

# The Interplay Between China's Anti-Bribery Laws and the Foreign Corrupt Practices Act

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## TABLE OF CONTENTS

I.	INTRODUCTION .....	1015
II.	SPECIAL FCPA CONCERNS INVOLVING CHINA .....	1020
	A. <i>Foreign Officials Under the FCPA</i> .....	1021
	B. <i>State-Owned and State-Controlled Enterprises in China</i> .....	1022
III.	CHINA'S ANTI-BRIBERY LAWS AND THE FCPA.....	1025
	A. <i>China's Treatment of Bribes Paid to State Officials</i> .....	1025
	B. <i>Commercial Bribery in China</i> .....	1028
	C. <i>Common Factual Scenarios in Commercial Bribery Cases in China</i> .....	1029
	1. <i>The Direct Kickback Scheme</i> .....	1030
	2. <i>The Use of a Fictitious Separate Entity in a Kickback Scheme</i> .....	1032
	3. <i>Payments to Doctors and Hospital Administrators</i> .....	1033
	D. <i>China's Recent Anti-Bribery Provision for Payments to Foreign Officials</i> .....	1034
IV.	INTERNAL COMPLIANCE MEASURES .....	1036
V.	CONCLUSION.....	1036

## I. INTRODUCTION

The emergence of the People's Republic of China (PRC or China) as a global economic power<sup>1</sup> has thrust issues relating to the Foreign Corrupt Practices Act<sup>2</sup> (FCPA) into the forefront of concerns for multinational

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<sup>1</sup>For a discussion of China's recent economic development and its causes, see generally DANIEL C.K. CHOW & ANNA M. HAN, *DOING BUSINESS IN CHINA: PROBLEMS, CASES, AND MATERIALS* 12–25 (2012) [hereinafter CHOW & HAN, *DOING BUSINESS IN CHINA*].

<sup>2</sup>See Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended in scattered sections of 15 U.S.C.). An extensive discussion of the historical reasons for enacting the FCPA is contained in *United States v. Kay*, 359 F.3d 738, 746–55 (5th Cir. 2004).

companies (MNCs).<sup>3</sup> Given China's importance as a center of global business, many MNCs have set up business operations in China or, even if they do not have a physical presence in China, are engaged in cross-border business transactions with Chinese business entities that can implicate the FCPA.<sup>4</sup> Concerns about the FCPA by MNCs have heightened because, within the past decade, the United States Department of Justice (DOJ) has dramatically increased its enforcement of the FCPA.<sup>5</sup> Not surprisingly, given China's prominence as a center of global business, many of these recent FCPA enforcement actions involve China,<sup>6</sup> and this trend is likely to increase in the foreseeable future.<sup>7</sup>

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<sup>3</sup>For a general overview of the FCPA issues faced by MNCs in China, see generally Daniel Chow, *China Under the Foreign Corrupt Practices Act*, 2012 WIS. L. REV. 573–607 [hereinafter Chow, *China Under the FCPA*].

<sup>4</sup>The FCPA proscribes the payment of bribes to foreign officials for the purpose of obtaining business. See *infra* Part II. A U.S. company does not need to have an office or subsidiary to violate the FCPA. Suppose that a sales manager based in the United States travels to China for a meeting and makes a payment to a foreign official for the purpose of inducing the foreign official to make a purchase order for goods. Or suppose that the sales manager never leaves the U.S. but has a phone conversation or video conference and then arranges for a payment to a foreign official. Both of these acts would violate the FCPA, see *infra* Part II, even though the U.S. company involved does not have an office or subsidiary in China.

<sup>5</sup>For example, in 2000 DOJ brought no FCPA prosecutions. *FCPA and Related Enforcement Actions: Chronological List, 2000*, U.S. DEP'T OF JUSTICE, <http://www.justice.gov/criminal/fraud/fcpa/cases/2000.html> (last visited Aug. 11, 2012). In 2007, DOJ brought nineteen prosecutions. *FCPA and Related Enforcement Actions: Chronological List, 2007*, U.S. DEP'T OF JUSTICE, <http://www.justice.gov/criminal/fraud/fcpa/cases/2007.html> (last visited Aug. 11, 2012). The number of prosecutions jumped to thirty-four in 2009. *FCPA and Related Enforcement Actions: Chronological List, 2009*, U.S. DEP'T OF JUSTICE, <http://www.justice.gov/criminal/fraud/fcpa/cases/2009.html> (last visited Aug. 11, 2012). The Securities and Exchange Commission, which has jurisdiction over civil cases under the FCPA, brought only one action in 2000; in 2011, the SEC brought fifteen actions. *SEC Enforcement Actions: FCPA Cases*, U.S. SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml> (last modified Aug. 20, 2012). There are a number of explanations for the increased enforcement by the United States, but perhaps the most popular theory is that the U.S. government has stepped up enforcement after the attacks on the United States on 9/11 on the theory that corrupt foreign officials are more likely to deal with terrorists than officials who are not corrupt.

<sup>6</sup>See, e.g., Information at 12, *United States v. DaimlerChrysler China Ltd.*, No. 1:10-cr-00066-RJL (D.D.C. Mar. 22, 2010), 2010 WL 1557596, available at <http://www.justice.gov/criminal/fraud/cases/daimlerchrysler-china.html>. Since 2002, there have been twenty-seven FCPA actions involving corporate activities in China with thirteen of these cases targeting individuals. See F. Joseph Warin, Michael S. Diamant & Jill M. Pfenning, *FCPA Compliance in China and the Gifts and Hospitality Challenge*, 5 VA. L. & BUS. REV. 33, 48–55 (2010) (summarizing cases).

<sup>7</sup>See SHEARMAN & STERLING LLP, *FCPA DIGEST: RECENT TRENDS AND PATTERNS IN THE ENFORCEMENT OF THE FOREIGN CORRUPT PRACTICES ACT* 7 (Jan. 2012), available at <http://www.shearman.com/shearman--sterlings-recent-trends-and-patterns-in-the-enforcement-of-the-foreign-corrupt-practices-act-fcpa--fcpa-digest-01-03-2012/>.

China poses special risks for MNCs under the FCPA for several reasons. First, the FCPA applies with special force in China because of certain unique characteristics of China's legal and political system. For all of its recent economic progress, China's remains a one-party authoritarian state with the imprint of the state in almost every important facet of the political, economic, social, and legal affairs of the country.<sup>8</sup> This means that the FCPA, which proscribes bribes given to foreign officials, applies in many contexts in China because many persons that appear to be private or ordinary businesspersons will qualify as foreign officials.<sup>9</sup> Second, China has a business culture that tolerates petty corruption in the form of kickbacks, payoffs, gifts, and favors given in order to secure a business advantage or to build or fortify a business relationship.<sup>10</sup> This business culture dates back hundreds of years, long predating the present governing regime, and is tolerated so long as the amounts are relatively small and the practices are done privately and are unreported to the PRC authorities.<sup>11</sup> This practice is so ingrained that it will be difficult to change without a strong political will on the part of the Chinese government and changes in popular attitudes among the Chinese business community.

While China publicly denounces official corruption—that is, corruption that involves the Communist Party (Communist Party or Party) and government officials—petty corruption in a commercial setting involving private persons has been widespread and has been tolerated in the past by many PRC enforcement officials so long as it is kept discreet and private.<sup>12</sup> Once commercial corruption is made public through the filing of a formal complaint, however, PRC authorities come under pressure to act by at least beginning an investigation.<sup>13</sup> While most MNCs prohibit their employees from engaging in any type of commercial bribery, most MNCs do not view commercial bribery as a major problem that threatens the existence of the company.<sup>14</sup> However, as

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<sup>8</sup>For a discussion of the dominant role of the Communist Party in all aspects of China's governance, see DANIEL C.K. CHOW, *THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA: IN A NUTSHELL* 118–44 (2d ed. 2009) [hereinafter CHOW, *LEGAL SYSTEM OF CHINA*].

<sup>9</sup>See *infra* Part II.A.

<sup>10</sup>See He Qinglian, *Corruption Tolerated in China While Standards and Safety Continue to Decline*, *THE EPOCH TIMES* (U.K.), June 6–12, 2007, at 7.

<sup>11</sup>See *id.*

<sup>12</sup>This observation is based upon the author's own experience as an in-house lawyer at a multinational company in China. See KROLL, *REGIONAL ANALYSIS: ASIA-PACIFIC OVERVIEW*, *GLOBAL FRAUD REPORT* 9 (2009–10) (reporting that 96% of surveyed companies reported encountering fraud in the past three years, with 42% reporting vendor fraud, 31% reporting internal financial fraud, and more than 27% reporting bribery and related corruption).

<sup>13</sup>This observation is based upon the author's own experience as an in-house counsel working for a multinational company in China.

<sup>14</sup>This observation is based upon the author's own experience. The author was involved in several internal investigations of commercial bribery cases in China and had numerous interactions on these cases with senior management. In most instances, the

further examined below, there are many overlaps between China's domestic laws against commercial bribery and the FCPA, and many of the same transactions that violate China's commercial bribery laws will also violate the FCPA under the aggressive interpretations by DOJ.<sup>15</sup> The real risks posed by commercial bribery cases brought under PRC law are not the actions themselves, but the collateral FCPA prosecutions launched by DOJ that might ensue. Unlike commercial bribery, which is not viewed as a major threat by MNCs, violations of the FCPA are viewed as serious threats to the continuing viability and existence of the company itself.<sup>16</sup> Third, China has recently increased the enforcement of its own commercial bribery laws<sup>17</sup> and has just enacted a new anti-bribery law that proscribes payments to foreign officials<sup>18</sup>—China's own version of the FCPA. China is reluctant to enforce laws against corruption of state officials because of the potential embarrassment to the Communist Party, China's ruling elite.<sup>19</sup> Enforcement of laws against commercial bribery, however, allows China to emphasize its own intolerance of corruption without the risk of harming the Communist Party.

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suspected employees left the company, and senior management chose not to pursue the cases.

<sup>15</sup> See *infra* Part III.B.

<sup>16</sup> Many executives in MNCs refer to an FCPA offense as a “bet the company” type of offense and will commit whatever resources are needed to defend such a charge. See Seymour Mansfield, *Don't Mess Around with the Foreign Corrupt Practices Act: The Dangers of Complacency*, SUPER LAW. CORP. COUNS. EDITION, March/April 2009, at 20 available at [http://www.mansfieldtanick.com/CM/Articles/3-09%20eWatch%20Don't%20Mess%20Around%20with%20the%20FCPA%20\(2\).pdf](http://www.mansfieldtanick.com/CM/Articles/3-09%20eWatch%20Don't%20Mess%20Around%20with%20the%20FCPA%20(2).pdf). These same executives do not view commercial bribery cases under PRC law as a crime of the same gravity. This Article argues that MNCs should view commercial bribery cases with the same gravity because of the possibility that they can trigger an FCPA prosecution.

<sup>17</sup> See Fei Sun, *Fighting Commercial Bribery in China*, in ABD/OECD ANTI-CORRUPTION INITIATIVE FOR ASIA AND THE PACIFIC, THE CRIMINALISATION OF BRIBERY IN ASIA AND THE PACIFIC 97–98 (2010), available at <http://www.oecd.org/site/anti-corruptioninitiative/46587127.pdf> (discussing increased emphasis on fighting commercial bribery in China); see also Wang Guanqun, *Chinese Police Investigate 6,500 Cases of Commercial Bribery in 5 Years*, XINHUA ENG. NEWS (Apr. 17, 2011), [http://news.xinhuanet.com/english2010/china/2011-04/17/c\\_13833196.htm](http://news.xinhuanet.com/english2010/china/2011-04/17/c_13833196.htm) (“[T]he [Chinese government] plans to step up efforts in investigating commercial bribery cases and collecting information to discover more of such cases.”); Warin et al., *supra* note 6, at 36 (noting that leaders of the Communist Party are increasingly concerned about the threat that corruption poses to the social stability of the nation).

<sup>18</sup> See Zhonghua Renmin Gongheguo Xingfa [Criminal Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., July 6, 1979, effective Jan. 1, 1980) art. 164 (amended 2011), translated in WEI LUO, THE AMENDED AND ANNOTATED CRIMINAL CODE OF THE PEOPLE'S REPUBLIC OF CHINA WITH OFFICIAL INTERPRETATIONS (Wei Luo trans., 2d ed. 2012) [hereinafter PRC CRIMINAL LAW]; see also *infra* Part III.D.

<sup>19</sup> Warin et al., *supra* note 6, at 41 (“Further, Chinese authorities unsurprisingly censor stories of corruption that they worry could embarrass the regime.”).

Due to a number of overlapping elements contained in China's commercial bribery laws and the FCPA, violations of China's commercial bribery laws can in many instances also be violations of the FCPA.<sup>20</sup> This last aspect provides a major risk to MNCs as China has now indicated that it intends to increase enforcement of its own anti-bribery laws for commercial bribery, i.e., actions between what China considers to be actors who are not government officials.<sup>21</sup> However, DOJ monitors these actions,<sup>22</sup> and while China may not consider the entities involved to be government officials, under DOJ's aggressive interpretations, these same persons might be considered to be foreign officials and the payments subject to prosecution under the FCPA.<sup>23</sup> In other words, China's increasing aggressiveness in enforcing its laws against commercial bribery in cases involving the Chinese operation of U.S.-based MNCs will likely lead to an increase in the number of FCPA enforcement actions against those same MNCs by DOJ.

Recent attention focusing on FCPA issues in China has emphasized the reach of the FCPA to transactions in China<sup>24</sup> but has so far failed to identify the threat posed by China's enforcement of its own domestic laws against commercial bribery as a catalyst for DOJ to enforce FCPA violations against the same entities. But PRC enforcement actions of its own anti-bribery laws can potentially become a significant source of information leading to DOJ FCPA enforcement actions. Many of the illegal payments that occur in China are made in private and are unknown to DOJ and undiscoverable by DOJ.<sup>25</sup> DOJ is not permitted to put agents on the ground in China<sup>26</sup> and would not likely be willing to commit the resources to do so even if permitted. However, China has a massive law enforcement apparatus with hundreds of thousands of enforcement officials.<sup>27</sup> Moreover, in China many opportunities for whistleblowing in commercial bribery cases exist because of leaks by competitors and disgruntled

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<sup>20</sup> See *infra* Part III.

<sup>21</sup> See CHOW, *LEGAL SYSTEM OF CHINA*, *supra* note 8, at 140.

<sup>22</sup> See Mike Koehler, *World Bribery & Corruption Compliance Forum—Comments by U.S. Officials*, FCPA PROFESSOR (Sept. 16, 2010), <http://www.fcprofessor.com/world-bribery-corruption-compliance-forum-comments-by-u-s-officials> (statement by Charles Duross, Deputy Chief, Fraud Section, Dep't of Justice, that U.S. officials saw a story in the Chinese media about a Chinese bribery case involving a Fortune 50 company on Sunday evening and by Monday morning, DOJ had sent a letter to the general counsel of the company asking for an explanation).

<sup>23</sup> See *infra* Part II.A.

<sup>24</sup> See CHOW, *China Under the FCPA*, *supra* note 3, at 573–607.

<sup>25</sup> See Ling Li, *Performing Bribery in China: Guanxi Practice, Corruption with a Human Face*, 20 J. CONTEMP. CHINA 1 (2011).

<sup>26</sup> China has no specific laws concerning this issue, but the author's own experience indicates that China would likely consider the presence of foreign law enforcement officials in its territory to be a violation of its sovereignty.

<sup>27</sup> Michael Wines, *Chinese Law Governing a Police Force Is Approved*, N.Y. TIMES, Aug. 28, 2009, at A6.

participants in bribery and kickback schemes.<sup>28</sup> Without any intention to do so, PRC enforcement officials can serve to alert DOJ by bringing enforcement actions of Chinese anti-bribery laws, which are often reported in the public media in China.<sup>29</sup> These actions are often highly publicized to create deterrence in China and to signal the Communist Party's lack of tolerance for commercial corruption, but the public dissemination of information also alerts DOJ, which may then trigger DOJ's own investigation.<sup>30</sup>

This Article examines these themes in detail with a focus on the risk to MNCs that China's enforcement of its own domestic laws against commercial bribery will trigger an FCPA prosecution by DOJ. MNCs may not fully appreciate this risk and continue to regard commercial bribery cases in China as serious business problems, but not as catalysts that can lead to an FCPA prosecution, which can have far more serious consequences for the MNC and its corporate officers.

Part II of this Article briefly reviews the FCPA and why it applies with special force in China. Part III focuses on China's anti-bribery laws and their interplay and overlap with the FCPA. Part IV concludes with some observations about proactive steps that MNCs can take to mitigate risks in light of these developments.

## II. SPECIAL FCPA CONCERNS INVOLVING CHINA

The anti-bribery provisions of the FCPA prohibit any U.S. company, its personnel, U.S. citizens, foreign companies with shares listed on a U.S. stock exchange or otherwise required to file reports with the Securities and Exchange Commission as well as any person of any nationality while in the United States from corruptly paying, offering to pay, promising to pay or authorizing the payment of money, a gift, or anything of value to a foreign official or any foreign political party official for the purpose of obtaining or retaining business.<sup>31</sup> Each of these elements has a jurisprudence that has developed to

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<sup>28</sup> See *infra* Part III.C.

<sup>29</sup> Corruption cases are often reported in the general media, such as Xinhua, the official PRC news agency.

<sup>30</sup> See Spencer S. Griffith & Yuanming Wang, *Chinese Anti-Bribery Law: An Overview of the Chinese Laws and Their Importance to Foreign Companies Doing Business in China—Part I*, METRO. CORP. COUNS., Aug. 2010, at 11.

<sup>31</sup> See Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 78dd-1(a)(1), 91 Stat. 1494 (2006), *amended by* Foreign Corrupt Practices Act Amendments of 1988, Pub. L. No. 100-418, tit. V, subtit. A, pt. 1, 102 Stat. 1415 *and by* International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, 112 Stat. 3302 (codified as amended in scattered sections of 15 U.S.C.). The FCPA actually contains two sets of provisions. In addition to the anti-bribery provisions, the FCPA also contains books and records and internal control provisions. See *id.* at §§ 78m(b)(2)–(3). The anti-bribery provisions are enforced by the U.S. Department of Justice through civil and criminal penalties. The books and records and internal control provisions are enforced by the Securities and Exchange Commission through civil penalties. The focus of this Article is on the anti-bribery

define the meaning of these terms. In the case of China, three elements of the FCPA are especially problematic: (1) the meaning of “foreign official”;<sup>32</sup> (2) “anything of value”;<sup>33</sup> and (3) liability for the use of third-party intermediaries to make or facilitate an illegal payment.<sup>34</sup>

### A. *Foreign Officials Under the FCPA*

In the case of China, the most important issue under the FCPA is the interpretation of “foreign official.” DOJ has adopted an aggressive interpretation of foreign official that is still largely untested in the courts.<sup>35</sup> DOJ is able to adopt aggressive interpretations through the use of non-prosecutions agreements (NPAs), deferred prosecution agreements (DPAs), and settlement agreements with companies charged with FCPA violations. These agreements are popular because they allow companies to resolve charges under the FCPA without a court proceeding and to avoid the damaging effects of a DOJ investigation and prosecution and the severe penalties that may result from a prosecution.<sup>36</sup> However, these agreements do not need to be approved by the courts.<sup>37</sup> As a result, interpretations of the FCPA by DOJ contained in these agreements are not reviewed by courts. Not surprisingly, as DOJ is an enforcement agency, its interpretation of the FCPA is highly aggressive.

The FCPA defines a foreign official as an employee of a government or instrumentality thereof<sup>38</sup> and as any person acting in an official capacity on behalf of a government.<sup>39</sup> DOJ has adopted the position that state-owned enterprises (SOEs) and state-controlled enterprises are instrumentalities of a government and that any employee of an SOE qualifies as a foreign official under the FCPA.<sup>40</sup> To date, courts that have considered the issue have concluded that some state-owned companies may qualify as instrumentalities of the state and that whether an enterprise qualifies as an instrumentality of the state is a question of fact that must be determined on a case-by-case basis

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provisions, considered by most MNCs to create higher exposure because of the availability of criminal sanctions, including imprisonment.

<sup>32</sup> *E.g.*, *id.* at § 78dd-1(a)(1).

<sup>33</sup> *E.g.*, *id.* at § 78dd-1(a).

<sup>34</sup> *E.g.*, *id.* at § 78dd-1(a)(3).

<sup>35</sup> See *infra* notes 40–41, 52–54 and accompanying text.

<sup>36</sup> SHEARMAN & STERLING LLP, *supra* note 7, at 7–8.

<sup>37</sup> *Id.* at 9.

<sup>38</sup> 15 U.S.C. § 78dd-1(f)(1)(A) (2006).

<sup>39</sup> *Id.*

<sup>40</sup> See Mike Koehler, *The Façade of FCPA Enforcement*, 41 GEO J. INT’L L. 907, 916–17 (2010).

according to a list of factors specific to each entity.<sup>41</sup> Courts that have considered the issue conclude that some state-owned companies may qualify as instrumentalities of the state and employees of such companies may qualify as foreign officials.<sup>42</sup>

As discussed in the next section, this interpretation of foreign official by DOJ applies with special force in China because of the dominance of the PRC economy by SOEs and state-controlled enterprises.

### *B. State-Owned and State-Controlled Enterprises in China*

In the past decade, a great deal of media attention has focused on China's economic reforms and China's emergence as a dynamic, powerful economy and a center of global business.<sup>43</sup> Yet, despite China's dramatic transformation from a rigid economy under the almost total control of the state, China's economy continues to be dominated by SOEs due to political reasons, as further discussed below. An SOE can be defined as an entity that is:

[O]wned by the state as opposed to any private entity, individual, or group of individuals. An SOE was expected to meet state production targets, to turn over all of its revenues to the state, and to have all of its losses subsidized or

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<sup>41</sup> See Order Denying Defendants' Motion to Dismiss at 6298, *United States v. Carson*, No. 8:09-00007-JVS (D. Cal. May 18, 2011), 2011 WL 5101701, at \*3–4. The court set forth the following factors in determining whether a company is a state owned enterprise for the purposes of the FCPA:

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

*Id.*

<sup>42</sup> See *id.* at 6298–99; see also *United States v. Aguilar*, 738 F. Supp. 2d 1108, 1110 (C.D. Cal. 2011); Order Denying Defendant Joel Esquenazi's (Corrected and Amended) Motion to Dismiss Indictment for Failure to State a Criminal Offense and for Vagueness at 2–3, *United States v. Esquenazi*, No. 1:09-21010-CR-Martinez-Brown (S.D. Fla. Nov. 19, 2010), 2010 U.S. Dist. LEXIS 143572, at \*3–4.

<sup>43</sup> See Yan Ning & Gao Yuan, *CEOs Say Good Times Can Last*, WASH. POST CHINAWATCH (Nov. 25, 2011), <http://chinawatch.washingtonpost.com/2011/11/ceos-say-good-times-can-last.php> (quoting Pascal Lamy, Director-General of the WTO, as stating that "China ha[s] delivered an A plus performance since it joined the WTO" in 2001).



absorbed by the state. The state also controlled all of the enterprise's business and management functions . . . .<sup>44</sup>

Prior to China's economic reforms begun in 1978, SOEs dominated China's economy and accounted for nearly all of its industrial output.<sup>45</sup> Since economic reforms, SOEs have taken a diminishing role in the economy.<sup>46</sup> Some SOEs that have been fully or partially privatized as private enterprises have been allowed to assume an important role in China's post-reform economy.<sup>47</sup> However, although SOEs now account for a smaller part of China's industrial output, all important sectors of the economy continue to be controlled by SOEs; sectors such as banking, oil and gas production and exploration, steel production, telecommunications (including the Internet), electricity and water supply, and transport (including air and rail) are all controlled by the state.<sup>48</sup> The reason for the role of the SOE in all crucial sectors of the PRC economy is that SOEs are ultimately under the control of the Communist Party, which is the supreme authority in the PRC.<sup>49</sup> The Communist Party is intent on preserving its power by controlling all important aspects of the PRC economy.<sup>50</sup> Although private enterprises may play an important, even indispensable role in China's economic development, SOEs serve not only an economic purpose, but also the crucial political purpose of protecting the Communist Party's power.<sup>51</sup> The Communist Party seeks to assert control over every important economic, political, legal, and social aspect of the PRC. Control over the vital sectors of China's economy through the use of SOEs is a crucial part of these overall goals. This political reality means that so long as the Communist Party continues to be in power, SOEs will continue to dominate all important sectors of China's economy for the foreseeable future.

Entities can qualify as SOEs even if they are only partially owned by the state. Nothing in DOJ's definitions indicates that an enterprise must be wholly owned by the state to qualify as an SOE. A federal court has also concluded that state ownership is only one of many factors in determining whether an entity is

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<sup>44</sup> CHOW, LEGAL SYSTEM OF CHINA, *supra* note 8, at 23.

<sup>45</sup> *Id.* at 24.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at 24–25.

<sup>48</sup> *See id.* at 25.

<sup>49</sup> *Id.* at 119.

<sup>50</sup> *See* WORLD BANK OFFICE, BEIJING, QUARTERLY UPDATE 3 (2010); Michael Wines, *China's Government Fortifies State Businesses to Fuel the Nation's Growth*, N.Y. TIMES, Aug. 30, 2010, at A1, A6.

<sup>51</sup> SOEs are under the control of PRC government entities, which are in turn under the control of the Communist Party. *See* CHOW, LEGAL SYSTEM OF CHINA, *supra* note 8, at 23; *see also id.* at 118–19 (describing how the Communist Party controls the government). All important sectors of the economy continued to be dominated by SOEs, which means that the Communist Party can effectively control China's most important industries. *See id.* at 25.

an SOE.<sup>52</sup> In a recent case, a federal district court found that an entity qualified as an SOE even though the state had a minority ownership interest and that employees of the company were foreign officials under the FCPA.<sup>53</sup>

DOJ has further indicated that a state-controlled enterprise can qualify as an instrumentality of the state and that employees of such an enterprise can qualify as foreign officials.<sup>54</sup> This position can potentially expand significantly the number of persons who will qualify as foreign officials. A state-controlled enterprise, unlike an SOE, does not require any ownership by the state.<sup>55</sup> Any enterprise can qualify as a state-controlled enterprise if the state exercises control over the entity.<sup>56</sup> The issue that is posed by this DOJ position is that virtually every single enterprise in China, whether state-owned or privately-owned, could potentially qualify as a state-controlled enterprise. Under China's authoritarian system, every enterprise is subject to the supervision of a government bureaucracy.<sup>57</sup> For example, a detergent company is subject to the supervision of the Bureau of Light Industry, a metals company is subject to the Bureau of Heavy Industry, a college or university is subject to the Ministry of Education, and lawyers and the legal services industry are subject to the Ministry of Justice, and so forth.<sup>58</sup> The PRC divides its economy into vertical sectors, with each entity in the sector subject to the supervision of a government bureau, all converging at the top under the control of the State Council, the executive arm of the PRC government.<sup>59</sup> Each enterprise must file regular

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<sup>52</sup> See Order Denying Defendants' Motion to Dismiss at 6298, *United States v. Carson*, No. SACR 09-00077-JVS (C.D. Cal. May 18, 2011), 2011 WL 5101701, at \*5.

<sup>53</sup> In one case, the United States asserted that the employees of a Nigerian company were foreign officials within the meaning of the FCPA because the company was a state-owned enterprise even though the Nigerian government owned a minority (49%) interest in the company. Information at 6, *United States v. Marubeni*, No. 4:12-cr-00022 (S.D. Tex. Jan. 17, 2012), 2012 WL 130557.

<sup>54</sup> See, e.g., Government's Response in Opposition to Defendants' Motions to Dismiss, for a Bill of Particulars, and to Amend Schedule of Pretrial Submissions at 6, *United States v. Nguyen*, No. 2:08-cr-00522-TJS (E.D. Pa. Oct. 30, 2009), available at <http://www.justice.gov/criminal/fraud/fcpa/cases/nguyenn/10-30-09nguyen-dismiss.pdf>.

<sup>55</sup> Ownership and control are two distinct concepts. It is possible to control an enterprise without having any ownership interest in the enterprise. For example, if a government bureau has supervisory authority of an enterprise and the power to shut it down, the entity can dictate commands to the enterprise even though the government bureau does not actually own any interest in the enterprise. In China, every enterprise is subject to the control of a government supervisory bureau. See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 1, at 93. This feature of China's economy means that almost all enterprises can qualify as state-controlled enterprises under DOJ's expansive definition.

<sup>56</sup> Just as DOJ does not require that the state have a full ownership interest in an enterprise for it to qualify as an SOE, see *supra* note 53, DOJ will also likely assert that a state-controlled enterprise does not require that an enterprise be under the complete control of the state.

<sup>57</sup> See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 1, at 93.

<sup>58</sup> See *id.*

<sup>59</sup> See CHOW, *LEGAL SYSTEM OF CHINA*, *supra* note 8, at 97–101.

reports with its supervisory authority and, in theory, each supervisory bureau could immediately shut down an enterprise.<sup>60</sup> An enterprise subject to this type of control might be deemed by DOJ to qualify as a state-controlled enterprise. Under this expansive approach, virtually every enterprise in China would qualify as an instrumentality of the state. Further, DOJ has indicated that employees of state-owned or state-controlled enterprises qualify as foreign officials even if the individual is a low-level employee.<sup>61</sup> This definition means that even clerical staff might qualify as foreign officials. Under DOJ's approach, there could be millions of people in China who qualify as foreign officials within the meaning of the FCPA.

These expansive definitions of state-owned and state-controlled enterprises as instrumentalities of the state and employees of such entities as foreign officials create significant risks for companies under the FCPA. Companies in the United States are wary of DOJ's aggressive stance and have adopted a position of considering "everyone they deal with [to be] a 'foreign official' because they work for an SOE."<sup>62</sup> Under DOJ's aggressive stance, the universe of persons who qualify as foreign officials in China is vast. Combined with a business culture in which bribes are common,<sup>63</sup> China's business environment creates many opportunities for violations of the FCPA.

### III. CHINA'S ANTI-BRIBERY LAWS AND THE FCPA

This Part explores the intersection and overlap between China's anti-bribery laws and the FCPA. As further explained below, the risk for U.S. companies is that actions that China considers to be instances of commercial bribery—not involving government corruption—might fall within the FCPA under the aggressive approach by DOJ.

#### A. China's Treatment of Bribes Paid to State Officials

China has two sets of laws related to bribery: one set of laws deals with payments given to state officials, and a different set applies to commercial bribery between private persons. Laws that criminalize official corruption, defined as payments to state officials, include Articles 389–95 of the PRC

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<sup>60</sup> See CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 1, at 93.

<sup>61</sup> See Complaint at para. 8, 9, 13, SEC v. ITT Corp., No. 1:09-CV 00272 (D.D.C. Feb. 11, 2009), 2009 WL 365088 *available at* <http://www.sec.gov/litigation/complaints/2009/comp20896.pdf>.

<sup>62</sup> Declaration of Professor Michael J. Koehler in Support of Defendants' Motion to Dismiss Counts One through Ten of the Indictment at para. 447, *United States v. Carson*, No. 8:09-cr-00077-JVS (C.D. Cal. Feb. 21, 2011).

<sup>63</sup> See, e.g., Jay Hoenig, *Projects in China Need Vigilance*, ENGINEERING NEWS-REC. (Dec. 9, 2009) <http://enr.construction.com/opinions/viewpoint/2009/1209-ProjectsInChina.asp>.

Criminal Law.<sup>64</sup> A separate set of laws deals with commercial bribery. Commercial bribery is prohibited by Article 8 of the Anti-Unfair Competition Law<sup>65</sup> (AUCL) and by Article 163 of the PRC Criminal Law.<sup>66</sup>

Although China has laws governing bribes given to state officials, these laws are applied differently than laws that relate to commercial bribery. Almost all government officials at any level are members of the Communist Party, and every high-ranking government official at the central level is, without exception, a member of the Communist Party elite.<sup>67</sup> In any corruption case involving a Party member, the Communist Party has its own internal mechanism for handling the issue of discipline, and the Party will first decide how to resolve the case internally before handing the case over to legal authorities for formal legal proceedings.<sup>68</sup> In any corruption case involving a

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<sup>64</sup> See PRC CRIMINAL LAW, *supra* note 18, at arts. 389–95 (amended 1997). Article 389 provides:

Anyone, who violates the state regulations by offering money or property to a state functionary while engaging in a business transaction, where the amount involved is relatively large, or violates the state regulations by offering any kickbacks or transaction fees to a state functionary while engaging in a business transaction, shall be treated as having committed the crime of bribery.

*Id.* at art. 389.

<sup>65</sup> See Zhonghua Renmin Gongheguo Fan Bu Zheng Dang Jingzheng Fa [PRC Anti-Unfair Competition Law] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 2, 1993, effective Dec. 1, 1993) art. 8 [hereinafter PRC Anti-Unfair Competition Law]; *see also infra* Part III.B.

<sup>66</sup> Article 163 of the PRC CRIMINAL LAW, *supra* note 18, provides in relevant part:

Where an employee of a company or enterprise who, taking advantage of his position, demands money or property from another person or illegally accepts another person's money or property in return for the benefits he seeks for such person, if the amount involved is relatively large, he shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention; if the amount is huge, he shall be sentenced to fixed-term imprisonment of not less than five years and may also be sentenced to confiscation of property.

<sup>67</sup> See SUSAN V. LAWRENCE & MICHAEL F. MARTIN, CONG. RESEARCH SERV., R41007, UNDERSTANDING CHINA'S POLITICAL SYSTEM 1–3 (2012), *available at* <http://www.fas.org/sgp/crs/row/R41007.pdf>.

<sup>68</sup> The recent corruption scandal involving the formerly powerful Party official Bo Xilai is a good example of how corruption charges against high-level Party officials are handled. *Id.* at 2. Bo was the Party Secretary of Chongqing Province, the highest position in the Province (and more powerful than the position of governor) and was considered a candidate for a position in Politburo of the Communist Party, the core elite of the Party. A scandal erupted when Bo and his wife, Gu Kailai, became embroiled in a lurid tale of corruption involving hundreds of millions of dollars and the murder of a British businessman. Since Bo was removed from his position in March, he and his wife have been held in an undisclosed location and have not been heard from. Bo's case is being handled by the Communist Party and not by the police. After several months of being held in seclusion, Bo's wife was charged with the murder of a British businessman. Party leaders first deliberated on how to

Communist Party member, the Communist Party leaders will decide in secrecy how to dispose of the case.<sup>69</sup> There are two reasons for this approach. First, the Communist Party considers itself to be above the law and outside of the legal system.<sup>70</sup> As a result, the Party will not allow an external mechanism, such as the legal system, to discipline its members.<sup>71</sup> The Party first decides how the case should be resolved as a matter of Party policy and will then refer the case to the legal process.<sup>72</sup> The case will then move quickly through the legal system, which could include a criminal prosecution and a public trial.<sup>73</sup> However, the result of the legal case has already been determined by the Party's own internal procedures and decision-making process.<sup>74</sup> The legal case will not proceed independently but will reach an outcome that has already been preordained by the Party.<sup>75</sup> In other words, the role of the legal process is to affirm an outcome that has already been reached by the Party. A second reason for this approach is that any case involving corruption of a Party member can result in potential embarrassment for the Party, and so the Party will tightly control any information that is released to the public. For this reason, the resolution of any corruption case will first occur entirely within the Party without any knowledge by any non-Party entity, including PRC government enforcement authorities.<sup>76</sup> The Communist Party is highly sensitive to the issue of government and official corruption.<sup>77</sup> For better or worse, the perception by

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handle this case and then referred the case to legal authorities and instructed them to charge Bo's wife with a crime. For news coverage of the scandal, see, for example, Andrew Jacobs, *China Casts Ex-Leader's Wife in a Familiar Role*, N.Y. TIMES, July 27, 2012, at A1, A10; Michael Wines, *In Rise and Fall of Chinese Boss, a Ruthless Arc*, N.Y. TIMES, May 7, 2012, at A1, A10.

<sup>69</sup>For a description of how PRC courts and the Communist Party are interwoven, see Ling Li, *The "Production" of Corruption in China's Courts: The Politics of Judicial Decision-Making and Its Consequences in a One-Party State* 10–18 (2011) (unpublished manuscript), available at <http://www.usasialaw.org/wp-content/uploads/2011/07/The-production-of-corruption-in-Chinas-courts.pdf>.

<sup>70</sup>LAWRENCE & MARTIN, *supra* note 67, at 14.

<sup>71</sup>*See id.*

<sup>72</sup>Of course, there is no written law or Party document stating that the Party first decides controversies and cases and then has a show trial, but this is a widespread perception among the general population in China. See Andrew Jacobs, *Public Scorn for Reprieve in Murder Trial Wasn't Part of the Script*, N.Y. TIMES, Aug. 21, 2012, at A6 (noting that "[t]he party's carefully scripted trial" prompted anger and cynicism in China).

<sup>73</sup>*See id.* (quoting a dissident's statement of a popular belief that the party uses the "justice system for their purposes").

<sup>74</sup>*See id.* ("It's obvious to everyone that [the party] came up with the sentence before the facts were known.").

<sup>75</sup>*See id.*

<sup>76</sup>*See* Warin et al., *supra* note 6, at 41.

<sup>77</sup>*See, e.g.,* Keith B. Richburg, *In Bo Xilai Case, a Quiet Resolution Appears Likely*, WASH. POST, June 8, 2012, at A7, available at [http://www.washingtonpost.com/world/asia\\_pacific/risks-over-bo-xilai-case-could-prompt-china-to-seek-low-profile-resolution/2012/06/14/gJQAdJHmeV\\_story.html](http://www.washingtonpost.com/world/asia_pacific/risks-over-bo-xilai-case-could-prompt-china-to-seek-low-profile-resolution/2012/06/14/gJQAdJHmeV_story.html).

most people in China is that the Communist Party is rife with corruption.<sup>78</sup> Most people in China believe that all Party officials, without exception, are corrupt—the only question is to what degree.<sup>79</sup> For this reason, the Party wishes to handle issues involving corruption by its members on its own, revealing only those facts that it wishes the public to know, and will concoct an official version of events that will be disseminated to the public and the media.<sup>80</sup> A related reason is that corruption cases that seemingly involve one or a few Party officials can further implicate other Party officials since one person rarely acts alone.<sup>81</sup> The Communist Party may wish to avoid the public embarrassment of a widening scandal implicating many Party officials and may decide, after punishing the offender and appeasing the public, to protect other Party officials from prosecution to avoid public embarrassment. The ultimate goal is to punish a corrupt official in order to set an example and to appease the public, not the punishment of all guilty members of the Party.

The highly sensitive nature of corruption cases involving state officials indicates that such cases in China are likely to be under tight control and closely guarded with few facts disclosed to the public or to the media. In fact, some cases may never be known to anyone outside of the Party itself.

### B. *Commercial Bribery in China*

Commercial bribery cases are treated entirely differently by PRC authorities. By definition, commercial bribery cases in China involve persons who are not state officials, but rather those who act in a private capacity. Article 8 of the AUCL provides:

A business operator shall not resort to bribery, by offering money or goods or by any other means, in selling or purchasing commodities. A business operator who offers off-the-book rebate in secret to the other party, a unit or an individual, shall be deemed and punished as offering bribes; and any unit or individual that accepts off-the-book rebate in secret shall be deemed and punished as taking bribes.<sup>82</sup>

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<sup>78</sup> See *id.*

<sup>79</sup> See MINXIN PEI, CARNEGIE ENDOWMENT FOR INT'L PEACE, CORRUPTION THREATENS CHINA'S FUTURE 1–2 (2007), available at [http://www.carnegieendowment.org/files/pb55\\_pei\\_china\\_corruption\\_final.pdf](http://www.carnegieendowment.org/files/pb55_pei_china_corruption_final.pdf).

<sup>80</sup> Jacobs, *supra* note 72.

<sup>81</sup> See, e.g., Andrew Jacobs & Michael Wines, *Murder Aside, China Inquiry Puts Couple's Wealth on Trial*, N.Y. TIMES, Apr. 13, 2012, at A1, A8 (noting that in the investigation of a powerful Party official for corruption, “[a] campaign to expose the family’s web of business dealings carries certain risks, given that many members of China’s political elite profit from their connections and often stow their assets outside the country”).

<sup>82</sup> PRC Anti-Unfair Competition Law, *supra* note 65, at art. 8.

Violations of Article 8 of the AUCL and other provisions are punishable by civil and criminal penalties, including imprisonment for persons giving or receiving bribes.<sup>83</sup>

Commercial bribery cases often do not involve sensitive political issues, so the Communist Party may not get involved in the case at all but will allow the case to be conducted through the legal system and in a public manner and accessible to the media. In fact, the Communist Party views commercial bribery as driving up the cost of goods and compromising product safety, issues that can create problems of social instability.<sup>84</sup> The Party fears social instability because if it occurs on a large scale, such instability can lead to political unrest and the eventual overthrow of the Party.<sup>85</sup> As 2012 represented a once in a decade transition of power to a new set of government leaders, the Communist Party was particularly intent on demonstrating that it still has a firm grip on the country and is able to continue to shepherd the country through a continued period of growth and development.<sup>86</sup> These considerations create incentives for the Party to take a tough stance on any potentially destabilizing elements, such as commercial bribery, and provide additional incentives for the PRC to aggressively prosecute and publicize commercial bribery cases.<sup>87</sup> If this occurs, then some of these PRC cases might lead to collateral cases against U.S. companies under the FCPA.

As the following discussion illustrates, many commercial bribery cases under PRC law may also be subject to prosecution by DOJ under the FCPA.

### *C. Common Factual Scenarios in Commercial Bribery Cases in China*

Three fact patterns commonly arise in commercial bribery cases in China, each involving a different aspect of the FCPA. All of these cases involve sales and distribution channels between MNCs and Chinese entities, an area of commerce that involves many transactions on a daily basis. The kickback schemes described below occur countless times on a daily basis in China, so many opportunities arise for the prosecution of commercial bribery cases.

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<sup>83</sup> PRC CRIMINAL LAW, *supra* note 18, at art. 163.

<sup>84</sup> Amy L. Sommers & David D. Zhang, Anti-Bribery Enforcement with Chinese Characteristics: Not All Official, in K&L GATES GLOBAL GOVERNMENT SOLUTIONS 2012: ANNUAL OUTLOOK 45 (Jan. 2012), available at [http://www.klgates.com/files/Publication/6acbdd64-ecc6-4488-9377-3d820eb16946/Presentation/PublicationAttachment/8439490f-e62f-46d8-8d3a-3fb7aa9a5388/Antibribery\\_Enforcement\\_with\\_Chinese\\_Characteristics.pdf](http://www.klgates.com/files/Publication/6acbdd64-ecc6-4488-9377-3d820eb16946/Presentation/PublicationAttachment/8439490f-e62f-46d8-8d3a-3fb7aa9a5388/Antibribery_Enforcement_with_Chinese_Characteristics.pdf).

<sup>85</sup> See, e.g., Jonathan Watts, Chinese President Hu Jintao's Warning as Communist Party Celebrates 90 Years, GUARDIAN (U.K.), July 1, 2011, <http://www.guardian.co.uk/world/2011/jul/01/chinese-president-corruption-communist-party>.

<sup>86</sup> See *id.*

<sup>87</sup> See Sun, *supra* note 17, at 97.

### 1. *The Direct Kickback Scheme*

A common scenario that occurs is the use of a kickback as a means of procuring a sale.<sup>88</sup> For example, an MNC has set up a business entity in China in the form of a wholly foreign-owned enterprise or a joint venture<sup>89</sup> that is in the business of selling products, such as consumer daily use products, chemicals, or industrial equipment. The MNC's China business entity will have a sales department to solicit orders from customers. A sales agent gives a secret kickback to a purchasing agent in a state-owned enterprise for the purpose of inducing the purchasing agent to place an order for the MNC's products. To obtain the funds to make the kickback, the sales agent will often submit false expense reports using forged receipts. The funds that are received from the MNC's China business entity as reimbursement for fictitious business expenses are then used to make the kickback. The money is paid into the personal bank account of the purchasing agent; in return, the purchasing agent places an order for the products from the MNC. This arrangement benefits both the purchasing agent personally who receives a cash payment and the sales agent of the MNC. The sales agent is able to secure a purchase order for the MNC and is able to meet sales targets and can earn a bonus or a promotion.

This type of transaction can be a violation of the PRC AUCL. Article 8 of the AUCL prohibits the use of bribes in selling products and giving the purchasing agent an off-the-books kickback.<sup>90</sup> In fact, because such kickbacks are so common in China, the AUCL was enacted precisely to make this scheme illegal.<sup>91</sup>

This same kickback transaction, however, can also violate the FCPA. Suppose that the sales agent in the MNC's China business entity has made a payment to a purchasing agent of an SOE. DOJ will consider the SOE to be an instrumentality of the state and could also consider the purchasing agent,

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<sup>88</sup> The discussion in this section is based upon the author's own experience in China.

<sup>89</sup> Foreign companies must set up a business vehicle in accordance with PRC law in order to conduct business operations in China. See Issie Lapowsky, *10 Steps to Starting a Business in China*, INC. (July 12, 2010), <http://www.inc.com/guides/2010/07/how-to-start-a-business-in-china.html>. PRC law permits two major forms of business vehicles for foreign companies: a wholly foreign-owned enterprise, which, as its name suggests, is owned in its entirety by a foreign investor, such as an MNC. The other option, also very popular, is the joint venture, which is a partnership between the foreign investor and a local Chinese enterprise. Both the wholly foreign-owned enterprise and the joint venture are creatures of PRC law and are considered to be PRC legal persons. For a fuller discussion, see DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS* 489–90 (2d ed. 2010).

<sup>90</sup> See PRC Anti-Unfair Competition Law, *supra* note 65, at art. 8.

<sup>91</sup> See generally Spencer S. Griffith & Yuanming Wang, *Chinese Anti-Bribery Law: An Overview of the Chinese Laws and Their importance to Foreign Companies Doing Business in China—Part II*, METRO. CORP. COUNSEL, Sept. 2010, at 14, available at <http://www.metrocorpcounsel.com/pdf/2010/September/14.pdf>.



although a low-level employee, to be a foreign official.<sup>92</sup> The MNC's wholly owned enterprise or joint venture in China will be considered to be an "agent" of the MNC and acting on behalf of the MNC.<sup>93</sup> Under these circumstances, DOJ might charge both the MNC and its China business entity with violations of the FCPA. In fact, under similar factual circumstances, this was precisely the position asserted by DOJ.<sup>94</sup>

The kickback scheme described above is done in secrecy, and DOJ will have no means of detecting the arrangement. What might occur, however, is that the PRC authorities will learn about the commercial bribery scheme and will feel compelled to file a complaint and begin a legal proceeding and formal investigation. Once the PRC authorities commence a formal investigation, DOJ, which regularly monitors the actions of PRC enforcement authorities,<sup>95</sup> may become alerted to the scheme by the filing of a PRC complaint and proceeding, both matters of public record that may be reported in the media. But if the payments are done in secrecy, how would the PRC enforcement authorities learn of such a scheme in the first place? Such schemes often unravel because of one or more whistleblowers. Suppose that sales agents from a rival MNC company offer a kickback to a purchasing agent in an SOE but the purchasing agent refuses; the sales agents might then suspect that there is already an existing kickback scheme, or rival sales agents might learn about the kickback scheme through the rumor mill from other competitors. Or suppose that the sales agent in the MNC is supposed to make several kickbacks to several purchasing agents in the SOE but fails to make all of the payments or fails to make payments of the amounts promised. At this point, an angry competitor or a disgruntled employee in the SOE might make a report to the PRC authorities. If a formal complaint is made to PRC enforcement authorities, the officials will be under pressure to move ahead with the investigation and are not free to ignore the complaint without risking a reprimand from higher ranking authorities. In the ruthlessly competitive sales environment in China today, whistleblowing to undermine a competitor is common and is a fertile source of

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<sup>92</sup> See Dep't of Justice, FOREIGN CORRUPT PRACTICES ACT ANTIBRIBERY PROVISIONS 2-3, <http://www.justice.gov/criminal/fraud/fcpa/docs/lay-persons-guide.pdf> (last visited Aug. 27, 2012) ("The FCPA applies to payments to any public official, regardless of rank, or position.").

<sup>93</sup> Section 78dd-1(a) prohibits "any officer, director, employee, or agent" of a covered entity from making a bribe to a foreign official. Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 78dd-1(a), 91 Stat. 1494 (2006), *amended by* Foreign Corrupt Practices Act Amendments of 1988, Pub. L. No. 100-418, tit. V., subtit. A, pt. 1, 102 Stat. 1415 *and by* International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, 112 Stat. 3302 (codified as amended in scattered sections of 15 U.S.C.).

<sup>94</sup> In a non-prosecution agreement reached with RAE systems, DOJ indicated that it intended to charge both RAE Systems, a U.S.-based company, and its joint ventures in China for payments made by employees of the joint venture to PRC officials. See Letter from the U.S. Dep't of Justice to Carlos F. Ortiz & Roy K. McDonald (Dec. 10, 2010), *available at* <http://www.Justice.gov/criminal/fraud/fcpa/cases/rae-systems/12-10-10rae-systems.pdf>.

<sup>95</sup> See *Koehler*, *supra* note 22.

information leading to formal charges. This whistleblowing can begin a chain of events that could eventually lead to an FCPA investigation by DOJ. Since many whistleblowers are not innocent bystanders but were also involved in the kickback scheme and have become disgruntled, they have intimate knowledge of the scheme and can provide specific names, dates, and details of any sums transferred.

## *2. The Use of a Fictitious Separate Entity in a Kickback Scheme*

MNCs have grown wary about fraudulent expense reports and have instituted internal controls to detect such false reports.<sup>96</sup> These internal controls have caused perpetrators to set up fictitious outside entities as funnels for payments in a more elaborate kickback scheme.<sup>97</sup> For example, an employee works with accomplices to set up a domestic Chinese company, such as a travel agency. This can be easily done as there are few legal or capital requirements to set up a travel agency in China. The travel agency then arranges for a fictitious trip for several sales agents in the MNC or inflates the expenses for an actual trip. The travel agency bills the MNC for the fictitious or inflated travel expenses and the MNC pays the bill. The travel agency then uses the funds to make a kickback or payoff to the purchasing agent of a customer, an SOE. Or, in another variation, the travel agency arranges for sales agents to make a business trip, but the persons who actually travel are the purchasing agents from the SOE or are government officials from a state bureau that will then purchase products from the MNC's China business entity. The trip is arranged to travel to a resort location, such as Hong Kong and Macau, and lavish meals and leisure activities, such as golf outings or sightseeing, are arranged for the travelers. This type of scheme is now an increasingly common as a way to evade recent detection schemes used by MNCs.

This arrangement violates the PRC AUCL because it is a secret bribe paid to induce a customer to make a sale.<sup>98</sup> This same arrangement can also violate the FCPA. Under the FCPA, the China business entity and the MNC may be liable if the entity makes payments to a third party with knowledge or reason to know that the payments are being passed by the third party to foreign officials. If there are persons within the MNC who have knowledge of this scheme, a

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<sup>96</sup> See, e.g., Deferred Prosecution Agreement at c.z. 1–9, *United States v. Pfizer H.C.P. Corp.*, No. 1:12-cr-00169-ESH (D.D.C. Aug. 7, 2012) (outlining an agreement to implement fifteen internal controls to prevent FCPA violations, including implementing policies, standardizing investigations, creating reporting procedures, conducting proactive risk assessments, ensuring training, and managing vendor relationships).

<sup>97</sup> This discussion is based upon the author's own knowledge and experience.

<sup>98</sup> See PRC Anti-Unfair Competition Law, *supra* note 65, at art. 8 (“A business operator shall not resort to bribery, by offering money or goods or by any other means, in selling or purchasing commodities. A business operator who offers off-the-book rebate in secret to the other party, a unit or an individual, shall be deemed and punished as offering bribes.”).

highly likely possibility, then this knowledge will be imputed to the MNC. Note further that although the beneficiaries of the travel may not receive direct cash payments, the FCPA prohibits not only the giving of cash but also “anything of value.”<sup>99</sup> An all-expenses-paid trip to an exotic location, with expensive meals and lodging, will qualify as something of value in violation of the FCPA.<sup>100</sup> This type of elaborate scheme involving many parties creates many opportunities for whistleblowing since competitors may become aware of the scheme or any of the many participants in the scheme might come to believe that they are not receiving their fair share of the benefits of the scheme.

Competitors of the MNC that are engaged in the kickback scheme are likely to be aware of the prevalence of the scheme because the competitors are likely to engage in the same tactics. Whistleblowers leak information to authorities not because the whistleblowers are innocent bystanders and seek to serve the ends of justice—to the contrary they are often themselves engaged in the same tactics but seek to undermine similar schemes by their competitors whenever possible. This leads to a constant flurry of whistleblowing accusations and retaliatory charges, which creates a fertile source of information for PRC authorities.

### *3. Payments to Doctors and Hospital Administrators*

Many multinational pharmaceutical companies are involved in the manufacture and distribution of drugs for use in China's state-run hospitals.<sup>101</sup> Although there is a small but growing industry of private health care for wealthy individuals, the vast bulk of China's health care system is controlled and operated by the state.<sup>102</sup> It is well known by everyone in China that doctors and administrators in these hospitals who prescribed drugs for patients receive a

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<sup>99</sup> See Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 78dd-1, 91 Stat. 1494 (2006), *amended by* Foreign Corrupt Practices Act Amendments of 1988, Pub. L. No. 100-418, tit. V, subtit. A, pt. 1, 102 Stat. 1415 *and by* International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, 112 Stat. 3302 (codified as amended in scattered sections of 15 U.S.C.) (prohibiting “an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value” to a foreign official to obtain or retain business).

<sup>100</sup> The U.S. government has indicated that all-expenses-paid sightseeing for Chinese officials to Disneyland, the Grand Canyon, and Las Vegas qualifies as “anything of value” under the FCPA. See Complaint ¶ 1, SEC v. Lucent Techs. Inc., No. 1:07-cv-02301-RBW (D.D.C. Dec. 21, 2007), *available at* <http://www.sec.gov/litigation/complaints/2007/comp20412.pdf>.

<sup>101</sup> See *generally* PRICE WATERHOUSE COOPERS, *INVESTING IN CHINA'S PHARMACEUTICAL INDUSTRY* (2d ed. 2009), *available at* [http://www.pwc.com/gx/en/pharma-life-sciences/assets/en-pharma\\_03-26-small.pdf](http://www.pwc.com/gx/en/pharma-life-sciences/assets/en-pharma_03-26-small.pdf) (discussing the role of multinational companies in distribution of pharmaceuticals in China).

<sup>102</sup> See Dai Tao et al., *Fixing the Hospital System in China*, CHINA HEALTH POL'Y NOTES (The World Bank, Washington, D.C.), June 2010, at 1, 3–5, *available at* <http://siteresources.worldbank.org/HEALTHNUTRITIONANDPOPULATION/Resources/281627-1285186535266/FixingthePublicHospitalSystem.pdf>.

“commission” from the pharmaceutical company for each drug dispensed.<sup>103</sup> The sale and distribution of pharmaceuticals in China is a highly lucrative business given China’s huge and aging population. China is projected to become the third largest market for pharmaceuticals in the world.<sup>104</sup>

A “commission” given to a doctor by an MNC pharmaceutical company or its sales agents can constitute a kickback or bribe under the PRC AUCL for the same reasons set forth above in the discussion of other kickback schemes. Further, this same arrangement can be a violation of the FCPA. A doctor or administrator at a state-operated hospital will be considered to be a foreign official under the FCPA. A formal PRC investigation into a kickback scheme involving doctors and hospital administrators might lead to an FCPA investigation against the U.S.-based MNC pharmaceutical company and its China business entities by DOJ.

#### *D. China’s Recent Anti-Bribery Provision for Payments to Foreign Officials*

As part of its efforts to comply with its obligations under the United Nations Convention Against Corruption,<sup>105</sup> to which it is a signatory, the PRC enacted an amendment in 2011 to Article 164 of its Criminal Law, which now provides for the “Crime of Offering Bribes to Officials of Foreign Countries and International Public Organizations.”<sup>106</sup> The new amendment now proscribes bribes given to officials of foreign countries and international organizations to secure illegitimate business benefits.<sup>107</sup> This amendment is China’s version of the FCPA.

The law itself contains many unanswered questions that are beyond the scope of this Article.<sup>108</sup> Among the unanswered questions is whether the new

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<sup>103</sup> This observation is based upon the author’s own personal knowledge and experience.

<sup>104</sup> See Yahong Li et al., *Viagra in China: A Prolonged Battle over Intellectual Property Rights* 3 (Asia Case Research Ctr., The Univ. of H.K., Columbia CaseWorks No. 100303, 2010).

<sup>105</sup> See United Nations Convention Against Corruption, Oct. 31, 2003, S. TREATY DOC. NO. 109-06, 2349 U.N.T.S. 41, available at [http://www.unodc.org/documents/treaties/UNCAC/Publications/Convention/0850026\\_E.pdf](http://www.unodc.org/documents/treaties/UNCAC/Publications/Convention/0850026_E.pdf).

<sup>106</sup> See Official Notes following Article 164 of the PRC Criminal Law; PRC CRIMINAL LAW, *supra* note 18, at 90 (amended by Item 29 of the Eighth Amendment).

<sup>107</sup> Article 164 of the PRC CRIMINAL LAW, *id.*, states: “Anyone who bribes personnel of a company or enterprise in order to gain improper interests, if the bribery amount is relatively large, shall be sentenced to a fixed-term imprisonment of no more than three years of criminal detention.”

<sup>108</sup> For example, Article 164 of the PRC CRIMINAL LAW, *id.*, further defines foreign party performing official duties or unjustified business interests. Another issue is determining what constitutes an international public organization. Would this include non-profit organizations and non-governmental organizations? It is not unusual for Chinese laws to be vague, at least measured by U.S. standards. Broad terms give the PRC authorities leeway in enforcement and interpretation.

law applies to foreign nationals who make payments.<sup>109</sup> It is clear, however, that the law is designed to prohibit Chinese nationals from making payments to foreign officials. Despite ambiguities under Article 164, there is a likely scenario in which the same set of facts that cause a violation of Article 164 can also constitute a violation of the FCPA. For example, suppose that an MNC sets up a wholly foreign-owned enterprise or a joint venture in China.<sup>110</sup> The China business entity is considered to be a legal creature under Chinese law and qualifies as a Chinese legal person, with full rights and obligations under Chinese law.<sup>111</sup> Suppose that an employee, a U.S. citizen, of the MNC's China business entity now travels abroad or makes a payment to a foreign official in a third country to secure a contract for the purchase of goods or services. This type of scheme might violate Article 164 of the PRC Criminal Law because the payor works for a Chinese legal entity. This same transaction may also violate the FCPA because the employee works for a Chinese business entity owned by the MNC and that is acting on behalf of the MNC and because the employee has made a bribe to a foreign official. If the PRC authorities investigate such a case, the investigation can trigger an investigation by DOJ under the FCPA. While China is reluctant to publicly accuse its own officials, who are members of the Communist Party, China may be less concerned with public embarrassment when the payment is made to an official in a foreign country. Recent reports indicate that China intends to aggressively prosecute bribery by Chinese companies in foreign countries.<sup>112</sup> This trend could indicate that China intends to aggressively prosecute its new law against foreign bribery and that such actions might implicate U.S. companies in violations of the FCPA.

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<sup>109</sup> The FCPA applies to foreign nationals if the person makes an illegal payment while in the territory of the United States. See Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 78dd-1(a), 91 Stat. 1494 (2006), *amended by* Foreign Corrupt Practices Act Amendments of 1988, Pub. L. No. 100-418, tit. V, subtit. A, pt. 1, 102 Stat. 1415 *and by* International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, 112 Stat. 3302 (codified as amended in scattered sections of 15 U.S.C.). Article 164 of the P.R.C. CRIMINAL LAW, *supra* note 18, does not contain a similar provision so it is unclear whether it would apply to foreign nationals.

<sup>110</sup> For a detailed discussion of the wholly owned enterprise and the joint venture as business forms in China, see generally CHOW & HAN, *DOING BUSINESS IN CHINA*, *supra* note 1, at 85–160.

<sup>111</sup> See *id.* at 88.

<sup>112</sup> See *China to Curb Bribery by Companies Investing Abroad*, XINHUA ENG. NEWS (Apr. 20, 2012), [http://news.xinhuanet.com/english/china/2012-04/20/c\\_131541362.htm](http://news.xinhuanet.com/english/china/2012-04/20/c_131541362.htm) (discussing the Chinese government's concern about bribes given by Chinese companies in foreign countries). The news media in China is controlled by the state, so it is unclear whether these reports truly indicate a priority on the part of the Chinese government or are intended to serve propaganda goals.

#### IV. INTERNAL COMPLIANCE MEASURES

The discussion above indicates that MNCs must take forceful measures to deal with commercial bribery in China. It would be futile to attempt to implement a compliance program from the United States. These compliance measures must take the form of a program set up in China itself under the direction of a senior compliance officer who is permanently stationed in China. Many MNCs have existing internal compliance programs that are aimed at dealing with the FCPA. MNCs should combine any existing FCPA compliance programs with additional measures aimed at commercial bribery in China. In fact, MNCs should not even distinguish between the various types of bribes. All bribes should be proscribed, without any attempt to explain to company employees the differences between types of bribes or giving any reasons why bribes are prohibited.

MNCs should set forth clear written rules, with many specific examples, of what is prohibited and should make clear that termination of employment will be the result of violations. Training sessions should be held with employees placed in simulations and explanations should be given of what is prohibited. It should be emphasized that the point of the compliance program is not to teach employees that bribes are illegal, immoral, or harmful and could violate China's anti-bribery laws and the FCPA. Most employees, if they were being honest, would admit that they do not care that they are violating China's anti-bribery laws or that they will cause the company to be in violation of the FCPA. In fact, many employees are genuinely surprised and believe that they are being unfairly punished when they are disciplined for giving commercial bribes.<sup>113</sup> Many employees appear to truly believe that they are helping the company's business by obtaining purchase orders and that bribes are commonly used and are harmless.<sup>114</sup> The cultural attitude that there is nothing wrong with petty commercial bribery is so deeply ingrained that attempting to teach employees a different attitude could be futile and will probably be met with ridicule and derision. However, what employees do care about is losing their jobs, so an effective tactic would be a clear rule that giving bribes of any kind will result in immediate dismissal and, in appropriate cases, a report of the incident to PRC enforcement authorities. Then the rules must be rigorously enforced.

#### V. CONCLUSION

Many MNCs doing business in China are aware of the common practice of giving commercial bribes and have instituted controls to limit these schemes. However, these schemes are common, and new and ingenious methods are constantly being devised to circumvent the internal controls that are being put into place. It is the author's own observation and experience that while MNCs

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<sup>113</sup> This observation is based on the author's own working experience in China.

<sup>114</sup> *Id.*

do not tolerate commercial bribery and view it as a serious problem, MNCs do not consider commercial bribery to be the type of offense that could imperil the very existence of the company as a going concern. On the other hand, MNCs consider violations of the FCPA to be so serious as to pose a threat to the viability and continued existence of the company itself. This Article has argued, however, that MNCs should consider commercial bribery in China with the same level of concern because the many overlapping elements of both crimes can mean that a commercial bribery prosecution could lead to a collateral FCPA prosecution. Further, the many opportunities for whistleblowing of commercial bribery schemes in China's ruthlessly competitive marketplace can be a fertile source of information for DOJ of potential FCPA violations.

MNCs with China business entities need to raise their level of awareness of the seriousness of commercial bribery actions in China. The real risk for MNCs is not the PRC prosecution of commercial bribery, but the collateral DOJ action under the FCPA that might ensue. Forceful measures must be taken now to mitigate the growing risks that FCPA prosecutions involving China will increase significantly in the foreseeable future.

