An ALM Website

CORPORATE COUNSEL

January 11, 2012

From the Experts: Complying with the FCPA, Staying Competitive in China

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Increasingly, corporate counsel struggle to guide their companies in balancing compliance with the U.S. Foreign Corrupt Practices Act (FCPA) and business development in China. In China, gift-giving is a common business practice, and it is often difficult to identify who must be considered a "foreign official" under the FCPA. U.S. companies wishing to operate in the Chinese marketplace must design and implement an effective FCPA compliance program addressing the provision of gifts and other hospitality customs. This article offers practical advice regarding the design and implementation of an FCPA compliance program that balances the risks of gift-giving and the importance of staying competitive in China.

Gift-Giving in Chinese Business Culture

Gift-giving is a traditional introductory component of business transactions in China. The provision of gifts is often a prerequisite to even preliminary discussions with prospective Chinese business partners. In the Chinese model, gift-giving is important because the personal relationship is the foundation upon which business opportunity is built.

Chinese gift-giving dates back centuries and annually reaches a high point around the Chinese New Year, when "red envelopes" stuffed with cash are exchanged between business associates. The pressure to provide more cash and lavish gifts has been exacerbated by China's transition to capitalism. More and more, Communist Party leaders and employees of government-owned entities are tempted to use their positions to share in China's booming economy. In turn, prospective business partners are willing to provide expensive gifts with the expectation of a valuable business reward. The result is a high-risk corruption environment. Indeed, China ranked 78 out of 178 countries on Transparency International's 2010 Corruption Perception Index, behind Brazil, Ghana, and El Salvador.

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The FCPA's Anti-bribery Provisions, and What Constitutes a "Foreign Official"

The FCPA's anti-bribery provisions make it unlawful for any domestic concern to offer a corrupt payment to a foreign official for the purpose of obtaining or retaining business, or gaining a business advantage. A "domestic concern" includes any business entity organized under the laws of the United States or with its main place of business in the United States. A "corrupt payment" is anything of value intended to induce the recipient to misuse an official position to wrongfully direct business. A "foreign official" includes any officer or employee of a foreign government, instrumentality, or political party, regardless of rank or position.

"Facilitation payments" are excepted under the FCPA. Facilitation payments are nominal payments intended to expedite a routine governmental function. For example, a $25 payment to a customs inspector to immediately complete an inspection of a container of bananas sitting on a dock would likely be considered a facilitation payment under FCPA analysis.

There are two affirmative defenses to a violation of the FCPA's anti-bribery provisions: (1) the payment was lawful under the laws of the foreign official's government and (2) the payment was a reasonable expenditure directly related to the promotion of the payor's products or services, or the execution of a contract between the parties.

A particular challenge when evaluating business practices in China is determining who exactly is a "foreign official." Because so many businesses in China are state-owned (or the government is the majority shareholder), all employees of Chinese companies should initially be considered foreign officials for purposes of the FCPA. Further, many Chinese business executives are also Communist Party members.

U.S. authorities have taken an expansive view when identifying Chinese foreign

officials for FCPA purposes. For instance, in 2008 a U.S. medical device manufacturer agreed to pay a $2 million criminal penalty for payments it made to Chinese doctors. The doctors were considered foreign officials by the U.S. Department of Justice simply because they worked at government-owned hospitals. The DOJ also publicly stated that it considers journalists working at Chinese state-owned media outlets to be foreign officials.

Designing a FCPA Compliance Program for China

China presents a daunting challenge for corporate counsel: U.S. companies must embrace the opportunities offered by the opening of the Chinese market, while also recognizing that Chinese gift-giving tradition presents a high risk for corruption. This balance is best accomplished with a carefully planned FCPA compliance program. Following are practical tips for the design and implementation of such a program:

- Before entering the Chinese marketplace, U.S. companies should commit substantial resources to gaining a comprehensive understanding of the general Chinese business culture, as well as the business culture of the local region where the U.S. company plans to operate (remember that China is ethnically and culturally diverse, and its population and land area are larger than those of the United States). This is most easily accomplished by the retention of reputable local business consultants or local compliance officers. Local consultants or officers understand what is expected from Chinese business partners and are able to creatively identify acceptable gift-giving alternatives that comply with the FCPA.
- Determine if your prospective Chinese business partners are state-owned. This analysis should be conducted at the outset of the relationship and periodically updated. If there is any doubt, you should assume that the entity is state-owned and that all dealings with employees must be governed by your FCPA compliance program.
- Training should be culturally sensitive and in the local language to be effective and prevent errors in interpretation—particularly in regard to the definition of "foreign official."
- Gifts should be nominal in value and should be branded with your company's name and/or logo, to allow the gifts to be considered promotional under the FCPA's affirmative defenses.
- Consider requiring all hospitality and gift expenses to be made by company credit card, to assist the accounting function and discourage fraud. The receipt system in China is not precise or reliable.
- All gift and hospitality expenses should be recorded and reported via a pre-authorized expense report system, requiring a certification from the gift-giving employee that the gift is not to be given in exchange for any improper benefit.
- Gifts and hospitality should never be channeled through third-party intermediaries, such as consultants, distributors, or public relations firms.
- Be particularly wary of paying for employees of Chinese companies to travel to the United States. U.S. companies have been subject to FCPA liability because they paid for employees of Chinese companies to travel to the United States for "product demonstration," "training," or "factory inspections," when the trips included mostly tourist activities in U.S. cities where the U.S. company had little or no operations.
- Your compliance program should require that all travel expenses for product promotion and demonstration be modest, and implement controls to prevent and detect corruption. For example, payments should be made directly to travel providers, stopovers should not be allowed, and travel expenses for spouses and families should never be authorized.
- Design your program to prohibit facilitation payments. Remember that the facilitation payment exception applies only to nondiscretionary government function. Prudence counsels to stay clear of this exception until there is some type of concrete guidance regarding how it will be applied to gift-giving and hospitality in China.

While these points are by no means exhaustive, they provide the initial groundwork for an effective FCPA compliance program in China. Remember, implementation of a robust compliance program, while expensive and time-consuming, may save your company headache, negative publicity, and exponentially higher future costs. As the Chinese proverb states: "The best doctor prevents illness, an average doctor visits when the illness is imminent, and the unskilled doctor treats your present illness."

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