The Chinese Puzzle Box: the Conundrum of Distinguishing a Permissible Gift from an Illegal Bribe

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With recent headlines proclaiming stringent enforcement of the U.S. Foreign Corrupt Practices Act ("FCPA") by the U.S. government, companies covered by the FCPA can no longer afford to maintain an attitude of "business as usual" in China. The FCPA prohibits U.S. companies and companies listed or having sponsored ADRs on U.S. stock exchanges from corruptly offering or providing anything of value to a "foreign government official" – including employees of state-owned entities ("SOEs") – for the purpose of obtaining or retaining business. U.S. companies doing business in China are often faced with the conundrum of deciding whether a gift is a permissible business courtesy or whether it has crossed the fine line into being an illegal bribe. The FCPA’s all-encompassing inclusion of "anything of value" within the definition of what constitutes a potentially corrupt payment or offer casts a wide net. Accordingly, because neither the FCPA nor case law sets any specific dollar-value threshold to distinguish a permissible gift from an illegal bribe, the question of whether a gift could be construed as an illegal bribe has been and continues to be the subject of much scrutiny and debate and corporate heartache. The issue is particularly relevant and sensitive in China given its gift-giving culture and "guanxi" – the complex dance of business courtesies and hospitality that forms the social foundation for conducting business in China.

State-owned Entities as Government Actors

In China, where most primary sectors, such as banking, power, telecommunications, and oil and gas, are predominantly state-owned, even rank-and-file employees at SOEs are deemed 'government officials' for purposes of the FCPA. Further, many of these 'government officials' behave like private players in commercial playing fields and not in the manner traditionally associated with the behavior of government officials.

Illegal payments do not necessarily have to be given as cash payments and can also come in the form of lavish gifts such as Rolex watches, real estate, stocks, fancy sports cars or even paid university tuition for an official’s son or daughter. The myriad forms in which companies provide bribes are limited only by the creativity of the bribe-payer. Notably, while the FCPA does not expressly prohibit the giving of gratuities or gifts, the U.S. government takes the position that lavish gifts and entertainment constitute illegal bribes when made in connection with obtaining or retaining business or business advantages (such as reduced taxes or customs levies). This poses cultural challenges in China.
where gifts and entertainment are expected and required just for business people to get a foot in the door.

Promotional Expenditures – The Affirmative Defense

The FCPA provides an affirmative defense for promotional expenditures incurred in connection with bona fide and legitimate business purposes. Such expenses must be bona fide and reasonable in value and directly related to the demonstration, promotion or explanation of products or services. Whether expenditures satisfy this affirmative defense is a highly fact-specific analysis and typically involves specific situations where product demonstration or training is provided. Other than specific situations covered by this affirmative defense, the U.S. government has tended to view high-value gifts and business courtesies with suspicion.

PRC Anti-Corruption Laws and Regulations

No discussion would be complete without examining another key consideration which many companies commonly overlook—local law. Notably, many of the FCPA’s prohibitions overlap with similar prohibitions under PRC law. For example, it is a criminal offense to provide PRC public officials with “money, property, fees or kickbacks” in order to obtain an improper advantage.¹ Unlike the FCPA, “public officials” in this context includes PRC government officials and specifically designated officials at or assigned to SOEs and does not include the rank-and-file employees at SOEs. It is also a criminal offense for private commercial parties to provide or receive money or property of “relatively high value” to secure an improper advantage.² Additionally, commercial bribery is prohibited in connection with the sale or purchase of goods and services.³ Notably, although PRC law does not specifically include employees of SOEs within the definition of public officials, such individuals are covered under PRC anti-commercial bribery laws.

Furthermore, PRC government officials are required to make filings with the authorities for any gift received (this administrative filing requirement does not explicitly include meals) that is valued at CNY100 or above.⁴ For any gift valued at CNY200 or above, the government official must “make a filing” and “hand up” the gift to the PRC authorities. But, if the aggregate value of the gifts that an official receives in a certain year exceeds CNY600, the recipient is supposed to “hand up” those additional gifts. Furthermore, all cash gifts, negotiable securities or gold and silver jewelry items are supposed to be “handed up” and the relevant filings must be made, excluding those gifts given between relatives and friends.⁵ Most importantly, the regulations mandate that PRC government officials “hand up” all gifts regardless of value, which may influence the “fair performance” of their official duties and that the relevant filings must be made.

In light of these criminal and civil law prohibitions and administrative regulations, gift giving should be tempered where prohibited under PRC law, even if the gift-giver itself may not necessarily be subject to all of these requirements.

One way in which some companies covered by the FCPA have deferred to local law considerations is to fix the threshold for any gift-giving at the CNY200 limit, thereby allowing public officials to comply with administrative requirements while fixing the value of the gifts at something that the U.S. government would also likely find to be reasonable. It is unlikely that a gift valued at CNY200 could be interpreted as influencing a decision to award business to a company. Nonetheless, in the past, enterprising individuals have attempted to bypass gift value thresholds by providing a large number of gifts, each valued at the CNY200 threshold, to the key decision-making individual so that the total value of gifts received far exceeds the minimum threshold.

To Gift or Not to Gift

Determining whether a gift is appropriate starts with an examination of local law and customary practice. One caveat to this is that the U.S. government has taken the
position that it is not a valid defense to assert that the company's actions do not violate the FCPA simply because all of its competitors are doing the same thing. Furthermore, even widespread industry practice is not a valid defense. Accordingly, local law and customary practice are not definitive, but merely serve as guidance.

Companies with Chinese operations are often called upon to decide what type of gift to give customers during major holidays such as the Spring Festival. This is a difficult decision, particularly in a business climate where some competitors give red envelopes containing cash ("hong bao") in amounts up to several thousand Chinese Yuan while others host and pay the costs for top customers' internal social functions and contribute annual party raffle prizes, ranging from transportation cards to MP3 players to overseas air tickets. Gifts are traditionally given during two major holidays in China – the Spring Festival (Lunar New Year) and the Mid-Autumn Festival. Prior to Spring Festival, in February or March of each year, hong bao are traditionally given, both in social and business settings. Although local tradition and practice appear to mandate cash gifts during the Spring Festival, cash gifts create the appearance of impropriety, and many companies covered by the FCPA therefore prohibit them out of prudence.

During the Mid-Autumn Festival, in September or October of each year, mooncakes are traditionally given. In contrast to hong bao, giving a box of mooncakes generally does not pose a problem and appears to be a perfectly acceptable business courtesy during the holiday season. However, compliance officers and executives should scrutinize even those requests to give government agencies and customers mooncakes. It is not uncommon for mooncake boxes to contain cash or other high value gifts at the bottom of the box. In other instances, vouchers are given instead of mooncakes.

Again, while this may look fine on the surface, upon digging a little deeper, the company may learn that the vouchers were exchanged for the cash value of the mooncakes so the recipient or customer never receives the mooncakes. As mooncakes can range in value from the relatively inexpensive CNY100 per box to thousands of Chinese Yuan per box, this gift is not always just a box of tasty sweets. Needless to say, understanding the precise nature of the proposed gift is critical to determining when a gift is a "gift" or something more nefarious.

Companies need to determine whether giving the proposed gift will create an appearance of impropriety. The non-exhaustive list of factors include the following: (i) the reasonableness of the gift as a matter of local business practice and custom, (ii) the identity of the recipient, (iii) whether there is any pending business or any pending approvals before the recipient, (iv) the frequency of gift-giving to the recipient, (v) the value of the gift, (vi) whether such a gift is being provided openly and transparently, and (vii) the overall circumstances surrounding delivery of the gift.

If the gift is not being given for the purpose of influencing business, and there is no current business pending before the government official or entity, then the gift may be acceptable under the FCPA, which, again, does not prohibit a company from giving a true gift. However, if there is a pending business contract before the recipient, either a state-owned entity or official and the contemplated gift is costly and the intended recipient just so happens to be the decision-maker, these circumstances create an appearance of impropriety. The U.S. government would likely view the gift with suspicion. Companies should therefore understand the risk that giving that gift will carry.

Sometimes the circumstances surrounding a proposed gift must be examined in light of past and anticipated future behavior. A company may decide that it is appropriate to give a gift valued at CNY1,000 for the Spring Festival, but then a second gift one month later valued at CNY3,000 for the official's birthday would likely not be appropriate given the aggregate total given. Alternatively, if there is currently no pending contract before that official's...
agency or department but the company is aware of or anticipates a potential sale within another month, a risk-adverse company would likely decide to not allow the gift to be given. Alternatively, the company may decide that giving more gifts with lower values to the officials or department presents far lower risk and therefore is tolerable.

**Varying Corporate Policies**

Some companies have no approval policy in place directly addressing gifts for officials, while others vest discretion for so-called ‘reasonable’ expenditures in a responsible businessperson. Other companies fix strict dollar-value thresholds with or without approved exceptions. Approval for gifts is typically given by one or more of the following: corporate management, legal department, ethics or compliance officers, and/or country or general managers.

In the absence of a clear policy, the burden resting on the decision-makers’ shoulders to exercise the proper discretion can be unbearably high - particularly in light of the potential risks under the FCPA for any approved improper payments. Hence, because of the inherent risks in making these types of judgment calls, some companies have prohibited the giving of gifts or business courtesies altogether.

In the ideal world, it would not be a violation of the FCPA and one could even arguably gift an official with a case of Chateau Lafite so long as there is an absence of intent to influence. However, it becomes very difficult to defend against the perception that giving such a lavish gift creates, particularly given the limitations on the affirmative defense discussed above. Further, where the acceptance of the gift is dubious or not permitted under PRC law or administrative regulations, giving high-value gifts of this nature carries significant risk - risk that many FCPA-covered entities are not-or should not be-willing to bear.

In sum, whether a particular business courtesy crosses the line of propriety and does not constitute a violation of the FCPA cannot be answered by referring to a simple yes or no checklist. In this age of increased enforcement under the FCPA, companies must tread carefully along the line of providing business courtesies which may create the perception of impropriety. While the FCPA does not prohibit companies from giving gifts to PRC government officials and employees of SOEs, providing extravagant gifts to those individuals presents risks that companies must monitor and evaluate – both under the FCPA and PRC laws and regulations. Companies that are covered by the FCPA should ensure that they have in place a rigorous approval system and policy regarding business courtesies to avoid inadvertently running afoul of the FCPA. Further, they should be actively monitoring on a periodic basis how the policy is applied and compliance with the policy.

**This article was published by**


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1 The threshold for a criminal commercial bribery offense is CNY5,000 for the recipient of the bribe, CNY10,000 for individual bribe-payers and CNY200,000 for enterprise bribe-payers. PRC Criminal Law, art. 389. Under Article 3 of the Regulations on Standards for Filing a Case for Investigation by the People's Procuratorate Directly (Trial), promulgated by the Supreme Procuratorate and effective as of September 16, 1999 ("Standards for Filing a Case"), a criminal case should be filed against public officials who accept CNY5,000 in bribes or who "extort money or property" from others. Additionally, Article 5 of the Standards for Filing a Case states that a criminal case should be filed against individuals who give bribes exceeding CNY10,000 or "pay bribes for illegal interests", among other things.

2 PRC Criminal Law (revised and promulgated by the National People's Congress on Mar. 14, 1997 and effective on Oct. 1, 1997), arts. 163 and 164.

3 PRC Anti-Unfair Competition Law (promulgated by the Standing Committee of the National People's Congress on Sept. 2, 1993 and effective on Dec. 1, 1993), art. 8.

4 See Measures for the Registration and Management of Gift Acceptance by Officials of Central Party Organs and Government Institutions in Internal Communications (promulgated by the Government Offices Administration of the State Council on Sept. 2, 1995 and effective as of the same date) (the "Measures"), art. 3.

5 See Measures, arts. 1 and 2.

6 U.S. v. Kay, 359 F.3d 738 (5th Cir. 2007).