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**DOING BUSINESS IN CHINA:
UNIQUE CORRUPTION COMPLIANCE
CONCERNS AND STRATEGIES**

by
Judith A. Lee
James D. Slear
Gibson, Dunn & Crutcher LLP



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INTRODUCTION

In an era when doing business in the People's Republic of China ("PRC") is rapidly becoming commonplace for major U.S. companies, those companies cannot assume that they can conduct "business as usual" there. While U.S. companies, or third parties acting on their behalf, may provide gifts and entertainment to clients as a means to lure or keep business, state control of many businesses in the PRC, in particular many of the largest businesses, creates a real risk of liability under the Foreign Corrupt Practices Act ("FCPA"). Indeed, the internal controls and books and records provisions of the FCPA dictate that companies ensure their foreign subsidiaries and agents conduct themselves in compliance with the FCPA. Cultural issues and corruption in the PRC further compound this problem. Recognizing these problems is the first step to avoiding a Securities and Exchange Commission (SEC) subpoena or an indictment. To go the full distance in ensuring compliance, it is critical to develop and monitor *effective* internal controls.

I. THE FOREIGN CORRUPT PRACTICES ACT

A. Antibribery Provisions

The antibribery provisions of the FCPA¹ prohibit any corrupt offer, payment, promise to pay, or authorization of the payment of money or any other thing of value to any foreign official for purposes of “influencing any act or decision of such foreign official in his official capacity,” “inducing such foreign official to do or omit to do any act in violation of [his] lawful duty,” “securing any improper advantage,” or “inducing such foreign official to use his influence . . . to affect or influence any [official] act or decision.”² In all cases, the acts must be done “in order to assist . . . in obtaining or retaining business for or with, or directing business to, any person.”³

It should be noted that the prohibition against securing “any improper advantage” was added by the 1998 amendments and has not been defined. This amendment appears to prohibit conduct beyond bribery in the classic sense and is likely to be violated by efforts to obtain inside information about a state-owned entity for the purpose of gaining an advantage in obtaining or retaining business.

¹15 U.S.C. §§ 78m – 78ff.

²15 U.S.C. §§ 78dd-1, 78dd-2, 78dd-3.

³15 U.S.C. §§ 78dd-1(a), 78dd-2(a), 78dd-3(a).

The FCPA applies to all “domestic concerns”⁴ and “issuers.”⁵ The FCPA applies to payments to any foreign official, regardless of rank or position.⁶ While the FCPA does not directly apply to foreign subsidiaries of U.S. companies, U.S. companies violate the FCPA if they have knowledge that a subsidiary or an agent is engaging in conduct contrary to the FCPA. Additionally, the FCPA’s books and records and internal controls requirements provide a basis for imputing liability on United States parents of foreign subsidiaries. Further, the FCPA prohibits corrupt payments made through intermediaries. Thus, it is unlawful to make a payment to a third party, knowing that all or a portion of the payment will go directly or indirectly to a foreign official.

Important for purposes of the analysis here is that the term “knowing” includes conscious disregard and deliberate ignorance.⁷ The legislative history of the 1998 amendments to the FCPA states that the knowledge requirement reflects existing federal law, including cases involving deliberate ignorance:

⁴The term “domestic concern” means: (1) any individual who is a citizen, national, or resident of the United States; (2) any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship that has its principal place of business in the United States, or that is organized under the laws of the United States. 15 U.S.C. § 78dd-2(h)(1).

⁵The term “issuer” means any entity (U.S. or foreign) that has a class of securities registered under Section 12 of the Securities Exchange Act of 1934 (“Exchange Act”) or that is required to file periodic reports with the United States Securities and Exchange Commission (“SEC”) pursuant to Section 15(b) of the Exchange Act. 15 U.S.C. § 78dd-1(a).

⁶15 U.S.C. §§ 78dd-1(f)(1)(A). The term “foreign official” means “any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of any such government, department, agency, or instrumentality, or for or on behalf of any such public international organization.” *Id.*

⁷15 U.S.C. §§ 78dd-1(f)(2)(A); 78dd-2(f)(3)(A); 78dd-3(f)(3)(A).

. . . knowledge of a fact may be inferred where the defendant has notice of the high probability of the existence of the fact and has failed to establish an honest, contrary disbelief. The inference cannot be overcome by the defendant's "deliberate avoidance of knowledge," *United States v. Manrique Aribizo*, 833 F.2d 244, 249 (10th Cir. 1987), his or her "willful blindness," *United States v. Kaplan*, 832 F.2d 676, 682 (1st Cir. 1987), or his or her "conscious disregard," *United States v. McAllister*, 747 F.2d 1273, 1275 (9th Cir. 1984), of the existence of the required circumstance or result. As such, it covers any instance where "any reasonable person would have realized" the existence of the circumstances or result and the defendant has "consciously chose[n] not to ask about what he had 'reason to believe' he would discover," *United States v. Picciandra*, 788 F.2d 39, 46 (1st Cir. 1986).⁸

It is an affirmative defense that the payment was lawful under the written laws of the foreign country or that the money was spent as part of demonstrating a product or performing a contractual obligation.⁹ Because these defenses are "affirmative defenses," the defendant is required to show in the first instance that the payment met these requirements.

B. Accounting Provisions

1. Books and Records

The FCPA's books and records provisions require issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."¹⁰ The SEC's enforcement policy is to treat any illicit payment as material, *per se*. Therefore, it must be recorded. These provisions have been considered by the SEC to apply not only to

⁸Omnibus Trade and Competitiveness Act of 1998, Pub. L. No. 100-418, H.R. Rep. No. 100-578, at 921 (1998) (Conf. Rep.), as reprinted in 1998 U.S.C.C.A.N. 1547, 1954.

⁹15 U.S.C. §§ 78dd-1(c); 78dd-2(c); 78dd-3(c).

¹⁰15 U.S.C. § 78m(b)(2)(A).

United States issuers but also to all of their majority-owned subsidiaries, including those outside the United States.

2. *Internal Controls*

The FCPA's internal controls provisions require issuers to devise and maintain a system of internal accounting controls that, among other things, "provide reasonable assurances that . . . transactions are executed in accordance with management's general or specific authorization."¹¹ Thus, controls must be adequate to protect against off-book accounts and disbursements and other unauthorized payments. The FCPA requires "reasonable" rather than absolute assurance that accounting controls are adequate.¹²

The importance of the internal controls requirements should not be overlooked. For example, in a recent settlement agreement between InVision Technologies ("InVision") and the United States Department of Justice ("DoJ"), the following conduct was described as a federal offense:

InVision failed to devise and maintain a system of internal controls with respect to foreign sales activities sufficient to assure compliance with the FCPA and, to that extent, provide reasonable assurances that InVision's transactions, including the Foreign Transactions, were executed in accordance with the authorization of InVision management. In addition . . . InVision had no effective FCPA compliance program and practiced insufficient, and in some countries virtually no, due diligence respecting the retention of agents or entry into subcontractor or distributorship agreements.¹³

¹¹15 U.S.C. § 78m(b)(2)(B).

¹²15 U.S.C. § 78m(b)(2)(A) and (B).

¹³*InVision Settlement Agreement*, Dec. 3, 2004, Appendix A.

The InVision agreement states that the FCPA violations took place through the acts of certain of InVision's employees, agents and distributors. Indeed, InVision was charged with violations based on lack of control over foreign distributors and sales agents that it chose,¹⁴ and with conducting inadequate due diligence of those third parties.¹⁵ Thus, InVision's lack of internal controls over its foreign subsidiary, foreign distributors and sales agents provided a basis for liability over the company itself.

Although InVision's standard agreement with its foreign distributors and sales agents contained a clause prohibiting violations of the FCPA, DoJ alleged that InVision failed to establish a program to monitor its foreign agents and distributors for compliance with the FCPA and failed to establish an internal system sufficient to prevent and detect violations of the FCPA.¹⁶ InVision was also alleged to have failed to provide formal training or education to its employees, sales agents, and/or its distributors.¹⁷

It is likely, therefore, that the government will hold a United States parent company liable under the internal controls provisions if it has failed to ensure that its internal controls were reasonably sufficient to ensure compliance with the FCPA by its subsidiaries.

¹⁴SEC Complaint, ¶ 19.

¹⁵*Id.*

¹⁶*Id.* ¶ at 21.

¹⁷*Id.* at ¶20.

II. SPECIAL CONCERNS REGARDING DOING BUSINESS IN THE PRC

Two factors require those doing business in the PRC to pay special attention to the FCPA. First, many major businesses in the PRC are state-owned or state-controlled. Many businesses in the PRC are operated under the supervision of the State-owned Assets Supervision and Administration Commission of the State Council (“SASAC”). The SASAC “is authorized to perform the function of a state owner, representing the state as shareholder in a company.”¹⁸ The SASAC’s mandate includes, in relevant part, allowing it to: “[s]upervise the maintenance and appreciation of state assets value for those state-invested enterprises;” “[a]ppoint, remove and evaluate the executives of the enterprises through legal procedures and grant rewards and punishments according to their performance;” “[s]afeguard the interest and rights of the owners of the state-owned assets;” “[d]raft laws, administrative regulations and related rules on the management of the state-owned assets;” and “undertake other issues assigned by the State Council.”¹⁹

Such a view of foreign officials is supported by the 1997 Organisation for Economic Co-operation and Development Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (“OECD Anti-bribery Convention” or “Convention”), which defines “foreign public official,” among other things, as “any person exercising a public function for a foreign country, including for

¹⁸Jiangyu Wang, *Dancing With Wolves: Regulation and Deregulation of Foreign Investment in China’s Stock Market*, 5 ASIAN-PAC. L. & POL’Y J. 1, 59 (2004).

¹⁹SASAC, *China State-owned Assets Management System Reform Entering New Stage* (2003). http://www.sasac.gov.cn/eng/eng_qygg/eng_qygg_0001.htm (last visited Feb. 24, 2006).

a public agency *or public enterprise*; and any official or agent of a public international organization.”²⁰ The Commentaries to the Convention explain that a “public enterprise” is “any enterprise, regardless of its legal form, over which a government may, directly or indirectly, exercise a dominant influence” (*e.g.*, by holding the majority of the enterprise’s subscribed capital, controlling a majority of the enterprise’s voting shares, or having the ability to appoint a majority of the members of the enterprise’s managerial board).²¹

On a more practical level, comments made by Peter Clark, who participated in the Justice Department’s enforcement actions against *Goodyear Int’l*, *Silicon Contractors* and *Syncor Taiwan* (referenced below), have led commentators to conclude that the Justice Department will take an expansive view of “foreign official,” and may apply it to entities even where a government is a minority shareholder.²²

Second, as commentators have noted, “[d]oing business in China generally entails the use of local partners and agents,” and that even in Sino-foreign joint ventures, the “responsibility for dealing with local government officials and obtaining necessary approvals is typically not in the foreign investor’s hands but lies with the Chinese partner.”²³ PRC laws prohibit bribery or other payments of cash or property

²⁰OECD *Anti-bribery Convention*, art. 1(4)(a), 1998 BDIEL AD LEXIS 19 (emphasis added), http://www.oecd.org/document/18/0,2340,en_2649_34859_35029714_1_1_1_1,00.html (last visited on Feb. 24, 2006).

²¹*Id.* ¶ at 14.

²²See Donald Zarin, *Doing Business Under the Foreign Corrupt Practices Act*, § 4:4.2 (Practicing Law Institute 2005) (citing statement of Peter Clark, Deputy Chief of Fraud Section, Criminal Division, in an address before the Foreign Trade Council (Apr. 21, 1994)).

²³Norton, *The Foreign Corrupt Practices Act: A Minefield for US Companies in China*, China Law & Practice (on-line ed.), Oct. 2005.

under most circumstances, including, in particular, to “gain illegal benefit” (criminal) or to sell goods or services (civil).²⁴ Even so, such corruption is widely recognized as pervasive in the PRC.²⁵

A. A Case in Point – Matter of Diagnostic Products Corporation

A recent case involving the conduct of a U.S. subsidiary operating in the PRC is instructive. On May 20, 2005, Diagnostic Products Corp. (“DPC”), a Los Angeles, California-based developer and manufacturer of medical testing technology and equipment, and its wholly-owned subsidiary in the PRC, DePu Biotechnological and Medical Products (DePu or DPC-Tianjin) Co. Ltd., entered into agreements with the SEC and DoJ to resolve investigations into alleged violations of the FCPA. As part of DePu’s agreement with the DoJ, it pled guilty to one count of violating the FCPA’s antibribery provisions and agreed to pay a criminal penalty of \$2,000,000.²⁶ In a separate settlement with the SEC, DPC agreed to disgorge another approximately \$2,800,000 – \$2,000,000 in “ill-gotten gains,” which represented DPC’s net profit in China during the period of DePu’s misconduct, *plus* \$749,895 in prejudgment interest.²⁷

These penalties resulted from the fact that, in marketing and selling its products and technologies in the PRC from 1991 to 2002, DePu paid “commissions”

²⁴L. Tjoa, O. Jianyu, and L. Pykstra, *Complying with PRC Antibribery Laws*, China Business Review (on-line ed.), Mar-Apr 2005.

²⁵*Id.*

²⁶http://www.usdoj.gov/opa/pr/2005/May/05_crm_282.htm.

²⁷<http://www.sec.gov/litigation/admin/34-51724.pdf>

totaling approximately \$1.6 million to doctors and laboratory employees responsible for purchasing decisions at a number of Chinese government-owned hospitals in exchange for business and contracts.²⁸ Most of the commissions, which ranged in value from 3% to 10% of sales, were paid in cash. DePu inaccurately recorded the commission payments in its financial statements as “selling expenses,” which, in turn, resulted in DPC maintaining inaccurate books, records and accounts in violation of the FCPA’s books and records provisions.²⁹

DPC discovered DePu’s improper commission payments as a result of a report by a senior DePu manager, which revealed that DePu’s auditors had identified certain Chinese tax issues surrounding DePu’s commission payments.³⁰ DPC ordered DePu to stop all commission payments and took remedial measures, including revising its code of ethics and implementing an FCPA compliance program.³¹ DPC also made voluntary disclosures to the SEC and DoJ. Despite all of these mitigating circumstances, DPC paid approximately \$4,000,000 plus its legal costs in addition to other expenses incurred in identifying and resolving the matter.

DPC’s settlement with the SEC also required DPC to retain an independent compliance consultant for three years.³² The consultant was to (i) review DPC’s compliance with its FCPA compliance program, and (ii) submit an annual report with

²⁸*Id.*

²⁹*Id.*

³⁰*Id.*

³¹*Id.*

³²*Id.*

recommendations to both DPC's Board of Directors and the SEC.³³ DPC agreed to compensate the consultant, and persons engaged to assist the consultant, at their reasonable and customary rates. Notably, DPC was required to refrain from asserting any privileges that would interfere with the consultant's transmission of information, reports, or documents to the SEC.³⁴ To preserve the independence of the consultant, DPC was required to forfeit any authority to terminate the consultant without prior written approval from a majority of DPC's independent directors *and the SEC*.³⁵

B. Traps for the Unwary: Inside Information and Expenses for Client Travel and/or Entertainment

The above example represents the manner in which the FCPA reaches what otherwise may have been considered a purely commercial business relationship, subject only to local laws, were it not taking place in the PRC. This creates traps for unwary subsidiaries or agents of U.S. companies engaging "foreign officials" in the PRC as commercial business contacts. Among those traps are the two concerns that may not be easily detected by internal controls that are focused on classic bribery scenarios: inside information and client travel.

1. Inside information – securing an improper advantage

As noted above, in 1998, the FCPA was amended to prohibit the securing of *any* improper advantage in obtaining or retaining business through corrupt

³³*Id.*

³⁴*Id.*

³⁵*Id.*

payments. Companies must be wary, therefore, of plying employees of PRC businesses for information about their employers' business needs. For example, if a state-owned enterprise is soliciting bids for new business and keeping certain information about competitors' bids or budgeting confidential, providing gifts or promising the employee anything of value to induce him or her to provide that confidential information may violate the FCPA.

In light of the emphasis on the use of local agents who have contacts inside these businesses in the PRC, it is critical that U.S. companies make sure their agents know that they may not engage in such conduct (or have others do so) in representing the U.S. companies' interests.

2. Potential concerns for benchmarking and training trips

Another special concern in the PRC – one that is easy to overlook in typical compliance efforts – is client travel for benchmarking and/or training in other countries. It is well known by companies doing business in the PRC that PRC businessmen value the opportunity to gain exposure to similar businesses outside of the PRC. As noted above, under the FCPA, it is unlawful to corruptly give or authorize the giving of anything of value to a foreign official for purposes of influencing any act or decision of such foreign official in his official capacity, inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or securing any improper advantage, or inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government, or instrumentality in order to assist such issuer in

obtaining or retaining business for or with, or directing business to, any person. Providing employees of state-owned enterprises with travel and entertainment may violate this prohibition.

Such trips may be built into contracts with PRC companies, though the contract may not spell out the amount of the contract value to be contributed to such overseas exposure/training and/or may provide little or no details about the mutual expectations for such travel. This can create an environment in which FCPA violations can be unwittingly committed by building in vacation time, entertainment, or providing *per diems* or gifts during such travel.

There are two affirmative defenses that permit some leeway in the area of client travel and, to a lesser degree, client entertainment expenses: (1) the payment, gift, offer, or promise of anything of value that was made was *lawful* under the written laws and regulations of the foreign official's country, and/or (2) the payment, gift, offer, or promise of anything of value that was made was a reasonable and *bona fide* expenditure, such as travel and lodging expenses, incurred by or on behalf of a foreign official, party, party official, or candidate and was *directly related* to (A) the promotion, demonstration, or explanation of products or services, or (B) the execution or performance of a contract with a foreign government or agency thereof. However, because these are affirmative defenses, the burden is on the issuer to establish that they apply.

A detailed review of PRC laws is beyond the scope of this WORKING PAPER, but several overarching points should be noted. First, PRC laws on this issue appear to be

vague and complex.³⁶ Second, it is important to understand that the affirmative defense does not take into consideration the customs and practices in the foreign official's country. Thus, even if it is common for gifts to be provided to clients or extravagant travel to be arranged for them, if such conduct violates local laws (even if not enforced), the affirmative defense is not available.

In any event, commentators have noted that travel expenses under the pretext of an investigation tour or training course may violate China's commercial bribery laws.³⁷ Additionally, extravagant payments or expenses even for trips that have a legitimate purpose may run afoul of other laws in the PRC.³⁸ Indeed, the Communist Party of China's ("CPC") *Regulations on Disciplinary Penalties* appear to prohibit any official from accepting "any gift that might affect his impartial exercise of a public

³⁶According to commentators, commercial bribery, which would apply to meals and travel (but not to cash payments, which may be subject to criminal bribery charges) requires (1) an offer of property; (2) involvement by a member of the working personnel of a company or enterprise; (3) a benefit or assistance to obtain a benefit; and (4) that the amount of the bribe is "relatively large" or "very large." There are no *de minimis* rules applicable to bribes to "working personnel of the state" for the purpose of obtaining a *quid pro quo*. Gifts, on the other hand, are the subject of a number of PRC rules and regulations, but if the gift is "relatively large" and the employee fails to turn it over to the state, the employee may be prosecuted. B. Ho and H. Fiske, *Demystifying the PRC Bribery Law*, <http://www.amcham-china.org.cn/amcham/show/content.php?Id=140&menuid=04&submid=04> (last visited Feb. 24, 2006).

³⁷See L. Tjoa, O. Jianyu, and L. Pykstra, *Complying with PRC Antibribery Laws*, China Business Review (on-line ed.), Mar-Apr 2005. See also *PRC Anti-Corruption Novel, "The Wrath of God": Insights into Official Corruption* (a review of a popular underground novelization of the corruption in Beijing Mayor Chen Xitong's government), <http://www.usembassy-china.org.cn/sandt/wrath.htm> (last visited Feb. 27, 2006) (regulations issued by the Central Disciplinary Commission on September 23, 1997 forbid party officials and leading cadres "the use of official position or influence to obtain assistance from any person or organization outside China to facilitate the foreign travel, visit with relatives or study of spouse, children, other relatives or friends"; Wang Jing & Co., Legal Newsletter, June 2005, <http://www.wjnco.com/download/en0506.pdf> (civil liability may be imposed for "tours, visits and so forth . . . in the name of travel and study."))

³⁸*Id.*

function” without registering receipt of the gift and surrendering it to the state.³⁹ These regulations enumerate a broad range of banned gratuities, including “acceptance of a dinner offer that might affect the impartial performance of a public function.”⁴⁰ It is reported that CPC regulations indicate that gifts with a value of 100 RMB (~\$12) should be registered, gifts valued at more than 200 RMB (~\$24) should be surrendered, and gifts in a single year should total no more than 600 RMB (~\$73). These rules are reportedly ignored and met with “incredulity” by Chinese businessmen.⁴¹ Chinese companies may ignore these limitations with the expectation that they will not be enforced; however, U.S. companies must comply with the FCPA, which only allows promotional and entertainment expenditures to the extent permitted by China’s “written laws and regulations.”⁴² Therefore, before attempting to rely on any *de minimis* gift rules in effect in China, an opinion from a reputable Chinese law firm should be obtained.

There is also substantial ambiguity built into the provision permitting reasonable and *bona fide* expenditures directly related to promotion efforts and contract performance. Therefore, U.S. companies should be circumspect in attempting to take advantage of these affirmative defenses. For example, while large *per diems* are likely to be held to be in violation of the FCPA, small *per diems* could still technically be deemed a violation. Meals are not specifically mentioned in the

³⁹P. Norton, *The Foreign Corrupt Practices Act: A Minefield for US Companies in China*, China Law & Practice (on-line ed.), Oct. 2005.

⁴⁰*Id.*

⁴¹*Id.*

⁴²*Id.*

statute, but if they are reasonable, they may be permissible. Gifts and entertainment expenses, particularly side trips, however, create a real risk of violating the FCPA.

While there are exceptions for the provision of things of value pursuant to a contract, expenses such as entertainment, side trips, vacation days, or *per diems* that are not called for by the contract may not be deemed to be directly related to the contract provisions. Even if the contract contains details about travel costs, companies must still be wary that the expenses are *bona fide*. For example, large *per diems* or extravagant accommodations to certain high level officials under contract still likely would be viewed as kickbacks. It may not be enough to expressly note that the client is paying for such expenses, as it could be argued that the contract price was artificially inflated to accommodate the otherwise improper expenses. Moreover, it is doubtful that extravagant contract provisions would be placed in public view. In many cases, contracts do not provide details or amounts allocated for such trips. There would seem little doubt that in most cases such expenses would be viewed as being borne by the U.S. subsidiary. If such expenses are not reasonable and directly related to a *bona fide* business purpose, the possibility of violating the FCPA would appear great. U.S. companies, therefore, should provide guidance to their employees, subsidiaries, and/or agents operating in the PRC with respect to payment for client travel/training.

III. SUGGESTIONS FOR BUSINESS IN THE PRC

- **Identify state-owned enterprises.** The first step toward ensuring compliance with the FCPA when operating within the PRC is knowing which

customers are state-owned or controlled enterprises. In the current era, it can be difficult to discern which clients fall into this category, and it is advisable to seek the advice of legal counsel in making determinations, particularly where there are joint ventures with multinational companies or some shares of the company are publicly traded. It cannot be assumed that such companies will not be considered to be state-controlled by the U.S. Government.

- **Prohibit all gifts to state-owned enterprise clients and require advance approval of other gifts.** In order to control the provision of gifts to state-owned enterprises, U.S. companies should require that all gifts to clients be approved by senior management and be reported to the U.S. company for monitoring. While it may be defensible to provide seasonal gifts (*e.g.*, moon cakes at New Year's), the better practice would be to prohibit use of company funds for this purpose in all cases where the client is a state-owned enterprise. To the extent that exceptions to such a prohibition are contemplated, legal counsel should be consulted.
- **Develop guidelines and require legal review of all client travel.** Written guidance should be provided in the provision of client travel to PRC state-owned or controlled entities to ensure that all expenses paid by the U.S. subsidiary or local agents meet the requirements of the FCPA. Legal counsel trained in the FCPA should develop these policies and approve the details of all such trips in advance.

- **Provide written FCPA guidance in Chinese.** Legal counsel should draft FCPA compliance materials for use by U.S. subsidiaries and branches worldwide. PRC employees of U.S. subsidiaries may, however, have a limited understanding of written English. It is risky to assume that these employees will read, understand, and properly interpret FCPA guidance that is written in English, particularly with respect to the definitions of “foreign officials” set forth in the text of the FCPA. It may be advisable, therefore, that guidance to PRC employees on this subject be written specifically to address the special problems that arise in the PRC and that this guidance be translated into Chinese.
- **Provide for thorough review of travel and entertainment expenses and/or audit PRC subsidiaries frequently; use credit cards whenever possible.** It is essential that U.S. companies have in place adequate internal controls to monitor travel and entertainment expenses so that they can be assured of FCPA compliance. This is particularly important in the PRC because of the fact that many otherwise lawful business relationship strategies are unavailable to companies doing business with companies there. Additionally, PRC controllers may lack a complete understanding of the accounting practices that are required in companies subject to U.S. laws. Therefore, it is critical to ensure that controllers are properly trained and have relevant experience.

It is also important to ensure that accounting staff scrutinize receipts and, wherever possible, that credit cards be used. The Fa Piao receipts system used in the PRC is easily abused because the receipts are usually provided in rounded-off amounts and the description of services/goods can lack descriptive qualities required for good record-keeping. Credit card receipts typically provide more accurate information and, therefore, the use of credit cards (and the submission of credit card receipts) for business expenses should be encouraged, if not required.

- **Require FCPA certification from and conduct due diligence on agents and subcontractors.** In the current enforcement environment, U.S. companies are expected to know with whom they are doing business. For all of the reasons stated in this article, this is even more critical for U.S. companies doing business in the PRC. Thus all agents and subcontractors should be required to complete FCPA certifications, and reasonable inquiries should be made to ensure that such companies are complying with the FCPA.
- **Avoid commission-based contracts for agents seeking to obtain business for subsidiaries of U.S. companies in the PRC.** It is common for foreign companies doing business in the PRC to use local companies, some of which are very small and may employ only a few retired employees of the potential client, because of their relationship (or claimed relationship) with employees of state-owned enterprises. These companies may represent that they can help obtain business or information about the client or a specific

procurement that will help to obtain business. The contracts at stake are often very valuable, and so commissions paid to such agents can be substantial. There is, therefore, an incentive for such agents, who may have very little in the way of expenses, to make payments (with the expectation of earning a large commission in return) to secure business, either for inside information or in the more classical bribery sense. Thus, such relationships lend themselves to violations and should be avoided if at all possible. If such relationships are necessary, companies should develop some means by which to monitor expenses on the part of the agent and/or seek to develop a pay structure that is based on the amount of work performed and not the size of the prime contract. Legal counsel should closely scrutinize all such relationships. But because even close monitoring cannot prevent an FCPA violation under these circumstances, companies that choose this path should recognize that by doing so they are accepting an increased risk of criminal or civil action by U.S. authorities.