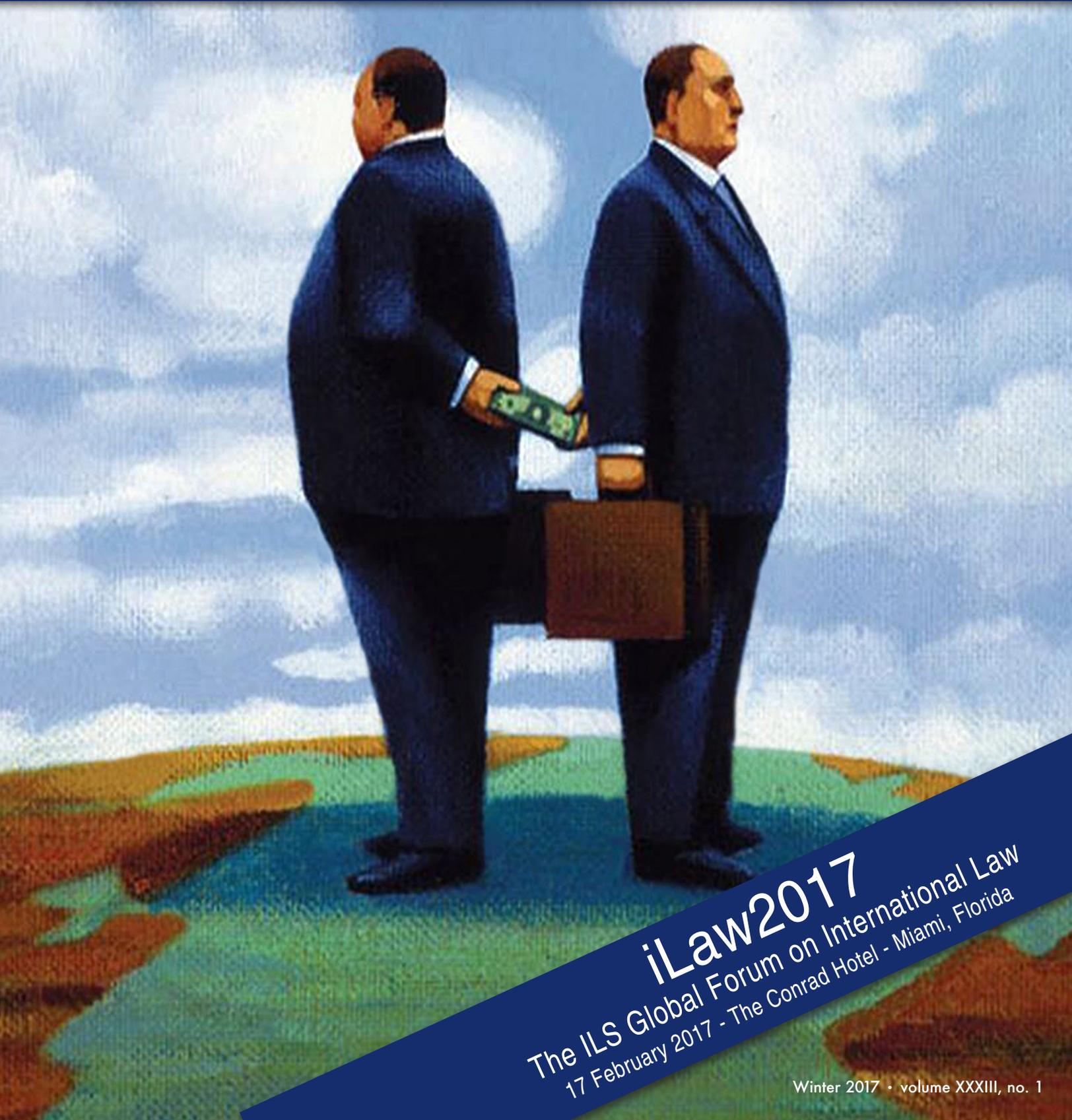


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Investigations in the Middle Kingdom: What Florida Lawyers Need to Know About Internal Investigations in the People's Republic of China

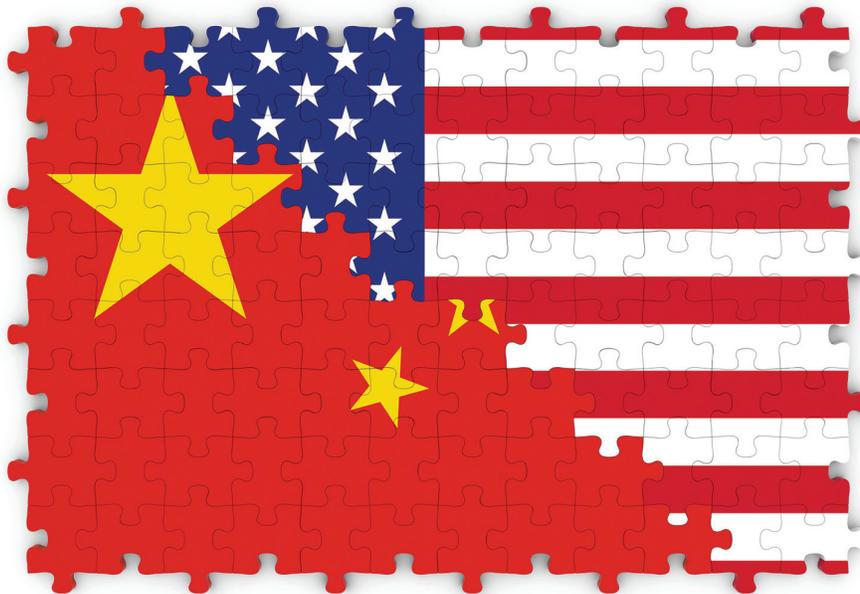
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As China's importance in the global economy has increased, so too has its importance to corporations with global ambitions. But this extended reach has also coincided with increased enforcement efforts from both within and outside of Asia. Extraterritorial enforcement efforts by U.S. regulators in China have been particularly noteworthy, especially in the anti-bribery field—financial press reports on new settlements for violations of the U.S. Foreign Corrupt Practices Act in China seemingly occur every week. In light of these enforcement efforts, corporations operating in China are often called upon to identify and manage risks within their business, including through the use of internal investigations.

But internal investigations in China are unlike those conducted in the United States in almost every respect—including the differing legal framework, data protection regulations, state secret laws and the confidentiality of attorney-client communications. And these stark legal differences are magnified through the lens of cultural and language differences.

The rocky shoals of Chinese law are not for the faint of heart, but the right map can guide investigators through the straits. To conduct an effective internal investigation in China—as in any jurisdiction—preparation is

paramount. This article addresses the key considerations for conducting internal investigations in China, including issues regarding state secrets and data privacy laws, varying attorney-client privilege laws and preserving *Upjohn* protections across language and cultural differences.



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Don't Take Attorney-Client Privilege for Granted

The first step in any internal investigation is to communicate with the client and triage any potential violations of law, and the existence of attorney-client privilege is critical to these communications. But the concepts of attorney-client privilege and the related attorney work product doctrine—despite their ubiquity in the United States and other jurisdictions—do not apply in China. While China has no U.S.-style attorney-client privilege, the People's Republic of China (PRC) legal system does recognize a limited confidentiality

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protection for attorney-client communications. Attorneys have a duty—and may also have a right—to keep confidential information learned during their representation. But attorneys in China can be made to disclose evidence that may threaten “national or public security,” which is often defined broadly. The limited privilege also does not exclude attorneys from the obligation to testify or prevent government demands to attorneys to cooperate by producing work product or other information. Attorneys may even be sanctioned for concealing important facts. Given these characteristics, attorney-client privilege in the Chinese context is better understood as a limited set of confidentiality stipulations than a legal doctrine.

The unclear role of in-house counsel in China makes this picture even murkier. China’s limited confidentiality protection only applies to licensed attorneys practicing in law firms registered in China or to licensed foreign lawyers working out of the local office of a registered international firm—it does not apply to in-house counsel. Indeed, because a lawyer who goes in-house loses an affiliation with a law firm, in-house counsel in China are by definition not registered attorneys. Because of this nuance, some U.S. courts have held that even U.S. attorney-client privilege rules do not apply to such communications.¹

This dynamic bears consideration at every step in an investigation, including whether in-house counsel will participate in interviewing witnesses and who outside counsel will brief about their findings at the conclusion of the investigation. Investigators should ensure that any internal investigation is conducted at the explicit direction of legal counsel and that it is clearly established at the outset that the investigation is for the purpose of providing legal advice. As an added protection, however, investigators should limit exposure of privileged documents to Chinese lawyers and in-house

counsel in China. Where the confidentiality of attorney-client communications is uncertain, investigators are better safe than sorry.

Know Your Data and Proceed Cautiously

Once the parameters of an internal investigation have been set, the investigators must collect any materials—both paper and electronic files—that may be relevant to the potential wrongdoing. The key early days of any fast-moving investigation are often spent resolving IT-related threshold questions. In China, several regulations make the collection and analysis of documents a delicate task.

Perhaps the most important applicable regulation in China is the State Secrets Law, which prohibits unauthorized individuals and entities from acquiring, possessing, recording, storing or transferring outside of China information deemed to be a “state secret.” State secrets are broadly defined to include documents related to areas deemed important to PRC national interests, which include categories familiar to U.S. lawyers with experience in the U.S. export control regime but also include broad and ambiguous categories covering topics such as economic development and a catch-all



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category for other matters classified as secret by the PRC government. Importantly, Hong Kong is treated as a foreign country for purposes of the State Secrets Law, so state secrets data sent to Hong Kong is considered an export under the law. This factor looms large for the many international law firms with an office in Hong Kong but not mainland China.

The export of information that is classified as a state secret before it has been reviewed and cleared of sensitive information can violate the State Secrets Law and subject the company and its attorneys to severe administrative law and/or criminal sanctions. In 2012, for example, Chinese regulators classified accounting data on local Chinese firms as a state secret, rendering it illegal to export such data abroad, even when such companies were listed on foreign stock exchanges. This classification ensnared the Chinese affiliates of the “Big Four” accounting firms, which had been required by the U.S. Securities and Exchange Commission (SEC) to provide audit materials for U.S.-listed companies but were prohibited by Chinese regulators from exporting these “state secrets.” The dispute was only resolved when the SEC entered into a memorandum of understanding with its Chinese counterparts, which allowed limited information to be exported after screening by Chinese regulators.

While the State Secrets Law has seldom been publicly enforced, recent history cautions that the consequences of violations can be severe and that investigators should be mindful of the expansive definition of state secrets. In 2010, for example, two foreign nationals in separate cases were given lengthy prison sentences for the illegal export of “state secrets” related to the location of oil and gas resources in China and the government’s purchases of iron ore. These convictions occurred under the previous iteration of the State Secrets Law, but the conduct leading to the convictions would squarely apply to the current version of the law.

To ensure they stay on the right side of the State Secrets Law, investigators should consider conducting the entire document collection and review process in China to allow for documents to be reviewed and cleared of

any secrecy concerns before they are shared outside China. Engaging a reputable PRC-registered firm can ensure that documents with potential state secrets are properly excluded from export or are redacted before they are exported. This two-step process can be time-consuming for a multinational corporation, but it ensures compliance with local law and, more importantly, that the investigation into potential wrongdoing does not itself cause further legal trouble for the client.

Other Chinese laws are also relevant to handling sensitive data in the PRC, even if it is not exported. Regulations on data privacy impose duties of privacy on various actors, including government and commercial organizations. PRC criminal laws prohibit the unlawful disclosure to unauthorized third parties of personal data collected in the financial, telecommunications, transportation, education or medical sectors, despite not clearly defining the concepts of personal data or unlawful disclosure. And the consequences of running afoul of these laws can also be severe. In one well-known example, a British corporate investigator who was part of an internal investigation into GlaxoSmithKline PLC was prosecuted and convicted of illegally collecting private information, leading to a fine and a sentence of two and a half years in prison.

Accordingly, before the investigative team begins gathering documents, especially those not yet in readily accessible sources (such as employee emails on the work server and personal Internet-use records), investigators should consider how to access such records legally. In an internal investigation requiring a deep dive into employee files and email, investigators should be aware that the personal data of employees and customers may be present even in unexpected places.

These risks should be analyzed in advance, especially in light of the increasingly sprawling and redundant server networks of international law firms, cloud storage providers and document review platforms. Simply put, investigators should “know your data”—your documents may not be located where you think they are, and they may not contain the information you assume they do. Because of the often-undefined contours of Chinese laws

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governing state secrets and data privacy, and the severe consequences of noncompliance, outside foreign counsel should work with experienced and trusted local counsel to ensure that a well-intentioned internal investigation does not inadvertently exacerbate the client's legal situation.

Interview Witnesses to Get the Right Information and Protect the Client

Interviews are a crucial part of any internal investigation, but can be challenging in a cross-border investigation. Language barriers and cultural misunderstandings can cause interviews to be useless at best and counterproductive at worst. Indeed, the worst case scenario is that the highly confidential nature of an interview in an internal investigation is disclosed by an employee who does not fully understand the need to keep the interview confidential. To mitigate the risk of such disclosures, outside counsel and company personnel should explain at the outset of an interview that cooperation and confidentiality are important, fashioning an *Upjohn* warning tailored to that employee. In our experience, an effective combination is to conduct

interviews with a team, pairing a local attorney who is a Chinese native speaker with an experienced investigator trained in U.S. law. This allows local counsel to focus on nuances in a witness's testimony and spot any potential issues in Chinese law while U.S. counsel can steer the interview toward areas relevant to potential liability.

But even the *Upjohn* warning, a familiar part of any corporate internal investigation in the United States, presents challenges in the Chinese context. U.S. counsel are familiar with the *Upjohn* warning, which warns an employee that the investigating lawyers represent the company and that the company, not the employee, controls the privilege. But if a U.S. company and its counsel seek to interview a Chinese national working for a subsidiary in the PRC, what embedded risks and strategic considerations should be carefully considered from the outset? Blind reliance on a standard U.S.-style *Upjohn* warning is often not enough to protect the company from subsequent claims by the employee based on local law.

Because U.S.-style attorney-client privilege does not apply in China, local employees in China are unlikely

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to fully appreciate the standard *Upjohn* recitation. The result is that employees who are terminated based on information they shared in an internal investigation interview may challenge that termination in court by arguing that they did not receive fair notice of the implications of the interview. To combat this, it is crucial to ensure that the attorney-client privilege clause in the *Upjohn* warning is clearly explained with the proper context to the employee who is receiving the warning.

Moreover, it is important to properly document the *Upjohn* warning for future reference. Chinese laws on employee discipline and termination differ sharply from U.S. analogs. Labor tribunals that hear employment complaints and suits are widely perceived to be pro-employee, and written evidence carries far more weight than oral testimony. Companies should collect sufficient evidence—the authenticity of which is forensically sound—during an investigation to mitigate the risk that an employee terminated for conduct identified during an investigation later would have grounds for a wrongful termination suit.

When an employee speaks only the local language, there are additional challenges to delivering an effective *Upjohn* warning. To avoid this, the *Upjohn* warning should be translated into the local language by a native speaker on the legal team (not a simple interpreter who likely will not understand the full context of the interview) and confirm that the written script satisfactorily establishes the nuance of legal concepts. The Chinese *Upjohn* warning should be read at the beginning of the interview, and the documentation of the *Upjohn* warning should appropriately reflect that the employee understands its contents. The script should be initialed by the employee and attached to the memo memorializing the interview.

Get Smart on the Local Context

Even beyond the legal issues described above, before beginning any investigation in China, a prudent investigator should be sure to develop at least a minimal working knowledge of the investigation's context in Chinese society. The investigator's credibility with

Chinese regulators, local client representatives and even third-party vendors can be won or lost in a first impression, with potentially serious implications through the course of the investigation.

In investigations of possible FCPA (Foreign Corrupt Practices Act of 1977) violations, for example, the eccentricities of the Chinese economy and government pose unique challenges. In China, state-owned enterprises comprise a substantial portion of all economic activity, meaning that a vast pool of individuals are considered “foreign officials” to whom corrupt payments are prohibited by U.S. law (and any data on a state-owned enterprise is, in turn, more likely to be considered a “state secret”). Because of the pervasive influence of the Chinese Communist Party, many individuals who would not otherwise be “foreign officials” will still be covered under the ambit of the FCPA. And any anticorruption investigation will occur against the backdrop of the recent crackdown on domestic corruption by the government of President Xi Jinping, which has led to the arrest of more than 100 senior officials and reverberated throughout the Chinese economy.

Because many investigations in China are linked to prominent state-owned enterprises and can implicate core interests of the Chinese government, recent geopolitical tensions between China and the United States will loom large. Where an investigation appears neutral at first glance, but may appear to Chinese regulators as a zero-sum game with foreign competitors, the PRC government may assert itself in unexpected ways.

Therefore, foreign investigators should be sure to know which way the proverbial wind is likely to be blowing across any internal investigation in China. Even better, foreign investigators should partner with counsel who have experience in China and the necessary language and cultural skills to hit the ground running.

Conclusion

Entire books can be written on conducting a corporate internal investigation in China, and it can take an entire

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legal career to understand the nuances of just a single area of Chinese law. But the core ideas and primary pitfalls of conducting an internal investigation in China should be remembered and revisited as an investigation unfolds and becomes more complex. Based on our experience conducting internal investigations in China, the early planning and adoption of a disciplined, pragmatic approach to resolving these potential issues will go a long way toward maintaining the integrity of an internal investigation and avoiding costly consequences.



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Endnote

1 See, e.g., *Wultz v. Bank of China Ltd.*, 979 F. Supp. 2d 479, 495-96 (S.D.N.Y. 2013).



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