Cultural Due Diligence: The Lost Diligence That Must be Found by U.S. Corporations Conducting M&A Deals in China to Prevent Foreign Corrupt Practices Act Violations

By

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I. Introduction

A. Corruption in China Will Not Keep U.S. Companies Out

In April 2004, Lucent Technologies fired four top executives in its Chinese subsidiary.[1] In February 2005, InVision Technologies (now GE InVision)[2] paid

[1] In this Article, the term "subsidiary" means a majority or wholly owned foreign company of a U.S. issuer, as defined by the FCPA. An issuer is any company that either must register securities on a U.S. stock exchange or must file reports under § 15(d) of the Exchange Act. For disclosure of the firings of the executives, s*ee* Lucent Technologies Inc., Current Report (Form 8-K), at 2 (Apr. 6, 2004). *See also* Peter S. Goodman, *Common in China, Kickbacks Create Trouble for U.S. Companies at Home*, WASHINGTON POST FOREIGN SERVICES, Aug. 22, 2005, at A01 (stating that Lucent fired the executives after discovering incidents and "internal controls deficiencies [in its operations in China] that could violate the Foreign Corrupt Practices Act"). *See also* Tom Leander, *In China, You Better Watch Out: Staying Out of the Foreign Corrupt Practices Act Penalty Box Requires a Vigilant Prevention Program*, CFO Asia, *at* http://www.cfo.com/article.cfm/5622331?f=home_featured (Mar. 20, 2006).

[2] In December 2004, General Electric ("GE") acquired InVision, which now operates under the name GE InVision, Inc. *See* Litigation Release No. 19,078, *available at* http://www.sec.gov/litigation/litreleases/ lr19078.htm (Feb. 14, 2005).

$1.1 million in penalties consisting of a $500,000 civil penalty, disgorged profits totaling $589,000, and approximately $28,700 of prejudgment interest.[3] In May 2005, Diagnostic Products Corp. surrendered $4.8 million in criminal and civil fines and disgorged profits.[4] In August 2005, Alltel Information Services ("Alltel") faced an informal inquiry by the Securities and Exchange Commission ("SEC") and the U.S. Department of Justice ("DOJ").[5] All these events share one common theme—they all stem from bribery of public foreign officials by Chinese subsidiaries or Chinese sales agents of U.S. corporations. Regardless of this

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[3] *See In re* GE InVision, Inc. (formerly known as InVision Technologies, Inc.), Exchange Act Release No. 51,199 (Feb. 14, 2005) (discussing the events which led up to the settlement). *See also* Litigation Release No. 19,078 (Feb. 14, 2005) (discussing the settlement).

[4] *See In re* Diagnostic Products Corp, Exchange Act Release No. 51, 724 (May 20, 2005), *available at* http://www.sec.gov/litigation/admin/34-51724.pdf (detailing the corrupt actions that led to a settlement and what course of action DPC will take to remedy the situation).

[5] After Alltel, then a division of Alltel Corp., was accused of committing bribery, the company informed the SEC and the DOJ that its audit and governance board committees and its board of directors would conduct an inquiry into the allegations. Alltel also agreed that it would cooperate with the SEC and the DOJ should these agencies begin an inquiry. *See* AFX News Limited, *Alltel Launches Inquiry into China Construction Bank Bribery Claims*, FORBES, May 4, 2005, *available at* http://www.forbes.com/home/feeds/afx/2005/05/04/afx2001747.html. *See also* David Barboza, *Lawsuit Involving Bribery Preceded Bank Resignation*, N.Y. TIMES, Mar. 22, 2005, at C6. The article gives an overview of a prominent Chinese bank executive who resigned in the midst of bribery and corruption accusations. A Beijing company, Grace and Digital Information Technology ("GDIT"), filed a lawsuit in a California court that accused the executive of accepting $1 million in bribes from Alltel, which caused GDIT to lose a $58 million contact. Although Fidelity National Financial of Jacksonville, Florida acquired Alltel in 2003, Alltel conducted an inquiry into the accusations. This inquiry indicates how severe even allegations of bribery and corruption may be for a company, because the lawsuit that triggered such investigation did not even name Alltel. Furthermore, the SEC and the DOJ did eventually conduct an informal inquiry, which Alltel's parent corporation had to disclose to shareholders. *See* Alltel Corp., Quarterly Report (Form 10-Q), at 39-40 (Aug. 9, 2005).

corruption, U.S. companies still flock to China with dreams of corporate globalization[6] and increased profits.[7]

The attributes of China provide a solid foundation for financial success for these U.S. corporate hopefuls. With a population of at least 1.3 billion that has begun to rise out of the depths of poverty,[8] China possesses a wide-ranging and eager consumer base. The new Chinese philosophy is "to get rich is glorious,"[9] rich meaning a higher social status that includes buying more luxury or brand names items. Not surprisingly, China boasts the second largest economy in the world based on purchasing power parity.[10] China also offers inexpensive wage laborers when compared to their U.S. counterparts. Considering all of this, it is

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[6] This Article defines "globalization" as the process by which a business field or company becomes international or starts operating at an international level. MSN Encarta® Dictionary, *at* http://encarta.msn.com/dictionary_/ globalization.html.

[7] *See* BIRGIT ZINZIUS, DOING BUSINESS IN THE NEW CHINA: A HANDBOOK AND GUIDE 1 (Praeger Publishers 2004). ("A successful opening up of the Chinese market presupposes [foreign investors'] direct presence in China. Presence in China [is] a categorical imperative for successful business in China.").

[8] The amount of impoverished Chinese decreased from 270 million to only 70 million between the years 1970 and 2000. *Id.* at 160.

[9] *Id*. at 160-161 (discussing this new Chinese philosophy and the history behind the new philosophy). The author argues that social status and wealth have become high priorities for many Chinese because China transformed from an underdeveloped nation to the world's second largest economy, and because now Chinese consumers have many choices and numerous products available to them. *Id*.

[10] Purchasing power parity is "the equivalent buying power in different currencies; it is a way of estimating national income by showing the number of currency units required to buy the same amount of goods and services in another country as one currency unit would buy at home." MSN Encarta® Dictionary, *at* http://encarta.msn.com/ dictionary_/purchasing%2520power %2520parity.html.

hardly surprising that U.S. corporations see China as a place with a "huge potential market beckoning with growth."[11]

Mergers and acquisitions ("M&A") present an effective way for U.S. corporations to establish a presence in China.[12] American culture and Chinese cultures differ on almost every level. This fact makes it more difficult for a U.S. corporation to establish a successful business presence in China. To facilitate the coveted assimilation U.S. corporations are using M&A transactions.[13] However, American businesses need to assimilate with caution. Although located in a foreign land, Chinese subsidiaries and agents of U.S. corporations may be subject

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[11] *See* Goodman, *supra* note 1, at A01. In fact, the *China Economic Quarterly* reported that 2003 was "the best year in at least a century for making money in China." *Id*. Mainland China and Hong Kong affiliates of U.S. publicly traded companies' earnings rose from $1.9 billion in 1999 to $4.4 billion in 2003. *Id*. A recent U.S. Government Accountability Office report on China trade stated that in 2004 China ranked twelfth among recipients of Foreign Direct Investment originating from the U.S. The report also stated that by 2004, cumulative U.S. investments in China totaled $15 billion. *See Foreign Investment in China,* The U.S.-China Business Council, Apr. 2006, *available at* http://www.uschina.org/info/chops/2006/fdi.html.

[12] This Article presumes that U.S. publicly traded companies establish a presence in China by using the M&A transactions. Specifically, such companies would either acquire a Chinese business or acquire or merge with another U.S. publicly traded company that had Chinese subsidiaries. This Article shall focus on U.S. publicly traded companies, which own and operate one or more Chinese subsidiaries because of an M&A transaction.

[13] A prime example of this is the recent acquisition by Best Buy Co., Inc. ("Best Buy"). Set to close in June 2006, Best Buy will acquire a majority interest in Jiangsu Five Star Appliance Co., Ltd. ("Five Star"), China's fourth-largest appliance and consumer electronics retailer. This transaction assists Best Buy in its recently announced strategy for global expansion. Acknowledging this advantage, Robert Willett, CEO of Best Buy, said, "they [Five Star] are strong leaders with considerable customer insights and strong local networks…this relationship complements our other efforts to learn about the Chinese retail environment." *See* Business Wire, *Best Buy to Acquire Majority Interest in Jiangsu Five Star; Fourth-Largest Chinese Retailer of Appliances and Consumer Electronics Provides Best Buy with Immediate Presence in Fast-Growing Global Market*, *available at* http:// www.eeproductcenter.com/showPressRelease.jhtml?printable=true&articleID=474745 (May 11, 2006).

to U.S. laws.[14] Certain aspects of Chinese culture, specifically guanxi (connections/networks) and mianzi (face/status),[15] pose a high degree of risk of violating the Foreign Corrupt Practices Act ("FCPA" or "the Act"). As a step towards eliminating bribery on an international level, the FCPA forbids bribery of foreign public officials, political parties, or candidates for political office.

B. A History of Corruption: How the FCPA Came to Exist

Enacted in 1977 as an amendment to the 1934 Securities Exchange Act, the FCPA criminalizes bribery of foreign public officials by U.S. businesses and individuals.[16] It also regulates the accounting procedures and internal control systems of publicly traded companies.[17] The FCPA evolved as a response to the

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[14] *See, e.g.*, 15 U.S.C. §§ 78dd-1(a) (2004) (for issuers), 78dd-2(a) (for domestic concerns). *See generally* Jason Matechak & Gregory S. Jacobs, *Focus on Foreign Corrupt Practices Act Enforcement*, Mondaq Business Briefing, *at* http://www.mondaq.com/article.asp?articleid=34041&lastestnews=1 (Aug. 19, 2005) (discussing the recent FCPA violations, enforcement activity, and indicating that Chinese subsidiaries and agents of U.S. corporations acted in a way that made the U.S. corporation liable). *See also* Marie Leone, *Coming Clean About Bribery*, CFO.com, *at* http://www.cfo.com/article.cfm/6764209?f=search (April 03, 2006) (analyzing the issue of Chinese agents' conduct being attributed to U.S. parent companies).

[15] Guanxi means a network or connections of people that are established and maintained via reciprocal behavior and mutual obligation involving gift giving and doing favors. *See infra* Part IV, Section C (1)(a) for a discussion of guanxi. Mianzi refers to a person's social and/or business status and self-image. *See infra* Part IV, Section C (1)(b) for a discussion of mianzi.

[16] *See* 15 U.S.C. §§ 78dd-1(a) (2004) (for issuers), 78dd-2(a) (for domestic concerns), 78dd-3(a) (for any person).

[17] *See* 15 U.S.C. §§ 78m(a) (2004) (for the contents of the reports by issuer of security), 78m(b) (for form of report, books, records, and internal accounting).

congressional outrage to Watergate and the scandal of the Nixon administration.[18] During investigations led by the SEC and the Internal Revenue Service ("IRS"), over 450 U.S. companies admitted to continuously bribing foreign public officials.[19] Moreover, the investigators uncovered many corporate slush funds.[20] Corporations used those funds to bribe foreign public officials.[21] The practice of offering kickbacks and making cash gifts in exchange for business as a normal part of conducting business was finally revealed.

C. The FCPA and the Corruption in China

The enforcement of the FCPA had been somewhat dormant since its enactment, but recently the SEC and the DOJ began to awaken this sleeping giant. Within the past six years, the SEC and the DOJ have conducted at least fourteen

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[18] *See* Barbara Crutchfield George, Kathleen A. Lacey, & Jutta Birmele, *On the Threshold of the Adoption of Global Anti-bribery Legislation: A Critical Analysis of Current Domestic and International Efforts Toward the Reduction of Business Corruption*, 32 VAND. J. TRANSNAT'L L. 1, 5 (1999).

[19] *See* CRUVER, *supra* note 19, at 3-5. Some of the prominent companies and illicit payments included Occidental Petroleum Corporation (almost $1.2 million), Bell Helicopter (almost $3.2 million), Gulf Oil Corporation ($10.3 million), General Tire & Rubber Company (almost $11 million), Exxon Corporation ($20.2 million), and Lockheed Aircraft ($22 million). *Id.*

[20] *See* Bill Shaw, *Symposium Fighting International Corruption & Bribery in the 21st Century: The Foreign Corrupt Practices Act and Progeny: Morally Unassailable*, 33 CORNELL INT'L L.J 689, 694-694 (2000).

[21] *See Id. at* 695 (quoting J. Lee Johnson, *A Global Economy and the Foreign Corrupt Practices Act: Some Facts Worth Knowing*, 63 MO. L. REV. 979 (1998)).

FCPA enforcement actions[22] and two informal inquiries.[23] Of those actions and inquiries, at least nine cases involved the foreign subsidiaries or agents of U.S. companies.[24] Moreover, almost half of the recent notable FCPA enforcement actions or inquiries involved the Chinese subsidiaries and agents of certain U.S. corporations.[25] Due to such activity, Bruce Kiparti, an assistant regional director at the SEC, recently said, "Chinese subsidiaries will be…likely target[s] for

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[22] *See generally* SEC v. Int'l. Bus. Machines Corp., Litigation Release No. 16,839, 73 SEC Docket 3049 (Dec. 21, 2000); *In re* Baker Hughes Inc., Exchange Act Release No. 44,784, 75 SEC Docket 1808 (Sept. 12, 2001); *In re* Chiquita Brands Int'l., Exchange Act Release No. 44,902, 75 SEC Docket 2308 (Oct. 3, 2001); *In re* Bell South Corp., Exchange Act Release No. 45,279 (Jan. 15, 2002); *In re* BJ Services Co., Exchange Act Release No. 49,390 (Mar. 10, 2004); *In re* Schering-Plough Corp., Exchange Act Release No. 49,838, 82 SEC Docket 3644 (June 9, 2004); U.S. v. Metcalf & Eddy, Inc., No. 99 Civ. 12,566 (D. Mass. Dec. 1999); U.S. v. Syncor Taiwan, Inc., No. 02 CR 01244 (C.D. Cal. Dec. 2002); U.S. v. Giffen, 326 F. Supp. 2d 497 (S.D.N.Y. 2004); U.S. v. Bodmer, 342 F. Supp. 2d 176 (S.D.N.Y. 2004); U.S. v. ABB Vetco Gray, Inc. & ABB Vetco Gray UK Ltd., No. 04 CR 27901 (S.D. Texas 2004); U.S. v. Montasanto Company, No. 05 CR 00008 (D.D.C. Jan. 2005); *In re* GE InVision, Inc. (formerly known as InVision Technologies, Inc.), Exchange Act Release No. 51,199 (Feb. 14, 2005); U.S. v. Titan, No. 05 CR 0314 BEN (S.D. Cal. Mar. 2005); *In re* Diagnostic Products Corp, Exchange Act Release No. 51, 724 (May 20, 2005).

[23] *See* Lucent Technologies Inc., Current Report (Form 8-K), *supra* note 1,at 2. *See also* Alltel Corp., Quarterly Report (Form 10-Q), *supra* note 5, at 39-40.

[24] *See generally* SEC v. Int'l. Bus. Machines Corp., Litigation Release No. 16,839, 73 SEC Docket 3049 (Dec. 21, 2000); *In re* Chiquita Brands Int'l., Exchange Act Release No. 44,902, 75 SEC Docket 2308 (Oct. 3, 2001); *In re* Bell South Corp., Exchange Act Release No. 45,279 (Jan.15, 2002); *In re* BJ Services Co., Exchange Act Release No. 49,390 (Mar. 10, 2004); *In re* Schering-Plough Corp., Exchange Act Release No. 49,838, 82 SEC Docket 3644 (June 9, 2004); U.S. v. Syncor Taiwan, Inc., No. 02 CR 01244 (C.D. Cal. Dec. 2002); U.S. v. ABB Vetco Gray, Inc. & ABB Vetco Gray UK Ltd., No. 04 CR 27901 (S.D. Texas 2004); *In re* GE InVision, Inc. (formerly known as InVision Technologies, Inc.), Exchange Act Release No. 51,199 (Feb. 14, 2005); *In re* Diagnostic Products Corp, Exchange Act Release No. 51, 724 (May 20, 2005) (for SEC and DOJ enforcement actions). *See also* Lucent Technologies Inc., Current Report (Form 8-K), *supra* note 1, at 2; Alltel Corp., Quarterly Report (Form 10-Q), *supra* note 5, at 39-40 (for informal inquiries by SEC and the DOJ).

[25] *See supra* notes 1-5 and accompanying text for the recent cases involving Chinese subsidiaries or agents of certain U.S. corporations.

[SEC] probes."[26] Consequently, U.S. corporations seeking to acquire a Chinese company and operate it as subsidiary must take heed to FCPA compliance. As the recent enforcement actions and inquiries indicate, a parent company ("parent")[27] will accept the legal responsibility for the FCPA violations of its wholly or majority owned subsidiaries.

The amount of corruption in China makes the recent FCPA violations in China less astonishing. For the past five years, China's ranking on the Corruption Perception Index (CPI) composed by Transparency International[28] has declined along with its CPI score[29] and Confidence Range.[30] The decline in China's CPI

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[26] *See* Leone, *supra* note 14. Mr. Kaparti spoke at a confab in New York held by the American Conference Institute. *Id*. The Article discusses the recent FCPA violations by companies such as GE InVision, Diagnostic Products, and Titan Corporation. *Id*. It also relays Mr. Kaparti's advice in terms of defenses and lists behaviors that he warns against. *Id.*

[27] For the context of this Article, "parent" shall mean a U.S. issuer that owns a majority interest in a foreign company or a U.S. issuer that wholly owns a foreign company.

[28] Transparency International is non-governmental organization based in Berlin, Germany that works to fight corruption in business and government practice on an international scale. *See* Transparency International Home Page, http://www.transparency.org.

[29] The CPI is the measure of corruption in a particular country on a scale of 0 to 10 with 0 being the most corrupt making 5.0 the threshold. Consequently, any country with a rating below 5.0 has a serious corruption problem. Transparency International Corruption Perceptions Index 2005, *available at* http://www.transparency.org/ news_room/in_focus/2005/cpi_2005#cpi (last visited Aug. 10, 2006).

[30] Confidence Range provides a range of possible values of the CPI score. This reflects how a country's score may vary, depending on measurement precision. Transparency International Corruption Perceptions Index 2005, *available at* http://www.transparency.org/news_room/ in_focus/2005/cpi_2005#cpi (last visited Aug. 10, 2006).

score only totals a fraction of a point.[31] However, the problem lies in the fact that the score is *below* the threshold, thus indicating a serious corruption problem in China. The Chinese government insists that it is making strides to eradicate the corruption via anti-corruption campaigns. They have implemented various programs designed to achieve that goal.[32] However, the world and the Chinese masses[33] will wait and see whether government officials will actually follow and enforce the new laws.[34]

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[31] From 2001 to 2005, China's CPI has declined from 3.5 to 3.2. *See* Transparency International Corruption Perceptions Index 2001, http://www.transparency.org/news_room/latest_news/press_releases/2001/cpi2001. *See also* Transparency International Corruption Perceptions Index 2005, *available at* http://www.transparency.org/ news_room/in_focus/2005/cpi_2005#cpi (last visited Aug. 10, 2006).

[32] *See e.g.*, ZINZIUS, *supra* note 7, at 162-163. The author describes the recent corruption in China that included a Chinese trading company embezzling more than $500 million in 2002. *Id.* She also goes on to discuss the Chinese government's three-step reform program to "deprive corruption of its economic and political base." *Id.*

[33] *See generally* Benjamin Robertson, *Dark Side of China's Frenetic Growth*, Aljazeera, Aug. 4, 2004, *at* http://english.aljazeera.net/NR/exeres/BD6B2D4E-EE98-49A3-AF91-E4801BD26B68.htm (discussing the recent corruption levels in China and its negative impact on the economy and the different segments of society; it also discusses how the Chinese public does not trust the government to reform).

[34] *See* Stephanie Hoo, *Graft Dogs China's Government*, THE CAIRNS POST/THE CAIRNS SUN (Australia), Feb. 2004 at 14 ("While China's government has made it clear corruption is no longer acceptable, the bitter truth is that its citizens have no faith in their leaders. [The Chinese government] promised robust economic reform, a better future for the masses and honest, upright government, but…their people simply don't trust them"). *But see Chinese Corruption: Deeper Reforms Are Needed to Stop the Rot*, FINANCIAL TIMES (London), March 28, 2005, at 14 (arguing that "jailing more offenders and issuing more rules" only "underline[s] the scale of the problem, without resolving it"). The author also argues that the weakness lies in China's weak and highly politicized regulatory machinery and that its corporate governance reforms depend too much on measures imposed from the top down.

D. FCPA Compliance Programs: How to Safeguard an Organization from Corruption

Until the corruption in China lessens or the U.S. government relaxes its desire to broadly enforce the FCPA, U.S. corporations acquiring Chinese businesses need to develop a protective strategy. According to the U.S. government, the best strategy remains a corporate ethics and compliance program ("compliance program" or "program").[35] Such a program is meant to deter and detect FCPA offenses.[36] Nonetheless, failure to prevent or detect a particular offense will not automatically deem the program generally ineffective in preventing and detecting criminal conduct.[37]

The language of the United States Sentencing Guidelines ("USSG") suggests that the main feature of an effective compliance program is the due

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[35] The term "corporate compliance and ethics program" means a program designed to prevent and detect criminal conduct. *See* U.S.S.G. § 8B2.1(a)(1) (2005). The accounting provisions of the FCPA, 15 U.S.C.A. § 78(m)(2)(B) (2004), state that issuers shall devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances of the following: (1) that transactions are executed with proper authorization; (2) transactions are recorded according to generally accepted accounting principles and assets are accounted for; (3) access to assets is allowed only with proper authorization; and (4) the recorded accountability for assets is compared to the existing assets at reasonable intervals and the differences are handled." *See also* David Katz, *The Bribery Gap: While Foreign Rivals May Make Payoffs Routinely, U.S. Firms Face New Pressure to Root Out Abuses*, CFO Magazine, Jan. 1, 2005, *available at* http://www.cfo.com/article.cfm/3515775/c_3516777?f= magazine_alsoinside ("Establishing an effective compliance and ethics programs is essential for an organization seeking to mitigate its punishment," said the U.S. Sentencing Commission).

[36] *See* U.S.S.G. § 8B2.1(a) (2005).

[37] *Id*.

diligence exercised by the parent in deterring and detecting FCPA violations.[38] Therefore, a U.S. corporation may infer that if it does not exercise proper due diligence such corporation will be deemed to have intentionally or knowingly committed an FCPA violation. If the DOJ or the SEC concludes that a U.S. corporation did not exercise the proper due diligence either or both agencies may start an enforcement action against that corporation. To assist a parent in satisfying the due diligence requirement, the U.S. Sentencing Committee released

[38] *See* U.S.S.G. § 8B2.1(a)-(b) (2005). *See generally* Daniel L Goelzer, *Designing an FCPA Compliance Program: Minimizing the Risks of Improper Foreign Payments*, 18 NW. J. INT'L L. & BUS. 282 (1998) (arguing that all companies private and public need a compliance program and "describes the process by which an FCPA compliance program may be structured for a multinational company").

seven minimum steps that a parent should take to achieve minimal due diligence.[39]

Additionally, the relevant principle of the USSG states that the "fine range [or punishment] for…[an] organization should be based on the seriousness of the offense and the culpability of the organization."[40] The culpability score

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[39] *See* U.S.S.G. § 8B2.1(b) (2005). Accordingly, at a minimum, due diligence requires the following:

(1) the parent corporation must implement standards and procedures to deter and detect criminal conduct;

(2) the governing authority of the parent must be knowledgeable about the content and operation of the compliance program and they must exercise reasonable oversight with respect to the implementation and effectiveness of the program; the high-level personnel of the parent must ensure that the subsidiary has an effective program; specific individual(s) within high-level personnel must be assigned overall responsibility for the program; specific individual(s) within the parent must be delegated day to day operational responsibility for the program; individual(s) with operational responsibility (i.e. the subsidiary) must report periodically to high-level personnel and the governing authority on the effectiveness of the program;

(3) the parent must use reasonable efforts not to incorporate into the substantial authority personnel of the Parent any person whom the Parent knew, or should have known via conducting due diligence, has participated in illegal activities or other conduct inconsistent with an effective program;

(4) the parent must take reasonable steps to communicate periodically and in a practical manner its program to its high-level personnel, substantial authority personnel, employees of the parent, and the agents of the parent (this includes the employees, officers, directors, and agents its subsidiary) by conducting effective training programs and disseminating information;

(5) the parent must take reasonable steps to (i) guarantee that the program is followed, this includes monitoring and auditing to detect criminal activity, (ii) to evaluate periodically the effectiveness of the program, and (iii) to have and publicize a system, which may include procedures that permit anonymous or confidential reporting of, or guidance in regards to, potential or actual FCPA offenses by employees or agents;

(6) the program must be promoted and enforced consistently throughout the parent and its subsidiary via appropriate incentives to perform in accordance with the program and appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to deter and detect FCPA violations;

(7) the parent must take reasonable steps to respond appropriately to the FCPA offenses once they have been detected and to stop additional similar misconduct, including modifying the program if necessary.

[40] This fine range is used for organizations that have not "operated primarily for a criminal purpose or primarily by criminal means;" if an organization has operated in that manner "the fine should be set sufficiently high to divest the organization of all its assets." *See* U.S.S.G., Ch. 8 intro. cmt. (2005).

determines the fault of an organization, which may decrease or increase depending on various factors.[41] The four factors that increase the punishment are (i) the involvement in or tolerance of criminal activity; (ii) the prior history of the organization; (iii) the violation of an order by the organization; and (iv) the obstruction of justice. The two factors that mitigate the punishment of an organization are: (i) the existence of an effective compliance and ethics program within the organization; and (ii) self-reporting, cooperation, or acceptance of responsibility by the organization. In sum, issuers may reduce their punishment (i.e. their culpability score)[42] by establishing an effective compliance program,[43] or self-reporting, cooperating, and accepting responsibility if a violation occurs.[44]

Using China as a prime example, this Article proposes that U.S. corporations acquiring companies in foreign countries must comprehend the

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[41] *See id.* (for a list of the factors).

[42] *See generally* U.S.S.G. § 8C2.5 (2005) (describing the method of calculating the culpability score).

[43] The first step in creating an effective compliance program involves understanding all aspects of the business for which the program is designed. Having knowledge of the employees who comprise the business and how the business functions will allow the creators of the program to design a program that will have success. Conducting CDD will provide such knowledge and insight. *See infra* Part IV for an examination of CDD.

[44] *See* U.S.S.G. § 8C2.5 (f) (2005) (describing how culpability points are deducted for having an effective compliance program). *See* U.S.S.G § 8C2.5 (g) (2005) (describing the method of deducting for self-reporting, cooperation, and acceptance of responsibility). *See* U.S.S.G. §§ 8C2.5 (a) – (c) (2005) (describing how points are added for: the involvement in or tolerance of criminal activity, prior history of violations, or violation of an order, and the obstruction of justice). *But see In re* ABB Ltd., Accounting and Auditing Enforcement Release No. 2049 (July 6, 2004) (ABB Ltd fully cooperated but still received heavy fines totaling a little over $16.4 million consisting of disgorgement and prejudgment interest in the amount of $ 5,915,000 and $10.5 million in criminal fines), *available at* http://www.sec.gov/litigation/litreleases/lr18775.htm.

culture of their newly acquired subsidiaries in order to comply with the FCPA. The most efficient way of achieving this goal is performing cultural due diligence ("CDD").[45] The traditional definition of CDD is the assessment by the acquiring company of how the target company conducts its business operations.[46] Thus, the traditional meaning of CDD only inspects the *corporate* culture of the target company.[47] However, this Article claims that in the international M&A field, CDD needs to expand to incorporate the *social* culture or societal norms of the country where the target company resides in order to comply with the FCPA.[48]

The necessity for this expansion increases when two elements exist. First, when the countries involved have completely different social cultures, which permeate into their corporate cultures, like the U.S. and China. Second, when one of the countries involved has a high level of corruption that may result from social culture or societal norms, like China. By understanding how the significant

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[45] In the context of this Article, the U.S. corporations who need to perform CDD are those with no presence in China (i.e. via subsidiaries) who seek to establish such a business presence via an M&A transaction.

[46] The traditional definition CDD also involves the acquiring company assessing its own corporate culture so that later it may compare it to the corporate culture of the target company in order to integrate the two cultures. However, this process typically involves two U.S. companies with no foreign subsidiaries. Therefore, that aspect of CDD goes beyond the scope of this Article. Because Chinese corporate culture dramatically differs from that of the U.S., a new corporate culture in the Chinese business, as opposed to integration, would more than likely be the best choice if a U.S. company acquired a Chinese business.

[47] Corporate culture refers to how a company conducts its daily business. *See infra* Part IV, Section A for a discussion of corporate culture.

[48] *See infra* Part IV, Section A for a definition of social culture.

aspects of Chinese social culture affect the corporate culture of Chinese companies, the acquiring U.S. corporation will have the requisite knowledge to create an effective compliance program thereby adhering to the FCPA. However, the creation and components of such a program go beyond the scope of this Article.

This Article only focuses on how major Chinese social concepts affect Chinese corporate culture in the context of committing an FCPA violation. Part II of this Article begins with Section A, which details the history of the FCPA. Section B discusses the amendments of the FCPA. Part II concludes with Section C, which presents a general overview of the anti-bribery, accounting, and internal controls provisions of the FCPA. Although all of the FCPA provisions apply to both domestic and foreign business operations, this Article mainly focuses on those that apply to foreign business operations. Therefore, Part III sets forth parent liability under the anti-bribery, accounting, and internal controls provisions in relation to subsidiaries. Overall, Part IV addresses the process of CDD. Section A provides a definition of CDD, while Section B examines the significance of CDD to a parent. Section C goes on to discuss the two most significant aspects of Chinese social culture as well as how they affect Chinese corporate culture. Finally, Part V concludes with a summary.

II. The History of the FCPA: Its Origination, Amendments, & Current Status

This part of the Article discusses the events that led up to the enactment of the FCPA. It then addresses the amendments to the original Act. Specifically, it details what changes were made and why. In conclusion, it gives the present state of the FCPA, including the primary components of the Act as well as its enforcement policies.

A. The Origination: In the Beginning Congress Said Bribery Is Immoral, Inefficient, Against Foreign Policy, and Unnecessary

In 1977, the Watergate scandal shocked the nation. The investigations led by the SEC and the Internal Revenue Service ("IRS") brought to light what Congress viewed as immoral behavior that harmed U.S. economic and political interests—bribery of foreign officials. Over 400 U.S. corporations admitted to making questionable or illegal payments to foreign government officials, politicians, or political parties.[49] U.S. multinational businesses used slush funds to bribe foreign officials to ensure favorable business dealings and highly

[49] *See* H.R. REP. NO. 95-640, at 4 (1977).

profitable contracts.[50] The payments exceeded well over $300 million in corporate funds.[51] To combat this behavior Congress adopted the FCPA.

The congressional view of bribery being immoral runs throughout the debates concerning the FCPA.[52] A House Report labeled the payment of bribes as "*unethical*…[and] counter to the *moral expectations* and values of the American public (emphasis added)."[53] According to Congress, bribery "erodes public confidence in the *integrity* of the free market system (emphasis added)."[54] Moreover, bribery rewards immorality by "directing business to those companies…too lazy to engage in *honest* salesmanship…(emphasis added)"[55] But this was not the only concern of Congress.

Congress also argued that bribery causes an inefficient marketplace, because it steers business away from companies that compete in terms of price, quality, and service. Congress argued that bribery produced economically harmful results, by guiding business to inefficient companies. Those companies received such a label because they could not "compete [fairly] in terms of price,

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[50] *See* Aaron G. Murphy, *The Migratory Patterns of Business in the Global Village*, 2 N.Y.U. J. L. & BUS. 229, 234 (2005).

[51] *See* H.R. REP. NO. 95-640, at 4 (1977).

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *Id.*

quality, and service..." [56] Congress believed that bribery to influence decisions of foreign officials short-circuits the marketplace, because those companies who should reap the benefits of having better prices, quality, and services do not receive such benefits.[57] Thus, bribery of foreign public officials was not just unethical, it was also bad business.[58] The concern did not end here.

Congress also expressed a few other worries. For example, they expressed a fear that bribing foreign officials, political parties, and candidates for office created foreign policy problems for the U.S.[59] Prior to the enactment of the FCPA some countries were against the U.S. forming alliances with certain foreign countries. These opposing countries used the bribery of foreign officials by U.S. corporations as a reason for why certain countries should not form alliances with

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[56] *Id*.

[57] *Id*.

[58] *Id*. *Cf*. Murphy, *supra* note 50 at 248 (discussing the moral ambiguity of bribery in relation to the FCPA provisions). This critic of the FCPA argues that bribery is only deemed immoral if it is economically inefficient. This argument rests on the economists' definition of the term "economic efficiency" not the congressional definition, which involves a fairness element. For economists, efficiency is the relationship between the value of the means of a particular result and the value of that result. When a transaction is inefficient it signifies that the results could have been produced with less means. Likewise, inefficiency also occurs when the means used could have produced more of the results desired. Less and more in this framework refers to less and more value. *See* Paul Heyne, *Efficiency*, THE LIBRARY OF ECONOMICS AND LIBERTY, *at* http://www.econlib.org/library/enc/ Efficiency .html. Therefore, Murphy argues that if bribery is the most valuable way of achieving the desired result, Congress will allow the bribery of foreign officials. He further insists that this idea is expressed in the congressional rationale behind allowing "grease" payments under the Act.

[59] *See* H.R. REP. NO. 95-640, at 5 (1977).

the U.S.[60] Congress also claimed that bribery is not necessary to conduct successful business in the U.S. or in other countries.[61] Lastly, Congress stated that a strong anti-bribery statute would actually assist U.S. corporations in resisting corrupt demands.[62]

B. The Amendments: In 1988 and 1998, the Corporate World Cried "Foul!"

1. The 1988 Amendments to the FCPA

After its enactment in 1977, the FCPA underwent amendments in 1988 and in 1998. Prior to the 1988 Amendments, the business community made many criticisms of the FCPA. It complained of the Act harming American businesses due to its vague language.[63] The community also argued that U.S. companies

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[60] For instance, in 1976, it was revealed that Lockheed had paid approximately $3 million in bribes to the office of the Japanese Prime Minister. The Lockheed scandal negatively affected the Japanese Government and gave opponents of close ties between the U.S. and Japan a useful tool to create friction between the two nations. Another example involved Prince Brenhardt of the Netherlands. He resigned due to an inquiry into allegations that he received $1 million in pay-offs from Lockheed. In addition, the accusations that Lockheed, Exxon, Mobil Oil, and other corporations allegedly gave payments to officials in the Italian Government eroded support for that government. It also jeopardized U.S. foreign policy with respect to Italy, the Mediterranean area, and the entire NATO alliance. *See Id.*

[61] The Former SEC Chairman Hills testified: "…we find in every industry where bribes have been revealed that companies of equal size are proclaiming that they see no need to engage in such practices." *See Id*.

[62] *See Id*. Congress agreed with the former Chairman of Gulf Oil Co., Bob Dorsey, when he stated before Congress "if we [U.S. corporations] could cite our [U.S.] law which says we [U.S. corporations] just may not do it, we [U.S. corporations] would be in a better position to resist these pressures and refuse those requests." *Id*.

[63] Congress noted that it intended to "[clarify] the existing foreign anti-bribery standard of liability under the Act as passed in 1977" in terms of the mens rea requirement. *See* H.R. REP. NO. 100-576, at 920 (1988) (Conf. Rep.).

were at a competitive disadvantage in the international markets because of the FCPA.[64] Critics claimed that American businesses declined legitimate transactions because they were unsure if those transactions were legal.[65] Under the Omnibus Trade and Competitiveness Act of 1988, Congress took heed to these criticisms. They made four amendments to the anti-bribery provisions, three amendments to the accounting provisions, and broadened the enforcement role of the DOJ.[66]

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[64] U.S. companies argued they were at a competitive disadvantage compared to other foreign companies who routinely paid bribes. Moreover, some of these countries also allowed companies to deduct the cost of bribes as business expenses on their taxes. *See* Foreign Corrupt Practices Act: Anti-Bribery Provisions, *available at* http://www.usdoj.gov/criminal/fraud/fcpa/dojdocb.htm. *See also* Jennifer Dawn Taylor, *Ambiguities in the Foreign Corrupt Practices Act*, 61 LA. L. REV. 861, 867 - 871 (2001) (discussing the negative effects of corruption in developing countries, the reality of bribery in these countries, and examines both sides of the competitive disadvantage issue). *See also* Daniel Patrick Ashe, *The Lengthening Anti-Bribery Lasso of the United States: The Recent Extraterritorial Application of the U.S. Foreign Corrupt Practices* Act, 73 FORDHAM L. REV. 2897, at 2907 (discussing how other countries resisted enacting laws to prevent bribery and that some European countries allowed for bribery tax deductions). *See also* David Ivanovich, *Cutting Off Corruption's Supply Side; More Nations Join U.S. War on Bribery,* Houston Chron., Oct. 30, 1998, at Business 1.

[65] *See* Steven R. Salbu, *Bribery in the Global Market: A Critical Analysis of the Foreign Corrupt Practices Act*, 54 WASH. & LEE L. REV. 229, 243 (1997).

[66] *See generally* H.R. REP. NO. 100-576, at 920 (1988) (Conf. Rep.) (accounts the congressional discussion regarding all the 1988 amendments to the FCPA). *See also Id*. at 923 (indicating that the "Attorney General may issue general guidelines describing examples of activities that would or would not conform with" the DOJ's enforcement of the FCPA). For a detailed discussion of such guidelines *see infra* Part II, Section C (2)(b).

The 1988 amendments to the FCPA attempted to clarify the Act[67] and "level the global playing field" in international competition.[68] The amendments to the anti-bribery provisions accomplished the following: (1) clarified the knowledge requirement;[69] (2) defined the scope of facilitating payments definition;[70] (3) added affirmative defenses;[71] and (4) increased both the civil and criminal penalties for violations of the anti-bribery provisions.[72] The amendments to the accounting provisions[73] accomplished the following: (1)

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[67] *See generally* Melysa Sperber, *Foreign Corrupt Practices Act*, 39 AM. CRIM. L. REV. 679 (2002) (this article provides a general overview of the FCPA and anticipated developments in the fight against corporate corruption).

[68] *See* Taylor, *supra* note 64 at 870 (citing Steven R. Salbu, *Battling Global Corruption in the New Millennium*, 31 LAW & POL'Y INT'L BUS. 47, 57-59 (1999)).

[69] Congress removed the phrase "having reason to know" and added an "actual knowledge" standard. *See* H.R. REP. NO. 100-576, at 920 (1988) (Conf. Rep.). Nonetheless, Congress still agreed that prohibited actions that "evidence a conscious disregard or deliberate ignorance of known circumstances that should reasonably alert one to a high probability of violations of the Act" remain violations. *See* H.R. REP. NO. 100-576, at 920 (1988) (Conf. Rep.). *See infra* note 91 for an in depth discussion of the knowledge requirement.

[70] Congress tried to describe precisely what constituted such permissive acts under the FCPA. *See* H.R. REP. NO. 100-675, at 921 (1988) (Conf. Rep.). *See infra* note 97 for a description of facilitating payments.

[71] The defenses are: (1) lawful payments under the written laws and regulations of the foreign official's country and (2) reasonable and bona fide expenditures for promotional activities. *See* H.R. REP. NO. 100-675, at 922 (1988) (Conf. Rep.). *See also infra* notes 98-99 and accompanying text for further explanation of these defenses.

[72] The maximum criminal penalty doubled to $2 million for domestic concerns and issuers. *See* H.R. REP. NO. 100-576, at 924 (1988) (Conf. Rep.) (details the increase in criminal fines for issuers, domestic concerns, and individuals as well as creating a new civil penalty). The criminal fine for individuals increased ten times to $100,000. *Id.* at 924. The amendments also added a new civil penalty of $10,000 for natural persons. *Id.* at 924. The penalties will be discussed in further detail in Part II, Section C(2)(c).

[73] *See infra* Part II, Section C(1) for a detailed explanation of the current accounting provisions.

deleted the "reason to know" standard;[74] (2) clarified the responsibility of a corporation with respect to its subsidiaries;[75] and (3) clarified the standards on record-keeping and internal control compliance.[76] In addition to adding the above amendments, in 1988 Congress also directed the Executive Branch to encourage America's trading partners to pass anti-corruption laws.[77] This international bribery campaign eventually led to the 1998 FCPA amendments, which implemented the Organization of Economic Cooperation and Development ("OECD") Convention on Combating Bribery of Foreign Officials in International Business Transactions ("OECD Convention").

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[74] According to the legislative history, a person must knowingly circumvent a system of internal accounting controls or knowingly falsify books, records, or accounts in order to be held criminally liable. *See* H.R. REP. NO. 100-675, at 916 (1988) (Conf. Rep.). *But see* Christopher J. Duncan, *The 1998 Foreign Corrupt Practices Act Amendments: Moral Empiricism or Moral Imperialism?*, 1 ASIAN-PAC L. & POL'Y J. 14, (2004), citing Homer E. Moyer, Remarks at The ABA/CLE Conference on the Foreign Corrupt Practices Act: How to Comply Under the New Amendments and the OECD Convention, in Marina del Rey, CA. (Feb. 19, 1999) (arguing that the amendments were "anti-climatic" in that they had little or no effect on the law, and one broad standard was replaced by another).

[75] In addition, this provision establishes responsibility of an issuer for another company based on the ownership interest of the issuer. The conferees acknowledged that it is "unrealistic to expect a minority owner [issuer] to exert a disproportionate degree of influence over the accounting practices of [another company]." Therefore, if an issuer owns fifty percent or less of the voting power it only has to show a good faith effort to cause the company that it owns the interest in to comply with the FCPA. *See* H.R. REP. NO. 100-675, at 917 (1988) (Conf. Rep.).

[76] The amendments defined the terms "reasonable detail" and "reasonable assurances" to mean that level of detail and assurance that "would satisfy prudent officials in [conducting] their own affairs." 15 U.S.C. § 78m(b)(7) (2004).

[77] *See* H.R. REP. NO. 100-675, at 924 (1988) (Conf. Rep.) (requesting that the President develop an anti-bribery agreement "with member countries of the Organization of Economic Cooperation and Development").

2. The 1998 Amendments: The OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions

America's international anti-bribery campaign resulted in the OECD Convention.[78] Signed in December 1997 by the U.S. and thirty-two other nations, the OECD Convention represented an obligation to "criminalize the bribery of foreign public officials in international business transactions."[79] In 1998, Congress ratified the OECD Convention as an amendment to the FCPA.[80] First, the new legislation broadened the category of liable persons.[81] Second, it added criminal and civil penalties for those new liable persons.[82] Third, it eliminated the discrepancy between U.S. nationals and foreign nationals in terms of criminal

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[78] *See* Oren Gleich & Ryan Woodward, *Foreign Corrupt Practices Act: Survey of White Collar Crime*, 42 AM. CRIM. L. REV. 545, 546 (2005) (provides a detailed overview of the anti-bribery and accounting provisions of the FCPA).

[79] *See* William J. Clinton, *Statement by the President*, (Nov. 10, 1998), *available at* http://www.usdoj.gov/criminal/ fraud/fcpa/signing.htm.

[80] *See* 15 U.S.C. §§ 78dd-1 (2004) (for issuers), 78dd-2 (for domestic concerns), 78dd-3 (for any person), 78ff (for penalties). The amendments called the International Anti-Bribery Act of 1998 became law on November 10, 1998 when President Clinton signed the bill into law. Clinton, *supra* note 79.

[81] The FCPA now covers "any person" who commits an act in furtherance of a foreign bribe while in the U.S. territory, not just issuers and domestic concerns. *See e.g.*, 15 U.S.C. § 78dd-3(a) (2004) (for any person). Therefore, foreign nationals who work as agents or employees of U.S. issuers may now face FCPA liability.

[82] The FCPA expanded who is subject to the act by adding the phrase "any persons other than the issuers or domestic concerns." *See* 15 U.S.C. § 78dd-3(a)(2004). Hence, the FCPA added penalties for this new group. They must face the same penalties as issuers and domestic concerns. *See* 15 U.S.C. §§ 78dd-3(e) (2004) (for penalties for any person), 78dd-2(g) (for penalties for domestic concerns), 78ff(c) (states the penalties for violations committed by issuers, officers, directors, stockholders, employees, or agents of issuers). The penalties will be discussed in further detail in Part II, Section C.

penalties.[83] Fourth, the amendments subjected all employees and agents of issuers to penalties.[84] Fifth, the new legislation expanded the definition of "foreign official."[85] Sixth, it broadened the purpose of illicit payments.[86] Finally, it stretched the jurisdiction of the FCPA beyond the borders of the U.S.[87]

C. The FCPA Today: What Conduct the Act Prohibits & the Punishment That Results From Disobedience

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[83] Prior to the 1998 amendments foreign nationals acting as agents or employees of U.S. issuers were only civilly liable under the Act. *See* CRUVER, *supra* note 19 at 76 (discussing the way the FCPA existed prior to the 1998 amendments and the effect the amendments on the FCPA). Now these parties may face criminal liability too. *See* 15 U.S.C. § 78dd-2(g)(2) (2004).

[84] The FCPA currently subjects all officers, directors, employees, or agents of an issuer, and a stockholder acting on behalf of such issuer to criminal and civil penalties. *See* 15 U.S.C. § 78ff(c)(2) (2004). *See infra* Part II, Section C(2)(c) for a further explanation of the penalties under the FCPA.

[85] The FCPA now includes officials of "public international organizations" within the definition of "public official." *See* 15 U.S.C. §§ 78dd-1(f)(1)(A) (2004) (for issuers), 78dd-2(h)(2)(A) (for domestic concerns), 78dd-3(f)(2)(A) (for any person). *See infra* note 93 for the full definition of a "public official" under the FCPA.

[86] The reason for making illicit payments now includes the prospect of "securing any improper advantage." S*ee* 15 U.S.C. §§ 78dd-1(a)(1)(A)(iii), (2)(A)(iii) and (3)(A)(iii) (2004) (regulating issuers), 78dd-2(a)(1)(A)(iii), (2)(A)(iii) and (3)(A)(iii) (regulating domestic concerns), 78dd-3(a)(1)(A)(iii), (2)(A)(iii) and (3)(A)(iii) (regulating any person). *See infra* note 95 for further discussion of "securing any improper advantage."

[87] The FCPA now "provide[s] for jurisdiction over the acts of U.S. businesses and nationals in furtherance of unlawful payments that take place wholly outside the U.S." *See* International Anti-Bribery Act of 1998: Legislative History, *available at* http://www.usdoj.gov/criminal/fraud/fcpa/leghist.htm. *See also* George, Lacey, & Birmele, *supra* note 18 at 11 (stating "the alternative jurisdiction provision eliminates any U.S. territorial nexus requirement for FCPA applicability to U.S. domestic concerns and issuers"). The result being that jurisdiction may be based solely on nationality. *See e.g., infra* note 89.

Congress designed the FCPA such that it consists of two parts: the anti-bribery provisions and the accounting and internal controls provisions. Ideally, these parts work together to deter and detect bribery. The anti-bribery provisions deter the illicit behavior and the accounting and internal controls detect those who are not deterred by requiring issuers to maintain highly accurate and detailed records of their transactions.[88]

[88] Due to the Watergate scandal, the SEC conducted thorough investigations that revealed a vast amount of bribery of foreign officials by the U.S. corporations. *See supra* Part II Section A for the events that lead up to the enactment of the FCPA. Moreover, the SEC discovered that many of the companies used their books and records to conceal the bribes. *See* CRUVER, *supra* note 19 at 2 (stating that the SEC believed that the most devastating factor to come from the investigations was "the extent to which, many companies had falsified entries in their own books and records").

1. The Anti-Bribery & the Accounting and Internal Controls Clauses

The anti-bribery provisions function as one mechanism of enforcement.

The anti-bribery clauses prohibit covered parties[89] from making a payment,

[89] This article will use the term "covered party" to include those entities or individuals to whom the FCPA applies, specifically, an issuer, a domestic concern, or any person other than an issuer, as defined by the Act, including their officers, directors, employees, agents, or stockholders acting on their behalf.

Under the Act, an "issuer" means those businesses that either (1) have securities registered pursuant to 15 U.S.C. § 78l(g) or (2) must file reports under 15 U.S.C. § 78o(d). Section 78l(g) states that any issuer engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded on a national stock exchange, and whose assets exceed $1 million and consists of more than five hundred shareholders must register its securities. Section 78o(d) states that each issuer shall file with the SEC "supplementary and periodic information, documents, and reports as necessary or appropriate in public interest or for the protection of investors." In sum, an issuer is any entity that must register its securities under § 12 of the Securities Exchange Act or must file reports under § 15(d) under the Exchange Act.

A "domestic concern" includes both U.S. individuals and business entities. The Act defines a "domestic concern" as any individual who is a citizen, national, or resident of the U.S. *See* 15 U.S.C. § 78dd-2(f)(1)(A) (2004). Also contained in this definition are any corporations, partnerships, associations, joint-stock companies, business trusts, unincorporated organizations, or sole proprietorships that (1) have their principal place of business in the U.S. or that (2) are organized under the laws of U.S. State, territory, possession, or commonwealth. *See* 15 U.S.C. § 78dd-2(f)(1)(B) (2004). In terms of issuers and domestic concerns, the FCPA has a far-reaching jurisdictional arm. For example, the anti-bribery provisions do not just apply to these two groups. The provisions also apply to any officer, director, member, employee, stockholder, or agent of an issuer or domestic concern *irrespective* of the individual's nationality. *See* 15 U.S.C. § 78dd-1(g)(1) (2004) (for issuers), 78dd-2(i)(1) (for domestic concerns). Accordingly, these people may venture abroad on business (i.e. a director goes to China) thus lacking any interstate commerce connection, but the anti-bribery provisions still apply to her. The nationality of the issuer or the domestic concern provides the basis for jurisdiction and is then imputed to their directors, officers, employees, and agents. Prior to the 1988 amendments, the Act only applied to issuers and domestic concerns. Now the Act applies to "any person" while within U.S. territory. *See* 15 U.S.C. § 78dd-3(a) (2004). As a result, a party's status as an issuer or domestic concern becomes irrelevant if within the U.S. The only relevant fact is that the act in question occurred within U.S. territory.

Under the FCPA, "person" means any natural person other than a national of the U.S. or any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship organized under the law of a *foreign* nation or political subdivision thereof (emphasis added). *See* 15 U.S.C. § 78dd-3(f)(1) (2004). Moreover, the courts have not determined the meaning of the phrase "while in territory of the U.S." *See* STUART H. DEMING, THE INTERNATIONAL PRACTITIONER'S DESKBOOK SERIES: THE FOREIGN CORRUPT PRACTICES ACT AND THE INTERNATIONAL NEW NORMS 10 (ABA Publishing 2005). This fact coupled with the many ways our society has to connect with each other could mean a broad application. For instance, consider this situation. A U.S. company has a Chinese subsidiary formed under the laws of China. Hence, the subsidiary is *not* subject to the FCPA. If a director of that Chinese subsidiary sends an e-mail to a foreign official, who receives the e-mail while in the U.S. one could argue that the director is within U.S. territory. In situations like this, the reason for a U.S. company to form a subsidiary under the foreign country's law completely deteriorates. Likewise, due to the 1988 amendments, if the director of the Chinese subsidiary (or any other agent of such subsidiary) came to the U.S. and committed a prohibited act, liability would flow to

[90] directly or indirectly,[91] of money or anything of value

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[90] The FCPA makes it unlawful for a covered party to make an offer, payment, promise to pay, or authorization of the payment of any money or anything of value to a public official. *See* 15 U.S.C. §§ 78dd-1(a) (2004) (for issuer), 78dd-2(a) (for domestic concern), 78dd-3(a) (for any person). Like the other aspects of the anti-bribery clauses, the "payment" requirement is broadly interpreted. Consequently, the following facts become irrelevant:

- whether the object of the bribe is actually possible;
- whether the foreign official in fact accepted the bribe;
- whether the payment was actually received; and
- the manner or means of payment, authorization, offer, or promise.

See generally STUART H. DEMING, THE INTERNATIONAL PRACTITIONER'S DESKBOOK SERIES: THE FOREIGN CORRUPT PRACTICES ACT AND THE INTERNATIONAL NEW NORMS 11 (ABA Publishing 2005) (discussing the anti-bribery provisions of the FCPA). *See generally* H. Lowell Brown, *Avoiding Bribery When Doing Business Overseas: A Primer on the Foreign Corrupt Practices Act*, 20 MAINE BAR J. 78 (2005) (provides a general discussion of the specific provisions of the FCPA including the exceptions).

[91] The Act criminalizes illicit payments made *directly* to foreign public officials, political parties, or candidates for political offices. Additionally, these payments may not *indirectly* transpire through third parties. Consequently, covered parties may not commit any of the prohibited acts "while *knowing* all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official, political party, or candidate (emphasis added). *See* 15 U.S.C. §§ 78dd-1(a)(3) (2004) (for issuers), 78dd -2(a)(3) (for domestic concerns), 78dd-3(a)(3) (for any person). The statutory language divides the knowledge requirement into three parts: (1) awareness, (2) firm belief, and (3) high probability. *See* Taylor, *supra* note 64 at 872. The article describes this three-part division, and then argues that even though the FCPA states a definition for "knowing," that definition is vague causing difficulty in deciding how much awareness triggers "knowing." *Id*. The FCPA deems a covered party with knowledge if:

(1) she is "aware" that the third party is involved in the conduct, that the situation exists, or that the FCPA offense is substantially certain to happen; *See* 15 U.S.C. §§ 78dd-1(f)(2)(A)(i), 78dd-2(h)(3)(A)(i), 78dd-3(f)(3)(A)(i) (2004).

(2) she has a "firm belief" that the situation exists or is substantially certain to happen; or *See* 15 U.S.C. §§ 78dd-1(f)(2)(A)(ii), 78dd-2(h)(3)(A)(ii), 78dd-3(f)(3)(A)(ii) (2004).

(3) she is aware of a "high probability" of the existence of the situation. *See* 15 U.S.C. §§ 78dd-1(f)(2)(B), 78dd-2(h)(3)(B), 78dd-3(f)(3)(B) (2004).

Hence, the "head-in-the-sand" problem which involves a "conscious disregard," "willful blindness," or "deliberate ignorance" constitutes an FCPA violation. *See* H.R. REP. NO. 100-576, at 919-920 (1988) (Conf. Rep.), *available at* http://www.usdoj.gov/criminal/fraud/fcpa/1988hist.htm. Courts may use acts of the "head-in-the sand" problem to draw an inference from the circumstances that the covered party in question had the requisite knowledge. *See* Brown, *supra* note 90 at 79. However, the Act does not attach liability to acts of "simple negligence" or "mere foolishness." *See* H.R. REP. NO. 100-576, at 920 (1988) (Conf. Rep.), *available at* http://www.usdoj.gov/criminal/ fraud/fcpa/1988hist.htm.

[92] to foreign government officials, political parties, or candidates

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[92] Under the FCPA, a covered party may not give "anything of value" to a foreign public official, political party, or candidate with corrupt intent. *See* 15 U.S.C. §§ 78dd-1(a) (2004) (for issuers), 78dd-2(a) (for domestic concerns), 78dd-3(a) (for any person). The Act does not limit the term "anything of value" to just cash or cash equivalents like, checks, bank accounts, or marketable securities. The term "anything of value" could actually be almost anything, including almost any form of direct or indirect benefit to the recipient. *See* DEMING, *supra* note 90 at 11. Case law mainly defines what constitutes "anything of value." Examples of the vast number of payments or offers of payment include the following:

(a) Airline tickets; *See* United States v. Liebo, 923 F.2d 1308, 1311-1312 (8th Cir. 1991) (holding the defendant gave the airline tickets in order to retain business; therefore the tickets had value).

(b) Employment offers; *See* Rotec Indus. v. Mitsubishi Corp., 163 F. Supp. 2d 1268 (D.Or. 2001) (finding an offer of a quality control position to a foreign government official, who served on the Bid Evaluation Committee of China's Three Gorges Dam Project, represented something of value).

(c) Charitable contributions; *See* Lamb v. Phillip Morris Inc., 915 F.2d 1024, 1027 (6th Cir. 1990) (holding charitable contributions made to "induce favorable action" constitute something of value)

(d) Transportation; *See* United States v. Kenny Int'l Corp., 2 Foreign Corrupt Practices Act Rep. 649 (D.D.C. 1996) (concluding that providing transportation of voters, who favor the ruling party, amounted to something of value).

Further, in cases construing domestic and foreign bribery statutes, courts concede that the phrase "anything of value" includes tangibles and intangibles. *See, e.g.,* United States v. Girard, 601 F.2d 69, 71 (2d Cir. 1979) (holding that "thing of value" is a term of art and notwithstanding the word "thing" it is "generally construed to cover intangibles as well as tangibles").

[93] to corruptly

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[93] The Act broadly defines a "foreign official" as "any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of such government or department, agency or instrumentality, or international organization." *See* 15 U.S.C. §§ 78dd-1(f)(1)(A) (2004) (for issuers), 78dd-2(h)(2)(A) (for domestic concerns), 78dd-3(f)(2)(A) (for any person). The ambiguity with this definition lies in the term "instrumentality" of the government. The FCPA has not defined what the term means. However, the DOJ has stated that if a foreign government has even a one percent ownership interest in a company, that minor interest will make the company an instrumentality of that foreign government under the FCPA. *See* Stephen A. Best, Taken to the Extreme: Prosecutions under the FCPA, MEALEY'S CORP. GOVERNANCE REP., Dec. 2003, at 22. This determination is problematic in former communist states such as China, where it is difficult to distinguish between government and non-government officials. *See* Murphy, *supra* note 50 at 244. This difficulty arises because the government once owned and controlled every part of the Chinese economy. After the Cold War ended, many state-owned enterprises went to private parties and entities. Nevertheless, the government still maintains a significant role in the Chinese economy and its development. *Id*. As a result, U.S. corporations and their Chinese subsidiaries must proceed with caution. It may be virtually impossible to know if one's business associate meets the criteria of being an instrumentality of the government. Thus, simple acts such as, inviting or taking a business associate to dinner, could cause FCPA liability to ensue. Furthermore, *de facto* members of the government are included in the definition of foreign officials. *See* DEMING, *supra* note 90 at 12. In the realm of guanxi (connections/network), *de facto* members of the government may include family members of government officials depending on how involved they are.

According to the Act's definition of a "public international organization," organizations whose officials are given diplomatic immunity under U.S. law may not receive illicit payments. *See* 15 U.S.C. §§ 78dd-1(f)(2)(B) (2004) (for issuers), 78dd-2(h)(2)(B) (for domestic concerns), 78dd-3(f)(2)(B) (for any person). Such organizations as the United Nations, the World Bank, the International Monetary Fund, and even the Hong Kong Economic and Trade Offices and the Asian Development Bank qualify as a "public international organization." *See* 22 U.S.C. § 288 (contains a list of all the organizations that have immunity under the International Organizations Immunities Act).

[94] induce or influence a foreign government official to act or omit to act, to secure an improper advantage,[95] or in order to obtain, retain, or direct business to any

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[94] Although the FCPA prohibits offers, payments, promises to pay, or authorizations of the payment of anything of value in a corrupt way, it does not define "corruptly." *See generally* 15 U.S.C. §§ 78dd-1(f) (2004), 78dd-2(h), 78dd-3(f) (these are the definitional sections of the Act; upon review one will not find a definition for "corruptly"). *See also* Taylor, *supra* note 64 at 872 (discussing the corrupt intent requirement and how the FCPA fails to define the term "corruptly" thus one must look to legislative reports for such a definition). Nonetheless, Congress did give some guidance in the legislative history of the FCPA. In a Senate Report, Congress stated that "corruptly" implies "an evil motive or purpose, [and] an intent to wrongfully influence the recipient." *See* S. REP. NO. 95-114, at 10 (1977). Accordingly, the term "corruptly" indicates that the offer, payment, promise to pay, or authorization of anything of value "must be intended to induce the recipient to misuse his official position in order to wrongfully direct business to the payor or his client…" *Id*. Courts have followed in this interpretation. *See, e.g.,* United States v. Tomblin, 46 F.3d 1369, 1379 (5th Circuit 1995) (holding that the corrupt intent contains a *quid pro quo* aspect; thus the recipient must take the thing of value in return for misusing his official power). *See also* H. Lowell Brown, *Parent-Subsidiary Liability Under the Foreign Corrupt Practices Act,* 50 BAYLOR L. REV 1, 4 (1998), citing United States v. Johnson, 621 F.2d 1073, 1076 (10th Cir. 1980) (finding that "the government must show that the money was knowingly offered to a public official with the intent and expectation that, in exchange for the money, some act of a public official would be influenced).

[95] *See* 15 U.S.C. §§ 78dd-1(a)(1)(A)(i)-(iii) (2004) (for issuers), 78dd-2(a)(1)(A)(i)-(iii) (for domestic concerns), 78dd-3(a)(1)(A)(i)-(iii) (for any person). Neither the courts, the SEC, the DOJ, nor Congress has defined "improper advantage." *See* Sperber, *supra* note 67 at 688 n.60. However, some commentators argue that the language represents an attempt to synchronize the FCPA with OECD provisions. *See* Gleich & Woodward*, supra* note 78 at 556, n.64 citing Alan Cohen, *Foreign Corrupt Practice Act*, *in* CONDUCTING DUE DILIGENCE 1999, at 611, 644 (PLI Corp. L. & Prac. Course Handbook Series No. 1119, 1999) (describing implementation of the FCPA amendments). Nevertheless, the corrupt intent and the inducement or influencing a foreign official are closely linked. *See supra* note 94. Namely, the *quid pro quo* aspect of the mandatory corrupt intent represents the official act or omission that an offender seeks to induce to secure an improper advantage, obtain, retain, or direct business. Overall, the anti-bribery provisions criminalize any effort by a covered party to influence or induce a foreign government official to use her official power improperly to assist the offender. *See* 15 U.S.C. §§ 78dd-1(a)(1)(A) (2004) (for issuers), 78dd-2(a)(1)(A) (for domestic concerns), 78dd-3(a)(1)(A) (for any person).

person.[96] However, Congress did limit the breadth of the anti-bribery provisions. The FCPA allows for facilitating or "grease" payments for routine governmental actions.[97] Further, the Act sets forth two affirmative defenses for offenders of the anti-bribery provisions. If the acts in question are legal in the country that they

[96] Under the FCPA, a covered party shall not make or offer to make a corrupt payment in order to acquire new business, renew current business, or to induce or influence the official decisions affecting the execution of existing business. *See* H.R. REP. NO. 100-576, at 918 (1988) (Conf. Rep.). To illustrate, a payment to a foreign public official for the goal of receiving favorable tax treatment constitutes an FCPA violation, because it affects the execution of current business. *See* In re Baker Hughes, Inc., Exchange Act Release No. 44,784, 75 SEC Docket 1808 (Sept. 12, 2001), *available at* http://www.sec.gov/litigation/admin/34-44784.htm. Nevertheless, Congress limited the provision by stating, "the term [retaining business] should not…be construed so broadly as to include lobbying or other normal representations to government officials." *See* Brown, *supra* note 90 at 918-919 (provides a general overview of the FCPA's provisions).

[97] *See* 15 U.S.C. §§ 78dd-1(b) (2004) (for issuers), 78dd-2(b) (for domestic concerns), 78dd-3(b) (for any person). The FCPA establishes "facilitating payments" as those that expedite or secure the performance of routine governmental action by the foreign government official, political party, or candidate. "Routine governmental action" means only action that are ordinarily and commonly performed by a foreign official such as processing governmental papers, obtaining licenses or permits, providing police or phone service. *See* 15 U.S.C. §§ 78dd-1(f)(3)(A) (2004) (for issuers), 78dd-2(h)(4)(A) (for domestic concerns), 78dd-3(f)(4)(A) (for any person). Consequently, "routine governmental action" does not include any decision-making process by a foreign official to grant new business or renew existing business. *See* 15 U.S.C. §§ 78dd-1(f)(3)(B) (2004) (for issuers), 78dd-2(h)(4)(B) (for domestic concerns), 78dd-3(f)(4)(B) (for any person). Further, Congress stated that "actions of a similar nature" would also be viewed as routine governmental action. *See* H.R. REP. NO. 100-576, at 921 (1988) (Conf. Rep.), *available at* http://www.usdoj.gov/criminal/fraud/fcpa/1988hist.htm. These "grease" payments continue to subsist as one of the most controversial aspects of the FCPA due to the ambiguity, because the FCPA does not set a monetary amount to the payments. *See generally* Taylor, *supra* note 64 at 875-876 (for an insightful discussion of the ambiguities throughout the "grease" payments exception).

occurred[98] or if deemed "reasonable and bona fide expenditures"[99] no liability shall exist.

The accounting and internal controls provisions function as another mechanism of enforcement.[100] Congress intended for these provisions to address the problem of issuers hiding their bribery of foreign officials via improper

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[98] If the payment, gift, offer, or promise of anything of value that the offender made is considered lawful under the *written* laws and regulations of the foreign public official's country no liability shall exist. *See* 15 U.S.C. §§ 78dd-1(c)(1) (2004) (for issuers), 78dd-2(c)(1) (for domestic concerns), 78dd-3(c)(1) (for any person). This defense does not actually provide a realistic defense. Although corruption runs rampant in many countries, including China, none of those countries have written laws that such payments are acceptable. In the case of China, there are local commercial and political bribery laws. This fact makes this defense practically useless.

[99] Typically, these types of expenditures are travel and lodging expenses incurred by the foreign official, political party, or candidate. In order to qualify as "reasonable and bona fide expenditure," the expenditure must directly relate to (1) the promotion, demonstration, or explanation of products or (2) the performance of a contract with a foreign government. *See* 15 U.S.C. §§ 78dd-1(c)(2) (2004) (for issuers), 78dd-2(c)(2) (for domestic concerns), 78dd-3(c)(2) (for any person). Yet an offender may not use this defense if a payment is "corruptly made in return for an official act or omission, because then the payment cannot be a bona fide, good-faith payment..." *See* H.R. REP. NO. 100-576, at 922 (1988) (Conf. Rep.), *available at* http://www.usdoj.gov/criminal/fraud/fcpa/1988hist.htm. *See also* United States v. Metcalf & Eddy, Inc., 4 FCPA Rep. 699.749 (D. Mass. 1999) (finding that excessive travel and entertainment expenses paid to a foreign official violates the FCPA).

[100] The accounting and internal controls provisions are broad just like their anti-bribery counterparts. Therefore, they apply to *all* transactions of the issuer, domestic or foreign, corrupt or legal, material or immaterial. *See* S. REP. NO. 95-411, at 18 (1977) (stating that "the word 'transactions' in the [FCPA] encompasses accuracy in accounts of every character"). However, this article shall only focus on foreign transactions of the issuer, specifically those in China in relation to a Chinese subsidiary (including its officers, directors, employees, agents) that an issuer acquired in an M&A transaction.

accounting practices.[101] Therefore, these provisions require all issuers[102] to adhere to certain criteria in relation to their accounting practices, books, records, and internal controls. Issuers must maintain accurate books and records in a way that fairly reports all corporate transactions, not just those deemed material.[103] In accordance, issuers must implement and maintain a system of internal accounting controls that provides various reasonable assurances that all transactions receive

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[101] *See* George, Lacey & Birmele, *supra* note 18 at 7. The SEC uncovered three specific problems that Congress wanted to deter: (1) records that completely failed to record improper transactions; (2) falsified records created to conceal parts of improper transactions otherwise properly recorded; and (3) records that correctly described the quantitative aspects of transactions but did not do so for the qualitative aspects (i.e. the true purpose of certain payments) of those transactions. *See* CRUVER, *supra* note 19 at 14-15 citing SEC Chairman Harold M. Williams, Address at the American Institute of Certified Public Accountants (Jan. 13, 1981), in 46 Fed. Reg. 11,544 (Feb. 9, 1981).

[102] The accounting provisions apply to all issuers that have a class of registered securities pursuant to 15 U.S.C. § 78l and any issuer that must file reports with the SEC pursuant to 15 U.S.C. §§ 78o(d) (2004), 78m(b)(2). Nevertheless, all companies should attempt to meet these criteria, because the anti-bribery provisions may apply to them and following the accounting and internal controls provisions will assist in deterring and detecting illicit payments.

[103] The principal accounting clause requires issuers to make and keep books, records, and accounts, in a *reasonably detailed* manner such that they accurately and fairly reflect the transactions and dispositions of the assets of the issuers (emphasis added). *See* 15 U.S.C. § 78m(b)(2)(A) (2004). Under the Act, "reasonable detail" means "such a level of detail and degree of assurance as would satisfy prudent officials in the conduct of their affairs." *See* 15 U.S.C. § 78m(b)(7) (2004). *See also* H.R. REP. NO. 100-576, at 917 (1988) (Conf. Rep.). This high standard also applies to majority and/or wholly owned subsidiaries of the issuer. Accordingly, an issuer holding more than fifty percent ownership interest must ensure that its subsidiaries adhere to the accounting and internal controls provisions. *See infra* Part III, Section B for detailed discussion of vicarious liability under the accounting and internal controls provisions in relation to a parent and its subsidiary. In contrast, an issuer that holds fifty percent or less of an ownership interest in a foreign company is only required to make a good faith effort in ensuring that said company follows the accounting and internal controls provisions. *See* 15 U.S.C. § 78m(b)(6) (2004).

proper authorization.[104] In order to establish criminal liability under these provisions, the DOJ must prove a person "knowingly circumvent[ed] or knowingly fail[ed] to implement a system of internal accounting controls or knowingly falsif[ied] any book, record, or account."[105] On the other hand, no such knowledge or intent requirement is necessary to establish civil liability of an issuer, because civilly, issuers are strictly liable.

2. Enforcement of the FCPA: Penalties, Fines, & Jail Time, Oh My!

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[104] *See* 15 U.S.C. § 78m(b)(2)(B) (2004). Specifically, issuers must develop and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

(1) management authorizes, generally or specifically, transactions as required; *See* 15 U.S.C. § 78m(b)(2)(B)(i) (2004)

(2) transactions are recorded in a manner that (a) allows for the preparation of financial statements in accord with generally accepted accounting principles or any other criteria applicable to such statements and (b) maintains accountability of assets; *See* 15 U.S.C. § 78m(b)(2)(B)(ii) (2004)

(3) access to assets is only allowed in compliance with the general or specific authorization of management; *See* 15 U.S.C. § 78m(b)(2)(B)(iii) (2004)

(4) at reasonable intervals, someone compares the existing assets with the recorded accountability for assets and if she discovers any differences, appropriate action shall be taken. *See* 15 U.S.C. § 78m(b)(2)(B)(iv) (2004).

Under the FCPA, "reasonable assurances" means "such a level of detail and degree of assurance as would satisfy prudent officials in the conduct of their affairs." *See* 15 U.S.C. § 78m(b)(7) (2004). *See also* H.R. REP. NO. 100-576, at 917 (1988) (Conf. Rep.).

[105] *See* 15 U.S.C. § 78m(b)(5) (2004). Congress did not want to impose criminal penalties for "insignificant or technical infractions or inadvertent conduct." *See* H.R. REP. NO. 100-576, at 916 (1988) (Conf. Rep.). This provision ensures that criminal penalties are imposed where a person purposefully falsified accounts or circumvented accounting controls by an act or omission. *See id*. Therefore, § 78m(b)(5) works together with § 78m(b)(4) which states, "no criminal liability shall be imposed for failing to comply with the requirements of [the accounting and internal controls provisions]." *See* 15 U.S.C. § 78m(b)(4) (2004).

a. The DOJ and the SEC: How the FCPA Gets Enforced

Either the DOJ or the SEC may enforce the provisions of the FCPA.[106] For instance, the DOJ investigates and prosecutes all criminal charges[107] brought against any domestic concern for violations of the Act.[108] The SEC may not bring criminal charges, but it may civilly enforce the anti-bribery and accounting

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[106] Consequently, private parties do not have the right to bring a private action under the FCPA. *See* Lamb v. Phillip Morris, Inc., 915 F.2d 1024, 1029 (6th Cir. 1990) (rejecting the contention of the plaintiffs that "one isolated comment in an earlier House Report mandates recognition of a private action). Nevertheless, they may directly inform the SEC and the DOJ of FCPA violations. The agencies may also receive knowledge of FCPA violations indirectly via private parties filing lawsuits. *See, e.g.,* Barboza, *supra* note 5 at C6 (This article discusses the reasons for a complaint filed in December 2004 by Grace and Digital Information Technology ("GDIT"), a Beijing company, claiming that Alltel Information Services, since renamed Fidelity Information Services, bribed Zhang Enzhao, the then chairman government-owned China Construction Bank. Mr. Zhang resigned in 2005 in the midst of the bribery scandal. The complaint accused him of accepting $1 million in bribes from Alltel in exchange for directing business to Alltel. It also charges that Alltel assisted Mr. Zhang in paying for his son college education in London. The complaint also charges that Alltel paid for Mr. Zhang to travel to Pebble Beach for all-expenses paid golf trip. GDIT argues that the $1 million bribe prevented it from attaining a $58 million contract).

[107] The DOJ issued a statement, in 1979, of its "enforcement priorities" in relation to the anti-bribery provisions of the FCPA. *See* CRUVER, *supra* note 19 at 59 (citing Arthur Heymann, Address, The Justice Department's Proposed Program to Provide Advice to Businesses in Connection with Foreign Payments (Nov. 8 1979). The statement lists a variety of factors that "increase the likelihood" of investigation or prosecution, a few of which are:

- the past conduct of the involved parties; *Id.*
- the making of bribes to a foreign cabinet officer or another high-ranking official; *Id.*
- the size of the payments or the transaction; *Id.*
- the active or passive involvement of senior management officials; and *Id.*
- the involvement of lower-level employees where the corporation failed to perform due diligence in monitoring its employees actions. *Id*.

[108] *See* H.R. REP. NO. 95-640, at 12 (1977) (stating that the DOJ may begin criminal prosecutions and investigations against domestic concerns).

provisions of the Act.[109] However, this authority only reaches issuers and their officers, directors, employees, and agents, and stockholders acting on their behalf.[110] Hence, the DOJ handles all other civil enforcement actions against domestic concerns and individuals other than issuers.[111] Nevertheless, the authority to enforce the FCPA is not always mutually exclusive.

Sometimes the authority to enforce the FCPA is shared between the DOJ and the SEC.[112] To illustrate, the SEC may investigate issuers for appropriate SEC action,[113] but then submit such violations to the DOJ for criminal prosecution.[114] Furthermore, the DOJ may investigate issuers with or without an

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[109] *See* H.R. REP. NO. 95-640, at 9 (1977) (stating that the House does not intend to change the fact that the SEC, "since its creation…has been solely responsible for the conduct of all civil litigation). The report also stated that the SEC is "in a far superior position to investigate [issuers] alleged to have bribed foreign officials." *Id. See also* J. Lee Johnson, *A Global Economy and the Foreign Corrupt Practices Act: Some Facts Worth Knowing,* 63 MO. L. REV. 979, 987 (1998) (addresses the history and the main provisions of the FCPA).

[110] *See* DEMING, *supra* note 90 at 41 (this chapter details how the FCPA provisions are enforced by the DOJ and SEC).

[111] *See* H.R. REP. NO. 95-640, at 12 (1977). *See also* H.R. REP NO. 95-831, at 14 (1977) (Conf. Rep.) (stating that the DOJ may enforce violations of the FCPA by domestic concerns via civil injunctions).

[112] *See generally* SEC v Dresser Industries, Inc., 628 F.2d 1368, 1379 (D.C. Cir. 1980) (finding "the securities laws and the nature of the SEC's civil enforcement responsibilities *require* that the SEC retain full powers of investigation and civil enforcement action, *even after* [the DOJ] has begun a criminal investigation into the *same alleged violations*" (emphasis added)). *See generally* United States and SEC v. KPMG Siddharta, Litigation Release No. 17, 127 (Sept. 12, 2001), *available at* http://www.sec.gov/litigation/litreleases/lr17127.htm (stating that for the first time ever joint civil injunction action was filed by the SEC and the DOJ).

[113] *See* 15 U.S.C. § 78u(a) (2006).

[114] *See* S. REP. NO. 95-114, at 11-12 (1977), *available at* http://www.usdoj.gov/criminal/fraud/fcpa/1977sen.htm ("When the SEC believes it has compiled enough evidence for a criminal action, it refers the case to the [DOJ] for criminal prosecution"). *See generally* 15.U.S.C. §§ 78d-1 (2006) (discussing the delegation of functions of the SEC).

independent SEC investigation.[115] If a case does not involve a criminal prosecution, both the SEC and the DOJ may enforce the anti-bribery provisions against issuers via injunctive remedies.[116]

b. The Attorney General's Guidelines and Opinions: Another Way to Avoid Liability

Due to the 1988 amendments to the FCPA, the DOJ may issue guidelines and advisory opinions to inquirers.[117] However, the inquiry must pertain to *specific* business inquiries.[118] In 1992, the DOJ released a revised advisory opinion procedure allowing issuers and domestic concerns to receive an official government opinion.[119] The opinion informs inquirers as to the acceptability of their proposed actions in terms of the anti-bribery provisions.[120] Hence, the DOJ

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[115] *See generally* SEC v Dresser Industries, Inc., 628 F.2d 1368, 1377 (D.C. Cir. 1980) (holding "the SEC cannot always wait for the [DOJ] to complete the criminal proceedings if it is to obtain necessary prompt civil remedy").

[116] *See* S. REP. NO. 95-114, at 11 (1977) (stating that the only remedy the SEC may initiate on its own is an injunctive action). *See also* CRUVER, *supra* note 19 at 5 (discussing the division and shared enforcement powers of the FCPA by the DOJ and the SEC).

[117] *See* H.R. REP. NO. 100-576 at 923 (1988) (Conf. Rep.).

[118] *Id*.

[119] *See generally* 28 C.F.R. §§ 80.1 - 80.16 (2002) (these sections detail the FCPA opinion procedure).

[120] *See* 28 C.F.R. § 80.1 (2002) (for the purpose of the FCPA opinion procedure).

will not give advisory opinions regarding prospective record-keeping activities.[121] Receiving a favorable advisory opinion also gives the inquirer a rebuttable presumption that its proposed actions do not violate the FCPA. An inquirer may use this presumption in any subsequent action brought under the anti-bribery provisions.[122]

c. The Penalties

An FCPA violation committed by an issuer, a domestic concern, or their agents may result in criminal penalties.[123] To illustrate, issuers or domestic concerns, that are not natural persons, are subject to a criminal fine of up to

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[121] In other words, the DOJ will not release specific guidelines regarding the accounting provisions of the FCPA. *See* 28 C.F.R. 80.1 (2002) (for the purpose and limits of the FCPA opinion procedure)

[122] *See* 28 C.F.R. § 80.10 (2002). The presumption may be rebutted by a preponderance of the evidence. Courts will look to the following factors in considering whether the presumption has been rebutted: (1) whether the information given to the DOJ was accurate; (2) whether the information was complete; and (3) whether the action in question was within the scope of the conduct specified in the request. *Id.* It should be noted that this list is not exhaustive; the DOJ will consider all relevant factors. *Id.*

[123] *See* 15 U.S.C. §§ 78dd-2(g) (2004) (stating penalties for domestic concerns); 78dd-3(e) (stating penalties for any person); 78ff (stating penalties for willful violations and penalties for issuers and officers, directors, stockholders, employees, or agents of issuers).

$2,000,000 per violation of the anti-bribery provisions.[124] These entities may also receive a maximum fine of $25 million for willful violations of the accounting provisions.[125] Additionally, officers, directors, employees, agents, and stockholders may be assessed a criminal fine of up to $100,000 and/or imprisonment for up to five years per willful violation of the anti-bribery provisions.[126] These same individuals may face criminal sanctions for violations

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[124] *See* 15 U.S.C. §§ 78dd-2(g)(1)(A) (2004) (for domestic concerns); 78dd-3(e)(1)(A) (for juridical person); 78ff(c)(1)(A) (for issuers). However, if the violation caused a pecuniary gain or loss, then the alternative fines of the Sentencing Reform Act apply. *See* DON ZARIN, DOING BUSINESS UNDER THE FOREIGN CORRUPT PRACTICES ACT § 8:1.2 (2005). In that instance, an entity may receive a maximum fine of the greater of twice the gross gain or twice the gross loss. *See* 18 U.S.C. § 3571(d) (2006). In addition, chapter 8 of the USSG governs the sentencing of organizations that violate any section of the FCPA. *See* U.S.S.G § 8A1.1-BF1.1 (2005). The monetary amount of the penalty is determined by calculating a base fine and a culpability score. *See* U.S.S.G. § 8C2.4 (2005) (for the base fine calculation). *See* U.S.S.G § 8C2.5 (2005) (for culpability score calculation). The government then changes the culpability score into maximum and minimum multipliers, which are then used to decide the range of the fine. *See* U.S.S.G. § 8C2.7 (2005). The presence of an effective compliance program and/or self-reporting, cooperating, and accepting responsibility when a violation occurs will reduce the culpability score, on the other hand, the involvement of high-level personnel will raise the culpability score, and thus the multiplier range. *See* U.S.S.G. §§ 8C2.5-8C2.6 (2005). Sentencing for individuals who violate the anti-bribery provisions are determined under §2B4.1 of the USSG. The sentencing of individuals who violate the accounting provisions is determined under § 2B1.1 of the USSG. Several factors may increase the offense level including committing a substantial part of a fraudulent scheme outside the U.S. *See* U.S.S.G. § 2B1.1(b)(9)(B) (2005).

[125] *See* 15 U.S.C. § 78ff(a) (2004).

[126] *See* 15 U.S.C. §§ 78dd-2(g)(2)(A) (2004), 78dd-3(e)(2)(A), 78ff(c)(2)(A) (all these sections refer to natural persons). However, if the violation caused a pecuniary gain or loss, then the alternative fines of the Sentencing Reform Act apply. *See also* DON ZARIN, DOING BUSINESS UNDER THE FOREIGN CORRUPT PRACTICES ACT § 8:1.2 (2005). For individuals, these fines could total up to $250,000 per violation or the greater of twice the gross gain or loss that any person derived due to the violation. *See generally* 18 U.S.C. § 3571(b)–(d) (2006). Furthermore, fines imposed on individuals may not be paid by their employer or principal. *See* 15 U.S.C. 78ff(c)(3) (2004).

of the accounting provisions, i.e. a maximum fine of $5 million and/or twenty years in prison.[127]

An FCPA violation committed by an issuer, a domestic concern, or their agents may also result in civil remedies[128] and civil penalties.[129] All issuers are subject to a civil penalty of up to $10,000 for each violation of the anti-bribery provisions.[130] In addition, any officer, director, employee, agent, or stockholder acting on behalf of an issuer is subject to the same penalty.[131] A civil penalty of $10,000 for each violation of the anti-bribery provisions also applies to domestic concerns and their officers, directors, employees, agents, or stockholders.[132]

Other than the criminal and civil sanctions, a violation of the anti-bribery provisions by corporations may negatively affect the eligibility for various

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[127] *See* 15 U.S.C. § 78ff(a) (2004).

[128] The SEC may conduct an administrative proceeding and enforce such civil remedies as the following: injunctions, cease and desist orders, order an accounting or disgorgement. *See* DON ZARIN, DOING BUSINESS UNDER THE FOREIGN CORRUPT PRACTICES ACT § 8:1.1 (2005). Such remedies apply to the accounting provisions. *Id*.

[129] *See* 15 U.S.C. §§ 78dd-2(g)(1)(B) (2004) (for domestic concerns); (2)(B) (for officers, director, employee, agent, or stockholder of a domestic concern); 78dd-3(e)(1)(B) (for juridical person), (2)(B) (for natural person); 78ff (1)(B) (stating penalties for willful violations and penalties for issuers and officers, directors, stockholders, employees, or agents of issuers).

[130] *See* 15 U.S.C. § 78ff(c)(1)(B) (2004).

[131] *Id*.

[132] *See* 15 U.S.C. § 78dd-2(1)(B), (2)(B) (2004). Similarly, any natural person who violates the anti-bribery provisions shall face a civil penalty of up to $10,000. 15 U.S.C. § 78dd-3(e)(2)(B) (2004). In addition, any juridical person faces the same fate. 15 U.S.C. § 78dd-3(e)(1)(B) (2004).

government programs.[133] Such violations may also cause corporations or individuals to be disbarred or suspended from various government agencies.[134] Such violations may also result in the suspension of export licensing privileges.[135] Due to the amount of penalties and types of sanctions a corporation may face because it or its agents violated the FCPA, adherence to the Act becomes a top priority.

III. Parent-Subsidiary Liability under the FCPA

When a U.S. public corporation ventures into China seeking to conduct a highly profitable M&A transaction, parent-subsidiary[136] liability under the FCPA should become a high priority. These aspiring parents must prioritize the FCPA

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[133] *See* DON ZARIN, DOING BUSINESS UNDER THE FOREIGN CORRUPT PRACTICES ACT § 8:2 (2005).

[134] *See id.* at § 8:2.1 (2005).

[135] *See id. at* § 8:2.2 (2005).

[136] Recall, that the term "parent" connotes a U.S. issuer that owns a majority interest in a foreign company or wholly owns a foreign company. Also recall, the term "subsidiary" shall mean a majority or wholly owned foreign company of a U.S. issuer.

for two reasons: (1) parent-subsidiary liability affects both the pre-[137] and post-

[137] Discovering past FCPA violations of a target company could terminate the entire deal. Although a would-be parent saves itself from acquiring unwanted liability from the target company, it still suffers the loss of time, effort, and money spent during the pre-acquisition due diligence stages. Because the actions of a subsidiary may cause liability to transfer to its parent under the FCPA, an M&A transaction requires extensive due diligence prior to the deal. If the subsidiary has past violations of the FCPA, the parent may become the entity that must pay the penalties and suffer the sanctions. This fact may terminate the entire deal. *See generally* Accounting and Auditing Enforcement, SEC Release No. 2204 (Mar. 1, 2005) (The Release details the following facts. One of the most recent examples of an M&A deal that terminated because of FCPA violations occurred in June 2004. The $2.4 billion merger between the Lockheed Martin Corporation ("Lockheed") and Titan Corporation ("Titan") failed. When Lockheed decided to acquire Titan, it made the announcement and the extensive due diligence began. Unfortunately, Lockheed discovered FCPA violations that Titan's compliance program should have detected but did not. Apparently, Titan began a project to launch wireless phone services in the Republic of Benin in 1998. Titan hired an agent to assist in the project, because the agent claimed to have close ties with the then-President of Benin. This relationship alone did not violate the FCPA, but it should have raised a red flag. The violation occurred when, without properly investigating the agent, Titan began paying the agent over $3.5 million for consulting services. Approximately $2 million went to the election campaign of the incumbent President of Benin at the direction of at least one former senior Titan officer. Titan further violated the FCPA by directing agents to falsify records and submit false invoice as a way of covering up the improper payments. Additionally, Titan lacked an effective internal controls system).

Once the violations were voluntarily reported to the SEC, Lockheed dropped its offering price by $200 million. Lockheed also gave Titan a deadline to cure the problems. If Titan could not cure the defaults prior to the acquisition, then Lockheed would succeed in the FCPA violations. Therefore, after Titan missed the deadline Lockheed abandoned the entire deal. The fiasco finally ended for Titan with a $28 million fine, the largest FCPA penalty to date. The failed deal also caused an increased focus on FCPA compliance in relation to mergers and acquisitions. *See* Kent J. Schmidt and Parker Schweich, *Foreign Corrupt Practice Act Compliance: A New Focus for Mergers & Acquisitions*, Dorsey & Whitney LLP, Feb. 2006. *See generally* Report of Investigation Pursuant to § 21(a) Exchange Act Release No 51,283 (Mar. 1, 2005), *available at* http://www.sec.gov/litigation/investreport/34-51238.htm (This Report details the penalties the SEC levied against Titan. It also lays out another issue for U.S. corporations to address in an M&A transaction—accurate representations and warranties. When Lockheed decided to acquire Titan on September 15, 2003, Titan made the usual representations and warranties. However, it also represented that to its knowledge, neither it nor any of its subsidiaries had violated the FCPA. Titan then publicly disclosed and distributed this representation twice. First, the proxy statement disclosed that "the merger agreement contains representations and warranties by Titan that expire upon completion of the merger as to, among other things … Titan's compliance with the [FCPA]." Second, Titan attached the merger agreement containing the representation to the proxy statement. Then Titan filed the proxy statement with the SEC and circulated it to its shareholders. Although both the proxy statement and the merger agreement were amended after September 15, 2003, the representation by Titan regarding the lack of FCPA violations remained unchanged.

In response to the unchanged representation the SEC issued this Report to "provide guidance [in regards to] potential liability under the Exchange Act Sections 10(b) and 14(a), and Rules 10b-5 and 14a-9 thereunder, for publication of false or misleading material disclosures regarding material contractual provisions such as representations." The SEC does not want issuers

acquisition[138] due diligence stages and (2) parent-subsidiary liability includes

[138] Parent-subsidiary liability affects the post-acquisition stages in two ways. First, the parent typically seeks to prevent responsibility for past violations of its new subsidiary. In order to achieve this goal, the parent will have to stipulate to various terms with the DOJ that will produce unforeseen costs. The DOJ has the authority to release advisory opinions regarding the proposed conduct of an inquirer. *See supra* Part II, Section C(2)(b) which details such opinions. Thus, a parent that finds past violations may inquire as to how to move forward with the deal. Because such advisory opinions will only result from inquiries based on real facts, each opinion only applies to that particular inquirer. *See* 28 C.F.R. § 80.5 (2002). However, other potential inquirers may look to these advisory opinions to get an idea of how the DOJ may respond to their potential or current conduct.

For instance, on January 15, 2003 the DOJ released an advisory opinion in regards to a U.S. issuer who wanted to buy the stock of Company A and then operate it as a subsidiary even after past FCPA violations are discovered. Company A was a U.S. company, which consisted of U.S. and foreign subsidiaries. *See* U.S. Dep't of Justice, FCPA Opinion Procedure Release 2003-01 (Jan. 15, 2003), *available at* http://www.usdoj.gov/criminal/ fraud /f cpa/o0301.htm. Even though this opinion will only apply to the specific inquirer, others have used this opinion as a guideline for what generally must occur if an acquirer (parent) wishes to proceed with an M&A deal where it uncovers that its target company violated the FCPA. First, an acquirer must report its findings to the target, and both companies should conduct parallel investigations and then disclose their findings to the DOJ and the SEC. If both parties wish to proceed, but the acquirer does not want to inherit liability for the past FCPA violations of the target, the acquirer shall do the following after the transaction closes and it owns the target:

(1) the acquirer shall continue to cooperate with the DOJ and the SEC and any foreign law enforcement;
(2) the acquirer will ensure that any wrongdoers receive the appropriate discipline;
(3) the acquirer must disclose to the DOJ all pre-acquisition violations that it uncovers after the completion of the acquisition;
(4) the acquirer shall extend its existing compliance program to the target with any necessary modifications; the program must be reasonably designed to detect and deter, via training and reporting, FCPA violations and foreign bribery laws; and
(5) the acquirer will guarantee that the target implements a system of internal controls, as well as creates and maintains accurate books and records.

If an acquirer does not have the resources to comply with the above criteria, it should consider terminating the deal.

The second way that parent-subsidiary liability factors into the post-acquisition stages stems from establishing and maintaining an effective compliance program and internal controls. Under the FCPA, a parent must ensure that its subsidiary establishes and maintains an effective compliance program and sufficient internal controls. Both of these mechanisms should be designed to detect and deter future FCPA violations.

Incidentally, this aspect of the FCPA makes CDD a high priority for the parent. In order to ensure that FCPA violations do not occur, the parent must properly inform its domestic and foreign employees via an effective compliance program. In situations where the culture of the parent drastically contrasts with that of its subsidiary, like the U.S. and China, the difficulties of teaching a new concept increases. By performing thorough CDD, a parent will discover how the Chinese communicate with each other. In a society such as China where properly addressing each other is important, knowing how to do so will allow a parent to assimilate and not be offensive. This knowledge will assist the parent in teaching its new employees, because the parent will

actions of third parties that the subsidiary hired or contracted, such as agents, sales/market representatives, and consultants.[139] Therefore, U.S. public companies seeking to conduct business in China via an M&A transaction must understand parent-subsidiary liability.[140] Whereas previous sections dealt with the liability in general of covered parties under the FCPA, the following two

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[139] Even if the third party is not governed by the FCPA, a parent may become liability if it authorizes, directs, or ratifies actions of its subsidiary prohibited by the Act. *See* Stuart H. Deming, *The Changing Face of White-Collar Crime: The Potent and Broad-Ranging Implications of the Accounting and Record-Keeping Provisions of the Foreign Corrupt Practices Act*, 96 J. CRIM. L. & CRIMINOLOGY 465, 476 (2006) (stating that an issuer may be held vicariously liable for the activities of a third party if such party acts on behalf of the issuer). The chain of events which establishes that a third party is acting on behalf of a parent and thus creates liability is as follows: (i) a subsidiary makes a payment to a third party (ii) who then bribes a foreign official with all or a portion of that payment, (iii) in order to cover up the payment the subsidiary instructs the third party to create a false invoice, (iv) the subsidiary falsifies its records by incorporating the fake invoice, and then (v) the parent in some manner ratifies the falsification (i.e. reporting the records in its books). In addition, liability would also result if the parent had authorized or directed its subsidiary to instruct the third party to create the falsified invoice. In short, the instant the parent and the subsidiary work together to intentionally falsify records or circumvent the internal controls, the parent will face liability for the misconduct of its subsidiary. As a precautionary measure, when a subsidiary requests approval for questionable activities its parent should expressly and unambiguously disapprove and renounce all of the questionable behavior and document such disapproval. *See also infra* Part III, Section A discussing the three ways that a parent may become liable for its subsidiary. This fact becomes crucial for U.S. issuers acquiring Chinese businesses due to the level of corruption in China and the tendency for bribery, under American standards, to occur due to their cultural beliefs in guanxi and mianzi. *See infra* Part IV, Section C defining guanxi and mianzi and discussing how these concepts increase the likelihood of bribery in China.

[140] The anti-bribery provisions of the FCPA do not explicitly govern subsidiaries. However, Congress expressed its desire to govern implicitly such entities via their parents. *See* H.R. REP. NO. 95-640, at 12 (1977) (Congress stated, "failure to include [foreign] subsidiaries would only create a massive loophole in [the FCPA] through which millions of bribery dollars would flow." Therefore, including the subsidiaries via their parents allows the FCPA "to be an effective deterrent to bribery"). This desire resulted due to the SEC investigations after the Watergate scandal, which revealed that at least sixty-four U.S. public corporations made questionable or improper payments via their foreign subsidiaries. *See* H.R. REP. NO. 95-640, at 21, note 2 (1977). Additionally, nineteen of those corporations made payments totaling at least $1 million over different periods of time. *Id*. Therefore, the anti-bribery provisions implicitly provide for vicarious liability for subsidiaries in both civil and criminal circumstances. *See* 15 U.S.C. §§ 78dd-1(a)(3) (2004) (for issuers), 78dd-2(a)(3) (for domestic concerns).

sections outlines the different ways that a parent company may become liable for the business actions of its subsidiaries.

A. The Anti-Bribery Provisions: The Bribery of the Subsidiary Becomes That of Its Parent

Under the anti-bribery provisions, a parent may have liability for the business conduct of its subsidiary or a third party if any or all of three requirements are met. First, liability for the conduct of a subsidiary emerges if a parent knew[141] that its subsidiary improperly induced a foreign official with anything of value. The knowledge factor is satisfied if a parent was "aware," had a "firm belief," or was aware of a "high probability" its subsidiary is or was

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[141] *See supra* Part II Section C (1) for a detailed discussion of the "knowledge" requirement. The 1988 amendments removed the "reason to know" standard. Now this requirement includes "willful blindness" and "conscious disregard." *See* H.R. REP. NO. 100-576, at 919 (1988) (Conf. Rep.). Likewise, a "conscious purpose to avoid learning the truth" will qualify as the requisite "state of mind" for liability to attach to a parent for the conduct of its subsidiary. *See* H.R. REP. NO. 100-576, at 919-920 (1988) (Conf. Rep.). *But see* DEMING, *supra* note 90 at 30 (arguing that in terms of how the anti-bribery provisions have been enforced little difference exists between the new "knowledge" standard and the old "reason to know" standard). However, the 1988 amendments did change the chance for "mere foolishness" or "simple negligence" to become the basis for liability. *See* H.R. REP. NO. 100-576, at 920 (1988)(Conf. Rep.).

involved in the bribery of a foreign official.[142] Second, if a parent explicitly or implicitly authorizes[143] its subsidiary to make improper payments a parent will

[142] The following circumstances satisfy the "knowledge" requirement:

(1) when the parent is "aware" that its subsidiary is currently involved in an FCPA violation or a parent is substantially certain that its subsidiary will be involved in such a violation; *See* 15 U.S.C. §§ 78dd-1(f)(2)(A)(i) (2004) (for issuers), 78dd-2(h)(3)(A)(i) (for domestic concerns).

(2) when a parent has a "firm belief" that a questionable situation presently exists involving its subsidiary or a parent is substantially certain its subsidiary will be involved in such a situation; and *See* 15 U.S.C. §§ 78dd-1(f)(2)(A)(ii) (2004) (for issuers), 78dd-2(h)(3)(A)(ii) (for domestic concerns).

(3) when a parent is aware of a "high probability" of the existence of an FCPA offense that involves its subsidiary. *See* 15 U.S.C. §§ 78dd-1(f)(2)(B) (2004) (for issuers), 78dd-2(h)(3)(B) (for domestic concerns).

[143] The anti-bribery provisions fail to stipulate a standard for authorization. *See* DEMING, *supra* note 90 at 33. Nevertheless, the legislative history does indicate the term "authorize" means to "order or carry out any act or practice constituting a violation" of the FCPA. *See* H.R. REP. NO. 95-640, at 6 (1977).

face liability.[144] Lastly, liability ensues if a parent maintains sufficient control over its subsidiary such that the law no longer views each entity as separate.[145]

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[144] The anti-bribery provisions prohibit a parent from directly authorizing its subsidiary to make an illicit payment to foreign officials. *See* 15 U.S.C. §§ 78dd-1(a) (2004) (for issuers), 78dd-2(a) (for domestic concerns). The provisions also prohibit a parent from indirectly making such an authorization by allowing or directing its subsidiary to hire a third party who then makes the improper inducement. *See* 15 U.S.C. §§ 78dd-1(a) (2004) (for issuers), 78dd-2(a) (for domestic concerns). In this context, a third party consists of individuals such as sales/marketing representatives, agents, or consultants.

[145] This concept finds it foundation in agency principals. Normally, a parent and a subsidiary exist as two separate entities. Yet, after examining the "totality of the circumstances," a court may find that a subsidiary functions as the "alter ego" of the parent. *See* United Steelworkers of America v. Connors Steel Co., 855 F.2d 1499, 1506 (11th Cir. 1988) (holding that "there is no litmus test for determining whether a subsidiary is the alter ego of its parent." Instead, [the court] must look to the totality of the circumstances, [because] [r]esolution of the alter ego issue is heavily fact-specific"). If a court makes such a determination, then the two entities become one, causing the court to disregard the corporate form or pierce the corporate veil. Hence, the parent shall endure the penalties or sanctions resulting from the FCPA violations of its subsidiary.

In the M&A context, the provisions of the FCPA implicitly disregard the corporate form if a parent corporation owns more than fifty percent of its subsidiary. *See generally* H. Lowell Brown, *Parent-Subsidiary Liability Under the Foreign Corrupt Practices Act*, 50 BAYLOR L. REV. 1, 17-30 (1998) (arguing that a "parent corporation may be compelled to relinquish the protection afforded by the separate incorporation in a subsidiary in order to take the steps reasonably necessary to avoid liability under the FCPA"). This argument comes from a review of the accounting and internal controls provisions. *Id*. Such provisions imply that if an issuer (parent) holds more than fifty percent of the voting power of its subsidiary, the issuer (parent) *must guarantee* that the internal accounting controls are consistent with those of the issuer (parent). *See* 15 U.S.C. § 78(m)(6) (the statute expressly states the standard for devising and maintaining internal accounting controls is less than a guarantee; if an issuer owns fifty percent or less of the voting power of a company such issuer only needs to "proceed in good faith" to implement internal accounting controls in that company). Hence, the FCPA requires that a parent exert such a degree of control over its subsidiary that both entities will more than likely be viewed as one.

The DOJ expressly ignores the distinction between a parent and a subsidiary. According to the Advisory Opinion released by the DOJ on January 15, 2003, if a U.S. corporation wishes to acquire a company that has violated the FCPA prior to the acquisition the deal may proceed so long as various criteria are met. *See* U.S. Dep't of Justice, FCPA Opinion Procedure Release 2003-01 (Jan. 15, 2003), *available at* http://www.usdoj.gov/criminal/ fraud/fcpa/o0301.htm. The two criteria on point state (1) the "[parent] shall *ensure* that its [subsidiary] implements a system of internal controls and makes and keeps accurate books and records;" and (2) that the parent "will extend to [its subsidiary] its existing compliance program modified, if necessary, to ensure that it is reasonably designed to detect and deter, through training and reporting, violations of the FCPA and foreign bribery laws." *Id*. If a parent must commit these acts, there is arguably enough control to render the subsidiary the "alter ego" of the parent, thus the court will disregard the corporate form. *See* H. Lowell Brown, *Parent-Subsidiary Liability Under the Foreign Corrupt Practices Act*, 50 BAYLOR L. REV. 1, 17-30 (1998).

B. Record-Keeping & Internal Controls: The Parent's Level of Care Will Be Its Subsidiary's Level of Care

Unlike the anti-bribery provisions,[146] the accounting and internal controls provisions directly apply to subsidiaries.[147] Specifically, a parent must assure that its subsidiary adheres to the same accounting and internal control standards as the parent.[148] Moreover, a parent may face both criminal and civil liability due to the business activities of its subsidiary.[149] Depending on which type of liability

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[146] *See* H.R. REP. NO. 95-831, at 14 (1977) (Conf. Rep.) (Congress expressed its view that any issuer which engages in bribery of foreign officials *indirectly* via a person *or entity* (i.e. a subsidiary) shall face FCPA liability for the actions of that person or entity (emphasis added)).

[147] *See* 15 U.S.C. § 78m (b)(2) (2004) (requiring issuers to make and keep book accounts in reasonable detail plus establish and maintain a system of internal controls with respect to their operations including their majority owned subsidiaries). *See also* 15 U.S.C. § 78m (b)(6) (2004) (allowing for a lesser standard for issuers that own fifty percent or less of the voting power in another company foreign or domestic). Accordingly, issuers with fifty percent or less of the voting power of another company must only "proceed in good faith" to the extent reasonable to cause the company to create and maintain a system of internal controls. *Id*. It was expected that an issuer with a majority interest in a firm would establish procedures to detect and deter FCPA violations. The expectation resulted from the fact that such issuers had control over such a firm. Congress defined control as "the power to exercise a controlling influence over the management and policies of an [entity]." *See* H.R. REP. NO 95-831, at 12 (1977) (Conf. Rep.). However, after the enactment of the FCPA, issuers became increasingly concerned in regards to their liability with respect to firms which they did not exert control. Hence § 78m(b)(6) was meant to distinguish the responsibility of an issuer with respect to minority and majority interests in another company. Therefore, an issuer should proceed with caution in terms of its degree of control over another company because the duty to influence the business activity of a foreign entity increases with respect to the degree of control. *See* Stuart H. Deming, *The Changing Face of White-Collar Crime: The Potent and Broad-Ranging Implications of the Accounting and Record-Keeping Provisions of the Foreign Corrupt Practices Act*, 96 J. CRIM. L. & CRIMINOLOGY 465, 474 (2006). Furthermore, legislative history expressly states that the degree of ownership an issuer maintains over its subsidiary directly correlates to its influence over its subsidiary in relation to enforcing internal controls and accounting procedures. *See* H.R. REP. NO. 100-576, at 917 (1988) (Conf. Rep.). Therefore, the more an issuer owns of a firm, the more control an issuer has over such firm and the greater the responsibility to comply with the FCPA.

[148] *See* 15 U.S.C. § 78m (b)(2) (2004).

[149] *See* 15 U.S.C. §§ 78m (b)(4)–(6) (2004) (for criminal liability), 78ff(c) (for civil liability).

emerges the knowing requirement varies. In order for criminal liability to flow to the parent, the parent must know that its subsidiary has knowingly circumvented or falsified the records and books.[150] On the other hand, in the case of civil liability, the knowledge requirement of the parent disappears. As a result, a parent may encounter strict liability, in the civil context, for accounting violations committed by its subsidiary.[151]

IV. Cultural Due Diligence in the International M & A Context

Part IV of this Article defines the term cultural due diligence ("CDD") and examines its importance. Additionally, the following sections outline what a parent would discover upon completion of conducting CDD in a Chinese business —the social culture concepts of guanxi (connections/network) and mianzi (status/ face). In conclusion, this Part details how Chinese social culture or societal norms may result in a business environment that breeds corruption and FCPA violations.

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[150] *See Id*. *See also* H.R. REP. NO. 100-576, at 916-917 (1988) (Conf. Rep.) (stating that criminal liability results from "the deliberate falsification of books and records to evade the internal controls requirement"). *See also supra* note 142 for examples of how the knowledge requirement may be satisfied by the parent.

[151] *See,* e.g., SEC v. Chiquita Brands International, Inc., Civ. Action No. 1:01CV02079 (D.D.C.)(filed October 3, 2001), *available at* http://www.sec.gov/litigation/litreleases/lr17169.htm. (Although Chiquita lacked knowledge of the FCPA accounting violations of its wholly owned foreign subsidiary, the SEC issued a cease-and-desist order against Chiquita and filed a settled compliant seeking entry of a consent order requiring Chiquita to pay a $100,000 civil penalty).

A. An Expanded Definition and Process of Cultural Due Diligence

There are two types of cultures—social and corporate. In a social context, "culture" means the beliefs, customs, practices, and social behavior of a particular nation or people.[152] These values and practices pervade a society and become the social culture of that society. On the contrary, in a business framework, "culture" refers to the pattern of norms, values, beliefs, and attitudes that influence individual and group behavior within an organization.[153] These values permeate through the company becoming more polished and tailored in the daily activities of the employees in the company.[154] The distilled result is the corporate culture of the company.

Traditionally, CDD only examines the corporate culture of an organization.[155] This includes a systematic assessment of the human factors[156] in

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[152] *See* MSN Encarta® Dictionary, http://encarta.msn.com/dictionary_/culture.html (last visited August 11, 2006).

[153] *See generally* Roger Miller, *How Culture Affects Mergers and Acquisitions*, 42 INDUSTRIAL MANAGEMENT 22, (2000) (this author discusses the ways to clarify and assess corporate culture; he also provides advice on integrating different corporate cultures once the clarification and assessment of both corporate cultures is completed).

[154] *See generally id*. This article defines CDD as the process of assessing and valuing the organizational culture.

[155] *See, e.g., id*. This article outlines how to clarify and assess organizational culture through a process the author defines as CDD. However, the societal norms of the country where the target company resides does not receive attention.

[156] Human factors include things such as dress code, decentralized or centralized corporate structure, hierarchical or entrepreneurial decision-making, corporate values, leadership, and communication styles.

relation to the environment within a company.[157] However, this definition excludes the social culture of the country where the company resides. This exclusion could lead to FCPA violations by the subsidiary in a couple of ways—the creation of an ineffective compliance program and the lack of skills to adequately communicate the program and its importance to the subsidiary. This is especially true when two circumstances exist. First, when vast differences exist between the social cultures of the parent and its subsidiary, like the U.S. and China. Second, when the social culture of the subsidiary may cause a business environment that breeds corruption and FCPA violations, like China. As a result, this Article proposes that U.S. corporations acquiring Chinese companies need to include social culture or societal norms in their CDD process. Therefore, in this Article, the definition of CDD means researching and analyzing the corporate culture of the business entity as well as the social culture of the society in which the entity resides. By understanding how the societal norms affect Chinese corporate culture, a parent will be in a better position to comply with the FCPA.

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[157] *See* William Scheimann and Jeff Zilka, *The Human Side*, THE DAILY DEAL Oct. 20, 2003. It should also be noted that in a business context, due diligence means the process of research, investigation, auditing, and analysis that takes place before an investment, takeover, or business partnership occurs. *See* Investopedia, http://www.investopedia.com/terms/d/duediligence.asp. In the M&A framework, the pre-acquisition analysis includes a review of the assets and liabilities of the target company and an evaluation of management of the target company. Due diligence is an ongoing process; thus after the M&A is complete the acquiring company may conduct due diligence in the form of monitoring its newly acquired business. Due diligence in the social context is beyond the scope of this Article. However, it refers to those actions that are viewed as prudent, responsible, and necessary to do in order to avoid liability. *See* BARRON'S LAW DICTIONARY 144 (4th ed. 1996).

This Article provides a very broad overview of how such societal norms affect Chinese corporate culture.

B. The Importance of Cultural Due Diligence

To comply with the FCPA, a U.S. company acquiring a Chinese company must devise a corporate compliance program and establish that program within the existing corporate codes of its newly acquired subsidiary.[158] Conducting CDD will make this feat more manageable, efficient, and successful,[159] because the parent will learn how the most significant aspects of Chinese social culture affect Chinese corporate culture.[160] This knowledge will allow a parent to determine the most effective way to structure and communicate its compliance and training programs. For instance, upon discovering that in China individuality does not receive the same emphasis as it does it in the U.S., a parent could create its

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[158] This Article presupposes that a U.S. company acquiring a Chinese company will operate it as a subsidiary governed by the FCPA.

[159] Performing a merger or acquisition poses its own inherent difficulties and obstacles. Adding to this complication is the reality that unless the parent is an "acquisition machine," acquisitions are transactions that only happen on rare occasions. The term "acquisition machine" means a corporation that achieves financial success by consistently conducting acquisitions, thereby making acquisitions the central core of its business. A good example of an acquisition machine is California-based telecommunications equipment manufacturer Cisco Systems. Since its first acquisition in 1993, it has averaged about one acquisition every six weeks for thirteen years. As of June 2006 Cisco has completed 110 acquisitions. In about a ten-year period, its revenue increased nearly twenty-fold from just $1.2 billion in 1995 to $22 billion in 2004. *See Cisco Plans for China*, ASIA TIMES ONLINE, June 18, 2005, http://www. atimes.com/ atimes/ China/GF18Ad01.html.

[160] In this Article, only the foreign employees (i.e. those of a Chinese subsidiary) will receive attention. Although it should be noted that a corporate compliance program must be followed by all employees, domestic and foreign.

programs tailored to this characteristic. Perhaps by rewarding groups rather than individuals for proper compliance.

Incidentally, performing CDD will also indicate to the DOJ that a parent exercised the mandated due diligence toward FCPA compliance.[161] Although exercising due diligence will not act as a defense to an FCPA violation, it may act as evidence that the parent did not have the requisite knowledge to commit a violation under the anti-bribery provisions.[162] The DOJ may infer that a parent had knowledge of an FCPA violation committed by its subsidiary if it determines that a parent did not exercise sufficient due diligence. Likewise, the DOJ may determine that a parent intentionally created an ineffective compliance program if that parent cannot prove it exercised adequate due diligence in creating and establishing its program.

A parent should perform as much due diligence as possible in order to protect itself from FCPA liability. If the DOJ determines that a parent exercised proper due diligence, it may lessen the penalties of a parent if its subsidiary commits a violation.[163] The U.S. Sentencing Committee released seven minimum

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[161] *See* U.S.S.G § 8B2.1(b)(1), (4) (2005) (the statute states that an organization shall exercise due diligence in order to detect and deter criminal conduct).

[162] *See supra* note Part III, Section A for the discussion of the knowledge requirement in regards to parent liability. *See also supra* Part I, Section D for discussion of the main features of the USSG.

[163] *See supra* Part I, Section D discussing how a parent may lessen its liability under the FCPA.

steps that a parent should take in order to satisfy the due diligence requirement.[164] The main steps require a parent to establish a compliance program that will deter and detect FCPA violations, and communicate the program to its employees, including those of its subsidiary. Conducting CDD *prior* to the implementation of the compliance program allows a parent to use the results in the creation *and* communication of the program. The DOJ may perceive this as demonstrative that the parent did everything possible to ensure that its subsidiary would not violate the FCPA.

Consequently, conducting CDD has two important functions and thus a parent should not ignore it when conducting an M&A in China. First, it operates as proof that a parent did not intentionally create a weak compliance program. Second, a parent may also utilize CDD as a tool for discovering all the cultural aspects of its newly acquired Chinese subsidiary. These findings will assist the parent in creating and communicating a compliance program for its Chinese subsidiary. In turn, this will help the parent achieve its ultimate goal of deterring and detecting FCPA violations.

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[164] *See* U.S.S.G § 8B2.1(b) (2005). *See also supra* note 39 and accompanying text for the seven suggested steps to follow to comply with the due diligence requirement.

C. How Chinese Social Culture Affects Chinese Corporate Culture in an FCPA Context

Upon completion of CDD, a parent will discover the Chinese cultural concepts of guanxi (connections/network) and mianzi (status/face). These ideals govern both social and business roles of the Chinese. Moreover, the ideals could potentially create a corporate culture that consistently violates the FCPA. Thus, a parent will want a thorough understanding of guanxi and mianzi. The subsections below provide a broad overview of these concepts.

1. Social Culture: Guanxi and Mianzi

Performing CDD will reveal two of the most significant aspects of Chinese culture—guanxi and mianzi. These concepts are so deeply rooted in Chinese social culture that they will inevitably affect business roles within and activities of a Chinese company. Although the essence of guanxi and mianzi promotes harmony, when strictly followed in a Chinese company governed by the FCPA the likelihood for corruption and bribery increases.[165] As a result, a parent of a Chinese subsidiary must understand guanxi and mianzi in order to ensure compliance with the FCPA. By knowing how these concepts affect FCPA violations, a parent will be better equipped to devise and establish an effective

[165] An example of a Chinese business governed by the FCPA is a Chinese business that is wholly or majority owned or controlled by a U.S. publicly traded company.

compliance program tailored to the needs of its Chinese subsidiary. Describing the elements of such a program is beyond the scope of this Article. However, this Article will address how the Chinese social culture pervades the corporate culture of a Chinese company in a way that my cause FCPA violations.

a. Guanxi: Social and Business Connections and Networks of Relationships

In China, making human connections and networking (i.e. guanxi) is an essential part of one's existence.[166] More than just connections, guanxi promotes harmony and proper social order through reciprocity and mutual obligation.[167] Guanxi functions as a tool for material and immaterial support;[168] it provides personal power based on mutual trust.[169] Without guanxi, accomplishing anything

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[166] *But see* Randall Peerenboom, *Globalization, Path Dependency and the Limits of Law: Administrative Law Reform and Rule of Law in the People's Republic of China*, 19 BERKELEY J. INT'L L. 161, 264 n.341 (2001) (citing Douglas Guthrie, *The Declining Significance of Guanxi in China's Economic Transition*, 154 CHINA Q. 255 (1998)). The article argues that in the urban industrial area the reliance on guanxi is decreasing due to the formation of formal legal structures and the emergence of a market economy. *Id.* In consequence, legal rules and procedures are increasingly determining corporate culture. Due to market reforms, the pressure on managers to show a profit is increasing. *Id.* As a result, guanxi is no longer as important as price, quality, and reliability. *Id.* Nevertheless, the significance of guanxi varies in relation to a person's place in the administrative hierarchy. *Id.* Similarly, managers of smaller companies still believe guanxi as most important. *Id.*

[167] *See* Patricia Pattison & Daniel Herron, *The Mountains Are High and the Emperor is Far Away: Sanctity of Contract in China*, 40 AM. BUS. L.J. 459, 484 (2003).

[168] *See* ZINZIUS, *supra* note 7 at 183.

[169] Guanxi has become a "work-around to the state government by providing information and avenues to obtain needed jobs, housing, goods, and services." *See* Pattison & Herron, supra note 167 at 484.

in China is virtually impossible.[170] As a result, the Chinese will dedicate a vast amount of time to assembling a solid network of family, friends, and acquaintances. Due to the functionality of this network, friends and acquaintances are often strategically chosen.[171]

To develop guanxi the Chinese reciprocate giving gifts and doing favors. For example, if X gives a gift to or does a favor for Y, Y now has the obligation to reciprocate the gift or favor. This indebtedness must always be repaid or reciprocated. The mutual obligation provides the foundation of guanxi. Additionally, the repayment is typically unequal; thus allowing the relationship to continue, because there will always be a gift or favor to reciprocate.[172]

There are three levels of guanxi.[173] The inner-circle or first level consists of family members, by both marriage and birth.[174] These are the most trusted and honored relations of guanxi.[175] The second level includes non-family members

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[170] *See* ZINZIUS, *supra* note 7 at 182. The author states that guanxi may help in situations dealing with tickets, licenses, bank transactions, legal protection and/or legal enforcement. *Id*.

[171] For instance, business people in China devote a lot of time building guanxi with respectable people. *See* Pattison & Herron, *supra* note 167 at 484.

[172] *See* Pattison & Herron, *supra* note 167 at 485.

[173] *See* Pattison & Herron, *supra* note 167 at 484 n.170 (citing Ming-Jer Chen, Inside Chinese Business 48 (2001)).

[174] *See* ZINZIUS, *supra* note 7 at 182.

[175] *Id*.

who have a significant connection based on trust or shared experiences.[176] This second level may include people from one's place of employment.[177] The last level consists of strangers who are not trusted because they are unknown.[178] The Chinese do not maintain a sense of responsibility or obligation to strangers. However, those in the third level may be elevated to the second level by overcoming the mistrust associated with strangers.[179] Likewise, those in the second level may be demoted to the third level.

b. Mianzi: Saving, Gaining, Losing, or Borrowing Face

Mianzi refers to one's self-image, reputation, character, and social standing.[180] A direct translation of the term "mianzi" is "face." The importance of mianzi stems from the focus of the Chinese on maintaining guanxi (connections). Face functions as an evaluation of status within the network or circle of connections. Face also involves promoting harmony and proper social order. In order to maintain harmony the Chinese must save face (weihu mianzi)

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[176] *See* Pattison & Herron, *supra* note 167 at 485.

[177] *See* ZINZIUS, *supra* note 7 at 182-184.

[178] *See* Pattison & Herron, *supra* note 167 at 484.

[179] *Id*.

[180] *See generally* ZINZIUS, *supra* note 7 at 121. *See also* Peter W. Scott & James Calvert, *Chinese Business Face: Communication Behaviors and Teaching Approaches*, BUS. COMM. Q., December 1, 2003, at 9-10 (The amount of mianzi a person has reflects the status of that person; thus if a person has a lot of mianzi that person has a high status and if a person has little or no mianzi such person has a low status).

by protecting their social and business roles.[181] Consequently, the Chinese ensure that social and business relations are structured in a manner that allows the involved parties to save face. Saving face in a relationship involves maintaining the proper emotion, etiquette, and relational position within such relationship.[182]

Just as a person may save face, she may also gain, lose, or give face.[183] To illustrate, when X shows Y respect or otherwise expands the reputation of Y,[184] X has given face (gei mianzi) and Y has gained face (zengjia mianzi).[185] On the contrary, if X compromises or disrespects Y in front of third parties, then both X and Y have lost face (diu mianzi).[186] Hence, mianzi also has a mutuality element. Moreover, the family members and acquaintances of both X and Y lose face.[187] A person may also lose face by not keeping promises, meeting expectations, or

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[181] *See generally* Scott & Calvert, *supra* note 180 at 9 ("This article describes how Chinese businesspersons conceptualize [mianzi] face and communicate accordingly").

[182] *See id*. at 9-10 (stating these values are demonstrated in relationships between parent and child, elder and younger, and superior and subordinate).

[183] It should be noted that mianzi concepts also apply to groups. Thus, a member of a group may cause the mianzi of the entire group to change (i.e. increase, decrease) or be borrowed. *See* Scott & Calvert, *supra* note 180 at 9, 11 (businesspersons will often praise the accomplishments of their peers in business or social functions as a way of increasing the mianzi of the praised individual and the group).

[184] Additional examples of giving face or expanding the reputation of a person include giving gifts, applause, agreeing with a person, or showing praise in front of peers or superiors.

[185] *See* Scott & Calvert, *supra* note 180 at 10.

[186] X has lost face because he has disrespected Y, which does not promote harmony.

[187] *See* Pattison & Herron, *supra* note 167 at 487.

disregarding social norms.[188] A person may also regain face by somehow rectifying the situation. Depending on the severity of the social faux pas, regaining lost mianzi may come with a simple apology.[189] Hence, the amount of mianzi can change, either by a person's own actions or by how others treat a person.

Mianzi and guanxi intertwine if a lower status person needs to borrow face (jie mianzi) from a higher status person. To illustrate, when X (a lower status person) wants to communicate with Y (a person of higher status), X will use one of the contacts in her guanxi (network) that has more mianzi (status) than X.[190] This intermediary will have enough status to communicate with Y on behalf of X. In this situation, X has borrowed the face (jie mianzi) of her intermediary to be introduced to Y. The intermediary will expect X to reciprocate this favor to the intermediary.

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[188] *See* ZINZIUS, *supra* note 7 at 123.

[189] *See* Scott & Calvert, *supra* note 180 at 10-11.

[190] This situation frequently occurs in the corporate world. As a result, understanding mianzi and how it relates to guanxi becomes important. Imagine a scenario where X, an employee in a Chinese subsidiary, borrows the face of Y, a family member of Z, in order to be introduced to Z, a foreign official, who then offers X a major contract or other business deal. However, in order to for the deal to go through, Z insists that X pay Y a large "service fee." In China, such a payment is viewed as maintaining and building guanxi (network/connections). However, under the FCPA a violation has occurred because X, an employee in a Chinese subsidiary, has bribed a foreign official, Z. Even though Z did not receive the payment himself, he received a benefit from Y receiving the payment. Thus, Z has received a "thing of value" under the Act.

2. Corporate Culture: Guanxi and Mianzi in the Chinese Workplace

The cultural concepts of guanxi and mianzi are the basis for the rules of Chinese society. They not only permeate social roles; they also pervade business roles. Thus, a parent of a Chinese subsidiary must understand how these concepts affect the corporate culture of its newly acquired Chinese subsidiary. Compliance with FCPA makes this knowledge a necessity. This subsection addresses how guanxi and mianzi affect the corporate culture of a Chinese subsidiary in terms of the FCPA.

a. How Guanxi Affects Foreign Corrupt Practices Act Compliance

The concept of guanxi does not dissipate in the business context. In China, the core of business consists of establishing relations by developing and nurturing guanxi.[191] Therefore, a parent will want to establish trust with its newly acquired Chinese subsidiary. Because the Chinese value family first and then friends and acquaintances, company loyalty in China is not as important as it is in Western countries.[192] Usually a parent will begin in the third level because the

[191] *See* ZINZIUS, *supra* note 7 at 159.

[192] *See* ZINZIUS, *supra* note 7 at 161.

parent is unknown to the subsidiary.[193] However, by showing it can be trusted a parent will be elevated within the third level or even to the second level of the guanxi of its subsidiary.[194] This feat will take time, but the result remains invaluable because the Chinese will view the effort as an indication of mutual respect.[195] Moreover, if a Chinese subsidiary lacks a sense of responsibility towards its parent, it will not feel obligated to follow the direction of its parent, including the compliance program. If a Chinese subsidiary does not abide by the compliance program FCPA violations will inevitably ensue.

The reciprocity and mutual obligation aspects of guanxi increase the chances that a Chinese subsidiary will commit FCPA violations. In the social context, reciprocity and mutual obligation are not only acceptable but also required in order to build up adequate guanxi (connections). This mentality also exists in the business context. In fact, in the corporate arena the reciprocity of guanxi may even increase because accomplishing business-related tasks in China is determined by whom one knows. As a result, managers in a Chinese subsidiary

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[193] For instance, the Chinese often regard foreigners who come into their country as businesspeople as "civilized strangers" as long as they save the mianzi of their future employees. This status may be elevated to "an esteemed stranger" if the businesspeople already have status of their own or if they commit acts that result in an increase in their status. *See* ZINZIUS, *supra* note 7 at 125.

[194] Because the family is the highest inner-circle of guanxi, a Parent who appeals to and supports family may gain acceptance into a higher level within the third level or elevate directly to the second level of guanxi.

[195] *See* ZINZIUS, *supra* note 7 at 184.

need to maintain good relations with the relevant government officials to guarantee timely delivery of their products and/or raw materials, or supply of necessary resources, like water and electricity. Such payments would usually receive the label of "grease" payments under the FCPA. However, if those payments are extremely high they become a violation. Due to the reciprocity element of guanxi, a small payment may not fulfill the obligation. According to guanxi principles, favors should be reciprocated unequally, thus maintaining the gift-giving relationship. Consequently, a permissible "grease" payment suddenly turns into an FCPA violation because it will more than likely be more valuable than allowed under the Act.

b. How Mianzi Affects Foreign Corrupt Practices Act Compliance

The respect element of mianzi will affect the corporate culture of a Chinese subsidiary in a manner that may violate the FCPA. To illustrate, if a person treated her subordinate as she would her superior, she causes herself to lose face, because she has not respected the hierarchy within the company. Therefore, a parent should make sure that it knows the corporate hierarchy of its subsidiary and address those individuals appropriately. A parent will not want to lose face and taking care to know who the top officials in the target company will assist the parent in gaining face. Additionally, if a parent decides to change the

hierarchy of its Chinese subsidiary it should do so quickly and unequivocally. The parent would not want to lose face by creating a corporate environment where the employees of the subsidiary do not know how to treat each other. This might be viewed as a lack of respect for the Chinese culture and result in disobedience. Disobedience could come in the form of a disregard of the FCPA compliance program.

The saving face element of mianzi may further create a corporate culture in a Chinese subsidiary that may lead to FCPA violations. A parent will want the employees of its Chinese subsidiary to report suspicious or questionable behavior that may violate the FCPA. The concept of saving face may prevent this, especially if a subordinate must report a superior. Moreover, an employee may not report her peers because supporting her peers in a compromising position helps her peers to save face.[196] The action of helping peers in a compromising position indicates that the helper has credibility and creates trust among business partners.[197] Therefore, in order to save face, some employees may tell untruths or make unwise business decisions,[198] some of which could lead to FCPA violations or the cover-up of FCPA violations. For example, if an employee made an

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[196] *See* ZINZIUS, *supra* note 7 at 123. *See also* Scott & Calvert, *supra* note 180 at 11 (It is demanded that Chinese businesspeople be skillful at saving mianzi for their fellow businesspersons and giving mianzi to their fellow businesspersons).

[197] *See* Peter Scott & Calvert, *supra* note 180 at 11.

[198] *See* Pattison & Herron, *supra* note 167 at 487.

improper payment the discovery of which would lead to her receiving disciplinary action, her superior may assist her by attempting to hide such payment by mislabeling it or not reporting it. If this false report goes undetected and is incorporated into the accounting records of the parent an FCPA violation has occurred.

Further, the principles of mianzi produce an environment for FCPA offenses to transpire in a Chinese subsidiary because rejecting a request typically results in a loss of face. If an employee in a Chinese subsidiary is conducting a business transaction with a foreign official, the employee will want to save face. Thus, if the foreign official asks for an improper payment the employee may agree to such payment as a way of saving face. In addition, if the employee has a lower social status than the foreign official does, the employee may wish to gain face by agreeing to make the improper payment. Even though the initiation of the bribe came from the foreign official, the parent of the Chinese subsidiary will ultimately be held liable under the Act.

The losing face component of mianzi also influences the area of discipline in a Chinese subsidiary in a manner that could cause FCPA violations. A parent must proceed with caution when it wishes to discipline its Chinese subsidiary, because a person loses face when she receives criticism or insults in front of a

third party.[199] If a parent loses face this could cause the Chinese subsidiary to no longer obey the parent or its compliance program. Therefore, a parent should prevent direct, public disciplinary actions and instead instruct an intermediary who holds a respected position in the guanxi of the disputant.

In the business context, an employee of a Chinese subsidiary may gain face by keeping and enhancing high-profile business relationships and obtaining favorable business contracts. The desire to do so, however, may result in bribery to attain those goals. In order to win business contracts Chinese employees may offer or promise gifts, money, or other valuable favors to the individual that decides to whom to award the contract. The Chinese would view such actions as developing guanxi. On the other hand, the FCPA deems such acts as bribery if the recipient is a foreign official or somehow affiliated with or an instrumentality of a foreign government.[200]

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[199] Other losing face scenarios in the corporate arena include directly addressing conflict and acting aggressively or arrogantly. *See* Scott & Calvert, *supra* note 180 at 11.

[200] Beyond these differing cultural views, other factors also contribute to the likelihood of a Chinese subsidiary violating the FCPA. The FCPA does not define an "instrumentality" of the government. Nonetheless, the DOJ recently stated that even a one percent ownership of a corporation by a foreign government suffices to make the corporation an instrumentality of that foreign government under the FCPA. *See* Stephen A. Best, *Taken to the Extreme: Prosecutions under the FCPA*, MEALEY'S CORP. GOVERNANCE REP., Dec. 2003, at 22. This broad standard becomes highly problematic in a former communist country like China. In China, the distinction between government officials and non-government official under the FCPA may not be obvious. *See supra* note 93 for a discussion of the ambiguity between government and non-government officials in China. Therefore, determining who or what an "instrumentality" of the government becomes even more difficult, because the threshold issue of determining whom or what is the government may not be possible. All these facts coupled with the desire to build relationships via gift giving or doing favors increases the chances for FCPA violations to occur. Thus, the broad standard of an "instrumentality" of the government creates a minefield filled with potential FCPA violations.

V. Conclusion

According to Thomson Financial, a division of the Thomson Corporation, the first quarter of 2006 turned out to be an extremely active period for international mergers and acquisitions with over 7,000 deals worth $843 billion.[201] However, studies indicate that a larger majority of mergers and acquisitions fail.[202] One of the major causes for this failure comes from the cultural aspects of both the target company and the acquiring company being overlooked. If more acquiring companies would perform CDD the risk of failure would dramatically decrease.

Traditionally, the process of CDD involves examining and assessing the corporate culture of both the acquiring and target companies. This is necessary in order to compare and contrast the cultures. However, when a U.S. acquirer conducts an M&A transaction in a foreign country, like China, where the societal norms are vastly different from those in the U.S. and such societal norms could lead to a corporate culture that violates U.S. laws, the process of CDD must

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[201] *See* Alistair Barr, *Thomson Insight: First Quarter to be Third-Busiest Ever for Global M&A*, THOMSON FINANCIAL NEWS, March 28, 2006.

[202] Failure in this context refers to the acquiring company not achieving the anticipated strategic results of the merger or acquisition. *See* Jennifer D. Duell, *Management Matters*, COMMERCIAL PROPERTY NEWS MAGAZINE, July 1, 2004. *See also* Mary van der Boon, *Cultural Due Diligence: Why Mergers Fail,* EXPATICA, Sept. 2002, *at* http:// www.expatica.com/source/ site_article.asp?channel_id=7&story_id=11577 (stating that "according to International Labour Organization 70% of mergers and acquisitions worldwide fail to meet their strategic objectives within in two years."). Nonetheless, CDD still gets overlooked because according to Patricia Whalen, an assistant professor at Northwestern University "culture is one of those things that you live in but it is very difficult to actually measure and define." *Id*.

expand. The expansion involves including societal norms or social culture in the CDD process. As a result, the U.S. corporation will have a solid view of both the corporate and social cultures of the Chinese company it seeks to acquire. All this knowledge will assist the U.S. corporation in managing its newly Chinese company thus preventing another failed M&A.

If a failing merger or acquisition does not create the need for CDD, the DOJ and the SEC have definitely done so. Due to the recent increase in FCPA investigations and enforcement actions, a U.S. corporation seeking to venture into China via an M&A deal needs to conduct CDD. China has a history of bribery and corruption; unfortunately, such behavior still exists today. In addition, the social culture or societal norms of the Chinese pulsate through the society such that it enters the corporate world. When this occurs in a Chinese subsidiary that the FCPA governs, it could result in heavy fines totaling millions of dollars for the parent U.S. corporation. However, performing CDD will give the parent sufficient knowledge about its newly acquired Chinese subsidiary such that the parent will be able to comply with the FCPA.