

# CHINA UNDER THE FOREIGN CORRUPT PRACTICES ACT

DANIEL CHOW\*

The Foreign Corrupt Practices Act (FCPA) prohibits the payment of bribes to foreign officials in order to obtain or retain business. The United States Department of Justice (DOJ) has adopted a broad and expansive definition of several key elements of this statute, including the meaning of a “foreign official.” The approach by the DOJ should raise special concerns for multinational corporations (MNCs) doing business in the People’s Republic of China (PRC or China) and their in-house counsel because the DOJ’s aggressive positions apply with special force in China. For all of its recent economic reforms, China continues to be a one-party authoritarian state, which means that many persons who appear to be ordinary business people may qualify as foreign officials under the aggressive interpretations of the DOJ and that payments or benefits given to such persons might be covered under the FCPA. In addition, the business culture of China has traditionally tolerated the use of payments and gifts as a common way of doing business. This creates additional risks for MNCs because PRC officials will often demand benefits that might fall under the FCPA and because employees working in the field often are eager to provide such benefits.

Given the unique features of China’s economic and political system, the attractiveness of China as a place to do business for MNCs in the modern global economy, and the aggressive positions of the DOJ, there are many pitfalls and traps that may await the MNC doing business in China. In response to these concerns, MNCs need to implement an effective on-the-ground FCPA compliance program to mitigate these risks.

Introduction .....	574
I. Overview of the FCPA and Its Major Elements .....	576
II. Elements of the FCPA that Present Special Concerns in China .....	578
A. Foreign Official .....	578
1. Foreign Official as an Employee of a State-owned Enterprise (SOE).....	578
2. State-owned Enterprises and State-controlled	

---

\* Joseph S. Platt-Porter Wright Morris & Arthur Professor of Law, the Ohio State University Michael E. Moritz College of Law. The author was in-house counsel for a multinational company in China and involved firsthand in some of the corporate governance and compliance issues discussed in this Article. Thanks to participants at a faculty workshop held at the University of Akron Law School on November 3, 2011, and to the participants in the *Wisconsin Law Review* Symposium on November 18-19, 2011, for their helpful comments. Mike Koehler also helped to correct several mistakes. Cindy Bi, Moritz Class of 2013, provided helpful research assistance on this Article.

Enterprises in China.....	580
3. Communist Party Cadres as Foreign Officials .....	586
B. “Anything of Value” .....	589
C. Third Party Intermediaries or Contractors and Pass- through Payments .....	592
D. Joint Venture Partners.....	598
III. Compliance Incentives and Elements of an Effective Compliance Program .....	600
A. Incentives to Create an Effective Compliance Program...	600
B. Designing and Implementing an Effective FCPA Compliance Program .....	602
1. Compliance Programs Must Be Implemented on the Ground in China .....	603
2. Due Diligence .....	604
3. Dealing with Demands by PRC Officials for Benefits.....	605
4. Seeking Clarification from the DOJ of Key Terms....	606
Conclusion.....	607

#### INTRODUCTION

With the rise of the People’s Republic of China (PRC or China) as a global economic power, multinational companies (MNCs) and their in-house counsel need to be aware of the multitude of recent issues that involve China under the Foreign Corrupt Practices Act (FCPA).<sup>1</sup> Within the past decade, both the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) have sharply increased their enforcement efforts against alleged FCPA violations.<sup>2</sup> Not surprisingly, many of these cases involve MNCs and their business activities in or connected to China, where many of the world’s leading MNCs have substantial business operations.<sup>3</sup> Given China’s importance

---

1. *E.g.*, 15 U.S.C. §§ 78b, 78dd-1 to -3 (2006). For a discussion of China’s remarkable rise as an economic power and its ramifications for the United States, see Chapter One of DANIEL C.K. CHOW & ANNA M. HAN, *DOING BUSINESS IN CHINA: PROBLEMS, CASES AND MATERIALS* (2012).

2. In 2003, the U.S. government initiated nine FCPA investigations; just four years later, in 2007, the U.S. government initiated twenty-nine FCPA investigations. SHEARMAN & STERLING LLP, *RECENT TRENDS AND PATTERNS IN FCPA ENFORCEMENT 2* (2008), *available at* [http://www.shearman.com/files/upload/FCPA\\_Trends.pdf](http://www.shearman.com/files/upload/FCPA_Trends.pdf). In 2010, there were seventy-four total FCPA investigations pending, almost double the number in 2007. Melissa Aguilar, *2010 FCPA Enforcement Shatters Records*, COMPLIANCE WEEK (Jan. 4, 2011), <http://www.complianceweek.com/2010-fcpa-enforcement-shatters-records/article/193665/>.

3. *See infra* Part III.

as a strategic location for foreign direct investment<sup>4</sup> by MNCs, it is likely that FCPA cases that involve China will continue to increase. This prospect should be a major business concern for MNCs doing business in China.

This Article examines important FCPA issues that arise from doing business in China. As we shall see, there are at least two reasons why FCPA issues involving China present a particularly thorny and elusive problem for MNCs. First, the DOJ takes an aggressive position on several key elements of the FCPA that apply with particular force to China. For example, the crux of the anti-bribery provisions of the FCPA<sup>5</sup> is a proscription against bribes paid to foreign officials to obtain a business advantage.<sup>6</sup> This proscription could capture a multitude of transactions that occur on a daily basis in China because, despite all of its recent economic reforms, China continues to be a one-party authoritarian state with an economy that is highly regulated by many different government bureaucracies.<sup>7</sup> The result of China's state-controlled economic system is that many persons who might appear at first glance to be private persons might qualify as foreign officials under the FCPA. These persons range from low-level employees in a profit-seeking business enterprise to doctors or administrators in state-operated hospitals under the DOJ's expansive interpretation of these terms.<sup>8</sup> As a result, what may appear at first to the MNC as unobjectionable or non-criminal behavior may be considered to be an FCPA violation by the DOJ.<sup>9</sup> Second, even today, the myriad ways in which business is conducted on a day-to-day basis on the ground by their China entities remains opaque to the senior management of many MNCs. What many local employees in China view as petty commercial corruption—giving kickbacks and providing favors—is common and occurs innumerable times on a daily basis in China.<sup>10</sup> Many of these acts occur in the field where it is impossible for an MNC to monitor. While many people in China view these acts to be acts of petty corruption tolerated by PRC enforcement officials, these same acts may be viewed by the DOJ as FCPA violations. Due to reasons of culture and language, many MNCs may not even be aware of the many ways in which their lower-level employees may be acting in violation of the

---

4. For a definition of foreign direct investment, see *infra* Part II.A.2.

5. For a discussion of these provisions, see *infra* Part II.B.

6. See *infra* Part II, for a detailed discussion of the elements of a violation of the FCPA anti-bribery provisions.

7. See DANIEL C.K. CHOW, THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA IN A NUTSHELL 23–24 (2d ed. 2009).

8. See *infra* Part II.A.2.

9. See *infra* Part II.A.2.

10. See *infra* Part II.B.

FCPA.<sup>11</sup> Lack of actual knowledge, however, is not a defense in an FCPA prosecution.<sup>12</sup> The number of possible FCPA violations in China indicates that China may be a trap for the unwary. The purpose of this Article is to expose the myriad ways in which FCPA violations may be occurring in China on a daily basis. MNCs need to address these issues immediately by implementing effective compliance programs.<sup>13</sup>

Part I of this Article will provide a brief overview of the FCPA's major elements and identify those elements that are being aggressively interpreted by the DOJ. Part II then examines each of these elements in detail and gives examples of how the broad definitions of key FCPA elements and their application to China's current political system and business culture could lead to a wide array of potential FCPA violations. Part III examines how MNCs might deal with these problems through compliance programs for their China business entities and what measures an effective compliance program must include.

#### I. OVERVIEW OF THE FCPA AND ITS MAJOR ELEMENTS

The FCPA contains two major sets of provisions: the anti-bribery provisions, which are enforced by the DOJ through civil and criminal penalties,<sup>14</sup> and the books and records and internal control provisions, which are enforced by the SEC through civil penalties.<sup>15</sup> The focus of this Article is on the anti-bribery provisions because they involve criminal penalties and are generally regarded by companies as creating greater risks and higher exposures. The following is a summary of the anti-bribery provisions of the FCPA. These provisions prohibit any U.S. company, its personnel, U.S. citizens, foreign companies with shares listed on a U.S. stock exchange or otherwise required to file reports with the SEC, or any person of any nationality while present in the United States from (i) corruptly paying, offering to pay, promising to pay or authorizing the payment of money, a gift, or anything of value to (ii) a foreign official or any foreign political party official for the purpose of (iii) obtaining or retaining business.<sup>16</sup>

---

11. See *infra* Part II.B.

12. For a discussion of the scienter requirement in FCPA actions, see *infra* Part II.C.

13. See *infra* Part III.

14. 15 U.S.C. §§ 78m(b), 78dd-1 to -3 (2006). For a discussion of the history of the FCPA and why Congress believed it was necessary to enact a statute that prohibits corrupt payments to foreign officials, see *United States v. Kay*, 359 F.3d 738, 746-56 (5th Cir. 2004).

15. § 78m(b)(2)-(3). For a discussion of the books and records and internal control provisions, see *infra* Part III.A.

16. § 78dd-1(a).

Of the elements set forth above, among the most troublesome for MNCs doing business in China are the broad definitions of “foreign official” and “anything of value.” Another important issue under the FCPA is that a covered person is liable if he or she makes a payment to a third party or an intermediary while knowing that all or a part of the payment will be made to a foreign official.<sup>17</sup> Each of these elements and their aggressive interpretations by the DOJ will be discussed below.

The DOJ’s aggressive interpretations have been largely untested in court. While a few key terms have been the subject of judicial decisions, there is still sparse case law developed by courts. The reason why many of the DOJ’s interpretations of major elements of the FCPA are untested in court is that most companies, when faced with the prospect of an enforcement action under the FCPA, will agree to a DOJ non-prosecution agreement (NPA), deferred prosecution agreement (DPA), or a plea or settlement with the DOJ or the SEC.<sup>18</sup> Rather than face the prospect of a criminal investigation or prosecution, most companies will simply agree to pay a fine and accept the conditions imposed by the DOJ and the SEC. The result of the widespread use of these settlement procedures is that the interpretations established by NPAs and DPAs for such key FCPA terms such as “foreign official” and “anything of value” have not been extensively reviewed by courts. These NPAs and DPAs are not approved or usually reviewed by courts so there is no judicial oversight or approval of any of these interpretations by the DOJ and SEC.<sup>19</sup> Given the reluctance of companies to contest FCPA charges in court, the DOJ’s interpretations of these terms serve as de facto case law. A number of commentators are highly critical of this approach, but it does not appear that this process will change anytime soon given the reluctance of most companies to defend an FCPA prosecution in court.<sup>20</sup> As the DOJ’s interpretations represent the views of an enforcement agency, the interpretations are, not surprisingly, highly aggressive and can create a host of compliance issues as well as legal uncertainties. As the next Part of this Article details, the DOJ’s aggressive interpretations apply with special force in China to create a potentially expansive application of the FCPA to many transactions and could present serious challenges and traps for the unwary.

---

17. § 78dd-3(a)(3).

18. Mike Koehler, *The Façade of FCPA Enforcement*, 41 GEO. J. INT’L L. 907, 909 (2010).

19. *See id.*

20. *See id.* at 927.

## II. ELEMENTS OF THE FCPA THAT PRESENT SPECIAL CONCERNS IN CHINA

This Part of this Article analyzes four problematic areas under the FCPA that should be of concern to MNCs doing business in China: (1) the broad definition of a “foreign official”; (2) the proscription of giving “anything of value”; (3) the actions of local joint-venture partners that are attributed to the joint venture and to the MNC; and (4) the problem of illegal pass-through payments by third parties.

### *A. Foreign Official*

The FCPA defines a foreign official as (1) an employee of a government or an instrumentality thereof; and (2) any person acting in an official capacity on behalf of a foreign government.<sup>21</sup> The discussion below examines each of these two prongs of the definition of a foreign official.

#### 1. FOREIGN OFFICIAL AS AN EMPLOYEE OF A STATE-OWNED ENTERPRISE (SOE)

The FCPA designates a “foreign official” as “any officer or employee of a foreign government or any department, agency, or instrumentality thereof.”<sup>22</sup> The DOJ has stated that because state-owned enterprises (SOEs) or state-controlled enterprises are instrumentalities of the state, any employee of such an enterprise qualifies as a “foreign official” under the FCPA.<sup>23</sup> As of today, only a few defendants have challenged whether a state-owned corporation can qualify as an instrumentality of a foreign government and all of these courts have agreed with the DOJ.<sup>24</sup> In a recent case, *United States v. Carson*,<sup>25</sup> the DOJ charged various defendants with making bribes to employees of a number of state-owned companies in China and other countries, including the China National Offshore Oil Corporation, China Petroleum Materials and Equipment, Dongfang Electric Corporation,

---

21. § 78dd-1(f)(1)(A).

22. *Id.*

23. *See* Koehler, *supra* note 18, at 916–17.

24. *See, e.g., United States v. Aguilar*, 738 F. Supp. 2d 1108, 1110 (C.D. Cal. 2011); *United States v. Esquenazi*, No. 09-21010-CR-MARTINEZ-BROWN, 2010 U.S. Dist. LEXIS 143572, at \*3–4 (S.D. Fla. Nov. 19, 2010).

25. *United States v. Carson*, No. SACR 09-00077- JVS, 2011 U.S. Dist. LEXIS 88853 (C.D. Cal. May 18, 2011).

Guohua Electric Power, Jiangsu Nuclear Power Corporation, and PetroChina.<sup>26</sup> The defendants moved to dismiss the indictment on the grounds that a state-owned corporation, as opposed to a government bureau or agency, cannot be an instrumentality of the state and therefore employees of such corporations cannot be foreign officials.<sup>27</sup> In *Carson* the federal district court, like the other courts that have considered the issue,<sup>28</sup> denied the motion to dismiss.<sup>29</sup> The court held that some state-owned companies and business entities may be “instrumentalities” of the foreign government within the meaning of the FCPA.<sup>30</sup> The court held that whether a company qualifies as an instrumentality is a question of fact.<sup>31</sup> Government ownership of the company alone does not automatically make the company an instrumentality of the government, but other factors must also be considered.<sup>32</sup> The court set forth the following factors:

- The foreign state’s characterization of the entity and its employees;
- The foreign state’s degree of control over the entity;
- The purpose of the entity’s activities;
- The entity’s obligations and privileges under the foreign state’s law, including whether the entity exercises exclusive or controlling power to administer its designated functions;
- The circumstances surrounding the entity’s creation; and
- The foreign state’s extent of ownership of the entity, including the level of financial support by the state (e.g., subsidies, special tax treatment, and loans).<sup>33</sup>

The court noted that these factors were not exclusive and that none of them was dispositive.<sup>34</sup> State ownership was merely one consideration in deciding whether a state-owned company constituted an “instrumentality.”<sup>35</sup> The court denied the defendants’ motion to dismiss on the grounds that the determination of whether the Chinese companies were instrumentalities of the state had to be made at trial.<sup>36</sup>

---

26. *Id.* at \*5–5.

27. *Id.* at \*3.

28. *Id.* at \*30–32.

29. *Id.* at \*40.

30. *Id.* at \*31.

31. *Id.*

32. *See id.* at \*11.

33. *Id.* at \*11–12.

34. *Id.* at \*12.

35. *Id.*

36. *Id.*

The conclusion reached by the court, as well as other courts that have considered the issue,<sup>37</sup> is that some state-owned enterprises qualify as government “instrumentalities”<sup>38</sup> and that employees of such companies can be “foreign officials”<sup>39</sup> within the meaning of the FCPA.

Given that the position of the courts is that some SOEs may qualify as instrumentalities of the state and that the position of the DOJ appears to be that all SOEs are instrumentalities of the state, what is the prudent course of action for U.S. companies on this issue? Some companies doing business in China feel compelled to take the position that “everyone they deal with is a ‘foreign official’ because they work for an SOE.”<sup>40</sup> As the next Subsection shows, under China’s current state-controlled economy, SOEs and state-controlled enterprises continue to play a pervasive role, increasing the possibility that the DOJ will consider employees of many business entities to be foreign officials.

## 2. STATE-OWNED ENTERPRISES AND STATE-CONTROLLED ENTERPRISES IN CHINA

SOEs continue to occupy a central role in China’s economy, which even today, displays many elements of a command economy that was typical of communist states in the 1950s through the 1980s. Prior to China’s 1978 economic reforms, China had a Soviet-style command economy in which SOEs dominated. In China’s pre-reform economy, SOEs were essentially administrative units of the state.<sup>41</sup> An SOE:

[was] owned by the state as opposed to any private entity, individual, or group of individuals. An SOE was expected to meet state production targets, to turn over all of its revenues to the state, and to have all of its losses subsidized or absorbed by the state. The state also controlled all of the SOE’s business and management functions . . . .<sup>42</sup>

Prior to economic reforms, SOEs accounted for over eighty percent of all of China’s industrial output.<sup>43</sup> Since the 1978 economic reforms, the

37. *Id.* at \*30.

38. *Id.* at \*31.

39. *Id.* at \*12–13, 31.

40. Declaration of Prof. Michael J. Koehler in Support of Defendants’ Motion to Dismiss Counts One through Ten of the Indictment at ¶ 447, *United States v. Carson*, No. SACR 09-00077- JVS (C.D. Cal. Feb. 21, 2011).

41. CHOW, *supra* note 7, at 21.

42. *Id.* at 23.

43. *Id.* at 24.

role of SOEs has steadily declined and some SOEs have been fully or partially privatized. “By 2004, SOEs accounted only for 15.3%” of China’s industry output.<sup>44</sup> Despite the diminishing role of SOEs, however, they continue to play a crucial role in China’s economy.<sup>45</sup> All important sectors of the economy, such as banking, telecommunications, steel production and manufacturing, oil and gas exploration and refining, electricity and water supply, and train and air transport (including commercial air travel) are controlled by SOEs for policy and national security reasons.<sup>46</sup> Given the crucial role of SOEs in such vital sectors of the economy, MNCs doing business in China are likely to be in contact with SOEs on a regular basis.

Although some SOEs have now been privatized, state administrative entities often continue to own a minority interest in these companies. There is nothing in the DOJ’s interpretation of an SOE as an instrumentality of the state that requires a company to be wholly owned by the state in order to qualify as an SOE. It is quite possible, even likely, that the DOJ will consider companies that are partially owned by the state, even with a minority interest, to be SOEs.<sup>47</sup> If that is the case, then the number of entities that would qualify as SOEs in China could expand significantly<sup>48</sup> and MNCs doing business in China will need to exercise due diligence in determining whether a business entity is fully privatized or whether the state continues to have any ownership interest.

The DOJ has also indicated that a “state-controlled enterprise” will be considered to be an “instrumentality” of the state and that therefore employees of such entities will also be considered to be “foreign officials.”<sup>49</sup> The DOJ’s position could potentially further expand significantly to qualify more PRC entities as instrumentalities of the state and employees that qualify as foreign officials. Under this interpretation, a company could qualify as a “state-controlled enterprise” even though the state has no ownership interest at all in the

---

44. *Id.* at 25.

45. *Id.*

46. *Id.*

47. For example, the United States has asserted that employees of a Nigerian company were foreign officials because the company was a state-owned enterprise even though the Nigerian government only owned a minority interest in the company. A consortium of private oil companies owned a majority share (fifty-one percent) of the Nigerian company. *United States v. Marubeni*, No. 12-CR-022 (S.D. Tex. 2012).

48. Wendy Wysong, *State-Owned Enterprises: An FCPA Risk You Can’t Ignore in Asia*, CORP. COMPLIANCE INSIGHTS (July 25, 2011), <http://www.corporatecomplianceinsights.com/state-owned-enterprises-an-fcpa-risk-you-cant-ignore-in-asia/>.

49. Koehler, *supra* note 18, at 916–17.

company so long as the state is deemed to be able to exercise control over the company. China continues to be an authoritarian state, so both in theory and in practice all companies are subject to the control and supervision of the state. China divides its economy into vertical sectors, and within each sector, all entities that operate under that sector, whether acting for profit or not, are under the supervision of a state agency.<sup>50</sup> For example, a chemicals company, whether private or state-owned, would be subject to the supervision of the Bureau of Light Industry, a government entity, and must file regular reports with the Bureau. Under China's authoritarian system, the state agency, if it wishes, can impose demands on any company operating under its sphere of authority and most companies will have little choice but to comply. Under this definition, virtually every company in China could qualify as a "state-controlled enterprise" and every employee in such a company could qualify as a "foreign official."

Given the expansive definitions discussed above, how might an unsuspecting MNC doing business in China violate the FCPA? Let us take a hypothetical situation, which is very common in China today. China is now one of the world's largest targets of foreign direct investment (FDI) by the world's most powerful MNCs.<sup>51</sup> FDI refers to the acquisition of a lasting ownership interest by a foreign owner in a business enterprise established under local or domestic law.<sup>52</sup> A common example of FDI occurs when an MNC sets up a wholly owned subsidiary in a foreign country or acquires a foreign company through the purchase of its assets or its shares.<sup>53</sup> These common scenarios can pose significant risks for the MNC. Another common example of FDI is when an MNC forms a joint venture, a separate legal entity, with a local company in China.

Suppose that a U.S.-based MNC establishes a wholly foreign-owned enterprise (WFOE) in China under relevant PRC laws.<sup>54</sup> The WFOE is a creature of Chinese law and is considered to be a separate legal entity from the MNC that owns it;<sup>55</sup> the MNC is protected by the separate entity status of the WFOE and principles of limited liability

---

50. See DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 492 (2d ed. 2010).

51. See CHOW, *supra* note 7, at 34.

52. See CHOW & SCHOENBAUM, *supra* note 50, at 366.

53. See *id.* at 369–70.

54. Most MNCs now prefer the WFOE as the preferred foreign investment vehicle, replacing the joint venture. CHOW, *supra* note 7, at 394.

55. [Wholly Foreign-Owned Enterprise Law (Revised)] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2000, effective Oct. 31, 2000), art. 2, *available at* <http://en.shippingchina.com/regulations/index/detail/id/224.html>.

under PRC law.<sup>56</sup> Suppose that the WFOE is engaged in the manufacture and production of chemicals that are commonly used in all types of consumer daily-use products, such as detergent and household cleansers. A sales agent in the WFOE provides a secret “kickback,” or a payment to a potential customer, a PRC company that uses the chemical ingredients in producing its laundry detergent, to the personal account of a purchasing agent.<sup>57</sup> The purchasing agent, in exchange for the payment, is induced to place a purchase order on behalf of its employer for the chemicals from the WFOE. The sales agent in the WFOE receives a benefit in the form of a commission or a promotion for having completed a sale. Both of the individuals involved have benefitted while conducting business on behalf of their employers. These types of kickbacks, as well as variations of this scheme, happen every day in China; in fact, they are so common that these kickbacks are viewed by many people in China as an expected way to do business. Many people in China are simply resigned to view kickbacks as a form of minor or petty corruption that must be tolerated or accepted.<sup>58</sup>

The DOJ, however, could take quite a different view of this transaction, one with potentially serious consequences for both the WFOE and the MNC. If the PRC detergent company is an SOE, the DOJ might then consider the company to be an “instrumentality” of the PRC government, and the purchasing agent, although a low-level employee of the PRC detergent company, might be deemed to be a “foreign official.” Therefore, the kickback in this case will be viewed as a payment within the meaning of the FCPA in order to obtain business. Although the WFOE is a separate legal entity from the U.S.-based MNC, the DOJ might consider the WFOE to be an “agent” of the MNC under the FCPA.<sup>59</sup> As a result, the actions of the WFOE and its sales agent will be attributable to the MNC. The DOJ could then bring an FCPA enforcement action against both the MNC and the WFOE for the payment of the bribe to the purchasing agent of the detergent company. In fact, under similar circumstances, the DOJ

---

56. [The Company Law of the People’s Republic of China (revised in 2005)] (promulgated by the Standing Comm. Nat’l People’s Cong., Dec. 29, 1993, effective Dec. 29, 1993), *available at* <http://gothenburg2.mofcom.gov.cn/aarticle/chinalaw/investment/200607/20060702763901.html>.

57. Such a “kickback” is illegal under Article 8 of the PRC’s Anti-Unfair Competition Act. [People’s Republic of China Anti-Unfair Competition Act] (promulgated by the Standing Comm. Nat’l People’s Cong., Sept. 2, 1993, effective Dec. 1, 1993), art. 8. However, it is often not pursued by PRC enforcement authorities unless the sums are large or the kickback is made public, which would cause embarrassment to the authorities if they did not bring a prosecution.

58. This observation is based upon the author’s own experience as in-house counsel for an MNC in China.

59. *See* 15 U.S.C. § 78dd-2(a) (2006).

charged both the MNC and its China business entity with FCPA violations.<sup>60</sup>

In a variation of the scenario set forth above, suppose that the PRC company, for which the employee receives the payment, is not a state-owned enterprise but is a joint venture between a U.S. multinational company and a PRC state-owned enterprise. A joint venture, a common business vehicle, is a PRC legal entity that is usually created through the combined investment of capital and technology by a foreign company and a local PRC company.<sup>61</sup> The parties then have an ownership interest in the joint venture in proportion to their capital contributions to the joint venture.<sup>62</sup> Many MNCs partner with state-owned enterprises as joint-venture partners and in some cases, the use of a SOE as a joint-venture partner is required by PRC authorities.<sup>63</sup> Suppose that the foreign investor is a majority owner with a sixty-percent share of the equity interests in the joint venture and the local partner, the state-owned enterprise, is a minority owner with a forty-percent share. This is a common arrangement in the PRC for joint ventures. Even though the state-owned enterprise is a minority owner of the joint venture and the joint venture is a profit-seeking enterprise in the PRC, the DOJ might consider the joint venture to be a state-owned enterprise for the purposes of the FCPA.<sup>64</sup> Nothing in the DOJ's interpretation of an SOE requires an SOE to be an enterprise that is wholly owned by the state.<sup>65</sup> The DOJ might well find that a company that is partially owned by an SOE, such as the Sino-foreign joint venture described above, might also be considered to be an SOE by the DOJ for the purposes of the FCPA.<sup>66</sup> Under these circumstances, the payment by the employee of the U.S.-based MNC's wholly foreign-owned enterprise in China to an employee of a joint venture in China might be considered by the DOJ to violate the FCPA. MNCs might be surprised that a joint venture might be considered to be an SOE and that the transaction described above might violate the FCPA, but it is

---

60. See Press Release, Dep't of Justice, DPC (Tianjin) Ltd. Charged with Violating the Foreign Corrupt Practices Act (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).

61. See CHOW & SCHOENBAUM, *supra* note 50, at 489-90.

62. See [Law of the People's Republic of China on Chinese-Foreign Joint Ventures] (adopted by the Nat'l People's Cong., July 1, 1979, amended March 15, 2001), art. 4.

63. There are many examples in [PRC Foreign Investment Industrial Guidance Catalogue] (promulgated by State Council, effective Dec. 1st, 2007) Part II.1 (sino-equity joint ventures required for mining).

64. See, e.g., *supra* note 47.

65. See *supra* note 47.

66. See, e.g., *supra* note 47.

entirely possible that the DOJ will adopt such a position based on existing precedent.<sup>67</sup>

Finally, the FCPA might apply to many transactions in the pharmaceutical sector that should be of keen concern for MNCs. The pharmaceutical market in China is projected soon to be the third largest in the world behind the United States and Japan,<sup>68</sup> and many U.S.-based MNC pharmaceutical companies have already made major investments in China.<sup>69</sup> At present, the vast majority of all hospitals in the PRC are operated by the state. Doctors, nurses, administrators, and other employees at state-operated hospitals, an instrumentality of the state, could qualify as foreign officials under the DOJ's interpretation.<sup>70</sup> MNC pharmaceutical companies that seek to sell their drugs in hospitals need to be aware that doctors are foreign officials and that giving "anything of value"<sup>71</sup> to these doctors in order for the doctor to prescribe their drugs to patients might violate the FCPA. In fact, it is well known in China that doctors who prescribe drugs in state-operated hospitals are often given a "kickback" in the form of a commission by the supplier of the drugs.<sup>72</sup> If the supplier is a Chinese wholesale distributor, there might not be a violation of the FCPA, but if the MNC or its agent supplies the drug or the MNC supplies the drug to the wholesale distributor with knowledge or a reason to know<sup>73</sup> that the distributor will provide a kickback to doctors, then the MNC might be deemed to have violated the FCPA.<sup>74</sup> Given the widespread nature of the practice of giving kickbacks to doctors and the difficulty of policing this conduct, this issue could create a serious problem for MNCs doing business in the highly lucrative pharmaceutical market in China.

---

67. See, e.g., *supra* note 47.

68. See YAHONG LI ET AL., ASIA CASE RESEARCH CTR., VIAGRA IN CHINA: A PROLONGED BATTLE OVER INTELLECTUAL PROPERTY RIGHTS 3 (2010).

69. For example, Pfizer, a U.S.-based company and the world's largest pharmaceutical company, has already invested \$500 million in China. See *id.* at 5, 16.

70. See, e.g., Press Release, *supra* note 60 (laboratory personnel and doctors employed by hospitals owned by the PRC government were "foreign officials" within the meaning of the FCPA).

71. The term "anything of value" is discussed *infra* Part II.B.

72. Kickbacks in commercial transactions are illegal under PRC law. [People's Republic of China Anti-Unfair Competition Act] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 2, 1993, effective Dec. 1, 1993), art. 8. However this practice is generally tolerated because it is hard to police and there is a perception, perhaps erroneous, that patients are not harmed by this practice.

73. See 15 U.S.C. § 78dd-1(a)(3) (2006).

74. See, e.g., Deferred Prosecution Agreement at ¶¶ 1-2, attach. A ¶¶ 12-18, 25-29, *United States v. AGA Medical Corp.*, No. CR 08-172 (D. Minn. June 3, 2008), available at <http://www.law.virginiial.edu/pdf/faculty/garrett/agamedical.pdf> (involving payments to doctors employed in a state-operated hospital to induce them to purchase drugs provided by AGA).

The discussion in this section is meant to be illustrative, not exhaustive, of the possible scenarios in which aggressive DOJ interpretations of foreign officials and SOEs could lead to the findings of FCPA violations in China. Given the widespread presence of SOEs in China as defined by the DOJ, there are many different permutations of the examples discussed above of possible FCPA violations involving SOEs.

### 3. COMMUNIST PARTY CADRES AS FOREIGN OFFICIALS

Apart from the definition of a foreign official as an employee of a state-owned enterprise, a different set of concerns arise in connection with other aspects of possible broad interpretations of the meaning of the term “foreign official.” A “foreign official” is also defined as “any person acting in an official capacity for or on behalf of any such government.”<sup>75</sup> The anti-bribery provisions provide that it is illegal to make a payment or give anything of value to a foreign official to do any act in violation of its official duties for the purpose of obtaining or retaining business.<sup>76</sup>

This definition can be interpreted to include members of the Communist Party of China (CPC) as foreign officials. Such a definition could also expand the possible sets of transactions to which the FCPA can apply in China because of the ubiquitous presence of the CPC in every important aspect of the political, social, and economic life in the PRC.<sup>77</sup>

Although the CPC refers to itself as a political party, it is not a political party in the same sense that such parties exist in the United States. The CPC is the de facto ruler of China.<sup>78</sup> The PRC has a government structure, including legislative and executive bodies, that is, in theory, separate and apart from that of the CPC, but the CPC has a parallel structure that at every level replicates the government structure.<sup>79</sup> For example, the PRC has a National People’s Congress and the CPC has a National Party Congress.<sup>80</sup> At certain points, the

---

75. § 78dd-2(h)(2)(A).

76. § 78dd-2(a)(1). The FCPA also prohibits payments to “foreign party officials” to induce them to violate their official duties, § 78dd-1(a)(2), but the term “foreign officials” appears to be broader. A foreign party official’s lawful duties could arguably relate only to duties that involve the political party whereas a foreign official’s duty could relate to the functions of a government entity, under the foreign official’s control, which has the power to award a business opportunity.

77. *See generally* CHOW, *supra* note 7, at 118–44.

78. *See id.* at 131–35.

79. *See id.* at 130–33.

80. *Id.* at 81, 125.

CPC bodies and the government bodies appear “to be fused or merged together.”<sup>81</sup> A prime example is the Central Military Commission, which controls China’s armed forces. The PRC government has a Central Military Commission and the CPC also has a Central Military Commission. The membership of the two commissions is identical.<sup>82</sup> Since the Central Military Commission controls China’s armed forces, including the powerful People’s Liberation Army (PLA), the CPC, by virtue of this power alone, controls China. By placing its members in all key posts in government, the CPC is able to exercise de facto control over the PRC government.<sup>83</sup> All important government posts in China, such as the President, the Vice President, the Premier, and the Vice Premiers, are members of the inner circle of the CPC, and the same holds true for corresponding positions at the provincial, municipal, and local levels.<sup>84</sup> In fact, the corresponding party position at each level is more powerful than the government position. For example, the most powerful official in a municipality or city is not the mayor, but the party secretary.

It would be almost impossible for anyone to rise to a high level in government without CPC membership. Given the common knowledge that the CPC controls the PRC government, most people who live in China do not distinguish between the CPC and the PRC government. Most people in China often refer to CPC members as “guan,” which means government official. There can be little doubt that CPC members “act[] in an official capacity” and that, at least in some circumstances, act “for or on behalf” of a government or department as defined in the FCPA.<sup>85</sup> For these reasons, due to the power and status of the CPC and its control over the PRC government, the DOJ may consider Party members to be foreign officials who act on behalf of a government.

While persons working in the private sector in China, such as privately owned enterprises, law firms, and accounting firms, do not need to be CPC members to achieve financial success, many persons in the private sector are also Party members. Having an association with the CPC is helpful because in every important political, social, or economic sector in China, the CPC is either directly involved or is involved not too far below the surface. For these reasons, even private-

---

81. *Id.* at 119.

82. *Id.* at 104–05.

83. *Id.* at 133, 143–44. The government serves a legitimating function for the CPC. Because the CPC acts through the filter of government organs, the CPC is acting legitimately and on behalf of the state. *Id.* at 135–36. Anyone who challenges the actions of the CPC can be viewed as challenging the actions of the state, which is considered treason and subject to the heaviest sanctions available under law. *Id.* at 136.

84. *See id.* at 132–34.

85. 15 U.S.C. § 78dd-2(h)(2)(A) (2006).

sector persons join the CPC, the largest political party in the world with just under seventy-five million members.<sup>86</sup>

The presence and importance of the CPC could give rise to FCPA issues in the following way. Many CPC officials, in addition to their other employment, now also operate their own private businesses and may then use their official positions to benefit their side businesses.<sup>87</sup> For example, a high-ranking CPC official may set up a number of private businesses in the import and export business. The status of the CPC official as a Party member allows his private business to receive preferential treatment from other PRC authorities, such as customs and tax bureaus. A sales agent in a China business entity owned by a U.S.-based MNC now makes a payment to the CPC official who is able to use his position to obtain lower customs duties or zero duties for imported goods that are then sold to the MNC's China business entity as raw materials used in manufacturing.<sup>88</sup> The savings in duties are passed on to the MNC in the form of a lower price for the imported goods. Even though the CPC official is operating a private business and even though the CPC official is not technically a government official, the DOJ may consider this transaction to be a payment to a foreign official to induce that official to abuse his position to provide a business advantage to the MNC or its agent. Many different variations of this scenario exist in China and similar transactions to that discussed above happen many times daily.

Another significant issue that is raised by the wide presence of CPC officials is that a company that is owned by a CPC official, even a private company, might be considered to be a state-controlled enterprise because it is under the control of a foreign official and is deemed to be an instrumentality of the government.<sup>89</sup> Any employee of a state-controlled enterprise, even low-level employees, may be deemed by the DOJ to be foreign officials.

The issue of illegal payments to foreign officials by MNCs or their agents is often complicated by the reluctance of many CPC members to disclose their Party membership to Americans. Most people in China are aware that the United States government and many people in the United States have a generally negative opinion of the CPC. For this reason, Party members will sometimes use business cards that do not directly reveal their Party affiliation. For example, the highest-ranking

---

86. See CHOW, *supra* note 7, at 122.

87. The author has personal knowledge of such arrangements in China.

88. A payment to induce foreign officials to charge lower customs duties can constitute a violation of the FCPA. *E.g.*, *United States v. Kay*, 359 F.3d 738, 748, 761 (5th Cir. 2004).

89. See *supra* text accompanying notes 49–50.

official in a university in China is not the president but the Party secretary. Many university officials, however, translate their position into English as “Provost” instead of Party secretary because “Provost” seems to result in a much better reception by their American counterparts.<sup>90</sup> For this reason, the MNC might come under a duty to conduct further due diligence before engaging in business transactions with certain seemingly private companies to determine whether any of the senior management are CPC members and would be considered as foreign officials by the DOJ.

### B. “Anything of Value”

Many PRC government and CPC officials would be hesitant to accept a suitcase or an envelope full of cash from an MNC or its agent. Although China will often tolerate petty corruption, many (but not all) officials in the PRC would be reluctant to engage in transactions that are so blatantly illegal under PRC law.<sup>91</sup> The FCPA, however, proscribes not only payments of money, but also the giving of “anything of value” to foreign officials to gain an illegal business advantage.<sup>92</sup> The DOJ’s broad definition of “anything of value” could present additional issues because many transactions that occur in China’s current business culture that are commonly viewed as acceptable, if not perfectly legal, might run afoul of the DOJ’s interpretation of the “anything of value” element of the FCPA.

The FCPA does not define “anything of value,” but the DOJ has interpreted the term in an expansive manner in its NPAs and DPAs. For example, paying for executive training programs at U.S. universities for Chinese foreign officials was considered to be a potential FCPA violation when the programs did not specifically relate to the company’s products or business.<sup>93</sup> Other possible examples of “anything of value” include payment for tuition for educational opportunities for Chinese officials, payment of tuition for an MBA degree, providing a paid internship for a daughter of a Chinese official, and payment for sightseeing trips for Chinese officials for places such

---

90. This was explained to the author by a visiting delegation of university officials to the United States.

91. See [Criminal Law of the People’s Republic of China] (promulgated by Order No. 83 of the Pres. of the People’s Republic of China, Mar. 14, 1997, effective Mar. 14, 1997) art. 389 (prohibiting bribes to PRC government officials).

92. 15 U.S.C. § 78dd-1(a) (2006).

93. Complaint at ¶¶ 16–18, *SEC v. UTStarcom, Inc.*, No. CV 09-6094 (N.D. Cal. Dec. 31, 2009), available at <http://www.sec.gov/litigation/complaints/2009/comp2157.pdf>.

as Disneyworld, the Grand Canyon, and Las Vegas.<sup>94</sup> Perhaps the broadest interpretation of “anything of value” occurred in a case that involved a charitable donation by a U.S. pharmaceutical company to a foundation where the director of the foundation was also in charge of a government health fund that purchased pharmaceuticals for use in hospitals.<sup>95</sup> Although that case involved the books and records provisions,<sup>96</sup> the implication of the position taken by the SEC was that the charitable donation satisfied the giving of “anything of value” element under the anti-bribery provisions of the FCPA. The payment was something of value even though the director received no monetary benefit, but received a benefit that could be measured only in subjective terms.<sup>97</sup>

The issue raised by the expansive interpretations of “anything of value” is that under China’s current business culture, providing what would be regarded as small favors (as opposed to the payment of cash) by one party to parties on the other side of the transaction, including PRC or CPC officials, is a widespread and accepted way of doing business. In fact, most people in China would see nothing wrong with providing these types of favors. Perhaps more importantly, Chinese officials often expect and ask for such favors from business enterprises under their sphere of supervision or authority. Officials who seek and expect favors are not new in China; this aspect of Chinese culture has been in existence for hundreds of years, long before the Communist Party assumed power in 1949.<sup>98</sup> Many PRC officials would be surprised to know that receiving a non-cash benefit from a business entity might violate a foreign law, such as the FCPA. Just as important, many PRC officials may have little concern for such a violation since they are not subject to liability under the FCPA and the chances of being prosecuted under PRC law for accepting a minor non-monetary benefit tend to be

---

94. See, e.g., Complaint at ¶ 1, *SEC v. Lucent Tech. Inc.*, No. 1:04-cv-01141 (D.D.C. Dec. 21, 2007), available at <http://www.sec.gov/litigation/complaints/2007/comp20414.pdf>; Letter from the U.S. Dep’t of Justice to Martin J. Weinstein, Esq., Re: Lucent Technologies, app. A ¶ 10 (Nov. 14, 2007), available at <http://www.law.virginia.edu/pdf/faculty/garrett/lucent.pdf> (non-prosecution agreement).

95. See *SEC v. Schering-Plough Corp.*, Litigation Release No. 18740, 82 S.E.C. Docket 3732 (June 9, 2004); *In re Schering-Plough Corp.*, Release No. 2032, 82 S.E.C. Docket 3644 (June 9, 2004).

96. The specific allegation by the SEC was that the donation was not properly recorded by Schering-Plough in violation of its duty to provide clear records of its transactions. *SEC v. Schering-Plough Corp.*, Litigation Release No. 18740, 82 S.E.C. Docket 3732 (June 9, 2004).

97. See Koehler, *supra* note 18, at 915–16.

98. See, e.g., JOHN KING FAIRBANK, CHINA: A NEW HISTORY 182 (1992) (describing “squeeze” as an expected benefit of being an official in Imperial China).

quite low. A common, though perhaps cynical, complaint in China is that there is no such thing as an “honest official” (*qing guan*); all officials are corrupt. The only question is to what degree.<sup>99</sup>

What is an example of how an expansive definition of “anything of value” could present a thorny issue in China today? Suppose that a Chinese business entity owned by an MNC needs a government certificate from an administrative bureau stating that certain goods are of a substandard quality and infringe the intellectual property rights of the MNC registered in China.<sup>100</sup> The chief of the administrative bureau may indicate that in order to issue the certificate the bureau needs to have the product analyzed. The bureau official may then ask the MNC’s China entity to obtain an analysis of the product and may refer the MNC to a company that is owned by a relative of the official to perform an analysis of the product for a fee. The official may receive no monetary benefits from such an arrangement that benefits a relative, but only the subjective satisfaction of having helped a family member.<sup>101</sup> If the MNC goes through with the arrangement, the DOJ might view this transaction as meeting the “anything of value” element of an FCPA violation.

A situation in which a government official refers a business entity to a company owned by a relative is quite common and could present a thorny problem for the MNC. In many instances, the person being asked for a favor is a junior local employee who may be completely unaware that the arrangement being requested by the official might implicate the FCPA. In addition, the junior level employee knows that if the request is refused, the certificate from the government bureau might not be forthcoming or might suffer long delays. These situations are troublesome because China business entities come under repeated and continuous pressure from PRC officials to provide favors or benefits that most officials see as minor or harmless. Requests for favors and benefits are common because most PRC officials know that

---

99. For example, in recent years, there has been a sharp increase in the number of students from China studying for undergraduate degrees in colleges in the United States and other foreign countries. Many of these students are children of PRC officials who earn less than U.S. \$20,000 per year and yet are able to pay full tuition at U.S. colleges. These officials also drive luxury European vehicles and live in villas.

100. This example is based on the author’s own knowledge of several incidents involving the Administration of Industry and Commerce.

101. A subjective benefit might qualify as “anything of value” under the FCPA. *See supra* text accompanying notes 95–97. Of course, the family member who has received a favor will provide a reciprocal benefit to the official, such as a gift or the referral of a business opportunity. Thus, even if the official does not receive a material benefit immediately as a result of the referral, the official will likely receive such a benefit at a later point.

asking for these types of favors, so long as the benefits involved are relatively small, are rarely, if ever, prosecuted under PRC law.<sup>102</sup>

As in the case of improper payments to foreign officials who work for SOEs, the hypothetical situation presented in this Section is just one example of a multitude of arrangements that might be viewed as harmless by PRC officials and by junior-level employees of China businesses owned by MNCs, but which may implicate the FCPA.

### *C. Third-Party Intermediaries or Contractors and Pass-through Payments*

The FCPA also prohibits the giving of a payment or anything of value to a third party while knowing that all or a portion of such payment or thing of value will be given to a foreign official.<sup>103</sup> Under the definitions set forth by the FCPA, a payor's state of mind is deemed to be "knowing" when the payor makes a payment or gives a thing of value and the payor is "aware" or has a "firm belief" of "circumstances" or "conduct" indicating a likelihood that a foreign official will receive the payment or thing of value from the third party.<sup>104</sup> This aspect of the FCPA can also be problematic for MNCs in China because it could capture a large set of transactions in China today involving third-party contractors hired by unsuspecting MNCs. These third parties often engage in bribes of PRC officials, such as judges, police, and administrative authorities. The DOJ might consider MNCs and their China business entities that make payments to their independent contractors as knowing or having reason to know that some or all of the payments will go to PRC officials.

As an illustration of the widespread practice of third-party payoffs of PRC officials, the following example examines practices in the area of intellectual property enforcement, a major business problem for many MNCs in China.<sup>105</sup> Many MNCs and their business entities in China are experiencing significant piracy and counterfeiting

---

102. The FCPA contains a defense for actions that are lawful under the written laws of the foreign country. 15 U.S.C. § 78dd-2(c)(1) (2006). The types of favors typically requested by PRC officials are not permitted by any written laws and although arguably illegal, are usually tolerated so long as the benefits involved are small.

103. § 78dd-2(a)(3).

104. § 78dd-2(h)(3)(A).

105. See generally Daniel Chow, *Anti-Counterfeiting Strategies of Multi-national Companies in China: How a Flawed Approach is Making Counterfeiting Worse*, 41 GEO. J. INT'L L. 749 (2010) [hereinafter *Anti-Counterfeiting Strategies*]. A particularly troublesome aspect of counterfeiting and piracy is that PRC officials are often directly or indirectly involved in counterfeiting. See generally Daniel C.K. Chow, *Organized Crime, Local Protectionism, and the Trade in Counterfeit Goods in China*, 14 CHINA ECON. REV. 473 (2003).

problems,<sup>106</sup> viewed by many to be the most significant counterfeiting problem in the world.<sup>107</sup> Many MNCs have set up their own internal brand-protection units, often led by a brand manager or a director from the corporate security department.<sup>108</sup> Although MNCs have their own internal units, most MNCs also hire outside private investigation firms and law firms to track down the counterfeiters and pirates.<sup>109</sup> The use of outside firms is necessary because locating counterfeiters can be dangerous work, and in some cases investigators can be threatened or physically attacked by suspected counterfeiters.<sup>110</sup> Private investigators must often use assumed identities in order to infiltrate a counterfeiting ring and can spend weeks or months during an investigation to earn enough trust with the counterfeiters to become an employee of the counterfeiting operation.<sup>111</sup> Many MNCs have no desire to have their own employees engage in this type of dangerous work or to expose them to the risk of physical harm and instead hire outside private firms, many of which are staffed with persons with police or military backgrounds.<sup>112</sup>

The private anti-counterfeiting industry has quickly become a massive, highly lucrative business for thousands or tens of thousands of private investigators and lawyers.<sup>113</sup> Many MNCs have annual budgets in the millions or tens of millions of dollars to combat counterfeiting, much of which is used to pay outside contractors.<sup>114</sup> There is intense competition for these dollars from MNCs with deep pockets and the private anti-counterfeiting industry has grown quickly.<sup>115</sup> Although the private investigation industry has grown rapidly, it is unregulated and

---

106. For a discussion of the origins of the counterfeiting problem, see Daniel C.K. Chow, *Counterfeiting in the People's Republic of China*, 78 WASH. U. L.Q. 1 (2000).

107. See China: Intellectual Property Infringement, Indigenous Innovation Policies, and Frameworks for Measuring the Effects on the U.S. Economy, Inv. Nos. 332-51433, 332-519 at 33 (June 15, 2010) (statement of Daniel Chow, Professor of Ohio State Univ. Moritz College of Law) (original manuscript on file with the Wisconsin Law Review). For a skeptical view of the claims by MNCs of the massive economic losses due to counterfeiting, see Daniel Chow, *Counterfeiting as an Externality Imposed by Multinational Companies on Developing Countries*, 51 VA. J. INT'L L. 785 (2011).

108. *Anti-Counterfeiting Strategies*, *supra* note 105, at 760.

109. *Id.* at 763-65.

110. *E.g.*, *China: Anti-Fake Business Flourishing*, CHINA DAILY, Aug. 13, 1998.

111. See *Anti-Counterfeiting Strategies*, *supra* note 105, at 763.

112. *Id.* at 763-64. Hiring former police and special forces agents is part of a "get tough" approach used by MNCs to combat the pirates. *Id.* at 761.

113. *Id.* at 767.

114. *Id.*

115. *Id.* at 763.

exists in a gray area of the law.<sup>116</sup> As a technical legal matter, private investigators, companies, and individuals are not allowed to conduct investigations involving illegal activities.<sup>117</sup> These investigations are considered to be a type of police work, “which is reserved to PRC government authorities.”<sup>118</sup> However, PRC enforcement authorities tolerate the existence of private investigators because the authorities lack the resources (and perhaps the willingness) to conduct the painstaking and time-consuming work of tracking down and infiltrating counterfeiting rings on their own.<sup>119</sup> Many private investigation firms obtain business licenses as “market research firms” although everyone knows that they are really investigating possible criminal activity.<sup>120</sup> Due to the unregulated and highly lucrative nature of the private anti-counterfeiting industry, many nefarious and unscrupulous individuals are drawn to work in this area. Private investigators hired by MNCs have been known to impersonate PRC officials in order to extort suspected counterfeiters, to seize cash and valuables on the premises without any authority, and to “rough up” suspected counterfeiters.<sup>121</sup>

Once a private investigation firm, often working in tandem with a law firm, identifies and locates a counterfeiter, the firm then notifies PRC authorities and applies for an enforcement action, which usually consists of a raid by the PRC officials of the suspected premises, seizure of the goods, and detainment of any suspected counterfeiters.<sup>122</sup> Often within fifteen to thirty minutes after the initial meeting with PRC authorities, the authorities will get into vans with the investigators who will direct them to the site and conduct a raid.<sup>123</sup> Time is usually of the essence in raid actions because of the possibility of tip-offs,<sup>124</sup> which are common. Once the raid is completed, the law firms take over the case and attempt to seek compensation, fines, and criminal charges, when possible.<sup>125</sup>

---

116. *Id.* at 764.

117. *Id.* at 764.

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.* at 761.

122. *Id.* at 751.

123. *Id.* at 761.

124. The raid needs to occur quickly and the private investigators will not reveal the location of the counterfeiters until they are in the vans with the PRC authorities. *Id.* This procedure is necessary to avoid tip-offs to the counterfeiters by the PRC authorities. *Id.* A wait of several hours usually means that the counterfeiter will disappear.

125. *See id.* at 764.

It is well known that private investigation firms often make payments to induce PRC officials to conduct raids and seizures.<sup>126</sup> These payments are sometimes referred to as “case fees” and are often demanded by PRC officials.<sup>127</sup> The PRC Public Security Bureau (PSB), the police, is known to sometimes ask for a “reward” for each arrest of a suspected counterfeiter.<sup>128</sup> The officials often argue that raids involve the heavy expenditures of resources: the use of many officers, vehicles, and storage or destruction of seized goods. These case fees are sometimes justified as compensating the authorities because they claim to have limited budgets. In complex enforcement actions involving large counterfeiting rings, many dozens of officers and vehicles need to be involved, and the authorities will ask for payments for these expenses.<sup>129</sup> In other cases, the authorities may need to travel to a remote location by airplane and will ask for payment of all of their expenses, including hotel and meals.<sup>130</sup> The sums demanded by officials can range from several thousand dollars to tens of thousands of dollars or more.<sup>131</sup> Many private investigation and law firms will pay these sums and then pass on the costs to the MNC as “miscellaneous expenses.” When the enforcement is over, the PRC officials are usually invited by the private investigation firms to lavish celebratory banquets.<sup>132</sup> This type of arrangement is very common in the PRC. Because many brand-protection units within the MNC are headed by persons who are not lawyers, these bills are usually paid with few

---

126. This is based upon the author’s own experience working as in-house counsel for an MNC in China and on the author’s continuing research conducted in the summer of 2011 in China.

127. *Id.* at 759 n.34.

128. While working as in-house counsel for an MNC in China, the author was present in a meeting at which a PSB official asked for a “reward” of U.S. \$5,000 for each arrest of a suspected counterfeiter. The offer was declined.

129. While working as an in-house lawyer for an MNC, the author often received specific requests for expenses from PRC officials whenever a large enforcement action was conducted. The officials asked if they could seek reimbursement (*bao xiao*) for their expenses.

130. As part of the work of directing the anti-counterfeiting activities of a multinational company in China, the author reviewed the receipts of private investigation firms hired by the multinational company. In the course of asking for explanations from private investigation companies for certain large expenses charged to the company, the author discovered that these expenses were reimbursements to the private investigation companies for their payment of airfare, hotel, and meals for government officials.

131. These observations are based on the author’s own working experience in China.

132. See David Ahlstrom, Garry D. Bruton & Kuang S. Yeh, *Private Firms in China: Building Legitimacy in an Emerging Economy*, 43 J. WORLD BUS. 385, 390 (2008).

questions asked. The MNC's brand-protection manager sees that raids have been conducted and products seized and is happy to report these results to senior management.<sup>133</sup>

The DOJ might find that MNCs are knowingly making payments to third parties who will then pass on the payments to PRC officials and might consider this practice to be an FCPA violation. Although MNCs may deny that they have knowledge of the pass-through of these payments, it is well known in the PRC that these payments occur. In addition, many brand-protection managers have taken the position that they do not need to know all of the details of the enforcement actions so long as results are achieved. The DOJ may take a dim view of this attitude as a "burying your head in the sand" excuse, and, given the current business culture in China, may deem the MNCs to either know or have reason to know of the pass-through payments.

The FCPA does contain an exception for "facilitating payments,"<sup>134</sup> commonly known as the "grease payment" exception. An act that qualifies as a grease payment is exempt from FCPA liability.<sup>135</sup> This exception applies, however, only to payments used to expedite a routine government action by a foreign official. The legislative history of the FCPA indicates that Congress recognized the grease payment exception as a concession to the realities of doing business in many developing countries where business cannot be conducted effectively without such payments.<sup>136</sup> Examples of routine government action are "obtaining permits, licenses or other official documents to qualify a person to do business" and scheduling "inspections related to transit of goods across country."<sup>137</sup> The grease payment exception is meant to apply to "largely non-discretionary, ministerial activities performed by mid- or low-level foreign functionaries."<sup>138</sup> An example of such a permissible facilitating payment is the payment of a small sum to a clerk to switch on the telephones of a newly established company. The act of turning on the phones is ministerial and involves no discretion. The clerk is required to turn on the phones once all of the proper procedures have been met, but the clerk may delay the action for several days or weeks unless a payment is made.

---

133. For an argument that this approach is not working and may even make the problem worse, see *Anti-Counterfeiting Strategies*, *supra* note 105, at 765–67.

134. 15 U.S.C. § 78dd-1(b) (2006).

135. *Id.*

136. H.R. REP. NO. 95-640, at 4 (1977); S. REP. NO. 95-114, at 10 (1977).

137. See *United States v. Kay*, 359 F.3d 738, 750–51 (2004) (quoting 15 U.S.C. § 78dd-1(f)(3)(A)) (internal quotation marks omitted).

138. *Id.* at 751.

Does the grease payment exception apply to the payment of thousands or tens of thousands of dollars to PRC enforcement officials, including bureau chiefs, who have discretionary authority over whether to conduct enforcement actions? The answer is unclear, but the DOJ might well take an aggressive stance and refuse to consider such payments as facilitating payments. So far this issue has yet to be tested in a DOJ enforcement action. Moreover, there are some types of payments in IP enforcement actions about which there can be little doubt about FCPA liability. For example, in a criminal enforcement action, lawyers have been known to make payments to prosecutors and judges in order to secure a conviction.<sup>139</sup> There would appear to be little doubt that these payments do not qualify under the FCPA exception for “facilitating payments.”

The discussion above concerns a specific industry that operates in a gray area of the law, where all types of widespread abuses can occur. The industry is highly lucrative and the competition for MNC clients with deep pockets is sharp and ruthless. Private investigation companies and law firms are out in the field far away from any oversight by the senior management of the MNC. Under these circumstances, they may engage in dubious behavior of all kinds in order to achieve the results that will keep the MNC happy and retain the MNC’s business.

While the illustration above has so far concerned the problem of pass-through payments made by contractors or intermediaries hired by MNCs in a specific industry, the problem is a general one. The PRC is a highly regulated state, and MNCs that do business in the PRC are under continuing requirements to secure various regulatory approvals. Law firms and consulting companies have many opportunities to make payments outside the purview of their MNC employers to PRC authorities in order to obtain a needed approval.<sup>140</sup> For many MNCs, staffed by senior foreign expatriates, the PRC political and regulatory system appears to be opaque,<sup>141</sup> and many senior managers do not have the ability, due to language or lack of will, to seek direct access to

---

139. This observation is based on the author’s own experience working for an MNC in China.

140. As an example, the author was present at a meeting in China concerning the stalled approval of a certification sought by an MNC. The approval concerned a certification of high technology status from a government bureau for a certain product that would allow for favorable tax treatment. The certification, although promised, had been delayed for months for reasons unknown. An outside consulting firm “guaranteed” that the approval could be obtained expeditiously from the PRC authorities if the MNC gave the consulting firm a fee of US \$10,000. The offer was declined.

141. To be clear, the PRC regulatory system also appears to be opaque to many native Chinese who have lived in China all their lives.

regulatory authorities, but prefer to hire third parties, such as law firms and consulting firms, to conduct the necessary contacts with PRC officials.<sup>142</sup> These arrangements invite or create many opportunities for pass-through payments that might be considered illegal by the DOJ under the FCPA.

#### *D. Joint-venture Partners*

Many U.S. companies continue to form joint ventures with local Chinese companies.<sup>143</sup> A joint venture is a creature of PRC law and is a separate legal entity from the parties that form the joint venture through the contribution of cash, real estate, or facilities.<sup>144</sup> Joint ventures continue to be popular as a vehicle of foreign direct investment in China and may even be required by the PRC government in certain industrial sectors.<sup>145</sup> The issue that arises for MNCs is that the local joint-venture partner may engage in illegal payments to PRC officials and the MNC may be deemed to be liable for the actions of the joint venture under the theory that it is an agent of the MNC.<sup>146</sup>

In a non-prosecution agreement reached with RAE Systems, the DOJ indicated that it intended to prosecute RAE Systems, a Delaware corporation with its headquarters in San Jose, California, under the FCPA for the actions of its majority-owned joint ventures in China.<sup>147</sup>

---

142. It is a curious but common practice that some PRC officials seem to be reluctant to meet on business matters in their offices with foreign managers directly, even with translators present, but prefer to meet with their Chinese representatives alone. Many PRC officials appear to have the sentiment, perhaps misguided, that meeting with foreign managers in their offices and official places of business allow foreign managers to get an inside look at the workings of their bureaucracies. An inside look by native Chinese employees seems acceptable to PRC officials because these employees are not viewed as “outsiders.” This attitude, while not progressive or commendable, appears to be common.

143. See CHOW & SCHOENBAUM, *supra* note 50, at 489–90. During the first phase of foreign direct investment in the 1990s, many MNCs felt that they needed a local partner to navigate the complex PRC legal and political system. Many MNCs now feel comfortable in entering into China on their own through a wholly foreign owned enterprise. See *id.* at 490. However, joint ventures continue to be a popular foreign investment vehicle in China.

144. See [The Law of the People’s Republic of China on Chinese-Foreign Equity Joint Ventures] (promulgated by the Nat’l People’s Cong., July 1, 1979, amended Mar. 15, 2001) art. 5–5; see also [The Law of the People’s Republic of China on Chinese-Foreign Equity Joint Ventures] (promulgated by the State Council, Sept. 20, 1983, revised Dec. 21, 1987, July 22, 2001) art. 2.

145. See *supra* text accompanying note 63.

146. See Press Release, *supra* note 60 (a wholly owned subsidiary of a U.S. company acted as its agent for making illegal bribes).

147. Letter from the U.S. Dep’t of Justice to Carlos F. Ortiz & Roy K. McDonald, attorneys for RAE Systems Inc. 1 (Dec. 10, 2010), *available at*

In this case, the local partners of the joint ventures, two Chinese companies, continued their previous practice of giving bribes to various state bureaucracies and departments after the joint ventures were formed with RAE.<sup>148</sup> The joint ventures sold RAE's chemical and radiation detectors to various government bureaus and departments.<sup>149</sup> For a number of years prior to entering into the joint ventures, the Chinese companies had been giving kickbacks to employees of government bureaus to induce them to purchase their products.<sup>150</sup> The Chinese companies paid their sales agents a commission on the sale of any products to PRC government entities.<sup>151</sup> The sales agents would then give a portion of the commission to an official at the government agency to induce that official to make a purchase.<sup>152</sup> The Chinese companies were aware of these kickbacks and viewed them as "aggressive" business tactics to build relationships.<sup>153</sup> The payments were considered to fall in a "gray" area and, according to the local Chinese companies, could arguably be considered to be lawful.<sup>154</sup> RAE Systems knew about these practices before it entered into the joint ventures and attempted to implement FCPA training and controls to prohibit these payments, but the DOJ concluded that these steps were ineffective "half-measures."<sup>155</sup> Even though RAE Systems attempted to implement FCPA controls, the employees of the local joint-venture partners continued to give bribes and then attempted to hide these payments.<sup>156</sup> The local joint ventures not only gave kickbacks but also continued to give gifts to government officials, "such as jade, fur coats, kitchen appliances, business suits, and high-priced liquor."<sup>157</sup> In addition, the local joint ventures also made payments of cash to

---

[www.justice.gov/criminal/fraud/fcpa/cases/rae-systems/12-10-10rae-systems.pdf-2011-02-16- Text Version \(non prosecution agreement\)](http://www.justice.gov/criminal/fraud/fcpa/cases/rae-systems/12-10-10rae-systems.pdf-2011-02-16-Text%20Version%20(non%20prosecution%20agreement)). This action involved the books and records provisions of the FCPA for failing to accurately report the illegal payments, *id.* at app. A ¶ 23–25, but it also gives a good indication that the DOJ considered the payments to be in violation of the anti-bribery provisions, *see id.* at app. A.

148. *Id.* at app. A ¶ 10.

149. *Id.* at app. A ¶ 2.

150. *Id.* at app. A ¶¶ 8–9.

151. *Id.* at app. A ¶ 8.

152. *Id.*

153. *See id.* at app. A ¶ 10.

154. *Id.* In the author's view, it would be more accurate to say that the Chinese companies knew that the kickbacks were technically illegal but that the risk of prosecution was quite low.

155. *Id.* at app. A ¶ 13.

156. *Id.* at app. A ¶ 13.

157. *Id.* at app. A ¶ 22.

consulting companies that funneled the payments to officials of a state-owned enterprise.<sup>158</sup>

Both of the joint ventures used a direct sales force for their sales operations in China.<sup>159</sup> This meant that it was impossible for the management of the joint ventures or MNC to monitor or control the actions of its sales agents when they were in the field meeting with PRC government officials, the prospective clients. This arrangement provided many opportunities for illegal payments.

The RAE Systems case is an illustration of the types of problems implicating the FCPA that can arise from entering into a joint venture in China. The MNC will often find that the local partner will engage in actions that are hidden and that may put the MNC at risk for violating the FCPA, as well as other laws. The next Part of this Article addresses the types of remedial measures that MNCs need to adopt to address the risks highlighted in this section.

### III. COMPLIANCE INCENTIVES AND ELEMENTS OF AN EFFECTIVE COMPLIANCE PROGRAM

Given the potentially large number of transactions occurring in China that may be covered by the FCPA, MNCs have strong incentives to institute effective FCPA compliance measures in China. This Part will elaborate why compelling incentives exist and then discuss specific measures that should be implemented to create an effective compliance program.

#### *A. Incentives to Create an Effective Compliance Program*

The DOJ uses its “Principles of Federal Prosecution of Business Organizations” contained in the U.S. Attorney’s Manual to set forth the factors that prosecutors should consider in deciding whether to bring a criminal action against defendants.<sup>160</sup> Among the mitigating factors include “the corporation’s timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents.”<sup>161</sup> The implementation of an effective compliance program will allow the MNC to detect and report possible infractions to the DOJ, earning mitigating credit that may lessen the potentially damaging

---

158. *Id.* at app. A ¶ 20.

159. *Id.* at app. A ¶ 16.

160. U.S. DEP’T OF JUSTICE, UNITED STATES ATTORNEY’S MANUAL § 9-28.300 (2008), *available at* [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/](http://www.justice.gov/usao/eousa/foia_reading_room/usam/).

161. *Id.*

impact of a criminal prosecution.<sup>162</sup> The stakes involved in a criminal prosecution are high; not only will the MNC be damaged in the eyes of the public by the filing of a criminal indictment and by undergoing a criminal investigation, but the FCPA provides for criminal penalties for the individual officers of the MNC, including imprisonment.<sup>163</sup>

If the MNC does not implement a compliance program, how often will potential FCPA infractions come to light and draw the attention of the DOJ? Many of the transactions, such as kickbacks discussed in Part III, which are perpetrated by payors, occur under clandestine circumstances designed to deliberately hide them from the MNC. While China tolerates petty instances of commercial or criminal corruption, the PRC authorities will prosecute cases involving large sums or any case of corruption that results in serious injury or death, often with draconian results.<sup>164</sup> In addition, PRC authorities will periodically engage in highly publicized campaigns against government corruption as well as other crimes for symbolic purposes.<sup>165</sup> No doubt the DOJ will take notice of any prosecutions brought by the PRC authorities that involve U.S.-based MNCs or their China business entities. If such cases come to the attention of the DOJ under these circumstances, as opposed to voluntary disclosure by the MNC, the DOJ will proceed without any “mitigating credit”<sup>166</sup> given to the MNC. These possibilities provide ample incentive for an MNC to institute an effective compliance program that can prevent or detect possible FCPA infractions.

Although most of this Article has focused on the anti-bribery provisions of the FCPA, the books and records and internal control provisions<sup>167</sup> provide additional reasons to implement compliance measures. Any company that is listed on a U.S. stock exchange is subject to the books and records and internal control provisions.<sup>168</sup> Recently, many PRC companies have begun to list their shares on U.S. stock exchanges.<sup>169</sup> If a Chinese business entity, owned by a U.S.-based MNC, lists its shares on a U.S. stock exchange then it will be covered

---

162. *Id.* at § 9-28.800.

163. 15 U.S.C. §§ 78dd-1(g), dd-2(i), dd-3(a) (2006).

164. *See, e.g., Former SFDA Chief Executed for Corruption*, CHINA DAILY (July 10, 2007), [http://www.chinadaily.com.cn/china/2007-07/10/content\\_5424937.htm](http://www.chinadaily.com.cn/china/2007-07/10/content_5424937.htm).

165. *See, e.g., Rio Tinto 4 Facing Chinese Trial Date*, DAILY MAIL (UK), Mar. 18, 2010.

166. *See* U.S. DEP'T OF JUSTICE, *supra* note 157, at § 9-28.720.

167. § 78m.

168. § 78m(a)-(b).

169. *See United States Stock Markets*, CHINASTOCKREPORTS.COM, <http://www.chinastockreports.com/USMarket.aspx> (last visited Jan. 14, 2012).

by the books and records and internal control provisions. These provisions require that the covered entity keep accurate and detailed records that accurately reflect the transactions and dispositions of the assets of the company.<sup>170</sup> The internal control provisions further require a covered entity to implement internal accounting controls to reasonably ensure that transactions are executed in accordance with the directions of management, are accurately recorded, and that access to the company assets is permitted only with management's general or specific authorization.<sup>171</sup> In order to meet these requirements, any Chinese business entity that is covered by these provisions will need to institute an effective compliance program.

MNCs also have reasons to implement compliance provisions that are independent of any legal requirements. The discussion in Part III indicates that instances of petty corruption, such as kickbacks, are widespread in many companies in China. Other instances of unethical, if not illegal, conduct also occur on a daily basis. For example, employees will leak or sell trade secrets and confidential business information to third parties, or be induced to leave one company to work for a competitor with an armful of documents containing valuable proprietary information or technology pilfered from the former employer.<sup>172</sup> Within a company, employees will act to undermine each other by frustrating or blocking a competitor-employee from achieving successful results.<sup>173</sup> These behaviors, some corrupt and some simply unethical, are detrimental to the success of the MNC. A compliance program should aim to implement company policies that prohibit illegal, unethical, and harmful conduct that will hinder the ability of the company to succeed.

### *B. Designing and Implementing an Effective FCPA Compliance Program*

The discussion above demonstrates that MNCs have strong incentives to implement FCPA and general compliance programs. This

---

170. § 78m(b)(2)(A).

171. § 78m(b)(2)(B).

172. *See Telecom Workers Charged with Data Theft*, CHINA DAILY, June 9, 2010. The theft of business secrets violates Article 10 of the PRC Anti-Unfair Competition Law, but this law is notoriously difficult to enforce because either there is a lack of probative evidence or the PRC authorities show little interest in what they consider to be a minor offense. The PRC authorities, like enforcement authorities in every country, have their own priorities. In China, violent crimes or crimes that threaten the state must always take precedence over minor economic offenses.

173. *See* DANIEL C.K. CHOW, A PRIMER ON FOREIGN INVESTMENT ENTERPRISES AND PROTECTION OF INTELLECTUAL PROPERTY IN CHINA 99-100 (2002).

Section now focuses on some of the general requirements of an effective FCPA compliance program.

1. COMPLIANCE PROGRAMS MUST BE IMPLEMENTED ON THE GROUND IN CHINA

U.S.-based MNCs can implement an effective program only through measures applied on the ground in China. It would be futile to attempt to implement a compliance program from the United States. Rather, the MNC should station a senior legal compliance officer in China on a permanent basis<sup>174</sup> to oversee, implement, and monitor such a program. This program should involve the use of clearly written rules and guidelines, with examples of what constitutes impermissible behavior and the consequences that will ensue. A major component of such a program should be the use of presentations of rules to employees and frank group discussions of these rules and the consequences for violating them. Most local employees in China, fresh from college, will have no familiarity with the FCPA and will be genuinely surprised that the reach of the statute is so broad and encompassing. The notion that a U.S. statute will reach activities that occur entirely in China conducted by PRC nationals with other PRC nationals will come as a shock to many people.

To be clear, the point of the compliance program is not really to teach the FCPA to employees of the company. Most employees of China business entities owned in part or in whole by MNCs, such as joint ventures or wholly foreign-owned enterprises, will admit, if they are being honest, that they do not really care about the FCPA or that their actions could cause the MNC to be in violation of the FCPA; what they do care about is losing their jobs. As a result, an effective compliance program needs to make clear in writing what constitutes acceptable and unacceptable behavior, institute controls that can detect such behavior, and indicate what consequences, such as termination of employment, follow from the violation of company policies. Once a violation occurs, the company must enforce the rules by immediately terminating those employees that violate such rules and, in appropriate cases, reporting the employees to the PRC authorities. Anything less than a forceful program that is rigorously enforced will be ineffective.

---

174. Based on the author's own experience as in-house counsel, MNCs usually rotate senior officers on a three to five year basis.

## 2. DUE DILIGENCE

The RAE Systems case, discussed in an earlier Section,<sup>175</sup> provides several lessons for MNCs concerning joint-venture partners. MNCs need to undertake careful due diligence of a local Chinese company before forming a joint venture. If the local company has allowed its employees to make kickbacks and other illegal payments in the past, it is likely that employees of the joint venture hired from the local partner will continue these practices after the joint venture is formed. Of course, the Chinese company will promise that it will immediately cease all of these payments once it forms a joint venture with the MNC, but experience indicates that this is unlikely to happen. Rather, the local Chinese partner may genuinely believe that because these payments fall into a “gray” area, there is little risk in continuing to make these payments. The Chinese partner also knows that since it has been giving these payments to PRC officials in the past, the officials have an expectation that the payments will continue. The local Chinese partner is more likely than not to continue to make these payments but hide them from the MNC. However, MNCs must be aware that if the local partner continues to make these payments, those actions will be attributed to the joint venture, which in turn will be viewed as an agent of the MNC under the FCPA.

MNCs also need to make a careful investigation of the business entities with which they do business. If a business entity is owned wholly or in part by a government bureau, then the business entity may qualify as an SOE, and any employee of the business entity may be deemed to be a government official by the DOJ. Such information will not always be easy to obtain since many PRC entities consider financial records to be confidential and they are often not readily available.<sup>176</sup>

The MNC may also wish to determine whether a business person who runs a private firm is a member of the CPC and might be considered to be a foreign official under the FCPA, or might be a foreign official due to some other position. For example, such a determination of the status of a businessperson might be necessary before the MNC invites the businessperson to a seminar in Hong Kong, Macau, or Singapore, along with a weekend of golf and other leisure activities. If the person is a private person, with no official capacity, a trip provided by the MNC would not implicate the FCPA. Under existing DOJ interpretations, however, the same trip provided to a foreign official might be found to be a FCPA violation.<sup>177</sup>

---

175. See Part II.D.

176. See CHOW & SCHOENBAUM, *supra* note 50, at 53.

177. See *supra* text accompanying notes 91–97.

## 3. DEALING WITH DEMANDS BY PRC OFFICIALS FOR BENEFITS

One particularly troublesome area that must be the focus of any compliance program is how to deal with demands for benefits or favors by PRC officials. The employees who get these demands are often junior-level employees who work in the field. For example, a sales agent or manager who is out in the field meeting with potential customers may be called to a meeting with Local Administration of Industry and Commerce (AIC) officials<sup>178</sup> where a request for benefits is made or implied. The junior employee often feels vulnerable in this situation (as would anyone) and needs to be prepared for this possibility and coached on how to deal with this demand without violating the FCPA or insulting the PRC authorities. Some MNCs have engaged in simulations in which professional consultants will play the role of PRC officials who ask directly or indirectly for an impermissible benefit and the employee is then coached on how to respond.<sup>179</sup>

The issue of demands by PRC officials for benefits or favors is such a troublesome matter that MNCs may wish to call attention to this issue with PRC central authorities in an appropriate manner. Employees of China business entities who come under constant pressure to provide a benefit or a favor may relent no matter how effective the MNC's compliance program. Dealing directly with the source of the demand should be a component of an overall compliance program. Recently, China has enacted its own version of the FCPA through an amendment to the PRC Criminal Law.<sup>180</sup> The new law prohibits illegal payments by Chinese persons or entities to foreign officials. This new law provides an opportunity for cooperation between the United States and U.S. industry groups with the PRC authorities to set guidelines on what violates the PRC statute. Since China now recognizes that it is a criminal act for Chinese entities to make a bribe to a foreign official in the United States, it would seem reasonable that PRC authorities would be willing to cooperate with the U.S. government or U.S. industry in setting forth clear and consistent standards on when violations under both legal regimes occur in the United States or in China. There are

---

178. AIC officials are in charge of all marketing and promotional activities in China.

179. This is based on the author's own conversations with business officials on MNCs in China.

180. *See* [Criminal Law of the People's Republic of China] (promulgated by the Standing Comm. of the Nat'l People's Cong., Feb. 25, 2011, revised article effective May 1, 2011), art. 164 ("Whoever gives any property to a functionary of a foreign country or an official of an international public organization for any improper commercial benefit shall be punished according to the provision of the preceding paragraph.").

many governmental or private bodies that seek to promote cooperation between the United States and China on business and legal matters.<sup>181</sup> One such project might be promulgating mutual guidelines on what constitutes violations of the FCPA and the new China criminal statute prohibiting bribery of foreign officials. Attention to acts of PRC officials that violate the FCPA may reduce the incentives on the part of these officials to ask for benefits or favors from China business entities owned by MNCs. Merely calling attention to these acts will reduce their occurrence.

#### 4. SEEKING CLARIFICATION FROM THE DOJ OF KEY TERMS

Designing an effective compliance program in China will inevitably be hampered by the legal uncertainties created by DOJ's broad and expansive interpretations of the FCPA. Given the reluctance of MNCs to challenge the DOJ in court, it is likely that the DOJ will continue to insist on broad interpretations of key elements in its NPAs and DPAs. The result of these expansive interpretations is to create incentives for MNCs to overinvest in compliance measures and will increase, perhaps substantially, the transactions costs of doing business in China.

There are numerous policy reasons why the DOJ, bent on aggressive enforcement of the FCPA, should not play such a decisive role in the interpretation of its terms.<sup>182</sup> This approach leads to considerable legal uncertainties for MNCs. But unless MNCs are willing to challenge some of these interpretations in court, the DOJ will continue to create de facto case law on the FCPA.<sup>183</sup> At present, MNCs often enter into NPAs and DPAs rather than assume the risk of litigation. Unless MNCs are willing to contest the DOJ's broad interpretations and allow courts to make judicial determinations concerning the scope and meaning of such key terms as "foreign official," "instrumentality," and "anything of value," legal uncertainties will continue to persist that create incentives for over compliance.

---

181. Governmental or private bodies include the U.S. Department of Commerce, twenty-first Century U.S.-China Joint Commission on Commerce and Trade, and the U.S. Chamber of Commerce.

182. *See generally* Koehler, *supra* note 18.

183. The DOJ provides an opinion procedure under which a company can request an opinion on whether a proposed course of conduct violates the FCPA. The request must describe an actual, as opposed to a hypothetical, transaction with real names, dates, details and full disclosure of all relevant facts. 28 C.F.R. § 80.6 (2011). The DOJ will provide an opinion within thirty days. So far this procedure, available since 1992, has been rarely used.

## CONCLUSION

The recent aggressive enforcement of the FCPA by the DOJ and the SEC in numerous cases involving China raises a host of new issues. Some of these issues, such as the clash between China's cultural norms that tolerate petty corruption and the application to conduct within China of U.S. laws that do not, are beyond the scope of this Article but merit exploration in additional academic studies.

For in-house counsel, this trend creates an immediate need on the part of MNCs to implement effective compliance programs on the ground in China. The rise of China as a global economic power means that many more DOJ and SEC enforcement actions will likely involve MNCs doing business in China. Several factors coalesce to make China an environment in which FCPA violations are likely to occur on a frequent basis and a trap for the unwary: aggressive DOJ interpretations, China's unique political and economic system, China's business culture in which many forms of petty corruption are tolerated, and China's continuing attractiveness as a place to do business for U.S.-based MNCs.

