal controls and books-and-records provisions by allowing corrupt payments to be made to win business in multiple countries. Siemens AG pleaded guilty to violating the FCPA's books-and-records and internal controls provisions—it and its subsidiaries agreed to pay a \$450 million fine. In the civil action, Siemens AG agreed to disgorge \$350 million in profits. The SEC alleged that Siemens made corrupt payments across many of its business units in many different countries, including China. The China projects included the design and construction of metro trains and signaling devices, the design and

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95. Press Release, U.S. Department of Justice, *AGA Medical Corporation Agrees to Pay \$2 Million Penalty and Enter Deferred Prosecution Agreement for FCPA Violations* (June 3, 2008), available at <http://www.justice.gov/opa/pr/2008/June/08-crm-491.html>.

96. Press Release, U.S. Department of Justice, *Faro Technologies Inc. Agrees to Pay \$1.1 Million Penalty and Enter Non-Prosecution Agreement for FCPA Violations* (June 5, 2008), available at <http://www.justice.gov/opa/pr/2008/June/08-crm-505.html>.

construction of high-voltage transmission lines, and the sale of medical equipment (the marketing of which involved lavish “study trips” to Las Vegas, Miami, and other U.S. vacation spots for Chinese physicians employed by state-owned hospitals).<sup>97</sup>

ITT Corporation (2009).....\$1,678,650  
Between 2001 and 2005, ITT’s Chinese subsidiary directly and indirectly (through intermediaries) made payments to Chinese government officials to obtain contracts for the supply of its water pumps for large infrastructure projects. The SEC alleged that ITT violated the FCPA’s books-and-records and internal controls provisions. ITT consented to the entry of a final judgment and agreed to disgorge approximately \$1,428,000 and pay a \$250,000 civil penalty.<sup>98</sup>

Avery Dennison Corp. (2009).....\$518,000  
Avery’s subsidiaries in China and Indonesia made payments to local government officials. In China, Avery’s Chinese subsidiary attempted to pay government officials to obtain contracts for the sale of its reflective materials for printing and road signs. In addition to kickbacks, it also paid for expensive sightseeing trips and gifts for Chinese officials. One sightseeing trip, in late 2005, involved domestic travel for approximately forty attendees and cost about \$15,500. The Avery manager disguised his part in planning the trip by having his secretary reallocate the costs to other expense categories and obtain altered invoices from the travel agency. The SEC filed a civil action against Avery alleging violation of the FCPA’s books-and-records and internal controls provisions; it also issued an administrative order finding Avery in violation of those provisions

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97. Press Release, U.S. Department of Justice, *Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations and Agree to Pay \$450 Million in Combined Criminal Fines* (Dec. 15, 2008), available at <http://www.justice.gov/opa/pr/2008/December/08-crm-1105.html>; Complaint, *SEC v. Siemens Aktiengesellschaft*, Case No. 1 :08-cv-02167 (D.D.C. 2008), available at <http://www.sec.gov/litigation/complaints/2008/comp20829.pdf>.
98. Litigation Release, U.S. Securities and Exchange Commission, *SEC Files Settled Charges Against ITT Corporation for Violations of the Books and Records and Internal Controls Provisions of the Foreign Corrupt Practices Act*, No. 20896 (Feb. 11, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr20896.htm>.

and ordering it to pay approximately \$318,000 in disgorgement. In the civil action, Avery agreed to pay a \$200,000 penalty.<sup>99</sup>

Control Components Inc. (2009) .....\$18,200,000  
From 2003 to 2007, CCI made payments totaling \$4.9 million to customers of state-owned enterprises in China, Malaysia, South Korea, and the United Arab Emirates to obtain contracts for the sale of its control valves (used in the nuclear, oil and gas, and power generation industries). CCI also gave its customers expensive gifts and extravagant overseas sightseeing trips. CCI pleaded guilty to violating the anti-bribery provisions of the FCPA, and agreed to pay an \$18.2 million fine.<sup>100</sup>

UTStarcom Inc. (2009).....\$3,000,000  
Between 2002 and 2007, UTStarcom's Chinese subsidiary spent nearly \$7,000,000 on 225 trips for employees of government-controlled telecommunications companies to attend overseas "trainings." The so-called trainings were held in popular tourist destinations such as Hawaii, Las Vegas, and New York City, where UTStarcom had no operations. UTStarcom entered into a non-prosecution agreement with the DOJ, agreeing to pay a \$1.5 million fine. It also settled with the SEC, consenting to pay a \$1.5 million penalty.<sup>101</sup>

Daimler AG (2010)..... \$185,000,000  
Between 1998 and 2008, Daimler AG and three of its subsidiaries

99. Litigation Release, U.S. Securities and Exchange Commission, *SEC Files Settled Charges Against Avery Dennison Corporation For Violating the Books and Records and Internal Controls Provisions of the Foreign Corrupt Practices Act*, Release No. 21156 (July 28, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr21156.htm>; Complaint, *SEC v. Avery Dennison Corp.*, Case No. CV-09-5493 (C.D. Cal. 2009), available at <http://www.sec.gov/litigation/complaints/2009/comp21156.pdf>.

100. Press Release, U.S. Department of Justice, *Control Components Inc. Pleads Guilty to Foreign Bribery Charges and Agrees to Pay \$18.2 Million Criminal Fine* (July 31, 2009), available at <http://www.justice.gov/opa/pr/2009/July/09-crm-754.html>.

101. Press Release, U.S. Department of Justice, *UTStarcom Inc. Agrees to Pay \$1.5 Million Penalty for Acts of Foreign Bribery in China* (Dec. 31, 2009), available at <http://www.justice.gov/opa/pr/2009/December/09-crm-1390.html>; Litigation Release, U.S. Securities and Exchange Commission, *SEC Charges California Telecom Company With Bribery and Other FCPA Violations*, Release No. 21357 (Dec. 31, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr21357.htm>.

made hundreds of improper payments worth tens of millions of dollars to foreign officials in at least twenty-two countries, including China, to secure government contracts for the purchase of Daimler vehicles. The payments were made through a variety of means, including corporate ledger accounts called “third-party accounts,” corporate cash desks, offshore bank accounts, deceptive pricing arrangements, and third-party intermediaries.<sup>102</sup> Daimler AG’s Chinese subsidiary was charged with making over \$5.6 million in improper payments to Chinese government officials (including employees of a division of Sinopec) in the form of “commissions,” gifts, and travel.<sup>103</sup> Daimler AG and its subsidiaries were charged with violating the anti-bribery, internal controls, and books-and-records provisions of the FCPA. Daimler AG’s Russian and German subsidiaries pleaded guilty to the anti-bribery charges, and Daimler AG and its Chinese subsidiary entered into a deferred prosecution agreement with the DOJ. In total, Daimler AG and its subsidiaries agreed to pay \$93.6 million in criminal penalties. Daimler AG also settled with the SEC, consenting to pay \$91.4 million in disgorgement.<sup>104</sup>

The majority of these companies faced bribery charges, although IIT and Avery Dennison were prosecuted solely under the books-and-records provision of the statute. Siemens is by far the most staggering case in the history of FCPA enforcement in terms of the scope of the corruption and the size of the penalty imposed. For more than a decade, Siemens paid bribes to influential government officials in China, Venezuela, Argentina, Bangladesh, and other nations to obtain contracts for infrastructure projects worth billions

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102. Press Release, U.S. Department of Justice, *Daimler AG and Three Subsidiaries Resolve Foreign Corrupt Practices Act Investigation and Agree to Pay \$93.6 Million in Criminal Penalties* (Apr. 1, 2010), available at <http://www.justice.gov/opa/pr/2010/April/10-crm-360.html>.

103. Information ¶¶ 45–46, 56, *United States v. Daimler AG*, No. 10-cr-00063 (D.D.C. Mar. 22, 2010).

104. Press Release, U.S. Department of Justice, *Daimler AG and Three Subsidiaries Resolve Foreign Corrupt Practices Act Investigation and Agree to Pay \$93.6 Million in Criminal Penalties* (Apr. 1, 2010), available at <http://www.justice.gov/opa/pr/2010/April/10-crm-360.html>; Litigation Release, U.S. Securities and Exchange Commission, *SEC Charges Daimler AG With Global Bribery* (Apr. 1, 2010), available at <http://www.sec.gov/news/press/2010/2010-51.htm>.

of dollars.<sup>105</sup> One SEC official commented that “[t]he scope of the bribery scheme is astonishing, and the tone set at the top of Siemens was a corporate culture in which bribery was tolerated and even rewarded at the highest levels of the company.”<sup>106</sup> Siemens’s plight has served as warning to other companies, and as a result, many international enterprises have increased their focus on FCPA compliance and now promptly disclose potential violations voluntarily. The following are examples of companies that have come forward with possible FCPA violations in China:

- In February 2009, Morgan Stanley reported potential FCPA problems to the SEC and fired a high-ranking executive in its Shanghai real estate group.<sup>107</sup>
- RAE Systems disclosed in November 2008 that payments made and gifts given in China may have violated the FCPA. It is currently in discussion and cooperation with the DOJ and SEC.<sup>108</sup>
- Avon Products voluntarily disclosed in October 2008 that it had opened an internal investigation into possible FCPA violations in its China operations relating to travel, entertainment, and other benefits for government officials.<sup>109</sup>
- Watts Water Technologies, Inc. voluntarily disclosed in August 2009 that it had received information regarding potentially improper payments made by its Chinese subsidiary.<sup>110</sup>
- In January 2006, BearingPoint Inc. identified internal controls issues relating to its operations in China; specifically, a subcontractor may have made improper payments. Additionally, the company may have incurred impermissible gift, travel, and entertainment expenses.<sup>111</sup>

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105. Josh Meyer, *Siemens to Pay Fines in Criminal Probe; the Company Settles Corruption Charges in the U.S. and Germany for \$1.34 Billion*, L.A. TIMES, Dec. 16, 2008, at C1.

106. *Id.*

107. David Barboza, *Morgan Stanley Fires Executive in China on Suspicions of Bribery*, N.Y. TIMES, Feb. 13, 2008, at B6.

108. *RAE Systems Reports Third Quarter 2008 Results*, REUTERS, Nov. 5, 2008.

109. *Avon Statement on Voluntary Disclosure*, INT’L BUS. TIMES, Oct. 20, 2008, available at <http://www.ibtimes.com/prnews/20081020/ny-avon-disclosure.htm>.

110. Watts Water Technologies, Inc., Quarterly Report (Form 10-Q), at 22 (Aug. 7, 2009), available at [http://www.wattswater.com/\\_investors/secFilings.asp](http://www.wattswater.com/_investors/secFilings.asp).

111. Ellen McCarthy, *BearingPoint Posts Results for 2004, Details Troubles*, WASH. POST, Feb. 1, 2006, at D01.

- Alltel Corp. launched an internal investigation into travel and lump sum expenses, characterized as consulting fees, paid to China Construction Bank in 2005. Because of Alltel's disclosure, the DOJ and SEC began to investigate the matter. The DOJ closed its investigation in May 2008, but the SEC investigation is ongoing.<sup>112</sup>

## 2. Prosecutions Against Individuals

U.S. authorities also actively prosecute *individuals* for FCPA violations in connection with bribes paid in China. In 2009, Richard Morlok, the former finance director of CCI, and Mario Covino, former director of the company's worldwide sales, pleaded guilty to conspiring to bribe officials at state-owned gas, oil, and power companies in China, South Korea, and other markets around the globe.<sup>113</sup> Morlok and Covino are merely two of the CCI executives targeted by the government, as six other CCI executives, including Hong Carson, former director of sales for China and Taiwan, were charged with bribery in April 2009.<sup>114</sup>

The employees of other corporations with FCPA problems in China have faced punishment as well. Si Chan Wooh, a former executive vice president and head of a Schnitzer subsidiary, pleaded guilty to criminal FCPA charges and settled the SEC complaint filed against him for \$40,000 in disgorgement and penalties for paying bribes to Chinese steel companies.<sup>115</sup> The SEC also brought an enforcement action against the former President and CEO of Schnitzer Steel, Robert Philip, for authorizing payments of cash and gifts to officials in Chinese and South Korean steel mills. Philip settled the SEC complaint for approximately \$261,000 in penalties and disgorgement.<sup>116</sup>

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112. Peter S. Goodman, *China Market Is Fertile Field For Bribes*, SEATTLE TIMES, Aug. 28, 2005, available at <http://community.seattletimes.nwsourc.com/archive/?date=20050828&slug=chinakickbacks28>.

113. Stuart Pfeifer, *2nd O.C. Exec Admits Bribing Foreign Officials*, L.A. TIMES, Feb. 4, 2009, at C3.

114. Nathan Olivarez-Giles, *6 More Are Charged with Paying Bribes; Former Leaders at an Orange County Firm Are Accused of Paying Foreign Officials*, L.A. TIMES, Apr. 10, 2009, at B3.

115. Litigation Release, U.S. Securities and Exchange Commission, *SEC Settles Charges Against Former Portland Steel Executive for Anti-Bribery Statute Violations*, Release No. 20174 (June 29, 2007), available at <http://www.sec.gov/litigation/litreleases/2007/lr20174.htm>.

116. Litigation Release, U.S. Securities and Exchange Commission, *SEC Charges Former Chairman/CEO of Schnitzer Steel for Authorizing Cash Bribes to Foreign Officials*, No. 20397 (Dec. 13, 2007), available at <http://www.sec.gov/litigation/litreleases/2007/lr20397.htm>.

Similarly, the SEC brought an action against Oscar Meza, the director of Asia-Pacific sales for Faro Technologies, for permitting the payment of bribes. The SEC's complaint alleged that Meza authorized a Faro sales manager to "do business [on behalf of Faro] the Chinese Way."<sup>117</sup> Meza settled with the SEC and agreed to pay approximately \$57,000 in disgorgement.<sup>118</sup> Finally, the SEC also brought an action against David Pillor, the former senior vice president for sales and marketing and a member of the board of directors of InVision. The SEC alleged that Pillor failed to maintain an adequate system of internal controls and that he indirectly caused falsification of the company's books and records. Pillor settled with the SEC and agreed to pay a \$65,000 penalty.<sup>119</sup>

In another high-profile prosecution, Shu Quan-Sheng, a Virginia scientist, pleaded guilty to selling rocket technology to China and to offering Chinese officials bribes on behalf of a French corporation. Quan-Sheng was sentenced in April to fifty-one months in prison and has already paid \$387,000 in restitution.<sup>120</sup>

As these cases evidence, the U.S. government is showing no intention of relaxing its FCPA enforcement efforts. U.S. authorities will continue to prosecute corporations and their employees in connection with Chinese business. It is therefore incumbent upon corporations and their leaders to take all reasonable steps to avoid potential problems. With this in mind, this Article now turns to the tricky issue of gifts and hospitality in China.

## II. GIFTS AND HOSPITALITY IN CHINA AND THE FCPA

Naturally, the pervasive climate of corruption in China is cause for any U.S. company with Chinese business to make the proper investment in its internal controls, including installing experienced compliance officers, maintaining an anonymous reporting system, conducting frequent training, and instituting effective controls over high-risk counterparties, to name a few

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117. Complaint at ¶¶ 9, 12–14, SEC v. Meza, Case No. 09-cv-01648 (D.D.C. Aug. 28, 2009), available at <http://www.sec.gov/litigation/complaints/2009/comp21190.pdf>.

118. Litigation Release, U.S. Securities and Exchange Commission, *SEC Sues Former Sales Executive For Foreign Bribery*, Release No. 21190 (Aug. 28, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr21190.htm>.

119. Litigation Release, U.S. Securities and Exchange Commission, *SEC Settles Charges Against Former InVision Technologies Senior Vice President for Sales and Marketing*, Release No. 19803 (Aug. 15, 2006), available at <http://www.sec.gov/litigation/litreleases/2006/lr19803.htm>.

120. Dena Potter, *Scientist Sentenced in Rocket Technology Case*, THE GUARDIAN, Apr. 7, 2009.

needed steps. Indeed, these are the types of measures that any company subject to the FCPA should take in *any* high-risk country. But, as is apparent from the above discussion of FCPA prosecutions, companies doing business in China must pay particularly close attention to business courtesy expenditures. Indeed, nearly one-half of all China-related corporate prosecutions under the FCPA since 2002 involved the provision of gifts, meals, travel, or entertainment. The prosecutions of Schnitzer, Paradigm, Lucent, Siemens, Avery, and UTStarcom show that no company subject to the FCPA can afford to ignore this risk in China. In that country's business climate, gifts are given far more frequently than is customary in the West.<sup>121</sup> For example, when starting a business, "you should expect to give out symbolic gifts to any officials who may be helping you as well as company executives that you meet."<sup>122</sup> Although always a trouble spot for anti-corruption compliance, the ubiquity of gifts, meals, entertainment, travel, and other business courtesies in China elevates the risk of misstep—especially for companies that lack adequate expenditure control, approval, and documentation regimes.

#### A. Chinese Cultural Context

The Chinese tradition of gift giving stems from the culture of relationship building. Business travelers are advised that the best time to give a gift is upon initially meeting someone "because it shows a relationship of friendship is being established, commemorated by the gift."<sup>123</sup> Business transactions in China are born from these relationships and connections, which in Chinese are called *guanxi*.<sup>124</sup> *Guanxi* has been characterized in this way: "Such connections are the single most important factor for success in China today. Without *guanxi*, it doesn't matter how intelligent or talented you are or how wealthy, you won't get ahead. People with better connections can block you at every move . . . ." <sup>125</sup> Because of the importance of *guanxi*, Chinese "dedicate a vast amount of time to assembling a solid network of family,

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121. CHAI & CHAI, *supra* note 1, at 113.

122. *Id.*

123. *Id.* at 114

124. *Id.* at 126–27.

125. *Id.* at 126.

friends, and acquaintances.”<sup>126</sup> Friends and acquaintances are often “strategically chosen.”<sup>127</sup>

To build *guanxi*, Chinese exchange gifts and favors. Once a gift is given or a favor done, the recipient has the obligation to reciprocate in the future—the mutual obligation created is the basis for the *guanxi*. When a gift is given or favor done to reciprocate, the reciprocation is often greater than the original gift or favor. This allows the mutual obligation to continue on, as the original gift giver or favor doer is now obliged to reciprocate.<sup>128</sup>

These informal relationships and connections are deeply rooted in Chinese tradition. Historically, Chinese commerce was “largely unregulated by formal law and was intensely relational.”<sup>129</sup> Chinese “generally conducted business with counterparts they knew personally or with whom they came into contact through mutual acquaintances or relatives.”<sup>130</sup> These informal relationships and connections substituted for a more formal legal system of rules and enforcement mechanisms.<sup>131</sup>

In the context of modern business relationships, *guanxi* can present a tangible corruption risk. As mentioned above, recently a former employee of Morgan Stanley in China “was undone by his pursuit of *guanxi*.”<sup>132</sup> Garth Peterson, a “rising star” at Morgan Stanley, joined its real estate investment operation in China about eight years ago.<sup>133</sup> Peterson spoke fluent Mandarin and was described by his colleagues as a “serial networker,” who became friends with the sons and daughters of powerful Chinese leaders.<sup>134</sup> He also “charm[ed] the Chinese executives of multinational corporations.”<sup>135</sup> Peterson’s job was to identify and execute real estate deals in China. In his quest for success, he taught himself the Shanghai dialect and sent his daughter to an exclusive school “known for attracting the sons and daughters of the influential.”<sup>136</sup> An internal review of some of Peterson’s projects in mid-2008 identified instances where investment assets were used for “improper

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126. Hine, *supra*, note 10, at 61.

127. *Id.*

128. *Id.*

129. Stanley Lubman, *Looking For Law In China*, 20 COLUM. J. ASIAN L. 1, 70 (2006).

130. *Id.*

131. *Id.*

132. George Chen & Steve Eder, *A Morgan Stanley Star Falls In China*, REUTERS, Nov. 10, 2009.

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

purposes,” and Morgan Stanley fired Peterson in December 2008 amid suspicions that he may have violated the FCPA.<sup>137</sup>

## **B. The FCPA’s Anti-Bribery Provisions and Business Courtesies in China**

As discussed above in Part I, the FCPA contains both anti-bribery and accounting provisions. The anti-bribery provisions prohibit the payment of anything of value to a foreign official with corrupt intent to influence the official in the exercise of his or her official duties to assist the payor in obtaining or retaining business.<sup>138</sup> Understanding the Chinese gift and hospitality risk through the prism of the anti-bribery provisions and their enforcement is essential to devising an effective system of internal controls to protect a corporation and its employees from U.S. prosecution.

### *1. Anti-Bribery Provisions*

The anti-bribery provisions apply to (1) issuers,<sup>139</sup> (2) domestic concerns,<sup>140</sup> (3) individual officers, directors, employees, agents, or shareholders of issuers or domestic concerns who are acting on behalf of the issuer or domestic concern,<sup>141</sup> and (4) any other persons or entities (or officers, directors, employees, agents, or shareholders thereof), while in U.S. territory, that use the mails or interstate commerce to commit acts in furtherance of the bribery.<sup>142</sup> The statute defines “issuers” as companies that have securities registered with the SEC or that must file periodic reports with the SEC pursuant to the Securities Exchange Act of 1934.<sup>143</sup> “Domestic concerns” include U.S. citizens, nationals, and residents, and business entities that have their principal place of business in the United States.<sup>144</sup> In sum, any company that has securities that are registered with the SEC or that has a principal place of business in the United States is subject to the FCPA’s anti-

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137. *Id.*

138. *See* 15 U.S.C. §§ 78dd-1(a), (g); 78dd-2(a), (i); 78dd-3(a) (2006).

139. 15 U.S.C. § 78dd-1.

140. 15 U.S.C. § 78dd-2.

141. 15 U.S.C. § 78dd-3.

142. *Id.*

143. 15 U.S.C. § 78m(b)(2).

144. 15 U.S.C. § 78dd-2(h)(1).

bribery provisions. The statute reaches broadly to cover both individuals and corporate entities.

The bribes prohibited by the FCPA are not limited solely to monetary payments. Rather, the statute encompasses “anything of value,” and there is no exception for items of de minimis value.<sup>145</sup> A box of mooncakes given to a police officer, therefore, would fall under the statute’s broad reach. In fact, any gift given to a foreign official in China exposes a company to potential liability under the anti-bribery provisions of the FCPA.

The statute does, however, require corrupt intent.<sup>146</sup> The DOJ advises that “[t]he person making or authorizing the payment must have a corrupt intent, and the payment must be intended to induce the recipient to misuse his [or her] official position to direct business wrongfully to the payer or to any other person.”<sup>147</sup> Absent a confession, corrupt intent must be inferred from the facts and circumstances of a given case. If the items given are of a low value, such as inexpensively packaged mooncakes, it is difficult to infer corrupt intent. Indeed, the lower the value of the gift to the recipient, the more difficult it is to infer that the “payment” was intended to induce the official to misuse his or her official position to direct business wrongfully to the payer.<sup>148</sup> But U.S. prosecutors do not examine payments in a vacuum and will look at the total number of “things of value” provided to the government official over a period of time.<sup>149</sup>

## 2. Facilitating Payments Exception

The FCPA contains one exception for “facilitating or expediting payment[s].”<sup>150</sup> To qualify for this exception, the purpose of the payment must be “to expedite or to secure the performance of a routine governmental

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145. 15 U.S.C. §§ 78dd-1(a), (g); 78dd-2(a), (i); 78dd-3(a).

146. *See id.* (all requiring that the offer, promise to pay, or payment be made “corruptly”).

147. U.S. Department of Justice, *Lay-Person’s Guide to FCPA*, available at <http://www.justice.gov/criminal/fraud/docs/dojdocb.html> (last visited Nov. 24, 2009).

148. As discussed below, however, there are situations where low-value gifts can present significant corruption risk. Again, the FCPA does not have an exception for items of de minimis value.

149. *See* Press Release, U.S. Department of Justice, *Westinghouse Air Brake Technologies Corporation Agrees To Pay \$300,000 Penalty To Resolve Foreign Bribery Violations in India*, (Feb. 14, 2008), available at [http://www.justice.gov/criminal/pr/press\\_releases/2008/02/02-14-08wabtec-agree.pdf](http://www.justice.gov/criminal/pr/press_releases/2008/02/02-14-08wabtec-agree.pdf) (explaining how Westinghouse Air Brake Technologies Corporation’s Indian subsidiary made repeated payments, some as low as \$67.00, to ensure that product inspections would be scheduled and performed).

150. 15 U.S.C. §§ 78dd-1(b); 78dd-2(b); 78dd-3(b) (2006).

action.”<sup>151</sup> Examples of “routine governmental action” provided in the statute are obtaining permits, licenses, or other official documents to qualify a person to do business in a foreign country; processing governmental papers such as visas and work orders; providing police protection, mail pickup, and delivery; scheduling inspections; providing phone service, power, and water supply; loading and unloading cargo; and protecting perishable products from deterioration.<sup>152</sup> The statute further provides that routine governmental action does *not* include any decision by a foreign official involving whether to award new business or continue business, or any action taken by a foreign official to encourage a decision to award new business or continue business.<sup>153</sup>

Despite this statutory guidance, the facilitating payments exception has been narrowly construed and, for a number of reasons, may not be a viable safe harbor for multinational businesses in China to engage in the practices necessary to build *guanxi*. First, the exception applies only to payments made for actions that are nondiscretionary.<sup>154</sup> It is often difficult to separate discretionary from nondiscretionary behavior. To date, there is no guidance from U.S. authorities on what constitutes nondiscretionary actions by foreign officials such that the facilitating payments exception would apply.

Second, the DOJ and SEC in recent enforcement actions appear to be reading the exception out of the statute. In 2008, the DOJ charged Westinghouse Air Brake Technologies Corp. (“Wabtec”) with violating the FCPA because its Indian subsidiary had made corrupt payments to officials from the Indian Railway Board.<sup>155</sup> The payments were made in four different circumstances: (1) to assist the subsidiary in obtaining contracts, (2) to schedule pre-shipping product inspections, (3) to have certificates of product delivery issued, and (4) to curb excise tax audits.<sup>156</sup> The non-prosecution agreement entered into with the DOJ states that Wabtec’s Indian subsidiary had made payments, some as low as \$67.00, to ensure that the product

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151. *Id.*

152. 15 U.S.C. § 78dd-1(f)(3)(A).

153. 15 U.S.C. § 78dd-1(f)(3)(B).

154. H.R. REP. NO. 95-630, at 8 (1977) (explaining that the FCPA is not meant to reach payments “which do not involve any discretionary action” and are of “an essentially clerical or ministerial nature”).

155. See Press Release, *supra* note 149.

156. Letter from Steven A. Tyrrell to Eric A. Dubelier, (Feb. 8, 2008) (Westinghouse Air Brake Technologies Corporation non-prosecution agreement), available at <http://www.law.virginia.edu/pdf/faculty/garrett/wabtec.pdf>.

inspections would be scheduled and performed.<sup>157</sup> Nothing in the non-prosecution agreement indicates that the payments were made to ensure a positive outcome for Wabtec; rather, it appears that the payments were made so that the inspections would be scheduled and performed. It is unclear why these payments would not qualify as facilitating or expediting payments to secure the performance of routine governmental action. Similarly, Wabtec's Indian subsidiary made payments in order to obtain certificates usually issued upon delivery of conforming products.<sup>158</sup> Again, on its face, these circumstances appear to be ones that would fall under the facilitating payments exception, but the DOJ did not apply it in the Wabtec case.

A third reason why the facilitating payments exception may not be a viable outlet for businesses in China is that Chinese anti-bribery law does not carve out an exception for facilitating payments. Article 389 of the Criminal Law of the People's Republic of China prohibits giving money or property to a government official to seek improper benefit.<sup>159</sup> There are monetary thresholds for prosecution—10,000 yuan (approximately \$1,465) for an individual and 200,000 yuan (approximately \$29,300) for a corporate entity.<sup>160</sup> In certain circumstances, however, authorities have the discretion to prosecute bribe payments that fall below the thresholds, such as if the bribes were given to a China Communist Party or government leader, or the bribes were paid to three or more officials.<sup>161</sup> The only exception in the statute is for payments that were made (1) because of blackmail by the government official *and* (2) for which no improper benefit was gained.<sup>162</sup> Because the law does not differentiate between facilitating payments and other types of bribes, facilitating payments are just as risky as any other bribe under Chinese law.

Finally, multinational companies may not want to rely on the facilitating payments exception because doing so will hinder internal efforts to build a values-based corporate culture of compliance. Accordingly, many multinational corporations now prohibit facilitating payments as a matter of compliance policy. An October 2009 TRACE International survey about facilitating payments revealed that approximately 35% of the companies

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157. *Id.*

158. *Id.*

159. Laetitia Tjoa, Ouyang Jianyu, & Like Pykstra, *Complying With PRC Antibribery Laws*, CHINA BUS. REV., Mar.–Apr. 2005, at 34, 35.

160. Alice Peng, *Give and Take*, CHINA L. & PRAC., Feb. 2009, at 11, 12.

161. Tjoa, Jianyu, & Pykstra, *supra* note 159, at 35–36.

162. *Id.* at 36; *see also* P.R.C. Criminal Law Article 389.

surveyed had policies prohibiting facilitating payments.<sup>163</sup> International organizations also pressure major multinationals to do away with corporate policies that permit facilitating payments. Recently, the Organization for Economic Cooperation and Development (“OECD”) called for a ban on facilitating payments.<sup>164</sup> The OECD characterized these payments as “corrosive” on “sustainable economic development and the rule of law,” and the OECD’s Secretary General stated that “[t]here should be no kind of payments allowed whether they are big or small.”<sup>165</sup> And the World Economic Forum’s Partnering Against Corruption Initiative (“PACI”) similarly recommends the elimination of facilitating payments in its PACI Principles for Countering Bribery.<sup>166</sup>

### 3. Affirmative Defenses

The FCPA’s anti-bribery provisions contain two affirmative defenses. The first affirmative defense is that the payment was lawful under the written laws of the foreign official’s country, and the second is that the payment was for reasonable expenditures directly related to the promotion of a payor’s products or services, or the execution of a contract between the parties.<sup>167</sup>

The first affirmative defense can be asserted when the written laws of the foreign official’s country expressly permit the payment. The legislative history of the FCPA’s 1988 amendments that added this affirmative defense indicates that the defense is to be construed narrowly.<sup>168</sup> The mere absence of a law in the host country prohibiting bribes would not qualify for the defense. Instead, the local law must expressly permit the payment in question.<sup>169</sup> There is little available guidance on this defense. In 2008, Judge Shira A. Scheindlin in the Southern District of New York wrote the first judicial

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163. *Facilitation Payments Seen As Problematic By Many Companies*, PR NEWSWIRE, Oct. 5, 2009; see also TRACE INT’L, TRACE FACILITATION PAYMENTS BENCHMARK SURVEY (Oct. 2009), <https://secure.traceinternational.org/documents/FacilitationPaymentsSurveyResults.pdf>.

164. Dionne Searcey, *Small-Scale Bribes Targeted by OECD*, WALL ST. J., Dec. 11, 2009, available at <http://online.wsj.com/article/SB126041281940684861.html>.

165. *Id.*

166. WORLD ECONOMIC FORUM, PARTNERING AGAINST CORRUPTION INITIATIVE (PACI), PARTNERING AGAINST CORRUPTION – PRINCIPLES FOR COUNTERING BRIBERY, 4.4.1 (2005), [http://www.weforum.org/pdf/paci/PACI\\_Principles.pdf](http://www.weforum.org/pdf/paci/PACI_Principles.pdf).

167. 15 U.S.C. §§ 78dd-1(c), 78dd-2(c), 78dd-3(c) (2006).

168. H.R. Rep. No. 100-576, at 922 (1988) (Conf. Rep.), reprinted in 1988 U.S.C.C.A.N. 1547, 1955.

169. *Id.*

opinion construing this affirmative defense in *United States v. Kozeny*.<sup>170</sup> In *Kozeny*, defendant Frederick Bourke and others were charged with making improper payments to Azeri officials to encourage the privatization of the State Oil Company of the Azerbaijan Republic and to participate in that privatization.<sup>171</sup> Bourke argued that the payments were lawful under Azeri law and asked Judge Scheindlin to instruct the jury on the FCPA's affirmative defense.<sup>172</sup> Under Azeri criminal law, although bribery is generally prohibited, the bribe payor is relieved of liability if the bribe was extorted or if the payor voluntarily reported the bribe after it was made.<sup>173</sup>

Bourke argued both that the payments were a product of extortion and that they should be excused because he reported them to the President of Azerbaijan.<sup>174</sup> Judge Scheindlin held that Bourke could not avail himself of the affirmative defense.<sup>175</sup> She explained:

For purposes of the FCPA's affirmative defense, the focus is on the payment, not the payer. A person cannot be guilty of violating the FCPA if the payment was lawful under foreign law. But there is no immunity from prosecution under the FCPA if a person could not have been prosecuted in the foreign country due to a technicality (e.g., time-barred) or because a provision in the foreign law "relieves" a person of criminal responsibility. An individual may be prosecuted under the FCPA for a payment that violates foreign law even if the individual is relieved of criminal responsibility for his actions by a provision of the foreign law.<sup>176</sup>

Because Azeri law prohibited the payment, the fact that an individual could be freed from criminal liability if there was extortion or voluntary reporting did not undermine the payment's original illegality.<sup>177</sup> By Judge

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170. *United States v. Kozeny*, 582 F. Supp. 2d 535 (S.D.N.Y. 2008).

171. *Id.* at 536–37.

172. *Id.*

173. *Id.* at 538.

174. *Id.* at 537.

175. *Id.* at 541.

176. *Id.* at 539 (footnote omitted).

177. *Id.* at 539–40. Judge Scheindlin did comment, however, that if there was truly extortion involved, Bourke may be entitled to an instruction relating to intent—if a bribe is paid as a result of extortion, a defendant may lack the corrupt intent necessary for FCPA liability. *Id.* at 540–41.

Scheidlin's interpretation, the affirmative defense would apply only in situations where the foreign law expressly allows the payment, not where it merely carves out exceptions to a general prohibition on such payments.

Because of this nuanced application of the first affirmative defense, multinational corporations operating in China should carefully analyze the Chinese statutes that could supply such a defense. Some will undoubtedly permit the provision of gifts, entertainment, and other things of value to Chinese officials. For example, the various U.S. and multinational insurance companies operating in China may be able to rely on this affirmative defense when providing training for the employees of state-owned banks that sell their insurance products.<sup>178</sup> Chinese insurance regulations require insurance companies selling their policies through banks to train the bank employees on the products that the bank will sell.<sup>179</sup> Further, the regulations permit the insurance companies to pay for the training.<sup>180</sup> Because most banks in China are state-owned or state-controlled, bank employees would qualify as foreign officials under U.S. authorities' interpretation of the FCPA. Considering that local law—here, insurance regulation—requires insurance companies to provide the training, the associated benefits obtained by the bank employees should fall under the affirmative defense. As is evident from this example and from Judge Scheindlin's opinion in *Kozemy*, however, the application of this affirmative defense is extremely limited and corporations with FCPA exposure must therefore proceed with caution.

The second affirmative defense has even greater relevance to the provision of gifts and other business courtesies under the FCPA. The statute states that it shall be an affirmative defense that the payment “was a reasonable and bona fide expenditure, such as travel and lodging expenses, incurred by or on behalf of a foreign official . . . and was directly related to (A) the promotion, demonstration, or explanation of products or services; or (B) the execution of a contract with a foreign government or agency thereof.”<sup>181</sup> Thus, the statute provides for covering travel and lodging

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178. See generally BRIAN METCALFE, FOREIGN INSURANCE COMPANIES IN CHINA (2008), available at [http://www.pwchk.com/home/webmedia/633555167808468096/foreign\\_insurance\\_cn\\_sep2008.pdf](http://www.pwchk.com/home/webmedia/633555167808468096/foreign_insurance_cn_sep2008.pdf) (describing the foreign insurance companies in China, their products, and distribution channels).

179. Circular of China Insurance Regulatory Commission and China Banking Regulatory Commission on Regulating the Bancassurance Business, Bao Jian Fa No. 70 (2006), available at [http://www.fdi.gov.cn/pub/FDI\\_EN/Laws/Banking/P020071115489645788521.pdf](http://www.fdi.gov.cn/pub/FDI_EN/Laws/Banking/P020071115489645788521.pdf).

180. *Id.*

181. 15 U.S.C. §§ 78dd-1(c), 78dd-2(c), 78dd-3(c) (2006).

expenses under specified circumstances. Various DOJ opinion procedure releases discuss situations in which such travel and lodging expenses have received the DOJ's stamp of approval.<sup>182</sup> The travel and lodging expenses described in the opinion procedure releases have certain common themes. The expenses are usually modest, such as economy class flights and hotel reimbursement within a specific dollar limit.<sup>183</sup> Payment often will be made directly to the providers (not to the officials), and the requestor will not cover expenses for officials' spouses, family, or other guests.<sup>184</sup> In at least one opinion procedure release, the requesting company made clear that it did not intend to pay for entertainment or leisure activity,<sup>185</sup> while in others the requesting company did specify that certain entertainment expenses, such as a four-hour sightseeing tour, would be covered.<sup>186</sup>

If nominal gifts given to foreign officials are branded with a company's name or logo, they likely will come within the second affirmative defense as the "promotion" of products or services.<sup>187</sup> Importantly, the DOJ does not

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182. *See, e.g.*, U.S. Department of Justice, FCPA Opinion Procedure Release 08-03 (July 11, 2008), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2008/0803.html> (approving payment of expenses for 20 journalists to attend a press conference in China); U.S. Department of Justice, FCPA Opinion Procedure Release 07-02 (Sept. 11, 2007), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2007/0702.html> (approving payment of expenses for six officials to attend internship program for foreign insurance regulators); U.S. Department of Justice, FCPA Opinion Procedure Release 07-01 (July 24, 2007), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2007/0701.html> (approving payment of expenses for six Asian officials to tour the requesting company's operations sites); U.S. Department of Justice, FCPA Opinion Procedure Release 04-04 (Sept. 3, 2004), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2004/0404.html> (approving payment of expenses for five foreign officials to attend a "Study Tour" to help the officials understand mutual insurance companies).

183. *See, e.g.*, U.S. Department of Justice, FCPA Opinion Procedure Release 08-03 (July 11, 2008), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2008/0803.html> (explaining that the payment would cover reimbursement for economy class travel and one night's lodging, which was not to exceed \$229 per journalist).

184. *See, e.g.*, U.S. Department of Justice, FCPA Opinion Procedure Release 07-01 (July 24, 2007), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2007/0701.html>.

185. *Id.* (explaining that the requestor represented that "apart from meals and receptions connected to meetings, speakers, or events the requestor is planning for the officials, it will not fund, organize, or host any entertainment or leisure activities for the officials").

186. U.S. Department of Justice, FCPA Opinion Procedure Release 07-02 (Sept. 11, 2007), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2007/0702.html> (explaining that the requestor intended to provide "a modest four-hour city sightseeing tour for the six officials").

187. *See* U.S. Department of Justice, FCPA Opinion Procedure Release 07-01 (July 24, 2007), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2007/0701.html>

require the promotion to be aimed at potential purchasers. In Opinion Procedure Release 07-02, a U.S. insurance company asked the DOJ whether it could pay certain expenses for foreign insurance regulators to attend an insurance conference in the United States.<sup>188</sup> The insurance company indicated that it would not pay for travel for the regulators to attend the conference, but it would pay for other reasonable expenses to educate the regulators. The insurance company further stated that any souvenirs it provided to the regulators (e.g., shirts or tote bags) would be of nominal value and would reflect the company's business or logo.<sup>189</sup> Even though these expenditures were made in a non-commercial context, the DOJ approved them as directly related to promotion of the insurance company's services. This approval shows that the promotion defense is not restricted to prospective governmental purchasers.

Reasonable and bona fide expenditures also constitute an affirmative defense if the payments are directly related to "the execution or performance of a contract with a foreign government or agency thereof."<sup>190</sup> Although there is little guidance on this provision, at least one DOJ release discusses payments related to the execution of a contract. Review Procedure Release 92-1 addressed FCPA concerns relating to Union Texas Pakistan, Inc.'s ("Union Texas") joint venture with Pakistan's Ministry of Petroleum and Natural Resources.<sup>191</sup> Union Texas intended to pay for training, travel, and meal expenses for Pakistani governmental officials in connection with the execution and performance of the joint venture agreement.<sup>192</sup> The agreement required Union Texas to provide training to government personnel to enable them to efficiently execute their duties relating to supervision of the

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(explaining that the requestor's expenditures, including for nominal value souvenirs reflecting the requestor's name and/or logo, were consistent with the FCPA's promotional expenses affirmative defense); U.S. Department of Justice, FCPA Opinion Procedure Release 07-02 (Sept. 11, 2007), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2007/0702.html> (explaining that the requestor's expenditures, including for nominal value souvenirs such as shirts or tote bags reflecting the requestor's name and/or logo, were consistent with the FCPA's promotional expenses affirmative defense).

188. U.S. Department of Justice, FCPA Opinion Procedure Release 07-02 (Sept. 11, 2007), *available at* <http://www.justice.gov/criminal/fraud/fcpa/opinion/2007/0702.html>.

189. *Id.*

190. 15 U.S.C. §§ 78dd-1(c), 78dd-2(c), 78dd-3(c) (2006).

191. U.S. Department of Justice, FCPA Review Procedure Release 92-1 (Feb. 1992), *available at* <http://www.justice.gov/criminal/fraud/fcpa/review/1992/r9201.html>.

192. *Id.*

petroleum industry.<sup>193</sup> The training was to take place in Pakistan, the United States, and Europe, and Union Texas represented that the expenditures for training outside Pakistan would not exceed \$250,000.<sup>194</sup> The DOJ approved the arrangement.<sup>195</sup>

Although the statute provides these affirmative defenses and the facilitating payments exception, these provisions are nuanced and have been narrowly construed. Further, those entities subject to the FCPA's accounting provisions must still ensure that they accurately record such expenses in their books and records.<sup>196</sup> In light of the statute's requirements and complexity, China's business culture, and the prevalence of public corruption in China, prudent multinational corporations should develop strong compliance programs to mitigate these risks.

### III. A COMPLIANCE PROGRAM FOR CHINESE OPERATIONS

Any multinational corporation's internal compliance framework must flow from a nuanced analysis of the company's business and the risks that attend its activities, particularly in high-risk countries like China. Understanding the Chinese cultural climate and its associated legal risks, as discussed above, is the first step in safeguarding a multinational company against anti-corruption compliance problems in China. To assist in the process of assessing corporate risks and devising internal controls to address them, the remainder of this Article provides some advice on one aspect of Chinese business that distinguishes it from other high-risk business environments—the role of gifts, entertainment, and other courtesies as an integral component of business culture.

#### A. Assessing the Company's Business Courtesy Risk in China

Before constructing compliance programs, organizations must assess their risks and determine their tolerance for these risks. This corporate risk assessment determines how a company should tailor its global compliance

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193. *Id.* Interestingly, and related to the first affirmative defense, Union Texas represented that Pakistani law permits the government to require petroleum exploration and production companies to provide such training. *Id.*

194. *Id.*

195. *Id.*

196. 15 U.S.C. § 78m(b)(2)(A)–(B) (2006).

program to operations in a specific country.<sup>197</sup> Understanding the risks that the organization faces will also provide a roadmap for mitigating those risks. International companies within the FCPA's ambit should look carefully at the ways in which their Chinese operations may present corruption risks different from those in countries such as Brazil, India, Mexico, and Russia. In China, the confluence of pervasive public corruption, a keen enforcement focus, the ubiquity of "foreign officials," and the prevalent role of business courtesies require companies to tailor their global compliance regime to address the risks posed by gift and entertainment expenditures.

In developing an FCPA risk picture, a multinational company should focus on the most frequent risky interactions with government officials.<sup>198</sup> The risk assessment should identify whom within the government the company interacts with and what the interactions look like. It can rely on both qualitative and quantitative data to do so.<sup>199</sup>

Qualitative information—human intelligence—usually provides the starting point. To gain an accurate understanding of the types of governmental interactions and the dangers they may pose, corporations should involve a cross-section of employees in the process, including those in internal audit, legal, compliance, and finance, as well as members of the business line and company leaders.<sup>200</sup> These employees' input about the qualitative nature of the company's interaction with government officials in the region will provide necessary insight and aid with organizational buy-in regarding any mitigating measures that evolve from the review. Candid evaluations from employees on the ground in all relevant areas of the company are invaluable. These employees can, for instance, explain the

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197. See U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(c) (2009) (recommending that an organization "periodically assess the risk of criminal conduct" and "take appropriate steps to design, implement, or modify" the various elements of its compliance program "to reduce the risk of criminal conduct identified through this process").

198. Memorandum from Mark Filip, Deputy Attorney Gen., U.S. Dep't of Justice, *Principles of Federal Prosecution of Business Organizations*, at § 9-28.800 (Aug. 28, 2008) (emphasizing that compliance programs "should be designed to detect" the types of misconduct that are "most likely to occur in a particular corporation's line of business").

199. See ASSOCIATION OF CORPORATE COUNSEL, FRAMEWORK FOR CONDUCTING EFFECTIVE COMPLIANCE AND ETHICS RISK ASSESSMENTS 9 (2008) (noting the need for both qualitative and quantitative analysis in a risk assessment).

200. See ETHICS AND COMPLIANCE OFFICER ASSOCIATION, THE ETHICS AND COMPLIANCE HANDBOOK: A PRACTICAL GUIDE FROM LEADING ORGANIZATIONS 16 (2008) (observing that "divergent business experiences, both inside and out of the organization, add richness to the data collection and analysis, and ensure that the risk assessment is not the exclusive product of a single department or mind-set").

attitudes of governmental actors and whether they expect gifts and entertainment from their private-sector counterparties. They can also provide a good picture of the attitudes of company employees and whether they will resist controls on business courtesy expenditures. Organizations may augment such direct input with employee focus groups and opinion surveys.<sup>201</sup> Ultimately, the nuanced understanding that qualitative data provides is vital not only for assessing and mitigating the risk, but also for harmonizing the necessary controls as effectively as possible with current business practices.

If available, the company should try to supplement this information with quantitative data.<sup>202</sup> In the area of business courtesies, mechanisms like expense reports, audits, and past compliance reports can all help underpin the assessment of and develop an accurate accounting of the officials benefiting from business courtesies, the frequency of such courtesies, and their value. As with the qualitative information, these findings will directly shape the controls surrounding gifts and entertainment.

As the organization develops a full risk picture, it should weigh the possibility of corruption problems along with the impact such problems would have on the business.<sup>203</sup> After finalizing its assessment and turning to the development of mitigating controls, the company may encounter a common conundrum: The more often the company provides gifts, entertainment, and travel accommodations to government officials, the greater the level of risk and the greater the need for compensating controls; yet, the greater the frequency of business courtesies for government officials, the more burdensome most conventional internal controls will be. There is no easy way to cut this knot. Arduous procedures can hurt business and incent circumvention. Lax policies will not adequately protect the organization. But working together, the business line and compliance officers should be able to craft creative solutions tailored to the company's business realities. What follows are some suggestions to aid in that process.

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201. *See id.* at 21.

202. *See id.* at 23.

203. COMMITTEE OF SPONSORING ORGANIZATIONS OF THE TREADWAY COMMISSION, INTERNAL CONTROL – INTEGRATED FRAMEWORK 42 (1994) (noting that risk assessment usually includes “[e]stimating the significance of a risk” and “[a]ssessing the likelihood (or frequency) of the risk occurring”).

## B. Reporting and Recording

For issuers, recording of all business courtesies is essential. As burdensome as it may be, the FCPA's books-and-records provision demands it.<sup>204</sup> Even U.S. companies whose securities do not trade on U.S. exchanges should maintain accurate accounting systems to sustain effective institutional control. The company can employ a standard business expense form that shows the essential facts surrounding the expenditure: date, recipient, nature of expenditure, and value. Employees should also attach to expense forms the receipts documenting the expenditures.

In addition to satisfying the FCPA's requirements, the recordation process can aid in the company's efforts to mitigate the risks associated with business courtesies in China. It can do this in two ways. First, by adding some additional detail to the expense form, the company can establish an auditable record of gifts and entertainment. Having such a record will permit internal audit to examine practices in this area and allow the company to reform its practices as needed, after future self-evaluations and risk assessments. The auditable record can also dissuade employees from pushing the envelope on such expenditures and, when necessary, aid internal investigations into compliance failures. For real-time compliance efforts, the record will show if a significant number of benefits are going to the same recipient, and allow compliance officers and controllers to prevent additional authorized benefits. Second, the form can also serve as an approval form, providing compliance officers with the information they need to determine whether to allow a particular expenditure. In addition to the details of the actual expenditure, an augmented expense form could, for instance, include some of the following information:

- A description of the purpose of the expenditure and how it is anticipated that it will aid the business.
- The identity of the recipient's supervisor and whether he or she is aware of the expense.
- A full description of any pending or anticipated business with, or decisions coming before, the recipient.
- A statement of whether the recipient has the power to assist or hinder the company's business and how he or she would do so.

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204. See 15 U.S.C. § 78m(b)(2)(A) (2006).

- An accounting for any other gifts or benefits provided to this individual within a recent time period (e.g., six or twelve months).
- A statement of whether any cash or cash equivalent (gift card, per diem, reimbursement, etc.) is provided to the recipient.
- An attestation of the requestor that the information provided on the form is, to the best of his or her knowledge, accurate and complete.
- The necessary approvals from supervisors and legal/compliance officers.

Among the most difficult decisions for any company in this area are when to require approvals for business courtesies and who should have approval authority within the organization. Different corporations will erect different approval frameworks based on a number of different factors. Such considerations should include the assessed risk level, the corporation's tolerance for particular risks, its institutional capacity to provide approvals (e.g., staff levels in the compliance function, sophistication of legal and compliance officials in the region, the existence of automated systems already used for approvals, etc.), and the number of individual expenditures each year.

To ensure a workable approval system, some companies set blanket exemptions for expenditures under a certain value threshold. Although this approach eliminates much of the hassle that attends any approval regime by focusing only on the few business courtesies that pose the greatest risk, it can be tricky. Undoubtedly, the lower the value of a particular expenditure, the harder it will be for the DOJ and SEC to infer corrupt intent under the FCPA. For instance, a standard, low-value mooncake would not be much of an incentive for corrupt behavior, and it is unlikely that the provider intended it to serve as an illicit inducement. But, as noted above, there is no de minimis threshold for the FCPA. Therefore, such value levels should be set prophylactically low. Further, it is important that the company focus on the *value* of the thing of value, not merely on its cost to the company. A company that manufactures wristwatches may be able to produce a \$300 timepiece for \$25, but that does not make it a low-value or low-risk gift to a government official. And, of course, the income and means of the particular government official determine how valuable even an inexpensive \$25 gift is to him or her. For some low-level functionaries, a \$25 watch could hold significant value. This is not to say that approval cutoffs and thresholds should not be used to make the approval system more workable—only that a company must

proceed with caution and be prepared to revisit its assumptions and judgments periodically.

A more sophisticated approach to setting approval cutoffs is to utilize a multi-factor scoring system for each proposed expenditure. Such an approach would assign a numerical weight to the recipients' salient characteristics (whether they are government officials and their seniority and authority within their organization), the value of the expenditure, the occasion of the benefit, and other meaningful factors. Tallying the figures for each of these factors generates a final numerical score. For scores lower than a certain established value, no further approval is needed, although employees must complete the form and should still certify that they have no reason to believe that the proposed benefit is being given to receive an improper benefit or violates any applicable law or regulation. The company can also require approvals from correspondingly more senior members of the organization as the final score rises. This multi-factor approach takes into account some of the nuance lost in a hard cutoff, but it has its own set of challenges. Employees may find performing the calculations to be burdensome, and it can be difficult to calibrate all of the different factors to generate outcomes that accurately reflect the actual risks and the company's tolerance for them. And, as with a hard cutoff, the company must revisit this tool periodically to ensure its efficacy.

Importantly, in addition to legal and compliance, both finance and internal audit should understand the reporting and recording system. In most companies, finance will bear responsibility for approving the release of funds to purchase the thing of value or to reimburse the requesting employee for the expenditure. If the approval system is circumvented, or if the information provided on a form raises a red flag, the employees in finance should be able to catch this problem. Internal audit must also understand the forms and their use if it is to audit the system effectively. With the proper understanding and communication, both functions will help to strengthen the control environment.

### **C. Designated Vendors and Pre-Approved Promotional Items**

Other tools that companies can employ in the area of gifts to avoid overburdening employees with approval requirements are designated vendors and pre-approved promotional products. These can reduce the need for specific approvals and establish a safe harbor for employees to engage in the necessary and expected exchange of business courtesies in China.

Having a designated vendor for certain frequently purchased gifts can help streamline approvals. For example, for every Moon Festival, the company could purchase mooncakes from the same bakery. This would facilitate gift recordation, as the company can more easily track the purchases made from a single vendor. It will also reduce the possibility that employees might purchase more valuable mooncakes from a different vendor, which could heighten the corruption risk. If all employees are told that mooncakes are to be bought from the same vendor every Moon Festival, the organization can retain more control over the types of gifts that are being given by its employees.

Similarly, a company should consider keeping in stock low-value promotional items to be given as gifts. As discussed above, one affirmative defense to the anti-bribery provisions of the FCPA is that the thing of value is promotional.<sup>205</sup> Any stock gift, therefore, that is branded with the company's name or logo may be within the reach of the affirmative defense. To facilitate compliance with this element of the anti-corruption program, a company should have on-site promotional items such as mouse pads, mugs, key chains, pens, notepads, and other low-value items that are branded or printed with the company's name. When an employee needs to give a gift to a Chinese official, the employee can draw from the stock of promotional items. Again, this simple practice makes adhering to the compliance program easier for the employees.

#### D. Effective Compliance Organization

Any approval system and, indeed, any compliance regime relies on the competence, industriousness, independence, and ingenuity of the organization's legal and compliance employees.<sup>206</sup> Without an effective, independent compliance function, any approval requirements are less meaningful and could become mere words on paper, effectively ignored by

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205. 15 U.S.C. §§ 78dd-1(c), 78dd-2(c), 78dd-3(c) (2006).

206. See U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(B)–(C) (2009) (identifying the need for personnel with designated compliance responsibility); U.S. Department of Justice, FCPA Opinion Procedure Release No. 04-02 (July 12, 2004), available at <http://www.justice.gov/criminal/fraud/fcpa/opinion/2004/0402.html> (noting the need for a company to have compliance officials with “responsibility for the implementation and oversight of compliance with policies, standards, and procedures”); Deferred Prosecution agreement at ¶ 7(b)(iii), *United States v. Baker Hughes Inc.*, (S.D. Tex. Apr. 11, 2007) (requiring Baker Hughes to appoint senior corporate officials to handle compliance with the corporate code of conduct).

the organization.<sup>207</sup> Assuming a corporation already has an otherwise well-functioning global compliance organization, the issues it must confront in China are (1) training the local compliance employees on the nuances of the FCPA and other applicable anti-corruption laws; (2) instilling in them a sense of independence from the business line (to match the actual independence of their reporting line); (3) ensuring their integration into the business operations of the organization without compromising their independence; and (4) educating them about Chinese business traditions and culture.

Successful recruitment of sophisticated compliance officers makes these tasks easier, but even these officers will still need introductory and ongoing professional training. Ideally, this training, just like the approval system, flows from the results of the periodic risk assessments, addressing new issues flagged by this process. Further, compliance employees in the region should routinely identify new risks or old risks that have become more or less acute. Any organization must maintain effective lines of communication back to the central organization so that such matters do not slip through the cracks.

One of the key questions for gift and entertainment approvals in China is when should the company require approvals from senior compliance officials outside of the local organization. Elevating approvals beyond local officers is undoubtedly burdensome, can lead to distrust and resentment from the Chinese organization, and can even undermine the development of a responsible local compliance group. Devolving too much power to the Chinese organization, however, has its own set of risks—most importantly, significant compliance lapses, if the local compliance officers lack the ability and independence to serve their control function effectively. Some Western organizations may seek Western or Western-trained lawyers for leadership roles in the Chinese organization as a way to address these concerns. But, as the Morgan Stanley scandal illustrates, Westerners can succumb to a corrupt climate, too.<sup>208</sup> Further, although such compliance officers may not need

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207. See Memorandum from Mark Filip, Deputy Attorney Gen., U.S. Dep't of Justice, *Principles of Federal Prosecution of Business Organizations*, at § 9-28.800 (Aug. 28, 2008) (“Prosecutors should . . . attempt to determine whether a corporation’s compliance program is merely a ‘paper program’ or whether it was designed, implemented, reviewed, and revised, as appropriate, in an effective manner.”).

208. CHEN & EDER, *supra* note 132; see also Complaint at ¶¶ 9, 12–14, SEC v. Meza, Case No. 09-cv-01648 (D.D.C. Aug. 28, 2009), available at <http://www.sec.gov/litigation/complaints/2009/comp21190.pdf> (alleging that Meza authorized a Faro sales manager to “do business the Chinese Way”).

supplementary training on the FCPA, they will need to learn about local laws, as well as cultural traditions that could be alien to them.

Ultimately, understanding the strengths and weaknesses of the local compliance organization is necessary to craft effective controls around gift and entertainment expenditures. The organization must also engage in periodic self-evaluation to ensure that its existing compliance regime continues to address institutional risks effectively. How well it functions will also play an important role in the company's future risk assessments.

### E. Employee Training

No matter how sophisticated its compliance regime, an organization's first line of defense against compliance problems is its business employees. This is particularly the case in the area of business courtesies. These employees are, after all, the ones who provide the thing of value to the recipient. If they understand the FCPA and other applicable laws, and exercise good judgment, the risk to the company declines substantially. An effective employee training program provides this understanding of the law and sensitivity to anti-corruption compliance pitfalls.<sup>209</sup> Most effective training regimes involve both in-person and electronic training, and this is certainly the case with regard to safeguarding the provision of gifts, entertainment, and hospitalities in China.

The benefit of in-person training is self-evident. Employees are more likely to pay attention to a human being who demands it. In-person training can be more interactive, with the trainees raising points of confusion about compliance procedures or challenging the assertions of the trainer. These sessions can also facilitate a dialogue between compliance and the business line, permitting compliance officers to identify risk areas and potential compliance challenges. But it also has its downsides. In-person training is expensive and saps significant resources from the compliance organization.

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209. See U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(4)(A) ("The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program . . . by conducting effective training programs . . ."); U.S. Department of Justice, FCPA Opinion Procedure Release No. 04-02 (July 12, 2004), available at <http://www.justice.gov/criminal/fraud/fcpa/opinion/2004/0402.html> (noting the need for "regular training concerning the requirements of the FCPA and applicable foreign anti-corruption laws"); TREADWAY COMMISSION *supra* note 203, at 29 ("Education and training, whether classroom instruction, self-study or on-the-job training, must prepare an entity's people to keep pace and deal effectively with the evolving environment.").

Additionally, the organization must install some sort of quality control to ensure that the trainers actually understand the law and do not give poor guidance, and it may be difficult to find experienced trainers with a nuanced understanding of the relevant anti-corruption laws (including the FCPA) and the local business, who also speak fluent Mandarin.

Electronic training allows for greater coverage and permits standardization of the message provided to line employees. It is also customizable—permitting, for instance, employees to complete the same training in Cantonese, English, or Mandarin. Testing employees' learning following the training is also much easier in an electronic setting. Finally, electronic training can be completed at an employee's convenience, thereby minimizing any disruption to the workings of the organization. Of course, electronic training lacks the many benefits of in-person training. Notably, it is easy to ignore.

Ideally, an organization should utilize both forms of compliance training. A broad swath of employees (any of those with potential corruption exposure in their jobs) should be able to complete the electronic training without significant difficulty or disruption to the business. Importantly, the company needs some way to measure successful completion of the training and its accompanying test, and it should ensure that new employees complete the training shortly after joining the organization. Employees in sensitive functions or in leadership positions should then participate in the in-person training. The risk assessment will determine how a given organization assigns employees for this training, which should be updated and repeated periodically, based on future risk assessments.

## CONCLUSION

Establishing and maintaining an effective anti-corruption compliance program in a multinational company's Chinese operations is undoubtedly challenging. The active anti-bribery enforcement regimes on both sides of the Pacific feed on a business environment that combines a robust and still rapidly growing economy with widespread public corruption. Complicating organizations' efforts to navigate these already-treacherous waters is the need in Chinese business culture to build *guanxi* through the exchange of gifts, meals, travel, and other business courtesies. Understanding this cultural background and the FCPA's legal framework, which has already ensnared a number of businesses and businesspersons in China, is the first step to protecting an organization. Once an organization has processed these risks

and evaluated them in light of its own activities, it can begin to safeguard itself and its employees.