

RECENT DEVELOPMENTS

AVOIDING THE PITFALLS OF “HIDDEN RULES” CHINESE GRAFT LAWS AND THE FCPA

By Robert Q. Lee, Sumeet H. Chugani, Vincent Li and
Xingjian Zhao

On July 28, 2009, the U.S. Securities and Exchange Commission (“SEC”) announced its settlement of civil and administrative charges brought pursuant to the Foreign Corrupt Practice Act (FCPA)¹ against Avery Dennison Corporation (“Avery”), a multinational corporation that specializes in the manufacture and sale of self-adhesive materials and office equipment.² From 2002 through 2005, both Avery and its local subsidiaries had engaged in a number of illegal transactions in China, Indonesia and Pakistan.³ These transgressions included bribing government officials, paying kickbacks to the executives of its corporate customers and hosting “sightseeing trips” for local bureaucrats.⁴ In one such instance, Avery executives in China agreed to pay a kickback to the project manager of a state-owned end customer. In order to conceal this illegal payment, the sales manager requested that a local distributor fill all order forms, and subsequently refund the agreed-upon kickback from the distributor’s expected profit. The corrupt transaction was disguised as a sale to the distributor, rather than the state-owned end user.

In another notable instance, Avery’s executives in China managed to procure two government contracts by agreeing to pay kickbacks to an institute affiliated with the PRC police ministry.⁵ Avery had devised a plan to artificially increase sales prices, and then refund the surplus amount to the local institute as “consulting fees.”⁶ All payments were presumably made for the personal benefit of institute officials.⁷ Although these illegal

¹ See Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (1977) (codified as amended at 15 U.S.C. §§78m(b), (d)(1), (g)-(h), 78dd-1 to -3, 78ff (2002)). See also 18 U.S.C. §§ 1341, 1343 (2008) (related mail and wire fraud statutes), 18 U.S.C. § 1952 (2002) (providing for federal prosecutions for violations of state commercial bribery statutes).

² SEC Files Settled Charges Against Avery Dennison Corporation for Violating the Books and Records and Internal Controls Provisions of the Foreign Corrupt Practice Act, Litigation Release No. 21156, Accounting and Auditing Enforcement Release No. 3020 (Jul. 28, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr21156.htm> (last visited Feb. 8, 2010).

³ *In re Avery Dennison Corp.*, SEC Cease-And-Desist Order File No. 3-13564 at 5 (Jul. 28, 2009), <http://www.sec.gov/litigation/admin/2009/34-60393.pdf> (last visited Feb. 8, 2010).

⁴ *Id.* at 5-6.

⁵ Cmpl. at ¶ 11, *S.E.C. v. Avery Dennison Corp.*, No. CV09-5493 DSF (CWx) (C.D.Cal. Jul. 28, 2009).

⁶ *Id.*

⁷ *Id.*

transactions were planned and conducted by *individual* executives at Avery's Chinese subsidiary, which is controlled by Avery's U.S. headquarters through intermediary corporate entities in Denmark and Hong Kong, the SEC nonetheless held Avery liable for FCPA violations.⁸ Avery's punishments were steep: In the administrative proceeding, the SEC ordered Avery to cease and desist from further illegal conduct violating the FCPA and to disgorge \$273,213 USD of its profits, along with \$45,257 USD in prejudgment interest.⁹ In the federal action, Avery agreed to the entry of a final judgment ordering payment of \$200,000 USD.¹⁰

Avery, unfortunately, is not the only multinational firm that has been caught violating FCPA provisions in China. According to the *China Youth Daily*, recent commercial bribery scandals in China have implicated such prominent multinational corporations as McKinsey, Alcatel-Lucent, IBM, Walmart, Coca-Cola, the Diagnostic Products Corporation ("DPC") and many more.¹¹ In the DPC case, for example, the Tianjin subsidiary of the world's largest medical diagnostic equipment manufacturer was found to have paid multiple bribes in the aggregate of \$1.6 million USD to a Chinese state-owned hospital between 1991 and 2002.¹² DPC used this scheme for the sole purpose of convincing these state-owned hospitals to purchase and use its goods.¹³ DPC's profits from the resulting purchases amounted to \$2 million USD, a sum dwarfed by DPC's subsequent disgorgement of \$2.8 million USD in ill-gotten gains and its payment of upwards of \$4.78 million USD in fines.¹⁴ DPC's story exemplifies the fact that non-compliance with the FCPA is simply not worth the risk.

In the United States, businesses caught paying kickbacks or engaging in alternative forms of commercial bribery face severe civil and criminal sanctions at both the state and federal levels.¹⁵ Unfortunately, this is not the case in China. Commercial corruption in the form of kickbacks, extravagant gifts or other less obvious means of bribery in exchange for business opportunities has been common practice for centuries and is an unavoidable norm deeply entrenched within the Chinese business culture.

⁸ *Id.* at ¶¶ 8, 19 & 21 (emphasis added).

⁹ *In re Avery Dennison Corp.*, *supra* note 3, at 6; see also SEC Files Settled Charges Against Avery Dennison Corporation for Violating the Books and Records and Internal Controls Provisions of the Foreign Corrupt Practice Act, *supra* note 2.

¹⁰ SEC Files Settled Charges Against Avery Dennison Corporation for Violating the Books and Records and Internal Controls Provisions of the Foreign Corrupt Practice Act, *supra* note 2..

¹¹ *Kua guo gong si pin shang shang ye hui lu bang dan: Zhongguo shi chang qianguize zhi gou?*, [Multinational Companies Dominate List of Commercial Bribery Cases: An Indictment of the Chinese Market's Hidden Rules], Aug. 3, 2009, ZHONGGUO QINGNIAN BAO (CHINA YOUTH DAILY), available at http://www.chinaworks.be/index.php?option=com_content&view=article&id=38:mno&catid=1:laatstenieuws&Itemid=15 (last visited Feb. 8, 2010).

¹² Press Release, United States Department of Justice, DPC (Tianjin) Ltd. Charged with Violating the Foreign Corrupt Practice Act (May 20, 2005) (on file with author), <http://www.justice.gov/criminal/fraud/press/2005/dpcfcpa.pdf> (last visited Feb. 8, 2010).

¹³ *Id.*

¹⁴ *Id.*

¹⁵ See, e.g., 42 U.S.C. § 1320a-7b(b) (2006) (prohibiting kickbacks to induce referrals of items or services covered by federally funded health insurance programs), 18 U.S.C. §§ 1961-68 (2006), *et seq.* (the federal Racketeer Influenced and Corrupt Organizations Act [RICO Act]). See also FLA. STAT. § 895.03, *et seq.* (the state of Florida's parallel to the federal RICO statute).

These prevalent practices are referred to as “hidden rules,” or *qianguize*, meaning unspoken rules that players in the field tacitly follow. In the medical equipment industry, for example, prevailing customs make it nearly impossible for a manufacturer to obtain purchase orders from a hospital unless it pays kickbacks to hospital administrators.¹⁶ According to Du Zhou, a reporter/columnist for China’s *IT Times*, the “kickback” rule in the medical equipment industry is so widely celebrated and practiced that it is an understatement to call it a “hidden rule.”¹⁷ It is just a rule.¹⁸

Accordingly, for a purchase order of medical equipment worth five million Renminbi (RMB), hospital administrators would typically demand kickbacks in the amount of one million RMB, or twenty percent of the order’s total worth.¹⁹ These “kickbacks” are included in the price paid to the seller but are eventually refunded to the state-owned hospital’s administrators. Of course, neither the seller’s nor the buyer’s financial records will reflect the payment of these kickbacks. Consequently, in any given transaction, a portion of the money paid by the hospital ended up in the pockets of the hospital’s own administrators. The same pattern holds true in China’s expanding pharmaceutical industry. Data from 2006 suggests that “China’s pharmaceutical industry bribes annually robbed 772 million RMB worth of state assets, or about 16% of all taxes paid by the industry for the whole year.”²⁰

Although kickbacks are the most common and obvious form of commercial bribery, commercial bribery can take on many other forms, such as luxurious “sightseeing tours” disguised as business trips, corrupt payments written off as “consulting fees,” hiring the bribee’s relatives and paying them lavish compensations, financially supporting the bribee’s children to study abroad or providing the bribee with free EMBA training.

I. Legal Risks for U.S. Companies Engaging in Commercial Bribery in China

The dilemma is obvious: either choose to conform and play by the “hidden rules,” or be an outlier and refuse to follow them at the risk of incurring a severe competitive disadvantage within a business culture driven by corrupt practices. As the *Avery* and *DPC* cases have demonstrated, following “hidden rules” entails serious legal risks since such conduct will most likely fall under the purview of the FCPA. Recently, the Chinese government has also become more aggressive in implementing its own anti-commercial bribery regulations and has issued more judicial interpretations specifically targeting commercial bribery.²¹ Although it is too early to predict how successful these new

¹⁶ Zhou Du, *You jian qian gui ze – kua guo gong si zai hua shang ye hui lu diao cha* [Hidden Rules Again – An Investigation of Commercial Bribery by Foreign Multinational Companies in China], IT SHIDAI ZHOUKAN [IT TIMES (CHINA)], Sept. 11, 2009, available at <http://www.ittime.com.cn/content.asp?id=7423> (last visited Feb. 8, 2010).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Commercial Bribery Serious Economic Problem*, CHINA ECONOMIC NET, Mar. 24, 2006, available at http://en.ce.cn/Business/Macro-economic/200603/24/t20060324_6477807.shtml (last visited Feb. 8, 2010).

²¹ See, e.g., *China Busts 6,200 Briberies*, AGENCE FRANCE-PRESSE (AFP), Feb. 23, 2009, available at http://www.straitstimes.com/Breaking%2BNews/Asia/Story/STIStory_341996.html (last visited Feb. 9,

administrative and judicial measures will be in reforming China's long-standing business culture, they will undoubtedly alter the calculus of costs and benefits associated with the practice of commercial bribery. To multinational companies willing to play by the "hidden rules," these new measures increase the costs of conducting commercial bribery, by making such firms vulnerable to multiple sanctions imposed not only by the United States, but also by China. Moreover, investigation or prosecution in one jurisdiction may expose the firm to parallel sanctions in the other.

II. The FCPA and its Enforcement Mechanisms

Home to robust trade and ever-increasing business opportunities, China has become an extremely attractive destination for foreign business and investment. This trend, joined with widespread corruption in China and the fact that China's government has a hand in managing the nation's business and trade sector, creates a fertile breeding ground for FCPA violations.²² Business leaders must take this overshadowing reality into account in the face of China's lure of profits and big business.

The U.S. Congress enacted the FCPA in 1977 to halt bribery and subornment by U.S. companies as a means of obtaining or preserving foreign business. Passed during Watergate's aftermath, this amendment to the Securities Exchange Act of 1934 generally prohibits U.S. citizens and corporations from corruptly paying or offering gifts to "foreign officials" directly or through third parties with the purpose of "obtaining or retaining business for or with, or directing business to, any person."²³ The FCPA also requires corporations registered or filing reports with the SEC to engage in strict record-keeping that accurately detail their corporate spending, disposition of assets and internal controls.²⁴ Enforcement of these statutory provisions are divided between the SEC for anti-bribery and recordkeeping functions, and the U.S. Department of Justice (DOJ) both for criminal enforcement and for civil enforcement against non-public companies and nations. Although this article will briefly highlight the FCPA's accounting provisions, it will primarily focus on the statute's anti-bribery provisions, which is more relevant to the topic of this comparative discussion.

a. Accounting Provisions

The FCPA's accounting provisions require companies registered or filing reports with the SEC to adhere to stringent accounting standards.²⁵ Pursuant to 15 U.S.C. § 78m(b)(2), a corporation must both create and regularly update record-keeping

2010). See also Chen Feng, *China Hunts Commercial Bribery in Industrial, Commercial Sectors*, XINHUA NEWS AGENCY, Sept. 14, 2006, available at http://www.gov.cn/english/2006-09/14/content_389067.htm (last visited Feb. 8, 2010).

²² See *China and India Rank in the Middle of Global Corruption Index*, 2POINT6BILLION.COM, Nov. 18, 2009, available at <http://www.2point6billion.com/news/2009/11/18/china-and-india-rank-in-the-middle-of-global-corruption-index-3056.html> (last visited Feb. 9, 2010) (China ranks as the 79th most corrupt nation out of the 180 measured). See also Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (1977) (codified as amended at 15 U.S.C. §§78m(b), (d)(1), (g)-(h), 78dd-1 to -3, 78ff (2006)).

²³ See 15 U.S.C. §§ 78dd-1 to -3, 78ff (2006) (the FCPA's anti-bribery provisions).

²⁴ See 15 U.S.C. § 78m(b)(2) (2006) (the FCPA's accounting provisions).

²⁵ See 15 U.S.C. § 78m(b)(2) (2002).

functions that accurately reflect all of its corporate transactions while maintaining an adequate system of internal accounting controls.²⁶ Failure to meet the high thresholds of the statute's recordkeeping and internal control standards will form a basis for both civil and criminal liability.²⁷ Consequently, most corporations doing business in China must create and implement adequate compliance programs evidencing corporate intention to comply with the FCPA. Regular reporting and constant self-monitoring have become not only the norm, but a necessity, when doing business in China.

b. Anti-Bribery Provisions

Pursuant to 15 U.S.C. §§ 78dd-1, -2, and -3, the anti-bribery provisions of the FCPA criminalize the use of corruptive bribery tactics upon foreign officials to induce unlawful action.²⁸ Essentially, the FCPA prohibits U.S. entities from engaging in illegal conduct in order to gain undue advantage over business competitors abroad. Unlike the accounting provisions, the anti-bribery provisions apply to *both* individuals and businesses. Pursuant to the 1998 amendments to the FCPA, "any person" may be held criminally liable for commercial bribery.²⁹ This means that individual employees, their corporate employers, and even certain stockholders may be prosecuted for FCPA violations. This prohibition also applies to businesses creating joint venture partnerships within China.³⁰ Many joint venture partners in China may be well-accustomed to the "hidden rules" and may themselves be – wittingly or unwittingly – practitioners of this unscrupulous custom. This acquiescence, however, violates the FCPA.³¹ Such practices by the Chinese partners will undoubtedly threaten prosecution for the U.S. venture partner.

The relevant FCPA provisions apply to any "offer, payment, promise to pay, or authorization of the payment of any money . . . or gift" to any foreign official, political party affiliate or candidate for political office.³² These conditions apply only to situations in which a "corrupt" purpose is present.³³ The payment must be intended to induce the recipient to exploit his or her official capacity and illegally direct business to either the

²⁶ See 15 U.S.C. §§ 78m(a)-(b) (2002).

²⁷ See, e.g., Thomas Fox, *FCPA Compliance and FCPA Enforcement: A Look Ahead to 2009 and Beyond*, CORPORATE COMPLIANCE INSIGHTS, May 19, 2009 available at <http://www.corporatecomplianceinsights.com/2009/fcpa-compliance-fcpa-enforcement-obama-mcnulty-ashcroft-comments-on-foreign-corrupt-practices-act> (last visited Feb. 9, 2010). This article discusses the 2009 charges against Halliburton, in which the company's internal controls failed to detect and prevent the bribery of Nigerian officials. Halliburton settled by agreeing to pay a fine of \$402 million, plus profit disgorgement of \$177 million. *Id.* This case demonstrates the sheer magnitude of the FCPA's power and impact when companies slip on compliance practices.

²⁸ 15 U.S.C. §§ 78dd-1 to -3 (2006).

²⁹ 15 U.S.C. § 78dd-1(g) (1998).

³⁰ Hank Bourg and Peter O'Neil, *Staying Complaint in China under the FCPA*, CHINA BRIEFING, Jul./Aug. 2009, available at <http://www.china-briefing.com/article/staying-compliant-china-under-the-fcpa-656.html> (last visited Feb. 9, 2010) (" . . . any violation of FCPA standards by one of those [joint venture] parties could result in the American company being vicariously liable under the FCPA.").

³¹ See *id.*

³² 15 U.S.C. §§ 78dd-1(a), (g) (for issuers); 78dd-2(a)(1)-(2), (f)(2)(A) (for domestic concerns); 78dd-3(f)(1), (2)(A)(B) (for any "person").

³³ *Id.*

payer or a third party. The corrupt act, however, need not succeed in its purpose for FCPA liability to attach. The FCPA's transactional prohibitions extend not only to monetary payments but far more broadly to "anything of value."³⁴ Note, however, that payments made to officials to secure performance of "routine governmental action" are explicitly exempted from FCPA liability.³⁵

In order to violate the FCPA, the offer must be made to a "foreign official."³⁶ This broad definition encompasses anyone working for a government-owned or managed institution or enterprise.³⁷ In addition, employees of international organizations have also been interpreted as foreign officials under the FCPA.³⁸ This is where the perplexities of conforming to the FCPA *explode* in China. China is rife with state-owned and state-controlled enterprises.³⁹ This creates considerable risks to foreign companies seeking to "break bread" in China. Companies disbursing funds to assumed private enterprises pursuant to China's customary "hidden rules" may find themselves in direct breach of the FCPA. Due to China's collectivist approach, any attempt to distinguish state-owned enterprises from private ones may prove perilous without proper investigation.

Foreign companies, professional advisors and joint venture partners within China face serious legal consequences and monetary risks when they acquiesce to the customary "hidden rules" or engage in any value-backed persuasion with Chinese officials or state-owned enterprises. The terms of these "hidden rules," which are typically in breach of FCPA provisions, will render foreign corporations and their affiliates liable under the statute's anti-bribery and record-keeping functions. Such adverse consequences are not limited to the purview of the FCPA. Private litigation based on the Racketeer Influenced and Corrupt Organizations Act (RICO) has become another source of concern and panic among foreign businesses. Lastly, the Chinese government has intensified its pursuit of both civil and criminal liability for commercial bribery.⁴⁰

³⁴ *Id.*

³⁵ See 15 U.S.C. §§ 78dd-1(b) (for issuers); 78dd-2(b) (for domestic concerns); 78dd-3(b) (for any "person"). In accordance with the 1998 amendments to the FCPA, "grease payments" or payments made to local officials to secure performance of "routine governmental action" are exempted from liability. In short, "grease payments" allow expediting an activity that a government employee should routinely do. Examples of grease payments including routine permits, visas and work orders, mail and delivery, phone service, power supply and the like. These actions are deemed non-discretionary and therefore do not encourage or award new business. However, the scope of this exception is narrow, for it does not include "any decision by a foreign official whether, or on what terms, to award new business to or to continue business with a particular party, or any action taken by a foreign official involved in the decision-making process to encourage a decision to award new business to or continue business with a particular party." 15 U.S.C. §§ 78dd-1(f)(3)(A) (for issuers); 78dd-2(h)(4)(B) (for domestic concerns); 78dd-3(f)(4)(B) (for any "person").

³⁶ 15 U.S.C. §§ 78dd-1(a), (f)(1) (for issuers); 78dd-2(a)(1)-(2), (h)(2)(A) (for domestic concerns); 78dd-3(f)(1), (2)(A), (B) (for any "person").

³⁷ *Id.*

³⁸ *Id.*

³⁹ Bourq and O'Neil, *supra* note 30.

⁴⁰ See, e.g., Zui Gao Renmin Fa Yuan he Zui Gao Remnin Jian Cha Yuan guan yu ban li shang ye hui lu an jian shi yong fa lü ruo gan wen ti de yi jian [Opinions from the Supreme People's Court and the Supreme People's Procuratorate of the People's Republic of China Regarding Several Issues of the Laws Applicable to Commercial Bribery Cases] (promulgated by the Supreme People's Court and the Supreme People's

III. Anti Commercial Bribery Law in China

In China, adherence to “hidden rules” and engagement in “gift-giving” has been long understood as a necessary step towards earning a profit. This paradigm is beginning to shift. More rigorous enforcement of anti-bribery laws has led to the exposure of many corrupt business tactics employed by such established and reputable corporations as Coca-Cola and Rio Tinto. Unquestionably, the Chinese government has intensified its enforcement of anti-corruption laws in order to create a more level playing field. However, foreign companies, especially those under the purview of the FCPA, question whether China is going far enough.

China’s Anti-Unfair Competition Law (“AUCL”) defines commercial bribery as “secretly giving and receiving money, property, or other benefits relating to transactions between business persons and entities, unless the giving or receipt of money, property, or other benefits are reflected in the financial books of the giver and the recipient.”⁴¹ According to Article 8 of the AUCL, commissions and discounts are considered illegal bribes unless they are recorded in the company’s financial books.⁴² AUCL provides for criminal sanctions against those who violate Article 8 and authorizes China’s State Administration for Industry and Commerce (“SAIC”) to investigate violations and impose sanctions.⁴³ As the agency in charge of administering all industrial and commercial enterprises, the SAIC enforces Article 8 by imposing strict monetary penalties – fines ranging from 10,000 to 200,000 RMB (approximately \$1,500 to \$30,000 USD) and the disgorgement of ill-obtained profits.⁴⁴

Three years after AUCL’s enactment, the SAIC adopted Decree 60 – Interim Rules on the Prohibition of Commercial Bribery – to amend Article 8.⁴⁵ Decree 60 seeks to clarify the definition of commercial bribery by providing, among other things, that: (1) commercial bribery includes not only kickbacks disguised as “promotion fees,” “advertising fees,” “support,” “research and development fees,” “labor fees,” “consulting fees,” and hidden commissions, but also “free sightseeing tours” or similar less tangible benefits; (2) gifts to customers and/or their representatives are prohibited, unless such gifts qualify as “small advertisement items” pursuant to trade custom; (3) commercial bribery committed by employees will be imputed to their employers as violation of AUCL; (4) secret refund, which is defined as “unrecorded refund of cash or property representing a percentage of the purchase price to the customer company or any individual employee,” is considered commercial bribery and thereby prohibited;

Procuratorate, Nov. 20, 2008), available at http://www.china.com.cn/policy/txt/200811/25/content_16820528_2.htm (last visited Feb. 10, 2010).

⁴¹ Zhonghua Renmin Gongheguo fan bu zheng dang jing zheng fa [People’s Republic of China Anti Unfair Competition Law] (promulgated by the Standing Comm. Nat’l People’s Cong., Sept. 2, 1993, effective Dec. 1, 1993), available at http://www.law-lib.com/law/law_view.asp?id=245 (last visited Feb. 10, 2010).

⁴² *Id.* at art. 8.

⁴³ *Id.* at arts. 17-19.

⁴⁴ *Id.* at art. 24.

⁴⁵ Guan yu jing zhi shang ye hui lu xing wei de zhan xing gui ding [Interim Rules Prohibiting Commercial Bribery] (promulgated by China’s State Administration for Industry and Commerce, Nov. 15, 1996), available at http://library.jgsu.edu.cn/zscq/04/Product3/Law/18_Oppose_dump/18_Oppose_dump1899.htm (last visited Feb. 10, 2010).

(5) recipients of cash or property given to them as bribes will be liable to the same extent as the briber; (6) as a safe harbor rule, discount on and/or refund from purchase prices are permissible as long as the giving and the receipt of such discount/refund is recorded in both the seller and buyers' financial books in accordance with accepted accounting standards; and (7) commissions to middlemen are permissible, so long as payment of such a commission is disclosed in the company's financial books.⁴⁶

Notably, the AUCL curtails "under-the-table" payments that are made to influence business decisions. This provision only targets the "hidden rules" and does not prohibit certain traditional business practices such as open rebate, open discount or commission payment.

If the amount seized in a corruption investigation is "substantially large," criminal prosecution will ensue. China's Criminal Code⁴⁷ outlines prosecution for eight corruption-driven offenses: (1) acceptance of bribes by non-government (or "enterprise") employees [Art. 163]; (2) offering bribes to non-government employees [Art. 164]; (3) acceptance of bribes by government employees [Art. 385]; (4) acceptance of bribes by organizations [Art. 387]; (5) offering bribes to government functionaries [Art. 389]; (6) paying bribes to organizations [Art. 391]; (7) introducing a briber to a government employee [Art. 392]; and (8) payment of bribes by an organization [Art. 393].⁴⁸

To amount to a "prima facie" claim, an offense must involve an amount that is either "substantially large" or "huge."⁴⁹ For the acceptance of bribes by non-government employees, the sentence is between from one month and five years for a "substantially large" infraction and five years or above for an amount designated as "huge."⁵⁰ If an individual is found to have paid bribes to non-government employees, the sentence ranges between one month and three years if the amount involved is "substantially large," and between three to ten years if the amount is designated as "huge."⁵¹ The provincial judiciary, in conjunction with provincial law enforcement agencies, is empowered to establish the precise thresholds for "substantially large" and "huge."

In Shanghai, for example, the standard for "substantially large" as set forth in the Opinions Regarding the Applicable Standards in the Prosecution and Trial of Certain Crimes – jointly issued by the Shanghai High People's Court, Shanghai High People's Procuratorate, Shanghai Public Security Bureau and Shanghai Department of Justice – is 15,000 RMB (about \$2,100 USD), while an amount of 100,000 RMB (about \$15,000 USD) qualifies as "huge."⁵² By these standards, a person *receiving* \$15,000 USD in

⁴⁶ *Id.* arts. 2-8.

⁴⁷ *See* Zhonghua Remin Gongheguo xing fa [Criminal Law of the People's Republic of China] (enacted by the Second Session of the Fifth National People's Congress ("NPC") on Jul. 1, 1979, as amended by the Fifth Session of the Eighth NPC on Mar. 14, 1997), available at <http://www.colaw.cn/findlaw/crime/criminallaw1.html> (last visited Feb. 10, 2010).

⁴⁸ *Id.*

⁴⁹ *See, e.g., id.*

⁵⁰ *Id.* at art. 163.

⁵¹ *Id.* at art. 164.

⁵² Guan yu ben shi ban li bu fen xing shi fan zui an jian biao zhun de yi jian [Opinions Regarding the Applicable Standards Governing this City's Prosecution of Certain Crimes] (promulgated by the Shanghai

bribes from a customer would face at least five years in prison, while a person *giving* the same amount in bribes *may* face a sentence of three years.

Economists believe that the sheer prevalence of corrupt practices in China's cloudy business world renders the enforcement of Chinese government laws against bribery particularly difficult. However, a recent upswing in commercial bribery enforcement actions against large corporations has heightened the fear of prosecution. According to a May 15, 2009 press release from Xinhua,⁵³ administrative authorities in China prosecuted 583 enforcement actions for anti-bribery violations during the first quarter of 2009.⁵⁴ Among those cases, 19.01% involved retail business, 11.30% involved telecommunications businesses, 7.36% involved construction businesses and 6% involved medical equipment and pharmaceutical businesses.⁵⁵

Prosecutions against multinational companies for commercial bribery are also prevalent. For example, in one high-profile case from 2007, a Shanghai-based IT company was discovered to have bribed employees of various multinational companies, including McKinsey, McDonald, Whirlpool and Xerox, to procure IT network installation contracts.⁵⁶ In another case involving Coca-Cola, two former employees of Shenmei, Coca-Cola's primary local bottler in Shanghai, were detained and investigated for extracting kickbacks from suppliers.⁵⁷ The recent prosecution of Stern Hu, an Australian citizen and the British-Australian mining giant Rio Tinto's chief representative in China, also includes commercial bribery charges based on bribes given to senior managers of Chinese steel enterprises in exchange for business contracts. The message is clear: the government can pursue anyone at any moment. The increasing rate of prosecutions for commercial bribery offenses in China illustrate that the Chinese Government is ready and willing to do so.

In a Judicial Opinion regarding the Applicable Laws Governing Commercial Bribery Crimes, the Supreme People's Court and the Supreme People's Procuratorate identified several industries of particular concern: medical institutions, schools and educational institutions, and public bidding.⁵⁸ One provision within this Judicial Opinion distinguishes bribery from a *bona fide* gift by using a four-factor test:

Municipal High People's Court, Shanghai Municipal High People's Procuratorate, Shanghai Municipal Public Security Bureau, and Shanghai Municipal Department of Justice on Oct. 25, 2000), *available at* <http://www.ronglaw.com/news/info.asp?id=477> (last visited Feb. 10, 2010).

⁵³ The Xinhua News Agency is the PRC government's official press agency.

⁵⁴ Yi ji du gong shang ji guan cha chu shang ye hui lu an jian 584 jian [State Administration for Industry and Commerce Authorities Investigated and Handled 584 Commercial Bribery Cases During the First Quarter], *available at* http://news.xinhuanet.com/newscenter/2009-05/15/content_11378239.htm (last visited Feb. 10, 2010).

⁵⁵ *Id.*

⁵⁶ Qing Lei, *Zai hu wai qi juan ru "xing hui men"* [Foreign Enterprises in Shanghai Involved in Bribery Scandals], CBF ZHONGGUO JINGMAO JUJIAO [CBG China Economics and Trade Focus], Mar. 2007, at 88-89, *available at* <http://www.gotoread.com/vol/4599/page480539.html> (last visited Feb. 10, 2010).

⁵⁷ *Coca-Cola Probe Leads to Multiple Bribes*, CHINA DAILY, Sept. 17, 2009, *available at* http://www.china.org.cn/china/news/2009-09/17/content_18543520.htm (last visited Feb. 10, 2010).

⁵⁸ Opinions from the Supreme People's Court and the Supreme People's Procuratorate of the PRC Regarding Several Issues of the Laws Applicable to Commercial Bribery Cases, *supra* note 41.

(1) The nature of prior transactions and the relationship between the parties, including family connections and friendship; (2) the value of the gift; (3) the reason for, timing of, and means of gift-giving, and whether the recipient is requested to confer a reciprocal benefit to the giver based on the recipient's position; and (4) whether the recipient actually used his/her position to confer a benefit upon the giver.⁵⁹

The question remains as to how this Opinion can be reconciled with Decree 60, which contains a blanket prohibition on the exchange of gifts other than small advertisement items.⁶⁰

IV. Compliance

Undoubtedly, the FCPA puts U.S. firms and citizens at a competitive disadvantage when operating in China's business and trade sector. To the extent the "hidden rules" remain customary practices within China's business community, it harms foreign businesses, which must not only comply with China's anti-corruption laws but also with analogous and possibly more stringent laws – such as the FCPA and its various counterparts – promulgated within their home countries. If China is indeed serious in its more rigorous enforcement of anti-corruption laws, then this creates a more equitable business landscape for multinationals. Some Chinese legal scholars have commented on the lax enforcement of corruption laws and are calling for more rigorous enforcement measures.⁶¹ Others suggest that new legislation, such as a more articulate "Anti-Commercial Bribery Code," will further combat and penalize commercial bribery.⁶² The Chinese government's recent zeal in prosecuting commercial bribery cases evidences China's movement towards more stringent regulation. Presumably, new legislation will be enacted to codify the current anti-commercial bribery sentiment. Yet precisely how effective the existing and anticipated legislative and enforcement efforts will be in curbing and eradicating the "hidden rules" remains to be seen.

Backed with a strong sentiment for the rigorous legislation and enforcement of an effective anti-corruption regime, multinational companies and foreign businesses hold the key to China's future progress in this domain. The persistence of these foreign firms in unilaterally eliminating unethical business conduct will contribute significantly to the general business environment by making less room for the "hidden rules." A platform for multinational companies to meet and discuss business ethics and compliance with anti-corruption laws, and to engage in concerted policy-making and action, may be necessary to accomplish this purpose. Institutions such as the American Chamber of

⁵⁹ *Id.* at art. 10.

⁶⁰ Interim Rules Prohibiting Commercial Bribery, *supra* note 45.

⁶¹ Wang Shichuan, *Bu pa qian gui ze, jiu pa gui ze qian* [What is Scary is Not the Hidden Rules, but the Fact that the Rules are Hidden], CHINA NEWS DAILY, Aug. 4, 2009, available at <http://finance.sina.com.cn/review/20090804/07156566814.shtml> (last visited Feb. 10, 2010).

⁶² Qing, *supra* note 56, at 89.

Commerce and the American Bar Association can and will play a facilitating position in bringing together representatives or in-house counsels of multinational companies to create compliance action plans.

For individual companies, compliance and risk prevention can be accomplished through better training, more effective management and increased legal sensitivity. With respect to training, it is important to formulate a clear anti-corruption policy and train employees at all levels, especially the mid-level locally recruited managers, in business ethics and anti-corruption laws. Managers should be apprised of the severe consequences of engaging in commercial bribery under not only Chinese, but also U.S. law.

As to management, attention should be paid to the marketing department, the sales department, the procurement department, the human resources department, the finance and accounting department and the IT department. Strict accounting and reimbursement rules must be instituted to carefully examine, categorize and record all incomes and expenses, especially funds and reimbursement requests from the marketing and sales departments. Each item or payment involving high-risk categories, especially “promotion fees,” “consulting fees” and “marketing expenses,” must be backed by invoices and other underlying transactional documents. Complete and accurate bookkeeping is also essential to preserve evidence of legal compliance and to enable the company to both keep track of and improve its compliance program.

Effective hiring is another important component of the risk prevention program. Understanding that connections and relationships are important in China’s business culture, some companies make hiring decisions based solely on candidates’ capabilities and social/business connections, without reference to important ethical considerations. In making hiring decisions, it is imperative to ensure that the candidate agrees with and is willing to abide by the company’s ethical standards, rather than follow the “hidden rules” in pursuit of greater profits. It is not only a good practice, but an essential one, to incorporate a pledge to abide by ethical practices into all employment contracts. For those working in such sensitive positions as marketing, procurement and sales, it is important that the employee’s compensation be based not only on revenues, but also on his or her ability to adhere to the company’s own ethical standards.

Finally, a company should institute a compliance program closely supervised by legal professionals who carefully and continuously monitor the most recent developments in anti-corruption legislation within both China and its home country. These experts must continuously update the corporate policies and compliance measures to minimize legal risks in light of an ever-changing legal landscape, and provide informed, competent advice to management and the operational departments regarding anti-corruption compliance. Anti-corrupt business practices should also be included in the company’s periodic auditing, which is another important component of the compliance program.

V. Conclusion

Without a strong, workable and carefully designed compliance program, foreign businesses conforming to China’s “hidden rules” are caught between the onerous choices

of profit maximization and legal compliance. Choosing to maximize profit without due regard for legal constraints may not only cost a company dearly in terms of revenue, but also result in graver long-term consequences such as damaged good will and stigmatized brand image. Although many foreign companies thrive amongst the shadows of both China's anti-corruption laws and the FCPA, the risk of companies' acquiescence to the "hidden rules" is undeniable. China's new round of legislation in promulgating anti-corruption laws to parallel the FCPA may help foster an entirely new business environment in China. Only time will tell whether China's business playing field will truly level out based on increased enforcement of local law, or whether the long-entrenched "hidden rules" will continue to threaten foreign businesses with crippling prosecution.

Robert Q. Lee is a partner, Sumeet H. Chugani and Vincent Li are associates and Xingjian Zhao is a law clerk at the law firm of Diaz, Reus & Targ LLP. Attorney Lee is located in the firm's Orlando, Florida office and can be reached by telephone at 407-550-0368 and by email at rlee@diazreus.com. Attorney Chugani and Mr. Zhao are located in the firm's Miami, Florida office and can be reached by telephone at 305-375-9220 and by email at schugani@diazreus.com and xzhao@diazreus.com, respectively. Attorney Li is located in the firm's Miami and Shanghai offices and can be reached by telephone at 305-375-9220 and by email at vli@diazreus.com.