Conducting investigations in China: four common pitfalls

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Conducting an investigation in a foreign country can be challenging, given the unfamiliarity with local laws, dynamic market conditions, the unpredictability of local enforcement actions and language barriers.

In China, many of these challenges are magnified. An investigation must contend with China’s vast and diverse market, unique social dynamics, the need to navigate a complex regulatory system and numerous enforcement authorities as well as the lack of publicly available guidelines and precedents to indicate how the laws and regulations might be enforced. In this update, we share with you four of the most common investigation pitfalls that companies operating in China may face.

1. Potential FCPA implications? Your biggest risk may be Chinese authorities

Traditional US-led compliance investigations often focus heavily on potential US Foreign Corrupt Practices Act (FCPA) implications. However, in China, President Xi Jinping’s ongoing anti-corruption campaign – now in its fifth year – has created heightened local bribery and corruption risks, including more aggressive enforcement action by local authorities. In addition to addressing concerns about FCPA compliance, businesses should also think about potential local criminal and administrative law bribery offense implications under the PRC Criminal Law and the PRC Anti-Unfair Competition Law (the latter deals with administrative level offenses).
In addition, when conducting an investigation in which the cross-border transfer of data may be required, other Chinese laws may come into play. This suggests the need to consider potential implications of laws and regulations governing state secrets, personal information and cybersecurity. Some of these laws and regulations have only recently been updated or promulgated, adding uncertainty around the ways they may be enforced in practice.

The enforcement of these varying laws and regulations is scattered across a number of local enforcement authorities, hence adding to the difficulty of mapping out a clear compliance/risk matrix. Company counsel should consider how relevant local authorities may address any potential misconduct being investigated (by both central and local authorities), in addition to how US authorities may examine such conduct under the FCPA. Companies need to prepare for possible local enforcement action, and not just focus on legal and regulatory implications outside of China.

2. Defining misconduct within and beyond the FCPA definition of “government official”

Since the Chinese definition of a "government official" is different from the FCPA's, the potential for some confusion may arise when compliance professionals inquire about the company's interactions with "government officials." Applying the broader FCPA definition means many state-owned/controlled companies' employees could be considered "government officials." Yet state-owned/controlled companies make up some of the largest companies in China. As a result, there are some interesting examples of individuals in China who could potentially be "government officials" under the FCPA due to their employment status with a state-owned/controlled company. Examples may include your joint venture partner's representatives, agents or employees; beer brewery sales staff; travel and vacation booking agents; bankers; journalists; health care professionals and even car-hire company drivers.

Furthermore, where misconduct points to individuals who are not "government officials" under the FCPA definition, the analysis does not end. PRC criminal and administrative bribery offenses cover both "government official" conduct as well as commercial bribery conduct among private parties.

Companies should consider taking a two-step approach to this situation. First, we suggest that legal counsel thoroughly explain the breadth of the FCPA definition of "government official" to local China colleagues by way of examples, so that they better understand the potential touchpoints. Second, set out a comparison of the US and Chinese definitions of "government official" to accurately map out your FCPA risk as well as potential PRC bribery concerns. Bear in mind that PRC bribery risk could include conduct which falls outside the scope of the FCPA to include private parties, which necessitates a separate local law analysis. If necessary, check with outside expert counsel on the nuances of the two different interpretations affecting your analysis.

3. Your investigation might not be confidential

Few challenges are as critical as protecting the investigation's confidential fact-finding process and its independence from potential conflicts of interest. Company dynamics on the ground are difficult to control, particularly when local departments may be more loyal to the business leader or the local general manager. Be very careful about sharing details of the investigation with anyone, including even the very existence of the investigation.

Additional threats to your investigation's confidentiality may arise from the use of social media. In China, smartphones are widely used by employees to covertly record meetings or interviews or to take pictures of documents or whiteboards, in an effort to use this information in an unauthorized manner. Employees also aggressively use personal social media chat platforms such as Wechat and QQ (similar to WhatsApp and Facebook) to take company-related discussions offline. These actions take place despite the fact that they often violate company policies. The consequent spread on these public social media platforms of rumors and misinformation may affect employee morale while threatening the confidential and independent nature of the investigation.

4. Everything can be faked

Trust in the company's local team is a fundamental part of effectively doing business abroad. However, it is important to know that, in China, almost everything can be faked. From fictitious meetings to forged invoices and counterfeit tax fapiaos (official government invoices) to paid actors posing as business executives, the creative
attempts to circumvent company policies and commit fraud against the company are numerous. For instance, there are channels available (literally called “yellow cattle” in Chinese) for employees to purchase fake invoices and other fabricated documentation that allows them to submit fake reimbursement claims; the funds generated are then used to pay bribes or are siphoned off to fund other illegal purposes.

Understanding the challenges of investigations and being able to anticipate potential problematic practices early on will lead to a more effective investigation – from targeting the correct areas to investigate to putting together the initial investigation plan and assembling the right internal and external components for your team.

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