

China's Crackdown on Commercial Bribery, Corruption in State-Owned Enterprises, and the Impact on U.S.-based Multinational Companies Doing Business in China

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The recent high profile crackdown on commercial bribery by China may result in increased legal risks to U.S.-based multinational companies (MNCs) doing business in China. Commercial bribery, further defined below, often involves a state-owned enterprise (SOE) as one of the actors in the bribery transaction. China's SOEs are known for their culture of corruption in which SOEs both give and receive bribes as a matter of course in doing business on a daily basis. As part of the crackdown on commercial bribery, China has issued an important legal interpretation that emphasizes enforcement against the payor of a bribe. This could indicate a shift in emphasis because China has been primarily concerned so far with focusing on the recipient of the bribe. A focus on the payor of the bribe could expose MNCs to liability because MNCs are often the payor of bribes to SOEs and government officials. Although this crackdown is not publicly aimed at U.S. and other foreign multinational companies, this crackdown creates a significant increased risk for U.S.-based multinational companies doing business in China. The highest risk is not in China's prosecution of its anti-bribery laws, but in prosecution by the U.S. Department of Justice and the Securities and Exchange Commission for violations of the Foreign Corrupt Practices Act (FCPA),¹ a federal law that prohibits the giving of bribes by U.S. companies to foreign officials for the purpose of obtaining or retaining business. As further explained below, the crackdown by Chinese authorities will expose practices, now hidden, which might be considered by the United States to violate the FCPA and result in an FCPA investigation. The United States regularly monitors the Chinese media and any serious national crackdown will draw the attention of U.S. authorities.

I. Crackdown on Commercial Bribery

President Xi Jinping became China's head of state on March 14, 2013, a once in a decade transition of power. On November 18, 2002, he warned that "corruption could kill the party and ruin the country," a sentiment reiterated repeatedly at local levels. President Xi warned that he would target "tigers and lilies"—high level as well as low level officials. As part of this anti-corruption campaign, China seems now to be intensifying its crackdown on commercial bribery. On November 20, 2008, the Supreme People Court's and the Supreme People's Procuratorate jointly issued an interpretation focusing on commercial bribery² and, more recently, on December 26, 2012, both institutions also issued an opinion, effective as of January 1, 2013,

¹ See 15 U.S.C. §§ 78m et seq. (2006).

² Opinions of the Supreme People's Court and the Supreme People's Procuratorate on Certain Issues concerning the Application of Law in Handling Criminal Cases of Commercial Bribery (effective on November 20, 2008).

focusing criminal prosecution of the payor of the bribe.³ China also recently announced a sweeping investigation of the pharmaceutical sector focusing on MNCs giving bribes to doctors and administrations of state owned hospitals for the purpose of influencing the doctors and officials to buy their pharmaceuticals. Local officials in Guangdong Province, a regional economic powerhouse, publically announced their intention to crack down on commercial bribery, among other economic crimes.

In this context, commercial bribery refers to a transaction in which the payor, usually a business entity, gives the recipient a bribe in order to obtain business or some other illegitimate business benefit. In many cases, both of the actors, the payor and the recipient, are business entities. These are business-to-business corruption cases or commercial bribery, an area of recent focus by China, which differs from government corruption. An example of commercial bribery is when an employee of one company that sells commodities gives a kickback to an employee of a company that purchases commodities. Another example is when the payor of the bribe gives cash to a vice director of the Ministry of Railways in order to obtain business, such as a contract to build a high speed train. This is also the gift of a bribe in order to obtain business so is considered to be commercial bribery. The key element in commercial bribery is the use of the use of a bribe to obtain business or another illegitimate benefit related to business. Contrast this type of transaction with a transaction in which both actors are government entities such as a state oil company and a state bank. The bank lends money to the state oil company to buy a foreign oil field but the loan is for a greater amount than the market value of the oil field. An official from the state-owned oil company keeps the extra amount of the loan and deposits the amount in his private offshore account. This would be an example of government graft or corruption. While China has focused on government graft, the Chinese government appears to now be focusing in addition on commercial bribery.

II. Commercial Bribery and State-Owned Enterprises

Since commercial bribery often involves a company-to-company transaction, an MNC and an SOE are often involved in the transaction. An MNC is involved on one end as the payor of the bribe and an SOE on the other end as the recipient of the bribe. Several factors indicate that with China's increased attention on commercial bribery, U.S.-based MNCs will be exposed to additional legal risk. As noted earlier, the greatest risk is not with the prosecution by Chinese authorities of its anti-bribery laws, but with exposure under the Foreign Corrupt Practices Act. There is increased exposure for the following reasons.

A. State-Owned Enterprises and the Business Culture of Corruption

³ The Interpretation of the Supreme People's Court and the Supreme People's Procuratorate of Several Issues Concerning the Specific Application of the Law in the Handling of Criminal Bribery Cases (effective as of January 1, 2013).

State-owned enterprises are “business entities established by central and local governments and whose supervisory officials are from the government.”⁴ Most people in China believe that SOEs commonly give and receive bribes when they do business. Most people in China accept petty corruption by SOEs and other government officials as a way of doing business. Many MNCs must constantly do business with SOEs because SOEs dominate in all core industries in China: petroleum and gas, financial services, including banking and insurance; automotive; electric, gas and water; real estate development, metals, mining, and telecommunications. When SOEs engage in procurement (i.e. buying commodities) or selling commodities, they often use bribes, gifts, and favors as part of the transaction. When MNCs deal with SOEs, MNCs often face demands for payments, gifts, and favors made by low level or mid-level employees at SOEs. For example, in a commercial bribery transaction, a sales agent from an MNC might feel pressure to give a kickback or bribe to the purchasing agent of an SOE to induce the purchasing agent to place an order to buy products from the sales agent and the MNC. From the perspective of the purchasing agent of the SOE, it makes little difference whether the agent places an order with any particular supplier since the purchasing agent, a low level employee, receives a fixed salary. The kickback or bribe serves as an inducement to the purchasing agent to place the order with the MNC because it gives the purchasing agent extra cash.

Under the FCPA, U.S. companies are prohibited from giving bribes to “foreign officials”⁵ for the purpose of obtain or retaining business. The U.S. Department of Justice considers all employees of SOEs from the highest ranking to the lowest to be “foreign officials.” This could well mean that a kickback or bribe given by an MNC to a SOE will be viewed as a bribe to a foreign official and trigger liability under the FCPA. With the increased emphasis on commercial bribery and on payors of bribes, Chinese authorities might begin an investigation against the MNC for paying bribes. This could draw the attention of the U.S. Department of Justice, which could then begin an investigation under the FCPA.

B. “Anything of Value”

The FCPA prohibits the giving of not just money but “anything of value”⁶ in order to obtain or retain business. Under China’s own anti-bribery laws, a payor must give “money or property” to be guilty of a bribe.⁷ In China’s current and traditional business culture, the giving of favors is viewed as a common form of doing business; many employees in SOEs and in MNCs may not view giving a non-monetary gift or a favor for a family member – such as giving an internship to the daughter of a government official -- as doing anything illegal or wrong, but

⁴ State Owned Enterprises in China: Reviewing the Evidence, OECD Working Group on Privatisation and Corporate Governance of State Owned Assets 3 (Jan. 26, 2009)

⁵ See 15 U.S.C. §§ 78dd-1(a)(1), 78dd-2(a)(1), 78dd-3(a)(1).

⁶ See 15 U.S.C. §§ 78dd-1(a), 78dd-2(a), 78dd-3(a).

⁷ See, e.g., Article 389 PRC Criminal Law (1997) (“Whoever, for the purpose of securing illegitimate benefits, gives money or property to a state functionary shall be guilty of offering bribes.”).

the same type of action might be viewed by the U.S. Department of Justice as giving something of value in violation of the FCPA.

C. Dealing with Third Parties

Many MNCs find that they must do business with third parties or hire third party independent contractors on a regular basis in China. In many instances, a U.S.-based MNC sets up a joint venture in China with an SOE as the joint venture partner. In this context, the joint venture is a China business entity formed under Chinese law and is jointly owned by the MNC and the local partner, often an SOE. The MNC contributes capital and technology and the local partner contributes its knowledge of the local market and its business and official connections. In some industries, joint ventures are required by law; an MNC is not permitted to set up a wholly foreign owned subsidiary but must partner with a local Chinese company. If the local partner is an SOE, the SOE might be used to giving bribes as part of how it did business in the past and once it becomes a partner in the joint venture, the SOE local partner might continue to give bribes to secure business from other SOEs or from government entities. This is exactly what happened to RAE Systems, a Delaware corporation, which formed several joint ventures with local SOEs. RAE had a majority interest in the joint ventures while the SOEs had a minority interest. The joint venture made chemical and radiation detectors and sold them to various government bureaus and departments. Before they entered into the joint ventures with RAE, the Chinese SOEs were paying bribes (kickbacks) to government bureaus to obtain sales. After they entered into the joint ventures, the Chinese employees from the SOEs continued to give kickbacks not only in money but in the form of jade, fur coats, kitchen appliances, and business suits. The actions of the joint ventures (as the agents of RAE) are attributable to RAE, the parent company under the FCPA. The U.S. Department of Justice intended to charge RAE with violations of the FCPA but the parties settled the case.

MNCs also have a common practice of hiring third parties as consultants for their China business entities. These third parties can be business consultants, public relations firms, private investigation companies, or lawyers. These third party consultants have been known to make payments (bribes) to government officials on behalf of the MNC and report the bribe to the MNC as a miscellaneous expense. The FCPA has a provision that giving money or anything of value to a third party knowing that the money will be given to a foreign official can constitute an FCPA violation.⁸

III. Consequences on the Crackdown on Commercial Bribery

China's recent crackdown on commercial bribery could expose MNCs to increased legal exposure, but the highest exposure does not lie in China's enforcement of its laws against MNCs but in the U.S. Department of Justice's enforcement of the FCPA against MNCs. The Chinese government sees a political and strategic value in cracking down on commercial bribery. In any

⁸ See 15 U.S.C. §§78dd-1(3), 78dd-2(a)(3), 78dd-3(a)(3).

bribery case, there are two choke points: it is possible to pursue the payor/giver of the bribe and also the recipient/taker of the bribe. So far China's emphasis has been on the recipient/taker of the bribe. In many cases, the recipient of the bribe can be a government official and a member of the Communist Party. In pursuing the recipient of the bribe, the Communist Party risks embarrassment as its own members are exposed as corrupt. A related risk to the CPC is any Party member that is accused of receiving a bribe might implicate other Party members higher in the Party order. From the Party's perspective, pursuing a commercial bribery case against an MNC carries fewer political risks but will also serve a political and symbolic purpose in demonstrating to the public that the Party is serious about cracking down on corruption. However, the CPC does not wish to inflict serious penalties on MNCs. Although the CPC might pursue individual executives within an MNC and even impose prison sentences on such executives, the CPC is unlikely to shut down the MNCs. Many MNCs have invested substantial capital and technology in their foreign-invested enterprises in China. The CPC realizes that shutting down or inflicting serious losses on MNCs and disrupting their businesses will ultimately harm China's economy and China's own long term interests. On the other hand, the penalties under the FCPA can be significant and can include terms of imprisonment for U.S.-based directors or officers of the company. The U.S. Department of Justice can also impose heavy monetary penalties. In recent cases, the U.S. Department of Justice settled an FCPA investigation with Total SA, a French company, for \$398 million and with JGC Corp. for \$218.8 million. In addition, any U.S. company that is the subject of an investigation by the U.S. Department of Justice could suffer immediate adverse publicity.

IV. Conclusion

The increased emphasis on enforcement against commercial bribery, which often involves an SOE as the recipient of the bribe, and a shift in emphasis on enforcement against the payor of the bribe (as opposed to the recipient) might pose significantly higher risks to MNCs doing business in China. The highest risk is not prosecution under China's anti-bribery laws for commercial bribery but prosecutions under the FCPA, which has much stiffer monetary penalties and also the possibility of imprisonment for U.S. executives involved directly or indirectly in the giving of the bribe.