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Olympic Boom in China Will Mean More U.S. Corruption Penalties, Say Consultants

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By [Matt Squire](#)

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The United States is likely to ramp up penalties against financial institutions and other companies that have bribed Chinese officials to gain entry into the Asian market, including business involving the Olympics, say financial consultants.

Violations of the Foreign Corrupt Practices Act (FCPA), which criminalized bribing foreign officials and employees of state-owned enterprises, have risen in recent years. The U.S. Justice Department and Securities and Exchange Commission have increased penalties from a total six in 2003 to 36 last year, according to a report by the law firm Gibson Dunn & Crutcher LLP.

With China's extensive government spending billions of dollars on services and construction related to the Olympics, "there's a lot of opportunities for Foreign Corrupt Practices violations in China right now," said Ellen Zimiles, chief executive officer of Daylight Forensic & Advisory, a New York-based regulatory compliance consultancy.

The vast amounts of money and rigid time constraints associated with the Olympics present "enormous" FCPA risks, said Alexandra Wrage, president of anti-bribery compliance consulting group TRACE International, in Annapolis, Md.

"People are trying to meet contract deadlines, and then they get obstreperous government officials with their hands out," said Wrage. "The temptation is quite high to make an inappropriate payment."

Under the FCPA, U.S. companies can be fined as much as \$2 million for bribing a foreign official in order to win business deals. Furthermore, there is no minimum dollar amount threshold applicable to the law.

"Technically you could bribe somebody not only with cash but with a logoed leather portfolio if you intend to get business in exchange for that," said Wrage.

And, at times, shifting cultural standards from country to country can lead companies to inadvertently violate FCPA regulations, he said.

"You can take a government official to a meal, or you can take a government official to a meal that is lavish and there is no guidance as to which is which," said Wrage. "The FCPA is probably the least predictable and least transparent law that I've dealt with."

In October 2006, a subsidiary of Portland, Ore.-based Schnitzer Steel Industries agreed to pay \$7.5 million as part of a deferred prosecution agreement on charges that the company made payments to Chinese officials in return for their business. Faro Technologies, a Lake Murray,

Fl.-based manufacturing software company was fined \$1.1 million in June 2008 for making \$4.9 million in bribes to Chinese officials for their business.

The potential for bribery and kickbacks in Olympic contracts is "just part of a broader problem," related to China's government-controlled economy said Laurence Urgenson, a partner with Washington, D.C.-based law firm Kirkland & Ellis.

"Everyone seems to be wearing a government hat," said Urgenson "It seems, at times, that everyone that foreign businesses deal with are government officials, so that creates a particular source of risk."

Complicating the issue for U.S. compliance officers is the fact that Chinese and other foreign officials often mask kickbacks by using government-sponsored consultants as intermediaries, said Zimiles.

"I've seen situations where someone from the government told the client 'You may want to hire this guy, he's very good in getting things done,'" and that person may be a relative of the government official, said Zimiles. "When the government is telling you who to hire, that can be a red flag."

Intermediaries can also take the form of companies indirectly owned by government officials in offshore jurisdictions, said Richard Dean, a partner in Washington, D.C.-based law firm Baker & McKenzie.

Compliance departments who vet the deals should determine whether intermediaries have a clear business purpose or are justified in getting their compensation, said Dean. Moreover, U.S. companies should be sure the intermediaries perform the duties they've been contracted to, he said.

In some cases, Chinese officials might solicit bribes through a one-time payment to a "favorite charity," said Zimiles. "All of sudden, they get a contract."

U.S. investigators have also penalized companies for bribing Chinese companies with travel and entertainment, bringing Chinese government employees to foreign plants under the auspices of learning about foreign technology, said Urgenson. "That otherwise legitimate conduct also provides opportunities for payments and abuse," he said. .

Lucent Technologies, for instance, agreed to pay a total of \$2.5 million in fines levied by the DOJ and the SEC for bribing Chinese officials between 2000 and 2003 with free sightseeing in the United States in exchange for telecom equipment projects.

Financial institutions that bank companies violating the FCPA have a hard time digging through the layers of intermediaries to discern the bribes, said Dean.

For banks, his is particularly difficult "where you have some kind of distribution network," said Dean. "Instead of using an intermediary, the fraud is set up through an entity that is one of the companies in the chain of distribution."

Under such a scheme, the funds used in the bribe are created through a mark up of the price of the goods as they travel between entities in the distribution chain, he said.

Before financing a business deal, banks should feel comfortable with their customers' plans to do business in China, said Zimiles. "In order to get the financing, the customer should have to demonstrate why they believe that it will be successful," Zimiles.

The Chinese have spent close to \$41 billion on infrastructure, energy, transportation and water supply projects between 2001 and 2007 to prepare for the 2008 Summer Olympics in Beijing, according to an August 4 report by *The Shanghai Daily*.

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