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## Managing Internal Whistleblower Complaints in China: Challenges and Strategies

Although internal whistleblower complaints have long played an important role in the Chinese government's anti-corruption campaign against government officials, these complaints have recently become a significant concern and challenge for many multinational companies ("MNCs") operating in China. Legal counsel and compliance officers for such MNCs would be well served to thoroughly evaluate all internal whistleblower complaints and develop an effective strategy to proactively resolve the complaints.

### Increase in Internal Whistleblower Reports

The number of internal whistleblower reports in China has increased substantially in recent years because of growing public awareness of compliance and greater ease in filing. Compared to just five years ago, people are now much more inclined to file whistleblower reports. Although the specific motivation to file varies from one matter to another, the filing is in many cases a result of the expansion of compliance knowledge and safeguards among employees. Various incentives to file may include, for example, an attempt to distance the whistleblower from suspicious practices, to help avoid a negative employment action (such as termination), or to retaliate against an employer.

A greater variety of reporting channels in 2015 also makes it easier to file whistleblower reports. Many companies have established a whistleblower hotline, an ethics and compliance email address, and other forms of information exchange to facilitate swift reporting and prompt intake and review. Moreover, some companies have appointed ombudsmen to receive and process whistleblower allegations from external sources, including business partners, third parties, distributors, agents, and even competitors.

### How Internal Whistleblower Complaints Become "External"

Whistleblower complaints are often filed through corporate channels involving senior management and are therefore subject to internal review. But if a complaint is improperly handled or insufficiently investigated, a dissatisfied whistleblower may report directly to the authorities in China or another jurisdiction. Once the Chinese authorities receive a complaint, the likelihood of a government investigation in China or a dawn raid on the

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MNC's China-based operations increases significantly, particularly if the whistleblower submits evidence to substantiate his or her complaint.

Also, due to limited resources in China and increased pressure to investigate, regulators are most likely to act on substantiated whistleblower complaints – that is, reports that provide regulators with sufficient evidence to prove the allegations in the complaint. For instance, in 2013, Chinese authorities initiated an investigation of a multinational pharmaceutical company after receiving anonymous reports that contained detailed evidence of misconduct. Eventually, in 2014, the Chinese courts imposed a record fine on the company of RMB 3 billion (approximately USD \$491 million)<sup>1</sup> for criminal bribery.

Moreover, in recent years, Chinese regulators have made it easier for whistleblowers to report wrongdoing directly to the Chinese authorities. In September 2013, the Central Commission for Discipline Inspection of the Communist Party of China (“**CCDI**”) launched an official website for whistleblowers to report government corruption and other wrongdoing. The website also allows anonymous whistleblower complaints. On June 18, 2015, the CCDI made it even simpler for whistleblowers by creating a mobile phone application for filing whistleblower complaints. On the day the mobile phone application launched, the CCDI received 1,033 tips, which was a sharp increase from the previous daily average of 250-300. Of the 1,033 tips, 67 percent were filed from mobile phones.<sup>2</sup>

Although the primary goal of the recently established CCDI whistleblower channels is to target Chinese officials, MNCs can still be ensnared in a complaint alleging that the MNC is involved in a bribery scheme (either through offering bribes or receiving improper benefits). Beyond facilitating more efficient reporting to the Chinese authorities, the collateral effect of regulators' efforts has been to foster a broader whistleblower culture in China that may touch MNCs, even when government officials are not implicated.

In addition to the risk of increased whistleblower reporting in China, MNCs headquartered in the United States, of course, must also be concerned about the potential for reports to U.S. enforcement authorities. Indeed, whistleblowers may file complaints about the Chinese operations of a MNC headquartered in the United States directly to U.S. enforcement authorities.

The U.S. government has taken steps to incentivize such reporting by granting monetary rewards to whistleblowers. In August 2011, the Securities and Exchange Commission's (“**SEC**”) new whistleblower program under the Dodd-Frank Act took effect. It enables the SEC to pay a cash reward to any individual (including a non-U.S. party) who voluntarily provides the SEC with original information that leads to a successful SEC judicial or administrative action resulting in monetary penalties of more than USD \$1 million. The reward can range from 10% to 30% of the penalty collected. Also, importantly, whistleblowers are provided significant protections against retaliation by employers under U.S. law.

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1 The exchange rate used in this article is 6.367, which is based on the rate announced by the State Administration of Foreign Exchange on Sep. 17, 2015.

2 See *CCDI Lures Whistleblowers with New App Function*, News Xinhuanet, June 21, 2015, available at [http://news.xinhuanet.com/english/2015-06/21/c\\_134344740.htm](http://news.xinhuanet.com/english/2015-06/21/c_134344740.htm).

These incentives are having an effect on reporting. The 2014 annual report on the SEC's whistleblower program reflects a general increase in whistleblower complaints. The Office of the Whistleblower received 3,620 tips in fiscal year 2014 (almost 400 more than the prior fiscal year). Those whistleblower tips included 70 originating from the United Kingdom, 69 from India, 58 from Canada and 32 from China. Although the tips originating from China represent a relatively small portion of the total received by the SEC, whistleblower complaints originating from China will likely increase in coming years.

## Enhanced Protection for Whistleblowers

China's constitution provides general protections for whistleblowers. Although enforcement of these protections has been irregular, recent legislative efforts have sought to fortify it.

On July 21, 2014, China's Supreme People's Procuratorate issued the second amendment to the *Rules Dealing with Whistleblowing by the People's Procuratorate*. This amendment clarifies for the first time the rights of whistleblowers to inquire about the status of a complaint, request a review of the case docketing decision, request protection, and seek rewards. This amendment demonstrates meaningful progress in protecting whistleblowers and mimics China's current aggressive anti-corruption campaign.

Labor laws in China also grant whistleblowers protection by specifically prohibiting retaliation. For instance, the *Labor Law of the People's Republic of China* grants labor administration bureaus the right to impose fines on enterprises that retaliate against whistleblowers.<sup>3</sup> And the *Regulation on Labor Security Supervision* provides for enterprises that retaliate against whistleblowers to be fined between RMB 2,000 (approximately USD \$314) and RMB 20,000 (approximately USD \$3,141).<sup>4</sup>


## Strategies for MNCs In Light of Increase in Complaints

Enforcement authorities across the globe are placing greater emphasis on establishing robust and risk-based corporate compliance programs. An effective compliance program and a sound compliance culture are fundamental to preventing corporate officers, employees, and third-party agents from engaging in illegal practices such as bribery, collusion, and fraud. In order for a compliance program to function properly, employees must feel empowered to ask questions and report problems. Significantly, the SEC has noted that it has received many complaints from employees who first reported internally but believed their complaints were ignored or not treated seriously.

To help increase the likelihood that employees first report potential issues internally, MNCs in China need to proactively foster a culture of open communication within the organization and establish comprehensive and effective whistleblower and non-retaliation policies. MNCs should also prepare for intervention by Chinese authorities by devising and implementing protocols for swiftly and comprehensively responding to investigations or dawn raids.

<sup>3</sup> See Article 101 of the Labor Law of the People's Republic of China (issued by the National People's Congress on July 5, 1994).

<sup>4</sup> See Article 30 of the Regulation on Labor Security Supervision (issued by the State Council on November 1, 2004).



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Upon receipt of a whistleblower complaint, it is important for MNCs to analyze the underlying allegations and facts to determine whether to initiate an internal review. Once this decision is made, the company should determine the appropriate scope of the review and, if necessary, map out an investigation plan. Key principles for conducting an effective internal investigation include independence, comprehensiveness, confidentiality, and timeliness.

For certain allegations, particularly those that may involve disclosure obligations under U.S. laws (e.g., Foreign Corrupt Practices Act violations that are material to a public company's business), the company should consider engaging experienced outside counsel to perform investigative tasks and help maintain the independence and integrity of the investigation. Then, at the conclusion of the investigation, the company should carefully evaluate whether there were any gaps or lapses in the company's compliance processes or controls that may have led to the impropriety. Compliance program shortcomings must be remedied in order to reduce the likelihood that the misconduct will recur. During the course of the investigation, it is also important to keep the whistleblower(s) aware that the complaint or concern is being taken seriously and that the investigation is being handled competently.

In cases where a whistleblower allegation is substantiated and a legal or ethical impropriety discovered, a company should take appropriate and proportionate disciplinary action against employees who engaged in the misconduct. Under Chinese law, an employer may take disciplinary action (up to and including termination) against an employee, if he or she violates the company's internal policies, provided that such policies (i) do not violate China's laws and regulations, (ii) were adopted by the employer through employee consultation procedures; and (iii) have been made available to the employee in advance.<sup>5</sup>

Finally, MNCs in China should be aware that terminated employees often bring employment claims against the company, and that the local labor arbitration committees, as well as the labor courts, are generally employee-friendly in their approach to these matters. Therefore, companies should carefully document every investigation that could lead to employee termination in order to minimize the risk of future employment disputes and appropriately prepare for the possibility that such a claim will arise. The company should also consult with experienced counsel to discuss the risks created by employee terminations that result from whistleblower allegations.

*(This article was jointly authored by Vivian Wu of our Beijing office and Michelle Li of our Washington, DC office, and was first published in Baker & McKenzie's North America "Inside the FCPA: The Corruption & Compliance Quarterly" Newsletter.)*

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<sup>5</sup> See Article 39 of PRC Employment Contract Law issued by People's Congress on 29 June 29 2007; see also Article 19 of Interpretations of the Supreme People's Court Concerning the Application of Law to the Trial of Labor Dispute Cases (issued on 22 March 2001).

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