Why Compliance with the US Foreign Corrupt Practices Act Matters in China

How is it that US law can apply to certain Chinese companies and the conduct of Chinese business executives? The answer is the *Foreign Corrupt Practices Act* (FCPA), a broad-reaching US law enacted to prohibit bribery as a means of obtaining and retaining business. A common misperception in the business community is that the FCPA applies only to US companies and US citizens. However, under certain circumstances, the FCPA can also apply to the conduct of Chinese companies and Chinese business executives, making FCPA compliance crucial.

By Mike Koehler*

By all accounts, the Chinese government is increasing enforcement of its domestic corruption and bribery laws and Chinese business executives are no doubt well aware of the severe penalties and fines for engaging in bribery in China.[1] However, it may not be well understood that, under certain circumstances, Chinese companies and Chinese business executives engaging in bribery in China may also be subject to prosecution by the US government.[2]

This article does not aim to show how the actions of Chinese nationals employed by US companies in China can expose their US employer to FCPA liability – even though there have been several examples in recent years of this occurring. For instance, in December 2007, Lucent Technologies Inc. settled an FCPA enforcement action by agreeing to pay $2.5 million in combined fines and penalties based principally on the conduct of employees of its subsidiary in China.[3]

Rather, this article discusses how Chinese companies and Chinese business executives can directly be subject to US prosecution for violating the FCPA. As set forth below in more detail, there are at least three scenarios in which the FCPA can apply to the conduct of Chinese companies and Chinese business executives.

First, if a Chinese company lists shares on a US stock exchange, it becomes an "issuer" and is thus subject to the FCPA's books and records and internal control provisions, as well as its anti-bribery provisions to the extent any action is taken in the US in furtherance of a bribe payment.[4]

Second, if a Chinese company is a subsidiary of a US company, the Chinese subsidiary may be considered an agent of the US company and may itself be subject to the FCPA's anti-bribery provisions if it takes any action in the US in furtherance of a bribe payment.[5]

Third, if a Chinese business executive takes any action in the US in furtherance of a bribe payment, the executive is subject to the FCPA's anti-bribery provisions.[6]

These scenarios are not merely academic hypotheticals, but rather based on similar facts and circumstances from recent FCPA enforcement actions against foreign companies and foreign nationals.

AN OVERVIEW OF THE FCPA

The FCPA, an amendment to the US Securities Exchange Act of 1934, was enacted in 1977 to prohibit bribery as a means of obtaining or retaining business, and it is jointly enforced by the US Department of Justice (DOJ) and the US Securities and Exchange Commission (SEC). The FCPA generally prohibits those subject to its jurisdiction (including Chinese companies and Chinese business executives under the scenarios set forth above) from offering anything of value to a foreign official in order to obtain or retain business (the anti-bribery provisions).[7] The FCPA also requires companies that issue debt or equity in the US (including Chinese issuers) to keep books and records that accurately reflect the disposition of corporate assets and to maintain a system of internal accounting controls sufficient to maintain accountability of assets (the books and records and internal control provisions).[8]

In terms of the anti-bribery provisions, every Chinese business executive no doubt understands and appreciates that it is improper (even without fully understanding or appreciating the FCPA) to deliver a suitcase full of cash to a high-ranking member of the Chinese government to induce the official to use his or her influence in awarding a government contract. However, several elements of an anti-bribery violation have broad application, are not well understood or appreciated, and can result in FCPA exposure for a whole range of activity less culpable than such obvious scenarios.

Three key elements of an anti-bribery violation with broad application are "anything of value," "foreign official," and "obtain or retain business." The term "anything of value" is not defined in the FCPA but it has been broadly construed and can include not only cash but also other tangible and intangible benefits such as the payment of travel and entertainment expenses. The "obtain or retain business" element of an anti-bribery violation also has broad application. This element can be satisfied not only when something of value leads to a government contract, but also when the thing of value influences a foreign official to take action or refrain from taking action which allows the payor to conduct business in the general sense such as seeking reduced tax payments or obtaining a government issued license or permit.[9]

While the "anything of value" and "obtain or retain business" elements of an anti-bribery violation have broad application, it is the broad application of the "foreign official" element that is the most important in

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terms of FCPA compliance in China. The term "foreign official" includes "any officer or employee of a foreign government or any department, agency, or instrumentality thereof [...] or any person acting in an official capacity for or on behalf of any such government or department, agency or instrumentality ..."[10]

An individual can be classified as a "foreign official" under the FCPA not only by being a high-ranking member of government (or by virtue of being appointed to a government ministry or agency such as being a tax official or a customs official), but also by virtue of being employed by an "instrumentality" of a government. Once a company is deemed an "instrumentality" of a government, every single employee, from an administrative assistant to the chief executive officer, will be considered a "foreign official" for the purposes of the FCPA regardless of how local law may characterize the employee.

It is clear that US enforcement agencies view Chinese state-owned or state-controlled enterprises (SOEs) as being an "instrumentality" of the Chinese government and employees of SOEs as being "foreign officials" under the FCPA. What this means in terms of FCPA compliance in China can not be underestimated – personnel at Chinese companies subject to the FCPA must understand that employees of SOEs will be deemed "foreign officials" under the FCPA and interactions with such individuals will be governed by the FCPA.

The anti-bribery provisions also contain broad third-party payment provisions under which the actions of others (such as agents, distributors, and joint venture partners) can result in liability for those subject to the FCPA.[11] Thus, Chinese companies subject to the FCPA can not be willfully blind to the actions of business partners or funnel bribe payments through third-parties.

As to the books and records and internal control provisions, it is likely the case that an issuer will face an SEC enforcement action any time an improper payment is made (even if all the elements of an anti-bribery violation are not met). Such is the case 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 and the SEC will allege that had the company had effective internal controls, the improper payments would not have occurred.

Armed with this basic FCPA knowledge, Chinese companies and Chinese business executives can better understand how the FCPA presents real risks and exposure.

SCENARIOS IN WHICH CHINESE COMPANIES AND CHINESE BUSINESS EXECUTIVES CAN DIRECTLY BE SUBJECT TO US PROSECUTION FOR VIOLATING THE FCPA

A Chinese Company With Shares Listed on a US Exchange

Chinese companies are increasingly listing shares on US stock exchanges.[12] However, with the upside of access to US capital comes risk, and one of the consequences of a Chinese company listing shares on a US exchange (and thus becoming an "issuer") is that it becomes subject to a variety of US laws, including the FCPA. It is clear that the SEC, the primary enforcer of US securities laws, will hold Chinese issuers accountable under US securities laws. For instance, LDK Solar Co., a Chinese issuer listed on the New York Stock Exchange, has reportedly been under investigation by the SEC in connection with a financial reporting issue.[13]

Although no Chinese issuer has yet been prosecuted in the US for FCPA violations, it is likely only a matter of time before a Chinese issuer becomes entangled by the broad reach of the FCPA given the following FCPA enforcement trends: (i) an increase in overall FCPA enforcement activity; (ii) an increase in FCPA enforcement activity against foreign companies and foreign nationals subject to the FCPA; and (iii) an increase in FCPA enforcement activity concerning business activity in China.

That US enforcement agencies will not draw a distinction between US FCPA violators and foreign FCPA violators was made clear by the 2006 prosecution of Statoil ASA (Statoil), an international oil company headquartered in Norway with shares listed on the New York Stock Exchange. In announcing resolution of an FCPA enforcement action against Statoil (in which the company agreed to pay approximately $21 million in combined penalties and fines for making improper payments to Iranian government officials in connection with oil and gas field projects in Iran), a high-ranking DOJ official stated:

"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."[14]

US government enforcement agencies were able to prosecute Statoil for payments made to Iranian officials because the improper payments were made to a consultant through a US bank.[15] The Statoil enforcement action was the first criminal FCPA enforcement action against a foreign issuer for FCPA anti-bribery violations, but will surely not be the last. In fact, the largest FCPA investigation likely underway concerns the German issuer Siemens, which has already disclosed numerous payments in various countries that may have violated the FCPA.[16]

Statoil was not only prosecuted for violations of the anti-bribery provisions, but also charged with violations of the books and records and internal control provisions.[17] Unlike anti-bribery violations, there is no US nexus required for a foreign issuer to be charged with violating the books and records and internal control provisions (other than the fact that, as an issuer, the company must file reports with the SEC in the US). In the Statoil matter, the books and records and internal control violations were charged because the payments were improperly characterized on the company's books and records as "consulting fees" and because the company's internal controls did not detect and stop the payments.[18]

The Statoil enforcement action should alert Chinese issuers that if a bribery scheme has any nexus to the US (such as use of a US bank, use of US computer servers, etc.), the company could be subject to US prosecution. Such prosecutions could be based not only on a situation in which a Chinese issuer makes an improper payment to a high-ranking

government official in order to secure a government contract, but also, because of the broad scope of the anti-bribery provisions, a situation in which a Chinese issuer provides things of value to SOE employees in order to obtain or retain business. The Statoil enforcement action also should alert Chinese issuers that books and records and internal control violations will also likely be charged any time the company makes an improper payment.

Chinese issuers are not the only China-based companies that can directly be subject to US prosecution for violating the FCPA. Under certain circumstances, a Chinese subsidiary of a US company can also be prosecuted for FCPA violations.

A Chinese Subsidiary Company Acting as an Agent of a US Company

Even though foreign subsidiaries of US companies acting alone are generally not thought to be directly subject to the FCPA,[19] a Chinese subsidiary may nevertheless be directly subject to FCPA prosecution if US enforcement agencies conclude that the subsidiary acted as an agent of the US company and took action in the US in furtherance of an improper payment.

This aggressive theory of FCPA prosecution is best demonstrated by the DOJ's prosecution of DPC (Tianjin) Co. Ltd. (DPC (Tianjin)), the Chinese wholly-owned subsidiary of US issuer Diagnostic Products Corporation (DPC).[20] In 2005, DPC (Tianjin) pled guilty to violating the FCPA for making improper payments to physicians and laboratory personnel employed by Chinese government-owned hospitals (individuals deemed "foreign officials" under the anti-bribery provisions). The prosecution was based on the theory that DPC (Tianjin) acted as an "agent" of DPC in making the improper payments and because DPC (Tianjin's) General Manager and Deputy General Manager regularly sent proposed budgets and financial statements which contained the improper payments to DPC's offices in the US.

Given the extent of interaction between a US parent company and its Chinese subsidiaries (including the routine exchange of e-mails, budgets, financial statements, etc.) the theory of prosecution in the DPC (Tianjin) matter could conceivably subject any Chinese subsidiary of a US company to direct US prosecution any time it is found to have participated in a payment prohibited by the anti-bribery provisions.

A Chinese Business Executive Acts in the US In Furtherance of a Bribe Payment

The anti-bribery provisions can reach not only Chinese issuers and Chinese subsidiaries of US companies, but also Chinese business executives individually if the executive acts in the US in furtherance of an improper payment.[21]

That US government enforcement agencies will aggressively pursue individual FCPA violators, regardless of the individual's nationality, is best demonstrated by the 2007 prosecution of Christian Sapsizian, a French citizen and former executive of French issuer Alcatel CIT, who pled guilty to violating the FCPA in connection with improper payments to Costa Rican government officials.[22] US enforcement agencies were able to prosecute the French citizen for making improper payments to Costa Rican foreign officials because Sapsizian processed various payment requests from a consultant (which were used to fund the improper payments) through his employer's bank account at a US bank.[23]

By engaging in payment schemes prohibited by the FCPA, Chinese business executives employed by Chinese issuers also risk SEC charges for violating and/or aiding and abetting violations of the books and records and internal control provisions. For instance, in September 2007, the SEC filed a settled civil action against Chandramowli Srinivasan, an Indian resident who was the president of a unit of a subsidiary of US issuer Electronic Data Systems Corporation (EDS).[24] According to the SEC's complaint, Srinivasan made improper payments, either directly or indirectly, to Indian officials in order to obtain business. The payments were funded through fabricated invoices that were ultimately incorrectly recorded on EDS's books and records.[25] Based on this conduct, the SEC charged Srinivasan with knowingly falsifying EDS's books and records and knowingly circumventing or knowingly failing to implement a system of internal controls – all in violation of the books and records and internal control provisions.[26]

CONCLUSION

One of the overlooked consequences of globalization is the application of one nation's laws to companies and individuals from other nations. As demonstrated above, such a result occurs when Chinese companies and Chinese business executives are subject to the FCPA. Accordingly, Chinese business executives must understand the circumstances under which the FCPA applies and be able to recognize FCPA issues. It is hoped that this article addresses these issues and steers Chinese companies and Chinese business executives subject to the FCPA down the path of FCPA compliance.

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Endnotes

1 See, e.g., Brandon Kirk, "Managing Risks In China – Bribery, Corruption, and Little Red Packets, CLP November 2007.
2 For more information about the issues in this article please also visit www.fcpaenforcement.com
3 See Department of Justice Release No. 07-1028 (December 21 2007); *Securities and Exchange Commission v. Lucent Technologies Inc.* (D.D.C. December 21 2007).
4 See 15 U.S.C. § 78dd-1(a).
5 See id.
6 See 15 U.S.C. § 78dd-3(a).
7 See 15 U.S.C. §§'s 78dd-1, 78dd-3.
8 See 15 U.S.C. § 78m(b).
9 See, e.g., *US v Kay*, 359 F.3d 738 (5th Cir. 2004).
10 15 U.S.C. § 78dd-1(f)(1).
11 See 15 U.S.C. § 78dd-1(a)(3).
12 See "Partial Eclipse: LDK Solar Highlights China Stocks' Risk," *The Wall Street Journal* (October 20 2007) (noting that approximately 75 mainland Chinese companies are listed on major US markets).
13 See id.
14 See "US Resolves Probe Against Oil Company that Bribed Iranian Official," US Department of Justice News Release (October 13 2006).
15 See *US v. Statoil, ASA*, (S.D.N.Y. October 13 2006).
16 See e.g., Siemens Form 6-K (filed with the SEC November 8 2007).
17 See SEC Release No. 54599 (October 13 2006).
18 See id.
19 See H.R. Conf. Rep. No. 95-831, at 14 (1977), reprinted in 1977 U.S.C.C.A.N. 4098.
20 See *US v. DPC (Tianjin) Co. Ltd*, (C.D. Cal. May 20 2005).
21 See 15 U.S.C. § 78dd-3(a).
22 See *US v. Sapsizian*, (S.D. Fla. June 6 2007).
23 See id.
24 See *SEC v. Srinivasan*, (D.D.C. September 25 2007).
25 See id.
26 See id.