

# Compliance Investigations in China Take On New Urgency

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The ongoing trade tensions between the U.S. and China have caused some U.S. companies to become increasingly concerned that the Chinese authorities may subject their local operations to closer scrutiny, leading these companies to conduct internal compliance reviews to minimize any risks to their businesses. For their part, U.S. authorities have stepped up scrutiny of Chinese companies, as evidenced by the Department of Justice's (DOJ) "China Initiative." (See our November 29, 2018, client alert "[DOJ Announces 'China Initiative' to Investigate and Prosecute Chinese Companies.](#)") Prudent executives of multinational companies are right to be vigilant in ensuring that any compliance and employee misconduct issues in their China-based operations are promptly detected, investigated and remediated. U.S. companies doing business in China also should pay close attention to key areas of interest to the local authorities.

## Be Mindful of Local Laws

For U.S. lawyers, the instinctive response upon being alerted to potential misconduct is to gather all the relevant facts — immediately, if possible. This instinct must be tempered with caution when the matter requires evidence-gathering in China, as Chinese authorities, to avoid infringement on the country's sovereignty and the privacy rights of its citizens, impose strict limits on the types of "investigations" that nongovernmental and unlicensed actors can conduct. China also has increasingly stringent laws relating to data collection that, if breached, can expose a company to civil and criminal liabilities in China.

## Protect the Attorney-Client Privilege

While Chinese attorneys are prohibited from breaching client confidences, disclosing information to the authorities is permitted — indeed, required — in various circumstances. Chinese law does not provide analogous concepts to attorney-client privilege and the

work-product doctrine that entitle the attorney to resist, on the client's behalf, the Chinese government's requests for information. Because of the absence of legal privilege in China, U.S. courts have upheld subpoenas and discovery requests directed at communications between Chinese counsel and their clients. To preserve the privilege under U.S. law, companies should structure China-based internal reviews — particularly those that may also implicate issues of U.S. law — under the direction of U.S.-qualified attorneys and memorialize this arrangement at the outset of the engagement.

## Have a WeChat Policy

WeChat, an instant communications app commonly installed on smartphones, has become so ubiquitous in China that it has largely replaced corporate email for many employees. Because a WeChat account is tied to a phone number, unless an employee uses multiple phone numbers, he or she is likely to have only one WeChat account for both personal and business use.

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This raises a host of challenging compliance and legal issues, but few companies have clear policies and procedures regarding WeChat use. The DOJ's updated Foreign Corrupt Practices Act Corporate Enforcement Policy, which has been incorporated into the United States Attorneys' Manual, now conditions the award of cooperation credit on the company having a document retention policy that "prohibit[s] employees from using software that generates but does not appropriately retain business records or communications" — a description that takes direct aim at communications apps like WeChat. Companies should examine how employees use WeChat and devise policies that both comply with legal requirements and take into account the realities of modern electronic communications in China.

### **Stand Behind Remediation Decisions**

China's labor laws are among the most stringent in existence and impose a highly demanding standard of proof. Hence, a company may devote significant resources to completing an investigation and arrive at robust remediation decisions, only to encounter substantial pushback from the human resources department or Chinese labor lawyers when they are asked to execute the disciplinary recommendations or terminate an employee. However, the failure to terminate "bad apples" or implement remediation decisions potentially exposes the company to further (and typically far more serious) violations of law and internal policies, and it may be regarded by U.S. regulators as a failure

to remediate, jeopardizing the company's credibility and any cooperation credit to which it may otherwise be entitled. None of this suggests Chinese labor law considerations are secondary. However, disciplinary decisions, once made, should not be revoked lightly.

### **Cultivate a Robust Compliance Culture**

Cultivating a robust compliance culture and a strong compliance tone from the top is paramount but may be especially difficult for multinational companies in China. Depending on the industry, foreign companies may have no choice but to partner with a Chinese joint venture (JV) to enter the Chinese market, which may have a vastly different compliance culture. Moreover, as compliance remains a relatively new business concept in China, companies in China very rarely have stand-alone compliance departments, much less ones with the stature and autonomy necessary to deter and investigate violations and change behavior. There is no magic formula to inculcating a strong culture, but being prepared is a good starting point.

Before entering into a JV relationship, companies may consider conducting enhanced due diligence to identify the areas where improvements are needed and get all parties to commit to a remediation plan as part of the deal terms. Consideration should also be given to structuring the reporting lines to enable the local compliance personnel to report directly to company headquarters instead

of local business managers and supervisors, thereby insulating them somewhat from local business pressures.

Another noteworthy area is training. While easy-to-administer online trainings have their place in a company's repertoire, nothing can replace in-person, impactful sessions utilizing local and recent real-life examples delivered in the employees' native language to small groups. Recent DOJ statements make it clear that companies relying on trainings that do no more than go through the motions will not be entitled to much, if any, credit from prosecutors and regulators in the event of violations.

### **Conclusion**

The enforcement landscape for U.S. companies with operations in China may prove challenging in the coming year. The same may be true for Chinese companies with a U.S. presence. To be prepared, companies should ensure that they have a robust compliance infrastructure in place to detect and remediate issues in their China-based operations and seek legal counsel in navigating different U.S. and Chinese legal requirements.

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