THE UNIQUE FCPA COMPLIANCE CHALLENGES OF DOING BUSINESS IN CHINA

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I. INTRODUCTION

Companies continue to view China as an expanding market for products and services given the red-hot economy in that country. However, any company doing business or seeking to do business in China must first understand and appreciate the significant risks of doing business in that country in terms of Foreign Corrupt Practices Act ("FCPA") compliance. While the FCPA (a U.S. law which prohibits bribery of foreign officials to obtain or retain business) applies to all international operations, FCPA compliance in China poses a unique risk and challenge given the prevalence of state-owned or state-controlled enterprises as well as certain cultural norms and expectations.

Failure to understand and appreciate the unique FCPA risks of doing business or seeking to do business in China can expose a company and its personnel to significant criminal and civil liability under U.S. law, harsh collateral sanctions, and cause damage to a company's reputation. Thus, any company with a presence in China or seeking to do business in China should have in place effective, comprehensive, and well-communicated FCPA compliance policies and procedures.

Section II of this article documents how U.S. companies are increasingly dependent on China sales to boost growth and meet profit targets resulting in a surge of business to China. Section III provides a background on the FCPA and its two components the Anti-Bribery and the Books and Records and Internal Control provisions. This section discusses several broad elements of an FCPA Anti-Bribery violation that are likely not well-understood or appreciated by business leaders doing business or seeking to do business in China. Specifically, Section III discusses the broad application of the "foreign official" element of an FCPA Anti-Bribery violation and how this element has resulted in

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several recent FCPA enforcement actions against companies doing business in China because officers and employees of state-owned or state-controlled enterprises in China are deemed "foreign officials" under the statute. Section IV of this demonstrates the unique challenges FCPA compliance challenges in China given the prevalence of state-owned or state-controlled enterprises as well as certain cultural norms and expectations of doing business in China. Section V addresses the misperception that the FCPA can be circumvented by doing business in China through foreign subsidiaries or other third parties and describes how the actions of various third parties in China, such as agents or distributors, can result in FCPA liability for a parent company under the FCPA's broad Third Party Payment provisions.

Despite numerous FCPA compliance challenges in China, the FCPA risks of doing business in that country are manageable and can best be attained through effective, comprehensive, and well communicated FCPA compliance policies and procedures. Section VI concludes with guidance for business leaders to consider in developing a comprehensive and effective FCPA compliance program that will ensure a company is able to legally, effectively, and efficiently navigate the lucrative Chinese market and avoid the costly and embarrassing shortcomings of other companies who rushed into China without fully knowing their business and without a full understanding and appreciation for the FCPA.

II. THE EXPANDING CHINA MARKET

The geographic scope of business has changed. Whereas companies historically relied on North American markets to meet revenue projections, companies now are increasingly dependent on China sales to boost growth and meet profit targets. Entry into China or expansion of existing operations in China is near the top of many corporate strategies. The Chinese market has a population approaching 1.4 billion, a fast growing industrial and service sector, and a growing upper and middle class with disposable income to purchase goods and services. For this reason, business leaders are hopeful that the Chinese market will provide a market for their products and services as big as, if not bigger than, existing North American markets within the next decade.

Like many U.S. companies, Wisconsin companies are among those with corporate growth strategies focused on China and it is no surprise that Wisconsin companies, supported by the state's elected

officials, are seeking every available opportunity to foster and grow business relationships in China. For instance, in May 2006 Milwaukee Mayor Tom Barrett signed an economic and cultural cooperation agreement with the Deputy Communist Party Secretary of Ningbo, a booming Chinese port city of over five million people, with the goal of increasing business and economic relationships between the two cities.[1] This followed a March 2004 trade delegation to China led by Wisconsin Governor Jim Doyle, during which the Governor, joined by representatives from approximately fifty Wisconsin companies and various civic and state leaders, sought new opportunities for Wisconsin businesses in China.[2] Governor Doyle again led a delegation of Wisconsin business leaders to China in September 2007.[3] In announcing this second trade mission to China in three years, Governor Doyle stated that the trade mission would be a "great opportunity for Wisconsin companies to meet the customers and business leaders that will help them build their sales in these important markets."[4]

The combined efforts of Wisconsin business leaders and elected officials have led to a surge of Wisconsin exports into China. China is currently Wisconsin's fastest growing export market and the third largest export market overall for Wisconsin companies.[5] In 2006, exports to China totaled $870 million, a twenty-nine percent increase compared to 2005.[6] One only needs to be a casual observer of business news to realize that the "race to China" is well underway. Recent press reports and trade publications evidence the flurry of business activity in China by some of Wisconsin's largest companies such as Brady Corporation, Briggs & Stratton, Harley Davidson, Johnson Controls, Joy Global, Kohler Company, Manitowoc Company, Modine Manufacturing, and Rockwell Automation.[7]

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1 John Schmid, *Barrett, Chinese Officials Finalize Economic Ties*, MILWAUKEE J. SENTINEL, May 12, 2006, at 1D.

2 Press Release, Office of Governor Doyle, China Represents Challenges and Opportunities (Mar. 26, 2004), http://www.wisgov.state.wi.us/journal_media_detail.asp?prid=465&locid=19.

3 Press Release, Office of Governor Doyle, Governor Doyle to Lead Trade Mission to China, Japan (Feb. 28, 2007), http://www.wisgov.state.wi.us/journal_media_detail_print.asp?prid=2553&locid=19.

4 *Id.*

5 *Id.*

6 *Id.*

7 *See, e.g., Brady to Manufacture in China*, BUS. J. MILWAUKEE, Aug. 18, 1999, http://milwaukee.bizjournals.com/milwaukee/stories/1999/08/16/daily18.html; Thomas Content, *Briggs Is Increasing Its Presence in China*, MILWAUKEE J. SENTINEL, Apr. 18, 1999, at 1D; Rick Barrett, *To Bring Hogs to China, Harley Chooses Partner*, MILWAUKEE J. SENTINEL, June 9,

However, with reward comes risks, and the lure of China profits can bring companies dangerously close to running afoul of the FCPA unless business leaders fully understand and appreciate the many nuances of the broad-reaching statute. In fact, many of the recent FCPA enforcement actions brought by U.S. government enforcement agencies involve business activity in China. In addition, several corporate self-disclosures to the enforcement agencies in which a U.S. company voluntarily discloses questionable business activity that could implicate the FCPA relate to business activity in China. Indeed, overall FCPA enforcement is on the rise and likely to increase in the coming years as U.S. enforcement agencies have increased FCPA resources, including the hiring of additional attorneys within the Department of Justice ("DOJ") fraud division and the hiring of additional FBI agents dedicated exclusively to investigating and prosecuting FCPA violations.[8] For these reasons, companies invite risk by entering China or expanding existing operations in that country without carefully considering and understanding the FCPA compliance risks.

III. BACKGROUND OF THE FCPA

The FCPA was enacted in 1977 to halt the practice of bribery as a means of obtaining or retaining foreign business and was in response to widespread, post-Watergate allegations that U.S. companies were securing foreign government contracts by making improper payments to foreign government officials.[9] The statute, an amendment to the

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2004, at 1D; *Johnson Controls Will Work with Chinese Firm*, MILWAUKEE J. SENTINEL, Aug. 1, 2000, at 2D; Rick Barrett, *Joy Global Looks to China for Growth*, MILWAUKEE J. SENTINEL, Nov. 2, 2006, at 1D; *Kohler Names VP For China Operations*, BUS. J. MILWAUKEE, June 26, 2002, http://milwaukee.bizjournals.com/milwaukee/stories/2002/06/24/daily27.html; Thomas Content, *China Ice Plant to Be Expanded*, MILWAUKEE J. SENTINEL, Jan. 21, 2004, at 3D; Rich Rovito, *Modine Establishes Base in China*, BUS. J. MILWAUKEE, July 18, 2003, http://milwaukee.bizjournals.com/milwaukee/stories/2003/07/21/story6.html; Alby Gallun, *Rockwell Expands in China*, BUS. J. MILWAUKEE, Apr. 30, 1999, http://milwaukee.bizjournals.com/milwaukee/stories/1999/05/03/story2.html.

[8] Alice S. Fisher, Assistant Attorney General, U.S. Dept. of Justice, Criminal Division, Comments at the American Conference Institute: FCPA Conference (Nov. 13, 2007).

[9] *See* U.S. Dept. of Justice, LAY PERSON'S GUIDE TO FCPA, http://www.usdoj.gov/criminal/fraud/docs/dojdocb.html [hereinafter LAY PERSON'S GUIDE] (last visited Jan. 22, 2007)

> As a result of SEC investigations in the mid-1970's, over 400 U.S. companies admitted making questionable or illegal payments in excess of $300 million to foreign government officials, politicians, and political parties. The abuses ran the gamut

Securities Exchange Act of 1934 ("Exchange Act"), generally prohibits U.S. companies and citizens, foreign companies listed on a U.S. stock exchange, or any person acting in the United States from corruptly paying, offering to pay, or authorizing the payment of money, a gift, or anything of value, directly or indirectly, to a foreign official in order to obtain or retain business (the "Anti-Bribery provisions").[10] The FCPA also requires companies that issue debt or equity in the United States to maintain books and records that accurately reflect the disposition of corporate assets and to devise and maintain internal controls sufficient to provide reasonable assurances, among other things, that transactions are executed in accordance with management's authorization (the "Books and Records and Internal Control provisions").[11] The DOJ and the Securities and Exchange Commission ("SEC") jointly enforce the FCPA. The DOJ is responsible for criminal enforcement of the statute and for civil enforcement of the Anti-Bribery provisions against non-public companies and foreign companies and nationals; whereas, the SEC is responsible for civil enforcement of the Anti-Bribery provisions with respect to issuers as well as overall responsibility for the Books and Records and Internal Control provisions.[12]

Proof of a U.S. territorial nexus is not required for the FCPA to be implicated against U.S. companies and citizens and FCPA violations can, and often do, occur even if the prohibited activity takes place entirely outside of the United States.[13] For this reason, business leaders must be knowledgeable about all business activity, including activity that takes place thousands of miles away from corporate headquarters, because how a company obtains and retains business in Beijing or Shanghai is as relevant as how it obtains or retains business in Boston or Seattle.

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from bribery of high foreign officials to secure some type of favorable action by a foreign government to so-called facilitating payments that allegedly were made to ensure that government functionaries discharged certain ministerial or clerical duties. Congress enacted the FCPA to bring a halt to the bribery of foreign officials and to restore public confidence in the integrity of the American business system.

[10] *See* Foreign Corrupt Practices Act (FCPA) of 1977, 15 U.S.C. § 78dd-1 (2000).

[11] *See id.* § 78m(b).

[12] *See* LAY PERSON'S GUIDE, *supra* note 9 (summarizing the statutory responsibilities of the SEC and the DOJ with respect to enforcement of FCPA provisions).

[13] *See* 15 U.S.C. §§ 78dd-1(a), -1(g), -2(a), -2(i) (2000) (delineating prohibited conduct of both issuers and non-issuers without requiring the conduct to have occurred in the United States).

A. ANTI-BRIBERY PROVISIONS

Those subject to the FCPA's Anti-Bribery provisions are generally prohibited from corruptly paying, offering to pay, or authorizing the payment of money, a gift, or *anything of value* to any *foreign official* or foreign political party for purposes of influencing any act or decision of such official in his or her official capacity, inducing such foreign official to do any act in violation of the lawful duty of such official, or securing any improper advantage in order to assist the payor in *obtaining or retaining business* for or with, or directing business to, any person.[14] Any business leader no doubt understands and appreciates that delivering a "suitcase full of cash" to a high-ranking member of the Communist Party in China to induce the official to use his or her influence in awarding a government contract is improper, even without fully understanding or appreciating the FCPA. However, several elements of an FCPA Anti-Bribery violation have broad application and are not well understood or appreciated by business leaders doing business or seeking to do business in China and can result in FCPA exposure for a whole range of conduct less culpable than the scenario set forth above. In particular, business leaders must firmly grasp the broad scope of the "anything of value," "obtain or retain business," and "foreign official" elements to ensure FCPA compliance in China.

B. "ANYTHING OF VALUE"

The term "anything of value" is not defined in the FCPA and the statute's legislative history is not illuminating.[15] The term, however, has been broadly construed and can include not only cash or a cash equivalent, but also discounts, gifts, use of materials, facilities or equipment, entertainment (including tickets and passes), drinks, meals, transportation, lodging (and accommodation upgrades), insurance benefits, and a promise of future employment among other things.[16]

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[14] *Id*. § 78dd-1(a).

[15] *See id.* § 78dd-1; S. REP. NO. 94-1031 (1976); H.R. REP. NO. 95-831 (1977) (Conf. Rep.).

[16] *See, e.g.,* United States v. Liebo, 923 F.2d 1308, 1311 (8th Cir. 1991) (regarding airline tickets); United States v. Metcalf & Eddy, Inc., No. 99-12566 (D. Mass. 1999) (final judgment granting permanent injunction regarding accommodation upgrades); U.S. Dept. of Justice Opinion Procedure Release 2000-01 (Mar. 29, 2000), http://www.usdoj.gov/criminal/fraud/fcpa/opinion/2000/0001.html (regarding insurance benefits and promise of future employment). Pursuant to 15 U.S.C. § 78dd-1(e), parties may submit contemplated action or business conduct to the DOJ and obtain a DOJ opinion whether the contemplated action or business conduct

Furthermore, there is no *de minimis* value associated with the "anything of value" element of an FCPA Anti-Bribery violation.[17] Rather, the perception of the recipient and the subjective valuation of the thing conveyed is often a key factor in determining whether "anything of value" has been given to a "foreign official."

A June 2004 FCPA enforcement action against Schering-Plough Corporation ("Schering-Plough") represents perhaps the broadest interpretation of the "anything of value" element of an FCPA Anti-Bribery violation.[18] In this matter, the SEC alleged that Schering-Plough violated the FCPA when its wholly-owned Polish subsidiary ("S-P Poland") improperly recorded a bona fide donation to a Polish charitable foundation that was dedicated to restoring castles and other historic sites in Poland.[19] The founder and president of the foundation was the director of a government health fund which provided money for the purchase of pharmaceutical products by hospitals throughout Poland and was thus considered a "foreign official" under the FCPA.[20]

Even though all of S-P Poland's charitable payments to the bona fide foundation were recorded as donations, the SEC alleged that the payments, which were not made with the knowledge or approval of any U.S. employee, were made to the foundation to improperly influence the director to purchase the company's products.[21] In fact, the SEC alleged that S-P Poland's payments to the foundation began shortly after the director began his tenure at the foundation, constituted between twenty to forty percent of S-P Poland's total promotional donations, and, during the relevant time period the payments were made, S-P Poland's sales of

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violates the FCPA. 15 U.S.C. § 78dd-1(e). However, the DOJ's opinion has no precedential value, and its opinion that the contemplated conduct is in conformance with the FCPA is entitled only to a rebuttable presumption should an FCPA enforcement action be brought. *Id.*

17 *See* Dow Chem. Co., Exchange Act Release No. 55,287, 89 SEC Docket (CCH) 3092, 3093 (Feb. 13, 2007) (noting that although certain improper payments "were in small amounts – well under $100 per payment – the payments were numerous and frequent."); Complaint at ¶ 43, SEC v. Titan Corp., No. 05-0411 (D.D.C. 2005) (alleging that improper payments included, among other things, a $1,850 pair of earrings for the wife of the President of Benin).

18 *See* Schering-Plough Corp., Exchange Act Release No. 49,838, 82 SEC Docket (CCH) 3644, 3644 (June 9, 2004); *see also* SEC v. Schering-Plough Corp., Litigation Release No. 18,740, 82 SEC Docket (CCH) 3732 (June 9, 2004) (discussing a companion case filed by the SEC to impose civil penalties), Complaint, SEC v. Schering-Plough Corp., No. 1:04CV00945 (D.D.C. filed June 9, 2004). While the Schering-Plough matter involved violations of the FCPA's Books and Records and Internal Control provisions only, it is commonly viewed as broadening the "anything of value" element of an FCDA Anti-Bribery violation.

19 Exchange Act Release No. 49,838, *supra* note 18, at 3644.

20 *See id.*

21 *See id.* at n.3.

two oncology products within the director's region increased disproportionately compared to sales of the products in other regions of Poland.[22] Based on this conduct, Schering-Plough settled the SEC enforcement action by paying a $500,000 civil penalty.[23]

The SEC's tacit interpretation of the term "anything of value" in the Schering-Plough enforcement action is significant because there was no allegation or indication that any tangible, monetary benefit accrued to the Polish "foreign official." Rather, the SEC brought the FCPA enforcement action on the basis of its apparent conclusion that S-P Poland's bona fide charitable donations constituted a "thing of value" because the donations were subjectively valued by the "foreign official" and provided him with an intangible benefit of enhanced prestige.

C. "OBTAIN OR RETAIN BUSINESS"

The "obtain or retain business" element of an FCPA Anti-Bribery violation also has broad application. In *United States v. Kay,* the court held that making improper payments to Haitian officials to lower corporate taxes and custom duties in that country could satisfy the "obtain or retain business" element of an FCPA Anti-Bribery violation by providing an unfair advantage to the payor over competitors.[24] The court concluded that there was "little difference" between this type of improper payment and an improper payment to a foreign government official to award a government contract or commercial agreement.[25] In short, the *Kay* court was convinced that Congress, by passing the FCPA, intended to prohibit a wide range of improper payments, not just those that directly influence the acquisition or retention of government contracts or similar arrangements.[26]

More recently, in a February 2007 FCPA enforcement action against Vetco International Ltd. ("Vetco"), the DOJ secured a $26 million settlement—the largest criminal FCPA fine ever—where the alleged improper payments were made by one of the company's foreign subsidiaries to Nigerian customs officials via a major international

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[22] *Id.* at 3644-45.
[23] Litigation Release No. 18,740, *supra* note 18, at 3732.
[24] United States v. Kay, 359 F.3d 738, 738 (5th Cir. 2004).
[25] *Id.* at 749.
[26] *Id.* at 748-50.

freight forwarder and customs clearance company.[27] The DOJ concluded that the payments were intended to induce the customs officials to provide the company preferential treatment during the customs process and allowed the company to secure an improper advantage in connection with a government deepwater oil drilling project.[28]

It is also clear that the business to be "obtained or retained" does not need to be with a foreign government for this element of an FCPA Anti-Bribery violation to be satisfied. For instance, in a February 2007 FCPA enforcement action, the SEC alleged that DE-Nocil Corp. Protection Ltd. ("DE-Nocil"), a "fifth tier subsidiary" of The Dow Chemical Corporation ("Dow Chemical") in India, improperly recorded payments to various Indian officials with discretionary authority over whether DE-Nocil's products would receive various government registrations required before the company could sell its product in that country.[29] The SEC alleged that the improper payments allowed DE-Nocil to obtain expedited registration for its product, thereby generating $435,000 in direct operating margin from the accelerated sales.[30] Based on the alleged improper conduct, Dow agreed to pay a $325,000 civil penalty.[31]

Even unsuccessful bribery attempts violate the FCPA's Anti-Bribery's provisions. In January 2005, Monsanto Company ("Monsanto") agreed to pay $1.5 million to settle an FCPA enforcement action based on allegations that it made improper payments to a senior Indonesian environmental official to persuade the official to repeal an environmental impact study requirement that was necessary before the company could sell its genetically modified crops in that country.[32] To increase the acceptance of genetically modified crops in Indonesia,

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[27] *See* Press Release, U.S. Dept. of Justice, Three Vetco International Ltd. Subsidiaries Plead Guilty to Foreign Bribery and Agree to Pay $26 Million in Criminal Fines (Feb. 6, 2007), http://www.usdoj.gov/opa/pr/2007/February/07_crm_075.html; *see also* United States v. Aibel Group Ltd., No. CR H07-05 (S.D. Tex. Jan. 4, 2007) (deferred prosecution agreement involving a subsidiary of Vetco International).

[28] *See* Press Release, *supra* note 27.

[29] *See* Exchange Act Release No. 55,287, *supra* note 17, at 3092; *see also* SEC v. Dow Chem. Co., Litigation Release No. 20,000, 89 SEC Docket (CCH) 3176, 3176-77 (Feb. 13, 2007) (summarizing the SEC's civil complaint and the companion cease-and-desist order issued by the SEC).

[30] Exchange Act Release No. 55,287, *supra* note 17, at 3093.

[31] Litigation Release No. 20,000, *supra* note 29, at 3177.

[32] *See* Press Release, U.S. Dept. of Justice, Monsanto Company Charged With Bribing Indonesian Government Official (Jan. 6, 2005), http://www.usdoj.gov/opa/pr/2005/January/05_crm_008.htm; SEC v. Monsanto Co., Litigation Release No. 19,023, 84 SEC Docket (CCH) 2284, 2284 (Jan. 6, 2005).

Monsanto retained an Indonesian consulting firm to lobby for the repeal of the environmental impact study requirement which was having an adverse effect on its business interests in that country.[33] According to the SEC, an employee of Monsanto's Indonesian subsidiary authorized the consulting company to make a $50,000 cash payment to the environmental official to "incentivize" him to repeal the requirement.[34] To fund the improper payment, a false invoicing scheme was devised and the $50,000 cash payment was ultimately made to the official by the consulting company.[35] However, despite the cash payment, the official never repealed the environmental impact study requirement.[36]

The *Kay* decision and Vetco, Dow Chemical, and Monsanto FCPA enforcement actions clearly demonstrate that U.S. enforcement agencies will not hesitate in bringing FCPA enforcement actions when improper payments to a foreign official allow a company to secure an advantage over competitors, even though the payments may not directly lead to any specific business or may not even be successful in accomplishing the intended result.

D. "FOREIGN OFFICIAL"

While the "anything of value" and "obtain or retain business" elements of an FCPA Anti-Bribery violation have broad application, it is the broad application of the "foreign official" element that makes FCPA compliance in China a unique challenge compared to other countries given the prevalence of state-owned or state-controlled enterprises in China (collectively "SOEs").

The FCPA's Anti-Bribery provisions broadly define the term "foreign official" to include "any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of any such government or department, agency or instrumentality, or for or on behalf of any such public international organization."[37] A foreign national can generally be deemed a "foreign official" under the FCPA's Anti-Bribery provisions in one of two ways.

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[33] Monsanto Co., Exchange Act Release No. 50,978, 84 SEC Docket (CCH) 2199, 2200 (Jan. 6, 2005).

[34] *Id.*

[35] *Id.*

[36] *Id.* at 2201.

[37] Foreign Corrupt Practices Act (FCPA) of 1977, 15 U.S.C. § 78dd-1(f)(1)(A) (2000).

First, an individual can be deemed a "foreign official" by virtue of a position or appointment he or she may have with the government, a government ministry, or a government agency. Second, and much more a risk for the unwary, an employee of a foreign company can be deemed a "foreign official" under the FCPA when his or her employer is an "instrumentality" of a foreign government—a term not defined in the FCPA or delineated in the FCPA's legislative history. Once a foreign company is deemed an "instrumentality" of a foreign government, every single employee, from the lowest ranking administrative assistant to the chief executive officer, will be considered a "foreign official" for purposes of the FCPA.[38] This is true regardless of how local law may characterize the employee.[39]

It is clear that U.S. enforcement agencies view Chinese SOEs as being an "instrumentality" of the Chinese government and employees of the SOEs as being "foreign officials" under the FCPA. This broad interpretation of the "foreign official" element of an FCPA Anti-Bribery violation is best demonstrated by several recent FCPA enforcement actions concerning business activity in China where the "foreign officials" alleged to have been bribed were employees of a Chinese SOE.

Most recently, in June 2008, Faro Technologies Inc. ("Faro"), a Florida based public company, agreed to pay combined fines and penalties of $2.95 million in connection with improper payments made to employees of Chinese SOEs in order to assist in obtaining and retaining business in violation of the FCPA.[40] Pursuant to a two year DOJ non-prosecution agreement, Faro acknowledged that its employees and agents paid approximately $500,000 in kickbacks to employees of the SOEs to secure contracts worth approximately $4.9 million.[41]

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[38] *See* LAY PERSON'S GUIDE, *supra* note 9 ("The FCPA applies to payments to *any* public official, regardless of rank or position. The FCPA focuses on the *purpose* of the payment instead of the particular duties of the official receiving the payment . . . .").

[39] *See* U.S. Dept. of Justice Opinion Procedure Release 94-01 (May 13, 1994) http://www.usdoj.gov/criminal/fraud/fcpa/opinion/1994/9401.html (opining that a general director of a state-owned enterprise being transformed into a joint stock company is a "foreign official" under the FCPA despite a foreign law opinion that the individual would not be regarded as either a government employee or a public official in the foreign country).

[40] *See* Press Release, U.S. Dept. of Justice, Faro Technologies Inc. Agrees to Pay $1.1 Million Penalty and Enter Non-Prosecution Agreement for FCPA Violations (June 5, 2008) (on file with author); *see also* Faro Technologies, Inc., Exchange Act Release No. 57,933 (June 5, 2008) (on file with author); *and* Faro Technologies Inc., U.S. Dept. of Justice Non-Prosecution Agreement (June 3, 2008) (on file with author).

[41] *See* U.S. Dept. of Justice Non-Prosecution Agreement, *supra* note 40.

Also In June 2008, AGA Medical Corporation ("AGA"), a privately-held Minnesota based medical manufacturer, entered into a deferred prosecution agreement with the DOJ in which it agreed to pay a $2 million criminal penalty for causing improper payments to be made through its Chinese distributor to, among others, physicians employed by Chinese government owned or controlled hospitals.[42] According to the filed criminal information, AGA conspired with its Chinese distributor to make improper payments and authorized the distributor to make improper payments to physicians employed by the hospitals to cause them to purchase AGA products.[43] The physicians either received a "reward" ranging from $300 to $1,000 per AGA product purchased or received kickbacks in an amount between 15% to 25% of the purchase price.[44]

In December 2007, Lucent Technologies, Inc. ("Lucent") agreed to settle parallel DOJ and SEC enforcement actions for improperly recording travel expenses and other things of value provided to employees of Chinese SOEs. Lucent acknowledged spending more than $10 million on hundreds of trips involving over a thousand SOE employees that had a disproportionate amount of sightseeing, entertainment, and leisure. Based on this conduct, Lucent agreed to pay $2.5 million in combined fines and penalties.[45]

Likewise, in October 2006, Schnitzer Steel Industries, Inc. ("Schnitzer Steel"), along with two of its foreign subsidiaries, agreed to settle an FCPA enforcement matter for making approximately $205,000 in improper payments in connection with thirty sales transactions to managers of government controlled steel mills in China.[46] According to the DOJ, the improper payments were intended to induce the managers to

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[42] *See* Press Release, U.S. Dept. of Justice, AGA Medical Corporation Agrees to Pay $2 Million Penalty and Enter Deferred Prosecution Agreement for FCPA Violations (June 3, 2008) (on file with author); *see also* U.S. v. AGA Medical Corp., Deferred Prosecution Agreement (D. Minn. filed June 3, 2008) (on file with author); *and* U.S. v. AGA Medical Corp., Information (D. Minn. filed June 3, 2008) (on file with author).

[43] *See* U.S. v. AGA Medical Corp., Information, *supra* note 42.

[44] *See id.*

[45] *See* Press Release, U.S. Dept. of Justice, Lucent Technologies Inc. Agrees to Pay $1 Million Fine to Resolve FCPA Allegations (Dec. 21, 2007) (on file with author); *see also* Litigation Release No. 20414, U.S. Securities and Exchange Commission, SEC Files Settled Action Against Lucent Technologies Inc. in Connection With Payments of Chinese Officials' Travel and Entertainment Expenses; Company Agrees to Pay $1.5 Million Civil Penalty (Dec. 21, 2007) http://www.sec.gov/litigation/litreleases/2007/lr20414.htm (on file with author).

[46] *See* Schnitzer Steel Indus., Inc., Exchange Act Release No. 54,606, 89 SEC Docket (CCH) 302 (Oct. 16, 2006); *see also* Complaint at ¶¶ 10-11, United States v. SSI Int'l Far East, Ltd., No. 06-398 (D. Or. 2006).

purchase scrap metal from Schnitzer Steel and were accomplished through a kick-back scheme to the managers of the mills, or funded through a scheme whereby the managers would cause the mill to overpay Schnitzer Steel for the steel purchase and then personally recover the "overpayment" from Schnitzer Steel.[47] Schnitzer Steel's gross revenue on the tainted transactions was approximately $96 million on which the company earned approximately $6.2 million in net profits.[48] As a result of this and other improper conduct, Schnitzer Steel and its foreign subsidiaries agreed to pay $15.2 million to resolve its FCPA liability (a $7.5 million criminal fine paid by the company's foreign subsidiary and a $7.7 million civil penalty paid by Schnitzer Steel).[49]

Similarly, in May 2005, Diagnostic Products Corporation ("DPC"), a producer and seller of diagnostic medical equipment, along with its Chinese subsidiary, DPC (Tianjin) Co., Ltd. ("DPC Tianjin"), agreed to settle an FCPA enforcement action in connection with alleged payments of approximately $1.6 million in the form of illegal commissions to physicians and laboratory personnel employed by government-owned hospitals in China.[50] According to the DOJ, the improper payments were allegedly paid between 1991 and 2002 for the purpose of assisting DPC obtain and retain business from the Chinese hospitals.[51] The improper payments were often paid in cash and hand-delivered by DPC Tianjin salespersons to the individuals who controlled purchasing decisions for the Chinese hospitals, and were typically calculated as a percentage of sales made to the Chinese hospitals.[52] DPC Tianjin agreed to pay a criminal penalty of $2 million to resolve its FCPA liability concerning these activities and DPC agreed to civil penalties of approximately $2.8 million.[53]

Likewise, in a February 2005 FCPA enforcement action, GE InVision, Inc., formerly known as InVision Technologies, Inc., a

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47 *See* Exchange Act Release No. 54,606, *supra* note 46, at 303.

48 *Id.*

49 *See id*. at 306; Press Release, U.S. Dept. of Justice, Schnitzer Steel Industries Inc.'s Subsidiary Pleads Guilty to Foreign Bribes and Agrees to Pay a $7.5 Million Criminal Fine (Oct. 16, 2006) (on file with author).

50 Diagnostic Prods. Corp., Exchange Act Release No. No. 51,724, 85 SEC Docket (CCH) 1319, 1319 (May 20, 2005); s*ee also* Press Release, U.S. Dept. of Justice, DPC (Tianjin) Ltd. Charged with Violating the Foreign Corrupt Practices Act (May 20, 2005), http://www.usdoj.gov/opa/pr/2005/May/05_crm_282.htm.

51 Press Release, *supra* note 50.

52 *Id.*

53 *See id.*

manufacturer of explosive detection systems used at airports, agreed to pay $1.3 million to resolve its FCPA liability in connection with improper payments made through foreign sales agents or distributors in China, the Philippines, and Thailand.[54] In China, the SEC alleged that InVision was aware of the "high probability" that its local distributor intended to use a $95,000 payment to fund foreign travel and other benefits for employees of a government-owned and controlled airport.[55]

As the Faro, AMC Medical, Lucent, Schnitzer Steel, DPC, and InVision enforcement actions clearly demonstrate, it is not the "suitcase full of cash" scenario that presents the greatest FCPA compliance risks for companies doing business in China. Rather, the risks are greatest in China given the number of individuals, like steel managers, physicians, laboratory personnel, and airport employees who will be deemed "foreign officials" under the FCPA Anti-Bribery provisions.

E. BOOKS AND RECORDS AND INTERNAL CONTROL PROVISIONS

The FCPA's Books and Records and Internal Control provisions supplement an issuer's Sarbanes-Oxley obligations and require issuers to "make and keep *books, records, and accounts*, which, in *reasonable detail*, *accurately and fairly* reflect the transactions and dispositions of the assets of the [i]ssuer."[56] These provisions give the SEC broad enforcement authority over the record-keeping procedures of issuers. The term "books, records, and accounts" is very broad and includes most corporate record keeping. The Exchange Act defines "records" to include "accounts, correspondence, memorandum, tapes, discs, papers, books, and other documents or transcribed information of any type, whether expressed in ordinary or machine language."[57] The addition of the terms "books" and "accounts" in the FCPA further broadens the scope; however, the SEC has specified some limitation on the scope of the FCPA's Books and Records provisions as records which are not related to internal or external audits, or to the internal control objectives

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[54] *See* SEC v. GE InVision, Inc., Litigation Release No. 19,078, 84 SEC Docket (CCH) 3048, 3049 (Feb. 14, 2005); Press Release, U.S. Dept. of Justice, InVision Technologies, Inc. Enters Into Agreement with the United States (Dec. 6, 2004), http://www.usdoj.gov/opa/pr/2004/December/04_crm_780.htm; *see generally* Complaint, SEC v. GE InVision, Inc., No. C05 0660 (N.D. Cal. 2005) (companion case filed by the SEC to impose civil penalties).

[55] Complaint, *supra* note 54, at ¶ 11.

[56] Foreign Corrupt Practices Act (FPCA) of 1977, 15 U.S.C. § 78m(b)(2)(A) (2000) (emphasis added).

[57] *Id.* § 78c(a)(37).

set forth in the FCPA, are not within the purview of the provisions.[58] However, because one of the FCPA's Internal Control provisions, discussed below, is that there be a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP, this limitation is rendered trivial in most instances because auditors, both internal and external, need access to most corporate records to permit preparation of financial statements.

The term "reasonable detail" in the FCPA's Books and Records and Internal Control provisions was intended as a qualification to the requirement to make and keep books, records, and accounts. "Reasonable detail" means "such level of detail as would satisfy prudent officials in the conduct of their own affairs."[59] Congress intended to make clear that "the [i]ssuer's records should reflect transactions in conformity with accepted methods of recording economic events and effectively prevent off-the-book slush funds and the payment of bribes."[60]

The FCPA's Books and Records and Internal Control provisions also require that the books, records, and accounts of issuers "accurately and fairly" reflect the transaction and disposition of assets. Congress did not intend the word "accurately" to mean exact precision as measured by some abstract principle; "[r]ather, it means that [i]ssuer's records should reflect transactions in conformity with accepted methods of recording economic events."[61]

In addition, the FCPA's Books and Records and Internal Control provisions requires issuers to "devise and maintain a system of internal accounting controls" sufficient to provide reasonable assurances that, among other things, transactions are executed in accordance with management's general or specific authorization, and transactions are recorded as necessary to permit the preparation of financial statements in conformity with generally accepted accounting principles and to maintain accountability for assets.[62]

In most cases, improper payments to a "foreign official" to "obtain or retain business" result not only in a DOJ criminal enforcement

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[58] *See* Statement of Policy Regarding the Foreign Corrupt Practices Act of 1977, Interpretive Release No. 17,500, 8 F. Sec. L. Rep. (CCH) ¶ 23,632H (Jan. 29, 1981).

[59] Foreign Corrupt Practices Act (FCPA) of 1977, 15 U.S.C. § 78m(b)(7).

[60] *See* H.R. REP. NO. 95-831, at 10 (1977) (Conf. Rep.).

[61] *See* S. REP. NO. 94-1031, at 11 (1976).

[62] 15 U.S.C. § 78m(b)(2)(A).

action for violations of the FCPA's Anti-Bribery provisions, but also a parallel SEC enforcement action against an issuer for violations of the FCPA's Books and Records and Internal Control provisions because improper payments are often disguised or inaccurately recorded on the company's books and records as "miscellaneous" expenses, "costs of goods sold," or under some other vaguely described account. Morever, issuer's internal controls will generally be subject to scrutiny anytime there is an improper payment to a foreign official on the theory that effective internal controls would have prevented the payment.

For instance the Schering-Plough, Schnitzer Steel, and DPC FCPA enforcement actions all involved violations of the FCPA's Books and Records and Internal Control provisions. In the Schering-Plough matter, the SEC concluded that the improper donations to the "foreign official" resulted from inadequate and insufficient internal polices at Schering-Plough which failed to detect possible FCPA violations by its foreign-owned subsidiaries because the policies and procedures did not require employees to conduct due diligence prior to making charitable donations to determine whether "foreign officials" were affiliated with the intended recipient.[63]

Likewise, in the Schnitzer Steel matter, the SEC concluded that the improper payments to the "foreign officials" were falsely described on the company's books and records as "sales commissions," "commission to the customer," "refunds," or "rebates."[64] Moreover, the SEC concluded that Schnitzer Steel lacked proper internal controls to detect possible violations of the FCPA because, during the relevant time period, Schnitzer Steel provided no training or education to any of its employees, agents, or subsidiaries regarding the requirements of the FCPA, and also failed to establish a program to monitor its employees, agents, and subsidiaries for compliance with the FCPA.[65]

Similarly, in the DPC matter, the SEC concluded that the improper payments to the "foreign officials" were improperly recorded as legitimate sales expenses on the company's books and records and that during the relevant time period the company did not have effective internal accounting controls to prevent and detect FCPA violations.[66]

Enforcement actions for violating the FCPA's Books and Records and Internal Control provisions can also occur in isolation even

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[63] Exchange Act Release No. 49,838, *supra* note 18, at 3645.

[64] Exchange Act Release No. 54,606, *supra* note 46, at 303.

[65] *See id.*

[66] *See* Exchange Act Release No. 51,724, *supra* note 50, at 1320.

when violations of the Anti-Bribery provisions are not alleged. This is often the case where the DOJ lacks jurisdiction against the individual or entity making the improper payment or where the DOJ lacks evidence, beyond a reasonable doubt, to satisfy the elements of an FCPA Anti-Bribery violation. A February 2007 FCPA enforcement action against El Paso Corporation ("El Paso"), a Texas-based energy company, is representative of an FCPA enforcement action based solely on the FCPA's Books and Records and Internal Control provisions.[67] In this matter, the SEC alleged that El Paso indirectly paid nearly $5.5 million in illegal surcharges to the Iraqi government in connection with purchases of crude oil from third parties under the United Nations Oil for Food Program.[68] The SEC concluded that the company, after becoming aware of Iraqi demands for illegal surcharges on oil sales, failed to maintain a system of internal controls sufficient to ensure that the company's transactions were recorded in accordance with management's authorization and that the transactions were recorded as necessary to maintain accountability of the company's assets.[69] The SEC also found that the company failed to accurately record the payments in its books, records, and accounts because the illegal surcharge payments were simply recorded as "cost of goods sold."[70] El Paso agreed to settle the matter by paying a civil penalty of $2.25 million and paying disgorgement of approximately $5.5 million.[71]

F. FCPA FINES AND PENALTIES

FCPA violations can expose a company and its personnel to significant criminal and civil penalties. Companies can be criminally fined up to $2 million per violation of the Anti-Bribery provisions and culpable individuals can be subject to a criminal fine up to $250,000 per violation, as well as imprisonment for up to five years.[72] Willful violations of the Books and Records and Internal Control provisions can result in a criminal fine up to $25 million for a company, and for culpable individuals, a criminal fine up to $5 million as well as

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[67] *See* SEC v. El Paso Corp., Litigation Release No. 19,991, 89 SEC Docket (CCH) 3020 (Feb. 7, 2007); Complaint, SEC v. El Paso Corp., No. 07CV00899 (S.D.N.Y. 2007).

[68] Litigation Release No. 19,991, *supra* note 67, at 3020; Complaint, *supra* note 67, ¶ 1.

[69] *See* Litigation Release No. 19,991, *supra* note 67, at 3021.

[70] *See id.*

[71] *Id.*

[72] *See* Foreign Corrupt Practices Act (FCPA) of 1977, 15 U.S.C. § 78ff (2000).

imprisonment for up to twenty years.[73] These fines and penalties are in addition to harsh collateral sanctions that can result from an FCPA violation, including termination of government licenses and debarment from government contracting programs.[74]

Enforcement agencies are also increasingly seeking disgorgement of company profits on "tainted contracts" secured through improper payments to foreign officials, a penalty that can be particularly significant as evidenced by the $28.5 million fine that Titan Corporation ("Titan") paid in March 2005 for making improper payments to a foreign official in the African nation of Benin.[75] Titan, a military intelligence and communications company, allegedly funneled $2 million to its agent in Benin (who was known at the time by Titan to be the Benin President's business advisor) to be used in the President's re-election campaign.[76] Titan allegedly made these payments to assist the company in its development of a telecommunications project in the country and to obtain the government's consent to an increase in the percentage of Titan's project management fees on the project.[77] The improper payments were falsely invoiced by the agent as "consulting services" and the actual payment of the money was broken into smaller increments and spread over time to avoid detection.[78] The $28.5 million fine paid by Titan included approximately $12.6 million in disgorgement.[79]

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[73] *Id.*

[74] *See* LAY PERSON'S GUIDE, *supra* note 9

> Under guidelines issued by the Office of Management and Budget, a person or firm found in violation of the FCPA may be barred from doing business with the Federal government. *Indictment alone can lead to suspension of the right to do business with the government*. The President has directed that no executive agency shall allow any party to participate in any procurement or nonprocurement activity if any agency has debarred, suspended, or otherwise excluded that party from participation in a procurement or nonprocurement activity. In addition, a person or firm found guilty of violating the FCPA may be ruled ineligible to receive export licenses; the SEC may suspend or bar persons from the securities business and impose civil penalties on persons in the securities business for violations of the FCPA; the Commodity Futures Trading Commission and the Overseas Private Investment Corporation both provide for possible suspension or debarment from agency programs for violation of the FCPA; and a payment made to a foreign government official that is unlawful under the FCPA cannot be deducted under the tax laws as a business expense.

[75] *See* SEC v. Titan Corp., Litigation Release No. 19,107, 84 SEC Docket (CCH) 3413 (Mar. 1, 2005); Complaint ¶ 1, SEC v. Titan Corp., No. 05-0411 (D.D.C. 2005).

[76] *See* Complaint, *supra* note 75, ¶¶ 2, 12.

[77] *See id.* ¶ 2.

[78] *See id.*

[79] *See* Litigation Release No. 19,107, *supra* note 75, at 3414.

Another FCPA enforcement trend that is particularly cumbersome for companies, not to mention expensive, is the appointment of an independent monitor to review and evaluate a company's internal controls, record-keeping, and financial reporting for purposes of ensuring future compliance with the FCPA. The independent monitor the SEC ordered Schnitzer Steel to retain for a period of three years is representative of such undertakings.[80] Per the SEC's Order, Schnitzer Steel was required to retain, through its Board of Directors, an independent monitor acceptable to the SEC to review and evaluate the company's internal controls, record-keeping, and financial reporting policies and procedures related to compliance with the Anti-Bribery and Books and Records and Internal Control provisions of FCPA.[81] Because the work of the monitor, such as inspection of relevant documents and procedures, onsite observation of various controls and procedures, and meetings and interviews with relevant personnel will be independent from the company, no attorney-client relationship will be formed between the monitor and the company; thus, the monitor can not withhold any information or documents from the SEC on the basis of any applicable privilege.[82] The SEC's Order also contemplates that the monitor will provide a written report to Schnitzer Steel and the SEC setting forth the monitor's assessment and make recommendations reasonably designed to improve the company's programs, policies, and procedures for ensuring compliance with the FCPA, which the company shall adopt unless it can show that the monitor's recommendations are unduly burdensome, impractical, or costly.[83] These penalties, sanctions, and collateral effects of an FCPA violation are in addition to the obvious damage a company's reputation suffers when it, or its employees, agents, or other affiliates, are alleged to have bribed a foreign official.

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[80] Independent monitors are now ordered by the SEC as a condition of settlement in most settled FCPA enforcement actions. *See*, *e.g.* Exchange Act Release No. 49,838, *supra* note 18, at 3646; Exchange Act Release No. 51,724, *supra* note 50, at 1320-21.

[81] *See* Exchange Act Release No. 54,606, *supra* note 46, at 304.

[82] *See id.*

[83] *See id.* at 305.

IV. THE UNIQUE FCPA COMPLIANCE CHALLENGES IN CHINA

Against this backdrop, companies invite risk by entering China or expanding existing operations in that country without carefully considering and understanding the FCPA compliance risks of doing business in China. While the FCPA applies to all international operations, FCPA compliance in China poses a unique risk and challenge given the prevalence of SOEs in that country as well as certain cultural norms and expectations of doing business in China.

A. SOEs

While China's economy is modernizing and has shades of a Western market-based economy, vestiges of state control and ownership are still present in many of the largest and most profitable Chinese enterprises, particularly in the resource extraction, infrastructure, and transportation industries. Reliable government statistics are difficult to obtain in China; nevertheless, statistics suggest that there are more than 120,000 SOEs in China.[84] Many SOEs in China have several attributes of a private enterprise, such as being publicly traded on a stock exchange; however, further due diligence often reveals that the enterprise is in fact majority owned or controlled by the Chinese government.

China's ShenHua Energy Co. ("ShenHua"), one of the world's largest coal companies, is an instructive example. ShenHua has been listed on the Hong Kong stock exchange since June 2005, yet its parent corporation, ShenHua Group Co. ("ShenHua Group"), is wholly-state owned.[85] Under the FCPA, ShenHua Group, as well as its majority owned subsidiaries, are thus considered "instrumentalities" of the Chinese government and, as evidenced by the above FCPA enforcement actions, enforcement agencies will consider employees of ShenHua to be "foreign officials" under the FCPA's Anti-Bribery provisions.

FCPA exposure in China is not limited to doing business or interacting with employees of SOEs. Many SOEs in China, particularly in the resource extraction, infrastructure, and transportation industries,

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[84] *See China's National Bureau of Statistics Clarifies SOEs Profits and Losses*, PEOPLE'S DAILY ONLINE, Mar. 31, 2006, (citing figures released by the National Bureau of Statistics and the Ministry of Finance) (on file with author).

[85] *See, e.g.,* Shai Oster, *Chinese Miner Looks Beyond Its Borders; Coal Firm Shenhua May Join Global Hunt For Commodities*, WALL ST. J. ASIA, Feb. 1, 2007, at 32.

also often engage a Chinese institution called a "design institute" ("DI") to serve as an engineering consulting firm in connection with certain contracts and projects.[86] Like Western style consulting firms, DIs often provide value-added technical services in exchange for a fee, and may be in a position to recommend or specify a company's product to an end-user SOE. Many DIs in China are transitioning to private, for-profit entities which compete for business just like any consulting engineering company in the United States; however, many of the DIs in China remain state-owned or state-controlled and enforcement agencies will also likely consider employees of the DIs to be "foreign officials" under the FCPA's Anti-Bribery provisions.

It can not be understated what the broad definition and interpretation of the term "foreign official" means in terms of FCPA compliance in China. A company's interaction with numerous individuals in China (individuals who likely are not viewed as a "foreign official" by business leaders and individuals who likely do not even view themselves as a "foreign official") will be subject to close scrutiny under the FCPA by U.S. enforcement agencies.

B. CULTURAL NORMS AND EXPECTATIONS

FCPA compliance in China is challenging enough for companies given the number of individuals in China who will be deemed "foreign officials" under the FCPA's Anti-Bribery provisions. Add to the mix certain cultural norms and expectations of doing business in China and the end result is a "perfect storm" for FCPA non-compliance.

Business leaders who venture to China well know that conducting business in that country is more formal compared to conducting business in other markets. Contract negotiations with Chinese customers can last for weeks, if not months, and executed contracts are often followed, at a minimum, by large banquet-like celebrations attended by hundreds of individuals, complete with the exchange of gifts, which are common and expected throughout China. Not surprisingly, another dynamic of conducting business in China is the "out of sight, out of mind" mentality of many Chinese national employees. Because of language and time zone differences, such

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[86] *See generally* Tianji Xu et al., *Development Strategies for Chinese Design Institutes*, J. MGMT. ENGINEERING, Apr. 2004, at 62, 63 (providing a general overview of DIs in China and discussing the transformation of DIs from traditional SOEs to Western-style consulting firms, the organizational structure of DIs, and the services they provide).

employees often lack effective oversight and thus become more familiar and comfortable with local business culture and practice. These employees may not understand or appreciate that their common, daily actions in China, thousands of miles away from corporate headquarters, can expose their ultimate employer to exposure under U.S. law.

A common retort often heard from Chinese employees of U.S. companies is: "Why can't I provide customers or prospective customers things that I know my friend down the street who works for a non-U.S. company does all the time?"[87] Facing competitive pressures, Chinese employees may fall back on Chinese style business practices where it is not uncommon for officials to accept bribes and kickbacks as part of their salary. In fact, it has been estimated that corruption in China erases

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[87] A common misperception is that the FCPA does not apply to non-U.S. companies. This was generally true prior to the 1998 amendments to the FCPA; however, the 1998 amendments expanded the FCPA to assert territorial jurisdiction over foreign companies and nationals. A foreign company or national is now subject to the FCPA if it causes, directly or indirectly through others, an act in furtherance of a corrupt payment to take place within the territory of the U.S.

An October 2006 FCPA enforcement action against Statoil, ASA, an international oil company headquartered in Norway, evidences the willingness of U.S. enforcement agencies to hold foreign companies accountable for improper payments to foreign officials. *See* Statoil, ASA, Exchange Act Release No. 54,599, 89 SEC Docket (CCH) 283 (Oct. 13, 2006); Press Release, U.S. Dept. of Justice, U.S. Resolves Probe Against Oil Company that Bribed Iranian Official (Oct. 13, 2006), http://www.usdoj.gov/opa/pr/2006/October/06_crm_700.html; Press Release, SEC, SEC Sanctions Statoil for Bribes to Iranian Government Official (Oct. 13, 2006), http://www.sec.gov/news/press/2006/2006-174.htm. In the Statoil action, the company allegedly made improper payments to an Iranian government official intending to: (i) induce the Iranian official to use his influence with the Iranian state-run oil company; (ii) influence the company's decision to award Statoil a development contract; and (iii) secure an improper advantage for Statoil by positioning it to obtain future business in Iran. Exchange Act Release No. 54,599, *supra*, at 283. The jurisdictional hook for charging an FCPA Anti-Bribery violation was that certain of the improper payments were made by wire transfer through a New York bank account. *See* Press Release, *supra*. In terms of the FCPA Books and Records and Internal Control provisions, the jurisdictional hook was that Statoil had American Depository Shares traded on the New York Stock Exchange and was thus considered an "issuer." *See* Exchange Act Release No. 54,599, *supra*, at 283-84.

Based on the improper conduct, Statoil agreed to pay a $10.5 million criminal penalty, enter into a three-year deferred prosecution agreement and pay disgorgement of $10.5 million. *See* Press Release, *supra*. In announcing the settlement, Alice Fisher, Assistant Att'y Gen. Criminal Division commented, "Although Statoil is a foreign issuer, the Foreign Corrupt Practices Act applies to foreign and domestic public companies alike, where the company's stock trades on American Exchanges. . . . This prosecution demonstrates the Justice Department's commitment vigorously to enforce the FCPA against all international businesses whose conduct falls within its scope." *Id.*

up to sixteen percent of China's annual gross domestic product.[88] The manner of corruption in China can take many forms, from small payments to facilitate better relationships to government officials accepting improper payments or abusing their position by failing to enforce various rules and regulations or otherwise harming the interests of companies.[89]

According to Transparency International's ("TI's") 2006 Corruption Perceptions Index ("CPI"), a ranking of countries in terms of the degree to which corruption is perceived to exist among its public officials and politicians, China is perceived to be one of the more corrupt countries in which a company is likely to do business.[90] Moreover, TI's 2006 Bribe Payers' Index, which complements the CPI and seeks to quantify the propensity of firms to pay bribes when operating abroad, suggests that Chinese firms had the second worst ranking, ahead of only India, meaning that only Indian firms were more likely to pay bribes in order to obtain or retain business.[91]

Many Chinese employees of U.S. companies doing business in China understand and appreciate the consequences of bribery and corruption; however, their view is often that bribery and corruption are only improper if they themselves personally benefit by the activity, such as in the form of a kickback or other tangible benefits. These employees often do not view it as being improper to lavish customers or prospective customers with company funded gifts, travel, or other forms of entertainment to help the company secure contracts or gain business. Indeed, a recent *Washington Post* study reveals that many China based

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[88] Clement Yeung, *Regulation of Gift-Giving and Corruption,* 2 DOING BUSINESS IN CHINA, at III-14.1, III-14.3 (Freshfields Brukhaus Deringer ed., 2006).

[89] *Id.* at III-14.06.

[90] *See* Transparency International, Corruption Perception Index (CPI) 2007, http://www.transparency.org/policy_research/surveys_indices/cpi/2007 (noting that China ranks 72 out of 179 countries in terms of transparency). Transparency International is a global, non-profit organization dedicated to fighting corruption, and its effects, worldwide. Transparency International, About Transparency International, http://www.transparency.org/about_us. Its annual CPI is a composite index and draws on corruption related data from various expert and business surveys carried out worldwide. Transparency International, Surveys and Indices, http://www.transparency.org/policy_research/surveys_indices/about.

[91] *See* TRANSPARENCY INTERNATIONAL, BRIBE PAYERS INDEX (BPI) 2006, at 4 (2006), *available at* http://www.transparency.org/policy_research/surveys_indices/bpi (last visited Jan. 27, 2008). The BPI is a ranking of thirty of the leading exporting countries according to the propensity of firms with headquarters within their borders to bribe when operating abroad. *Id.* at 3. It is based on the responses of thousands of business executives from companies in 125 countries to the following question: "In your experience, to what extent do firms from the countries you have selected make undocumented extra payments or bribes?" *Id.*

executives, sales agents, and distributors for U.S. multinational companies acknowledged during interviews that their companies routinely win business by paying extravagant entertainment and travel expenses to foreign officials.[92] Yet, it is this sort of activity which can, and often does, expose U.S. companies doing business in China to FCPA exposure.

A company's greatest FCPA exposure risk in China is often in the marketing and sales departments as individuals in these departments have daily contact with customers and prospective customers and often feel pressure to meet sales targets and revenue projections. An area particularly vulnerable to FCPA non-compliance in China, and a "thing of value" that Chinese customers and prospective customers often request before finalizing a business arrangement, is travel to the United States.

C. U.S. TRAVEL

Payment of a "foreign official's" travel, lodging, and other expenses in connection with travel to the United States (or elsewhere) is considered something "of value" to the "foreign official," and thus implicates the FCPA's Anti-Bribery provisions. Enforcement agencies often allege that a company's payment of such expenses is for the purpose of inducing the foreign official to act favorably towards the company in obtaining or retaining business.

Nevertheless, it is an affirmative defense to an FCPA Anti-Bribery violation if a payment or a benefit to a "foreign official" represents "a *reasonable* and *bona fide* expenditure" that is "*directly related* to . . . the promotion, demonstration, or explanation of products or services; or . . . the execution or performance of a contract with a foreign government or agency."[93] As an affirmative defense to an FCPA Anti-Bribery violation, a company will have the burden of showing that otherwise problematic payments meet these criteria should an FCPA enforcement action be brought.

Thus, if Chinese "foreign officials" are traveling to the United States to view a company's manufacturing facilities, test product, or to meet company personnel in conjunction with the negotiation or

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[92] Peter S. Goodman, *Common in China, Kickbacks Create Trouble for U.S. Companies at Home*, WASH. POST, Aug. 22, 2005, at A01.

[93] Foreign Corrupt Practices Act (FCPA) of 1977, 15. U.S.C. § 78dd-1(c)(2), 78dd-2(c)(2), 78dd-3(c)(2) (2000) (emphasis added).

performance of a contract, the business purpose of such travel is evident and the affirmative defense to an FCPA Anti-Bribery violation is likely met. However, if the Chinese "foreign official" brings his or her spouse or children on the trip or, while in the United States, takes side sightseeing trips to popular U.S. tourist destinations and the company funds all such expenses, the business purpose of such travel is less evident and the FCPA's Anti-Bribery provisions are likely implicated. In such situations, it will likely be the position of U.S. enforcement agencies that the company's payment of such expenses amounts to the payment of a bribe in exchange for the "foreign official's" decision to award business to the company or continue doing business with the company.

FCPA enforcement actions clearly demonstrate the U.S. government's willingness to subject payment of a "foreign official's" travel expenses to close scrutiny. For instance, the Lucent enforcement action was based solely on the improper recording of travel expenses for SOE customers. According to the government, while the trips Lucent paid for were "ostensibly designed to allow the Chinese foreign officials to inspect Lucent's factories and to train the officials in using Lucent equipment . . . . [T]he officials spent little or no time in the United States visiting Lucent's facilities [but instead] visited tourist destinations throughout the United States, such as Hawaii, Las Vegas, the Grand Canyon, Niagara Falls, Disney World, Universal Studios, and New York City."[94] On some occasions, the Chinese SOE customers spent as little as one or two days in the United States on legitimate business while spending up to two weeks on Lucent funded sightseeing, entertainment, and leisure.[95]

The trips were categorized by Lucent as either "pre-sale" or "post-sale" trips. Regarding the "post-sale" trips, the government noted that Lucent's contracts with SOE customers typically included provisions requiring Lucent to provide expense-paid trips to the United States for factory inspections and training and that it was "under the guise of fulfilling its contractual obligations" that Lucent paid for these "post-sale" trips.[96] Regarding the "factory inspection" visits, the government noted that beginning in 2001, Lucent began relocating its manufacturing operations to various locations, including China, leaving few factories in

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[94] *See* Complaint ¶ 1, SEC v. Lucent Technologies Inc. (D.D.C. filed Dec. 21, 2007) (on file with author).

[95] *Id*. ¶ 9.

[96] *Id*. ¶¶ 13-17.

the United States for the customers to visit. With no Lucent factories to visit, the government alleged that the visits "became primarily sightseeing, entertainment, and leisure trips, although one day of the visit would generally involve touring Lucent's headquarters or a Lucent facility (but not a factory) in order to create the appearance of legitimacy."[97] Regarding the "training" visits, the government alleged that even though engineers and technical employees from the SOE customers received some "bona fide" training at a Lucent facility, there was also a disproportionate amount of sightseeing, entertainment, and leisure activities for the visitors as well as per diems.[98]

Likewise, in an FCPA enforcement action against Metcalf & Eddy ("M&E"), a private environmental engineering firm, the company was prosecuted for violating the FCPA's Anti-Bribery provisions in connection with improper travel benefits paid to an Egyptian government official and his family.[99] Among other conduct, the DOJ alleged that M&E paid for the official, his wife, and two children to fly first-class to the United States for a promotional tour of M&E's facilities.[100] According to the DOJ, M&E also gave the official spending money while in the United States, even though the company already directly paid various service providers while the official and his family were in the United States.[101] In addition, M&E also allegedly paid for the official and his family to engage in sightseeing travel unrelated to business while in the United States.[102] The DOJ concluded that such travel and lodging expenses fell outside the affirmative defense to an FCPA Anti-Bribery violation because such expenses were not reasonable and bona fide business expenses.[103] Based on the above conduct, M&E agreed to pay a $400,000 civil fine.[104] Other recent FCPA enforcement actions concerning improper travel and entertainment expenses include the Dow Chemical matter where the improper payments to Indian government

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[97] *Id.* ¶ 18.

[98] *Id.* ¶ 24.

[99] *See* Complaint ¶ 1, United States v. Metcalf & Eddy, Inc., No. 99-CV-12566 (D. Mass. filed Dec. 14, 1999).

[100] *Id.* ¶¶ 20-21.

[101] *Id.* ¶¶ 19, 22.

[102] *See id.* ¶¶ 16, 19.

[103] *See id.* ¶¶ 22-23.

[104] United States v. Metcalf & Eddy, Inc., No. 99-12566, at ¶ 12 (D. Mass Dec. 1999) (Consent and Undertaking of Metcalf & Eddy, Inc.), *available at* http://www.corporatecompliance.org/Content/NavigationMenu/Resources/ComplianceBasics/MetcalfEddy.pdf.

officials included $37,600 for gifts, travel, entertainment, and other items.[105]

To be FCPA compliant, companies must ensure that payment of a "foreign official's" travel expenses are reasonable and bona fide expenditures directly related to a business purpose. This challenge, as in other areas of FCPA compliance in China, is greater when hosting Chinese "foreign officials" given the still-novel concept of Chinese nationals visiting the United States. In many cases, travel to the United States is a "trip of a lifetime" for a Chinese national and they are often eager to "experience the United States" by seeing what are viewed in China as U.S. cultural icons such as: New York City; Washington D.C.; Orlando and Disneyworld; Las Vegas and the Grand Canyon; Los Angeles, Hollywood and Disneyland; and Hawaii.

While Chinese government restrictions on citizen travel have been relaxed in recent years, it is still difficult for a Chinese national to obtain a tourist visa to visit the United States. On the other hand, business visas, supported by an invitation letter from a U.S. company, are often easier to obtain. As a result, business visas often serve as a foundation for a two week trip to the United States for the Chinese visitor. In many cases, three or four days of the trip are devoted to meeting with company officials, visiting manufacturing facilities, or testing products and are thus FCPA compliant. However, the remaining days of the trip, and indeed the majority of the trip, amount to a U.S. sightseeing tour for the Chinese "foreign official" and is thus not FCPA compliant if paid for by the U.S. company.

It is not uncommon for Chinese "foreign officials" to engage in non-FCPA compliant travel without the direct knowledge or involvement of business leaders at company headquarters. This can occur when travel arrangements are made exclusively by sales and marketing personnel in China, or when a Chinese travel agency is delegated the authority by the company for arranging the entire itinerary of the Chinese visitors. For instance, in the Lucent matter, the trips were funded by Lucent's wholly

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[105] Exchange Act Release No. 55,287, *supra* note 17, at 3093; *see also* SEC v. Samson, Litigation Release No. 19,754, 88 SEC Docket 1127, 1127 (CCH) (July 5, 2006) (including the payment of foreign officials' accommodations, meals, car services and other gifts and cash while they were in the U.S. within the improper payments); Complaint ¶ 13, SEC v. Samson, No. 1:06CV01217 (D.D.C. July 5, 2006); SEC v. ABB Ltd., Litigation Release No. 18,775, 83 SEC Docket 849 (CCH) (July 6, 2004); Complaint ¶ 14, SEC v. ABB Ltd., No. 1:04CV01141 (D.D.C. July 6, 2004) (alleging that payment of travel, meals, lodging, entertainment expenses, and "spending money" of $120 to $200 per day when the gross annual per capita income in the foreign official's home country was just $710 was part of the improper payments made by ABB).

owned subsidiary in China ("Lucent China") through its sales department and were approved by Lucent China executives. U.S. business leaders may meet with the Chinese "foreign officials" during the three or four day business portion of their trip, but because of language difficulties, normal social conversations, such as, "Where else have you been in the United States?" and/or "Where else are you going?" don't often occur, leaving business leaders with the impression that the Chinese "foreign officials" are not engaging in any non-business travel while in the United States. For this reason, business leaders must investigate the full itinerary of any trip by Chinese "foreign officials" and scour the itinerary for any portion of the trip that could be considered non-business travel.

Several FCPA Opinion Procedure Releases address the issue of payment of travel and entertainment expenses and provide useful guidance for business leaders in hosting "foreign officials."[106] For instance, in a 2004 FCPA Opinion Procedure Release, the requestor proposed sponsoring, in conjunction with a Chinese government ministry, a comparative law seminar on labor and employment law in China and the United States.[107] The seminar was to last approximately two days, be held in Beijing, and the requestor proposed to pay for the conference rooms, interpreter services, receptions and meals during the

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[106] *See, e.g.,* U.S. Dept. of Justice Opinion Procedure Release 04-04 (Sep. 3, 2004), http://www.usdoj.gov/criminal/fraud/fcpa/opinion/2004/0404.html (declining to take enforcement action against a company planning to host a study tour of foreign government officials in the insurance industry); U.S. Dept. of Justice Opinion Procedure Release 96-01 (Nov. 25, 1996), http://www.usdoj.gov/criminal/fraud/fcpa/opinion/1996/9601.html (declining to take enforcement action against a nonprofit planning to sponsor and provide funding for foreign government representatives to attend environmental training courses); U.S. Dept. of Justice Review Procedure Release 92-01 (Feb. 1992), http://www.usdoj.gov/criminal/fraud/fcpa/review/1992/r9201.html (declining to take enforcement action against a company planning to host Pakistani officials for technical training); U.S. Dept. of Justice Review Procedure Release 85-01 (July 16, 1985), http://www.usdoj.gov/criminal/fraud/fcpa/review/1985/r8501.html (declining to take enforcement action against a company planning to host French officials to inspect a company's plant); U.S. Dept. of Justice Review Procedure Release 83-03 (July 26, 1983), http://www.usdoj.gov/criminal/fraud/fcpa/review/1983/r8303.html (declining to take enforcement action against a company planning to host foreign officials in connection with a series of site inspections, demonstrations, and meetings); U.S. Dept. of Justice Review Procedure Release 83-02 (July 26, 1983), http://www.usdoj.gov/criminal/fraud/fcpa/review/1983/r8302.html (declining to take enforcement action against a company planning to host the general manager of foreign government-owned entity for the purpose of taking a promotional tour of a company's facilities); U.S. Dept. of Justice Review Procedure Release 82-01 (Jan. 27, 1982), http://www.usdoj.gov/criminal/fraud/fcpa/review/1982/r8201.html (declining to take enforcement action against the Missouri Department of Agriculture, which planned to host Mexican agricultural officials for a series of meetings).

[107] U.S. Dept. of Justice Opinion Procedure Release 04-01 (Jan. 6, 2004), http://www.usdoj.gov/criminal/fraud/fcpa/opinion/2004/0401.html.

seminar, as well as transportation and hotels costs for the Chinese government officials participating in the seminar.[108] In another 2004 FCPA Opinion Procedure Release, the requestor proposed to sponsor a trip for officials of a Chinese ministry to the United States to provide the officials with an opportunity to meet with U.S. public sector officials to discuss, among other things, U.S. regulation of employment issues, labor unions, and workplace safety.[109] The visit was to last ten days, would include stops in different U.S. cities, and the requestor proposed to pay the travel, lodging, meals, and insurance for the government ministers and one translator.[110]

In both instances, the DOJ opined that it did not intend to pursue an FCPA enforcement action with respect to the described conduct based on representations from the requestors that, among other things: (i) it would pay all costs directly to the providers of the services and that no funds would be paid directly to the officials; (ii) it did not select the specific officials participating in the events; and (iii) it would not provide any gifts to the officials in connection with the events.[111]

In sum, FCPA compliance in China poses a unique risk and challenge given the prevalence of SOEs in that country as well as certain cultural norms and expectations of doing business in China. As described in the section below, these challenges can not be overcome simply by doing business in China through third parties given yet another broad reaching FCPA provision—the third party payment provisions.

V. COMPANIES ARE NOT INSULATED FROM THE UNIQUE FCPA COMPLIANCE CHALLENGES IN CHINA BY DOING BUSINESS THROUGH FOREIGN SUBSIDIARIES OR OTHER THIRD PARTIES.

The FCPA's Anti-Bribery provisions contain broad third-party provisions under which the actions of foreign subsidiaries and other third parties such as agents, distributors, and joint venture partners can result in FCPA liability for a company. In other words, companies cannot insulate themselves from the unique FCPA compliance challenges in

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[108] *Id.*

[109] U.S. Dept. of Justice Opinion Procedure Release 04-03 (June 14, 2004), http://www.usdoj.gov/criminal/fraud/fcpa/opinion/2004/0403.html.

[110] *Id.*

[111] *Id;* Review Procedure Release 04-01, *supra* note 107.

China by doing business through foreign subsidiaries or other third parties, yet are responsible under the FCPA for ensuring that actions the company is directly prohibited from undertaking are not accomplished indirectly through others.

A. THIRD PARTY PAYMENT PROVISIONS

FCPA violations can be based on the wrongful acts of third parties because the Anti-Bribery provisions cover improper payments made to "any person, while *knowing* that all or a portion of such money or thing of value will be offered, given, or promised, *directly or indirectly* to any foreign official" (the "Third Party Payment Provisions").[112] Under the FCPA, a person's state of mind is "'knowing' with respect to conduct, a circumstance, or a result if: (i) such person is aware that another is engaging in such conduct, that such circumstances exist, or that such result is substantially certain to occur; or (ii) such person has a firm belief that such circumstances exist or that such result is substantially certain to occur."[113] Moreover, the FCPA states that knowledge is also established "if a person is aware of a high probability of the existence of such circumstance, unless the person actually believes that such circumstance does not exist."[114] Thus, a company can not be "willfully blind" to any action or fact that should reasonably alert its business leaders to a "high probability" of an FCPA violation occurring. In such cases, "knowledge" may be inferred even if a company does not have actual knowledge of an improper payment being made to a "foreign official."

B. FOREIGN SUBSIDIARIES

Given the potential for FCPA Anti-Bribery liability under the Third Party Payment provisions for the actions of others, reliance on foreign incorporation where there is U.S. management and control over a foreign subsidiary is a weak shield against parent corporation liability. Indeed, the FCPA's legislative history affirms that parent corporations may remain indirectly liable for FCPA violations by a foreign subsidiary, and the Third Party Payment provisions were enacted to prevent U.S.

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[112] Foreign Corrupt Practices Act (FCPA) of 1977, 15 U.S.C. § 78dd-1(a)(3) (2000) (emphasis added).

[113] *Id.* § 78dd-1(f)(2).

[114] *Id.*

companies from adopting a "head-in-the-sand" approach to the activities of foreign business partners.[115] Therefore, if a company controls a foreign entity and has actual or constructive knowledge that the entity is engaging in improper activity, a parent company may be considered to be a participant in those actions and subject to prosecution under the FCPA.

Recent FCPA enforcement actions confirm that enforcement agencies often do not draw an exacting legal distinction between the actions of a foreign subsidiary and its employees and a U.S. parent corporation when assessing FCPA liability. Indeed, in the current aggressive enforcement climate, enforcement agencies are increasingly pursuing actions against parent corporations for bribery of foreign officials by foreign subsidiaries, even when there is no indication that the parent company itself was involved in any improper payment or conduct violating the FCPA.

Many of the FCPA enforcement actions discussed above fall into this category. For instance, the Dow Chemical matter involved improper payments made by DE-Nocil, a fifth tier subsidiary of Dow, without the knowledge or approval of any Dow employee.[116] Likewise, the Schering-Plough matter involved improper payments made by S-P Poland, a wholly-owned subsidiary of Schering-Plough, without the knowledge or approval of any U.S. employee.[117]

In addition to these FCPA enforcement actions, several U.S. companies have recently publicly disclosed questionable payments made by foreign subsidiaries or affiliates to foreign officials. In February 2007, Johnson & Johnson, a U.S. healthcare conglomerate, disclosed questionable payments made by its foreign subsidiaries in two countries in connection with the sale of medical devices.[118] In July 2006, Pride International, one of the world's largest drilling contractors, disclosed that an internal investigation uncovered evidence that one of its foreign subsidiaries made improper payments to government officials in

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[115] *See* H.R. REP. NO. 95-831, at 14 (1977) (Conf. Rep.) ("[T]he conferees intend to make clear that any issuer or domestic concern which engages in bribery of foreign officials indirectly through any other person or entity would itself be liable under the [FCPA]."); H.R. REP. NO. 100-576, at 920 (1988) (Conf. Rep.).

[116] *See* Exchange Act Release No. 55,287*, supra* note 17, at 3092; Litigation Release No. 20,000, *supra* note 29, at 3177.

[117] Exchange Act Release No. 49,838, *supra* note 18, at 3646; Litigation Release No. 18,740, *supra* note 18, at 3732; Complaint ¶¶ 1, 11, *supra* note 18.

[118] *See, e.g.,* Avery Johnson, Kara Scannell & Jon Kamp, *J&J Reports Improper Payments,* WALL ST. J., Feb. 13, 2007, at A20.

Venezuela and Mexico.[119] In March 2006, United Parcel Services, Inc., the world's largest package delivery company, disclosed that it was undertaking an FCPA internal investigation of questionable conduct within one of its subsidiaries in certain locations outside the United States.[120] Also in March 2006, Outback Steakhouse, Inc. disclosed that it could be subject to fines and penalties under the FCPA because of improper payments made by employees of its South Korean affiliate to South Korean government officials.[121] All of these public disclosures concerning conduct by foreign subsidiaries or affiliates are likely to lead to an FCPA enforcement action and result in fines and/or penalties being paid by the parent company.

These FCPA enforcement actions and public disclosures make clear that companies must ensure FCPA compliance by their foreign subsidiaries through which it does business in China and also provide ample reason to infer that anytime there is a questionable payment involving a foreign subsidiary, a company's internal controls, policies, and procedures will be subject to close scrutiny under the FCPA.

C. OTHER THIRD PARTIES

Just as companies must ensure FCPA compliance by foreign subsidiaries in China, companies must also ensure compliance by all other third parties engaged in China including agents, distributors, or other channel partners, because improper actions by such third parties can also be attributed to a parent corporation under the FCPA's Third Party Payment provisions.

The FCPA compliance risk of engaging foreign agents or distributors is best demonstrated by the 2005 FCPA enforcement action against InVision. According to the SEC, InVision was aware of a "high probability" that its agents or distributors in China, Thailand, and the Philippines paid or offered to pay money to foreign officials or political parties in connection with transactions or proposed transactions involving the sale of its airport security screening machines.[122] In China, the SEC alleged that InVision agreed to sell two explosive detection machines through a Chinese distributor for use at a government-owned

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[119] *See, e.g.,* Lynn J. Cook, *Several Pride Managers Put on Leave; Company Looks into Allegations of Irregular Payments*, HOUS. CHRON., July 1, 2006, at 3.

[120] United Parcel Servs., Inc., Annual Report (Form 10-K), at 29 (Mar. 14, 2006).

[121] *See* Outback Steakhouse, Inc, Annual Report (Form 10-K), at 21 (Mar. 16, 2006).

[122] *See* Complaint ¶ 1, *supra* note 54.

and controlled airport.[123] Due to problems in obtaining an export license for its machines, InVision was unable to meet the intended delivery date of its product and was informed by the Chinese distributor that the airport authorities intended to impose a financial penalty on InVision.[124] However, the distributor informed InVision managers that the financial penalty could be avoided by offering foreign travel and other benefits to the airport officials.[125] Thereafter, the SEC alleged, the distributor requested financial compensation from InVision to pay for the supposed penalties and costs that would be incurred as a result of the shipment delay.[126] InVision then authorized the payment to the distributor even though it was aware of a "high probability" that the distributor intended to use part of the funds it received from InVision to pay for foreign travel and other benefits for the airport officials.[127] According to the SEC, InVision recorded the improper payments to the distributor in its books and records as a "cost of goods sold."[128]

In the Philippines, the SEC alleged that InVision paid a Filipino sales agent a commission of approximately $100,000 even though the agent previously indicated that it intended to use part of the commission to buy gifts or make cash payments to officials of a government-owned and controlled airport to influence their decision to purchase additional InVision products.[129] According to the SEC, InVision authorized the payment, recorded on its books and records as a "sales commission," even though it was aware of the "high probability" that the sales agent intended to use part of the commission to make improper payments to the Filipino airport officials.[130]

Finally, the SEC's allegations as to Thailand concerned contemplated illegal payments to Thai officials, funded not through actual payments from InVision to a third party, but rather generated by a foreign distributor's profit on resale.[131] Specifically, the SEC alleged that InVision retained a distributor in Thailand to lobby the Thai government, and an airport corporation controlled by the government, in

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[123] *Id.* ¶ 9.
[124] *Id.* ¶ 10.
[125] *Id.*
[126] *Id.* ¶ 11.
[127] *Id.*
[128] *Id.* ¶ 12.
[129] *Id.* ¶ 14.
[130] *Id.* ¶ 15.
[131] *Id.* ¶ 17.

connection with the construction of an airport in Bangkok.[132] Pursuant to the arrangement, the distributor would purchase InVision's airport detection machinery and then make its profit by reselling the machinery at a higher price to the airport authority.[133] According to the SEC, InVision was aware of the "high probability" that the distributor intended to offer gifts or other forms of payment to Thai officials with influence over the airport corporation and, further, that the distributor intended to fund such gifts or other forms of payment out of the difference between the price the distributor paid InVision to acquire the machinery and the price the distributor was able to resell the machinery.[134] Despite such awareness, the SEC alleged that InVision authorized the distributor to proceed with the transaction.[135]

The InVision enforcement action is unique and represents an expansion of the Third Party Payment provisions of an Anti-Bribery violation and is believed to be the first FCPA enforcement action against a U.S. company based on the actions of its foreign distributor. By including factual allegations in the complaint as to InVision's actions in Thailand, the SEC clearly put U.S. companies on notice that they can no longer turn a blind-eye to the actions of foreign distributors, and that FCPA violations can also result even if the improper payments are wholly funded by a third party, not by an exchange of funds with the U.S. company. The InVision enforcement action highlights the need for companies to subject all third parties engaged in China including agents, distributors, or other channel partners to FCPA compliant due diligence procedures described in more detail in Section VI below.

The FCPA compliance challenges in China, while unique and numerous, are not insurmountable and the risks are not unmanageable. The key to FCPA compliance in China is effective, comprehensive, and well-communicated FCPA compliance policies and procedures.

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[132] *Id.* ¶ 16.

[133] *Id.*

[134] *Id.* ¶ 17.

[135] *Id.* Completion of the potential $35 million transaction with the Thai airport authority was deferred after InVision became aware of its potential FCPA liability, and the company agreed that if the transaction proceeded, it would proceed only through a direct sale to the airport corporation. *Id.* ¶ 18.

VI. FCPA COMPLIANCE IN CHINA IS BEST ATTAINED THROUGH EFFECTIVE POLICIES AND PROCEDURES.

Companies should be motivated to implement effective compliance policies and procedures for many reasons, not just FCPA compliance in China. As an initial matter, it may be a breach of fiduciary duty for any company not to have a meaningful and effective compliance program.[136] In addition, enforcement agencies will assess the effectiveness of a company's compliance program in determining whether to criminally charge a business organization.[137] Under the so-called McNulty Memorandum—the DOJ's policy for prosecuting business organizations—one of the nine factors prosecutors will consider when making charging decisions is the "existence and adequacy of the corporation's *pre-existing* compliance program."[138] While the existence of a compliance program will not be sufficient, in and of itself, for a business organization to avoid criminal charges, federal prosecutors no doubt will view more favorably a company with an effective compliance program than a company without such a program.[139] Per the McNulty Memorandum, the "critical factors" in evaluating a compliance program are "whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives."[140] Finally, the U.S. Sentencing Guidelines incentivize a company to have a compliance program by allowing it to receive a sentencing credit, by way of a lower culpability score, which in turn translates into a lower sentence upon conviction of a criminal offense.[141]

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[136] *See e.g., In re* Caremark Int'l Inc. Derivative Litigation, 698 A.2d 959, 970 (Del. Ch. 1996); McCall v. Scott, 250 F.3d 997, 1001 (6th Cir. 2001).

[137] Memorandum from Paul J. McNulty, Deputy Att'y Gen., U.S. Dept. of Justice to the Heads of Dep't Components, U.S. Att'ys 4, 8 (Dec. 12, 2006) (on file with author).

[138] *Id.* at 4.

[139] *See id.* at 14.

[140] *Id.*

[141] *See* U.S. SENTENCING GUIDELINES MANUAL § 8 (2004). The Sentencing Guidelines set forth seven requirements of en effective compliance program: (1) policies and procedures; (2) senior management/board of director commitment; (3) avoiding the delegation of authority to the "ethically challenged;" (4) training and communication; (5) monitoring and auditing; (6) promotion and enforcement of the compliance program; and (7) response to violations. *Id.* § 8B2.1.

One component of an effective compliance program is effective, comprehensive, and well communicated FCPA policies and procedures. Just like other compliance objectives, FCPA policies and procedures will not ensure that a company will be one hundred percent FCPA compliant. However, should FCPA non-compliance occur, enforcement agencies will factor the absence of FCPA policies and procedures into their view of the matter and their assessment of appropriate fines and penalties. In describing the lack of internal controls in the Schnitzer Steel action, the SEC noted, "Schnitzer provided no training or education to any of its employees, agents or subsidiaries regarding the requirements of the FCPA. Schnitzer also failed to establish a program to monitor its employees, agents and subsidiaries for compliance with the FCPA."[142]

Likewise, in the Lucent matter, the SEC alleged that the problematic trips by Chinese SOE officials occurred because of the company's ineffective FCPA policies and procedures. Specifically, the SEC noted that "Lucent China's internal controls provided no mechanism for assessing whether any of the trips violated the FCPA [and] Lucent employees made little or no inquiry regarding whether the Chinese visitors were government officials under the FCPA, and no Lucent policies or controls were triggered with respect to whether the entertainment and leisure activities Lucent paid for could constitute things of value under the FCPA, or whether the purpose of the visit may have violated the anti-bribery provisions of the FCPA."[143] Further, the SEC alleged that the FCPA violations occurred because Lucent failed "to properly train its officers and employees to understand and appreciate the nature and status of its customers in China in the context of the FCPA."[144]

In sum, a company will be viewed less harshly by enforcement agencies if an FCPA violation occurs as a result of a "rogue employee" who was not complying with effective and well-communicated FCPA policies and procedures than if the violation occurred in the absence of any FCPA policies and procedures. While the full scope of a comprehensive and effective FCPA compliance program is beyond the scope of this article, set forth below is general guidance for business leaders to consider in developing a comprehensive and effective FCPA compliance program, including practical pointers to deal with common

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[142] Exchange Act Release No. 54,606, *supra* note 46, at 303.
[143] Complaint ¶ 12, supra note 94 (on file with author).
[144] *Id*. ¶ 3.

compliance challenges in China, such as travel of Chinese "foreign officials" and engagement of third parties.

A. FCPA TRAINING

FCPA compliance, like any compliance objective, is best achieved through raising awareness of the issue throughout the company, a goal best achieved through in-depth FCPA training. In fact, one of the first questions a company will hear from enforcement agencies, should FCPA non-compliance occur, is: "Tell me about your FCPA training program." At a minimum, an effective FCPA training program should accomplish the following objectives:

- Inform that compliance with the FCPA is part of the company's overall ethical value;
- Provide an overview of the FCPA's Anti-Bribery and Books and Records and Internal Control provisions, including the broad application of the "anything of value," "foreign official," and "obtain or retain business" elements of an Anti-Bribery violation and the Third Party Payment provisions;
- Provide an overview of recent FCPA enforcement actions to emphasize the "real-world" and serious nature of FCPA violations and the significant criminal and civil liability, collateral sanctions, and reputation damage that can result from such violations; and
- Provide hypothetical factual scenarios that force trainees to understand and apply key FCPA concepts.

Raising FCPA awareness within a company is best accomplished by in-person group training lead by a competent FCPA practitioner. Often times, valuable, collective information or ideas about past or future conduct is learned during live training sessions, whereas such interplay is not easily accomplished through computer module training. Further, FCPA training is too important to be completed by an employee over the lunch hour or at the end of a busy day before the training deadline—circumstances which often occur when a company relies on computer module training. If in-person FCPA training is not achievable, a company should generally avoid the many "off-the-shelf" FCPA computer training tools on the market. Rather, training should be tailored to the specific business scope of the company and should be

translated into relevant local languages to achieve maximum participation and understanding by all employees.

In terms of the scope of trainees, at a minimum, all business leaders and employees with international responsibilities, including most notably sales and marketing personnel, should participate in the FCPA training. In addition, because FCPA "red flags" or compliance issues many times could have been spotted by administrative assistants or other lower level employees, such employees should also participate in the FCPA training even though their job functions may not be viewed as critical to the success of international sales. In addition, a company should seriously consider company wide FCPA training, including members of the board of directors and/or audit committee, given that one of the requirements of an effective compliance program under the U.S. Sentencing Guidelines is that a company's governing authority be knowledgeable about the content and operation of the company's compliance program. Finally, given the FCPA's Third Party Payment provisions, a company should also strongly consider training its agents, distributors or other channel partners on FCPA compliance.

Given the FCPA compliance risks of paying for a Chinese "foreign official's" travel, and engaging third parties in China, a company's overall FCPA compliance program should also be supplemented by specific travel policies and procedures as well as specific due diligence procedures for all business partners.

B. TRAVEL POLICIES AND PROCEDURES

As discussed in Section IV, hosting Chinese "foreign officials" in the United States presents several FCPA compliance risks for a company. Such risks are best managed by FCPA compliant travel policies and procedures that are effectively communicated throughout the company, particularly among sales and marketing personnel. Implementation, communication, and oversight of the travel policies and procedures should be centralized and be the responsibility of one individual knowledgeable about the FCPA, rather than left to individual sales and marketing personnel. Also, depending on the frequency in which a company hosts foreign visitors, a company may also want to consider establishing a separate travel office within its sales or marketing organization to oversee all travel related issues.

Issues a company should consider before hosting foreign visitors include:

- Are the visitors or any guests "foreign officials" under the FCPA's broad definition of that term? If the answer to this question is a definite "no," a company can host the visitor consistent with its general travel policies and procedures because the FCPA is likely not implicated. If the answer to this question is anything but a definite "no," a company should also consider the issues below.
- Is the entire trip for the purpose of promoting the company's products or services or in connection with the execution or performance of a contract? To answer this question, a company should investigate the full itinerary of the proposed trip for any destination that could include non-business travel and be mindful of the fact that there is hardly ever a business reason for a "foreign official" to visit Disney locations, Las Vegas, the Grand Canyon, or other popular U.S. tourist destinations.
- Are the proposed expenses that will be paid by the company proportionate and reasonable in relation to the company's business purpose for inviting the "foreign official?" Examples of unreasonable expenses can include, but are not limited to, the following: first-class airfare, five-star accommodations, unlimited bar tabs or room service charges, health or fitness center fees, bar or night club expenses, tickets to sporting events or similar entertainment venues, and spending or "pocket money." A company should ensure that all expenses conform to generally accepted business travel standards to prevent even an inference that a "foreign official" is receiving "anything of value" other than what would be expected in a normal commercial context.
- How are the "foreign official's" expenses being paid? Ideally, a company should pay all expenses relating to a "foreign official's" travel directly to the service provider (airlines, hotels, etc.). If it becomes necessary for a company to reimburse the "foreign official" for such expenses, a company should obtain all itemized receipts and a detailed, signed statement from the "foreign official" for all expenses which reimbursement is requested. The FCPA compliance risk in simply reimbursing the "foreign official" for his or her expenses is that the "foreign official" may be inflating certain reimbursement requests, thus providing himself or herself with extra money.
- Who within the company is approving the trip? No trip by a "foreign official" should be allowed to proceed on the sole basis of a request

by sales or marketing personnel. Rather, all trips should be approved in writing by a senior manager with knowledge of the FCPA's applicable provisions. The request for approval to the senior manager should include a description sufficient for the senior manager to review the business purpose of the trip, the name, title, and a brief description of the "foreign official" traveling, the proposed itinerary, and an estimated cost per "foreign official."

- Are the expenses accurately described and recorded on the company's books and records? The company must ensure that accounting personnel are provided sufficient documentation, such as receipts and invoices, which allow an accurate and complete description of the expenses in the company's books and records including the nature, purpose, and amount of each expense incurred and paid in connection with the "foreign official's" visit.

C. DUE DILIGENCE PROCEDURES

Finally, any company doing business in China through third parties such as agents, distributors, or channel partner should conduct appropriate due diligence on the third party prior to engagement. Such due diligence is best and most efficiently accomplished through a questionnaire to the third party and/or an on-site visit or interview with the third party. Among other issues, an FCPA compliant due diligence questionnaire should be designed to elicit the following relevant information:

- Ownership structure, including the name, title, ownership percentage, and nationality of all owners, partners, directors, or shareholders of the third party;
- Other background information regarding the third party including financial and business references, financial statements, office locations, the number of individuals employed by the third party, and other customers or clients, including whether any of the customers or clients are owned or controlled by the government;
- The name, title, and nationality of all employees of the third party who will be acting on behalf of the company in the country, including whether the employee is affiliated with any other organization or enterprise in the country and/or is or has been an employee or official of a government entity.

The third party questionnaire will be useful in identifying the following FCPA "red flag" issues prior to engaging the third party:

- Is the third party related to a "foreign official" (keeping in mind the broad definition of that term) or maintain close social or business relationships with "foreign officials" or their family members?
- Was the third party recommended by a "foreign official" or his or her family members?
- Does the third party place heavy reliance on political or government contacts versus knowledgeable and qualified staff, adequate facilities, and investment of time?
- Is the third party willing and able to assist in developing or implementing a marketing plan?
- Is the third party willing to agree in writing to abide by the FCPA or other relevant anti-corruption laws?
- Does the third party want to keep the nature of the relationship with the company secret?
- Has the third party ever had an unexplained or inadequately explained hasty breakup with another company or other relationship problems with other companies?
- Has the third party ever been investigated, charged, or convicted on previous corruption allegations?
- Has the third party ever engaged in other suspicious conduct that would raise questions in the eyes of a rational and prudent person?

Existence of any of these FCPA "red flags" does not in and of itself suggest that the third party business partner is corrupt or likely to make improper payments to a "foreign official" in China in violation of the FCPA's Anti-Bribery provisions. However, the existence of any one of these "red flags" should trigger concern and appropriate review by an FCPA practitioner. The above described FCPA compliance policies and procedures will not ensure that a company will be one hundred percent compliant in China; however, should FCPA non-compliance occur in China, a company with an effective and well communicated FCPA compliance program will be viewed less harshly by U.S. enforcement agencies than if non-compliance occurred in the absence of any FCPA policies and procedures.

VII. CONCLUSION

A company should "know its business" no matter where in the world it is conducted. This principal takes on added significance when a company conducts business or seeks to conduct business in China given the unique FCPA compliance challenges of doing business in that country, most notably the prevalence of SOE entities and certain cultural norms and expectations, in that country. The FCPA challenges and risks associated with doing business in China can effectively be managed by following the strategies set forth in this article. Companies that adopt these strategies will be able to legally, effectively, and efficiently navigate the lucrative Chinese market and avoid the costly and embarrassing shortcomings of other companies who rushed into China without fully "knowing their business" and without a full understanding and appreciation for the FCPA.