

Special problems concerning the Foreign Corrupt Practices Act in the People's Republic of China

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In an era when doing business in the People's Republic of China (PRC) is becoming commonplace for major US companies, those companies cannot assume that they can conduct 'business as usual' there. While US 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). Cultural issues and corruption in the PRC may further compound this problem.

The Foreign Corrupt Practices Act

The anti-bribery provisions of the FCPA prohibit any corrupt offer, payment, promise to pay, or authorisation of the payment of any other thing of value to any foreign official to influence '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'. See 15 USC §§ 78dd-1, 78dd-2, 78dd-3, 78m – 78ff. These acts must be done 'in order to assist ... in obtaining or retaining business for or with, or directing business to, any person'. *Id.* at §§ 78dd-1 (a), 78dd-2 (a), 78dd-3 (a).

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'. *Id.* at § 78m(b)(2). They also contain provisions that 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'. *Id.* Thus, controls must be adequate to protect against off-book accounts and disbursements and other unauthorised payments.

The provisions of the FCPA do not directly apply to foreign subsidiaries or foreign agents of US companies, but US companies may violate the FCPA if they have knowledge that a subsidiary or independent agent is

engaging in conduct contrary to the anti-bribery provisions of the FCPA.¹ Additionally, the FCPA's books and records and internal controls requirements provide a basis for imputing liability to US parents of foreign subsidiaries.

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 and/or are operated under the supervision of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), which has broad supervisory authority and controls over state-owned enterprises. See SASAC, *China State-Owned Assets Management System Reform Entering New Stage* (2003).² Thus, the Justice Department is likely to take an expansive view of 'foreign officials' in the PRC. See Donald Zarin, *Doing Business under the Foreign Corrupt Practices Act*, § 4:4.2 (Practising Law Institute 2005).

Second, as commentators have noted, '[d]oing business in China generally entails the use of local partners and agents', and 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'.³ PRC laws prohibit bribery or other payments of cash or property most circumstances, including, in particular, to 'gain illegal benefit' (criminal) or to sell goods or services (civil).⁴ Even so, such corruption is widely recognised as pervasive in the PRC.⁵

Traps for the unwary: inside information and client travel

These circumstances create traps for unwary subsidiaries or agents of US companies engaging 'foreign officials' in the PRC as commercial business contacts. Among those traps are two concerns that may not be easily detected despite internal controls focused on classic bribery scenarios: inside information and client travel.

Inside information – securing an improper advantage

Because the FCPA prohibits the securing of *any* improper advantage in obtaining or retaining business, companies must avoid 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 this regard, 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, which 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 scrutinise all such relationships. But because even close monitoring cannot prevent an FCPA violation under these circumstances, companies that choose this path should recognise that by doing so they are accepting an increased risk of criminal or civil action by US authorities.

Potential concerns for benchmarking and training trips

Another special concern in the PRC 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 the PRC. Such trips may be built into contracts with PRC companies, but 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 diem* or gifts during such travel.

Maintaining accounting controls is further complicated because PRC controllers may lack a complete understanding of the accounting practices that are required in companies subject to US laws. Additionally, 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 provided can lack descriptive qualities required for good recordkeeping. Credit card receipts typically provide more accurate information and, therefore, the use of credit cards should be encouraged, if not required.

There are two affirmative defences 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 defences, the burden is on the issuer to establish that they apply.

A detailed review of PRC laws is beyond the scope of this article, but several overarching points should be noted. First, PRC laws on this issue appear to be vague and complex.⁶ Commentators have noted that travel expenses under the pretext of an investigation tour or training course may violate China's commercial bribery laws.⁷ Also, the Communist Party of China (CPC) Regulations on Disciplinary Penalties appear to prohibit any official from accepting 'any gift that might affect his impartial exercise of a public function' without registering receipt of the gift and surrendering it to the state.⁸ These rules are reportedly ignored and met with 'incredulity' by PRC businessmen.⁹ But while PRC companies may ignore these limitations with the expectation that they will not be enforced, US companies must comply with the FCPA. In this regard, it is important to understand that the affirmative defence does not take into consideration the customs and practices in the foreign official's country, but rather its written laws. Therefore, before attempting to rely on PRC laws as a defence, 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. 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

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 a *per diem* that is 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. Large *per diems* or extravagant accommodation granted to certain high-level officials under contract could still be viewed as kickbacks. It may not matter 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.

Conclusion

The PRC is fast becoming a ‘must’ investment for US companies. US companies should first, however, arm themselves with internal controls and be cautious about local agents and the roles that they are permitted to play. Education of PRC employees in FCPA compliance is critical to this effort. Such education should take place in Chinese, not English. An English policy directive that does not focus on the special problems *vis-à-vis* the definition of foreign officials in the PRC is likely to be doomed to failure from the start.

Notes

- 1 The term ‘knowing’ includes conscious disregard and deliberate ignorance. See, eg, 15 USC §§ 78dd-1(f)(2)(A); Omnibus Trade and Competitiveness Act of 1998, Pub L No 100-418, HR Rep No 100-578, at 921 (1998) (Conf Rep), as reprinted in 1998 USCCAN 1547, 1954.
- 2 See www.sasac.gov.cn/eng/eng_qygg/eng_qygg_0001.htm (last accessed 24 February 2006).
- 3 P Norton, *The Foreign Corrupt Practices Act: A Minefield for US Companies in China*, China Law & Practice (online ed), October 2005.
- 4 L Tjoa, O Jianyu, and L Pykstra, *Complying with PRC Antibribery Laws*, China Business Review (on-line edn), March–April 2005.
- 5 *Ibid.*
- 6 See, eg, B Ho and H Fiske, *Demystifying the PRC Bribery Law* www.amcham-china.org.cn/amcham/show/content.php?id=140&menuid=04&submid=04 (last accessed 24 February 2006).
- 7 See L Tjoa, O Jianyu, and L Pykstra, *Complying with PRC Antibribery Laws*, China Business Review (on-line edn), March–April 2005.
- 8 P Norton, *The Foreign Corrupt Practices Act: A Minefield for US Companies in China*, China Law & Practice (on-line edn), October 2005.
- 9 *Ibid.*

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