

Assessing Compliance Risk Under DOJ China Initiative

By **Jean Chow-Callam** (March 21, 2019)

On Nov. 1, 2018, then-Attorney General Jeff Sessions announced the U.S. Department of Justice's new China Initiative[1] aimed at countering national security threats to the United States from China and safeguarding U.S. economic interests. The initiative promises to investigate and prosecute Chinese companies aggressively for alleged trade secret theft, economic espionage, Foreign Corrupt Practices Act offenses and other violations of U.S. law.[2]



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In particular, the DOJ stated that it is trying to identify FCPA cases "involving Chinese companies that compete with American businesses." The DOJ views the FCPA as a means of safeguarding U.S. economic interests and it intends to focus its enforcement efforts on Chinese companies competing directly with American businesses.

To help implement this initiative, the DOJ created a working group of federal prosecutors from five U.S. attorneys' offices to work together with DOJ's National Security Division, senior officials from DOJ and the FBI.[3] They have been collectively tasked with leading the enforcement activities in connection with the China Initiative.

Our expectation is that the initiative will lead to an increase in the number of active investigations and prosecutions of Chinese companies and executives for a wide range of economic conduct.

This article will focus on risks that Chinese companies seeking to invest in and operate in the United States will now need to address. As the DOJ fact sheet's reference to "increased workflow" suggests, Chinese companies seeking to invest in the United States, especially in businesses involving "critical technology," should expect increased regulatory scrutiny.

What to Expect

Chinese companies with international operations would be wise to take measures to ensure that investment or operations in the United States or with U.S. companies are carefully controlled and planned.

For example, Chinese companies competing with U.S. companies should ensure that they have in place proper anti-corruption controls and screening mechanisms to help avoid potential liability under the FCPA and U.S. extraterritorial sanctions (e.g., those affecting Russia, Iran and North Korea). At a minimum, no less than what U.S. companies would do in day-to-day operations.

Other stated goals of the China Initiative will increase U.S. government scrutiny of Chinese investment in the United States, particularly those involving emerging technologies:

- Implementing the Foreign Investment Risk Review Modernization Act[4] at the DOJ (including working with the U.S. Department of the Treasury to develop regulations under the statute and prepare for increased workflow); and

- Identify opportunities to address supply chain threats, especially those impacting the telecommunications sector and relating to the transition to 5G networks.

How Companies Can Prepare

Chinese companies as well as multinational companies with Chinese subsidiaries or joint ventures or other U.S.-based investors in Chinese companies should take the new directive as a signal to design and implement strong anti-corruption and anti-bribery compliance programs.

An anti-corruption and anti-bribery compliance check of any China-related operations would be a prudent strategy. Companies that discover red flags or potential corrupt conduct in their Chinese operations might consider the option of voluntary disclosure under the DOJ's FCPA corporate enforcement policy, in consultation with the appropriate counsel, as that may help secure a favorable outcome.

When conducting a China-based internal review or risk assessment that might present FCPA issues, particularly in cases where U.S. legal advice is being sought, U.S. companies would be advised to structure the engagement in a manner that would make clear that the work, which might include work done by Chinese counsel and other professional advisers and consultants, is supervised by U.S. counsel to safeguard the attorney-client privilege and the resulting work product. This is important as attorney-client privilege is not recognized in China and this could have significant legal implications in the United States.

Other issues that might arise involve documents requested by U.S. courts with respect to the production of documents. Multinational companies might be caught between the competing demands of U.S. and Chinese laws. For example, potential issues could arise between the U.S. Clarifying Lawful Overseas Use of Data (CLOUD) Act in the United States and the Chinese Cybersecurity Law.

U.S. companies are now required under the CLOUD Act to respond to requests for information by U.S. authorities even if the requested information is located overseas, provided that the information is within the U.S. company's control or custody. This is at odds with the Chinese Cybersecurity Law, which requires data that are generated in the regular course of business in China to remain in China, limiting what data can be exported and by what means. It is recommended that companies make summaries of documents, along with redactions.

It is important to note that the Chinese Criminal Judicial Assistance Law requires that before any information may be provided to foreign criminal authorities, it must first be provided to Chinese authorities. In cases where both the U.S. and Chinese governments have made clear that investigations have been commenced, it might be possible to provide the information requested by the U.S. authorities to Chinese authorities so that they can decide what can or cannot be shared. Thoughtful and close coordination with authorities is recommended.

Chinese companies seeking investment in U.S. companies, especially high-tech companies that may be involved with "emerging and foundational technologies," should consider ways to structure their transactions to increase the likelihood that the transaction will be approved by the Committee on Foreign Investment in the United States. These might include:

- Limiting access to certain facilities or information to U.S. citizens;
- Ensuring that decision-making regarding “critical technologies”[5] is limited to U.S. citizens; or
- Waiving any right to appoint executives or directors in the U.S. company. Chinese investors should also consider consulting with CFIUS prior to filing notice of the transactions to ensure that the committee’s concerns are appropriately addressed.

Preventative Measures

By assessing the current state of their record-keeping, companies can determine whether their day-to-day operation is truly in the condition management thinks it is, and if any improvements are needed.

Risks to be reviewed include but are not limited to FCPA- and FIRRMA-specific issues, and require that companies start by:

- Analyzing books and records for patterns of the types of transactions that may be impacted by FIRRMA, and present them to counsel in a format that the counsel/adviser team can then assist the company to navigate through the challenges, either proactively or even in the middle of a deal.
- Selecting sample transactions to perform transactional testing, through the review of the general ledger, where all transactions are recorded, and taking into consideration the internal controls that are in place.

From the detailed testing of the selected transactions, one would be able to tell whether the compliance policy, if there is one, is being followed. If there is no policy in place, certain findings or patterns can be reported back to counsel for remediation.

Experienced advisers would not merely follow a checklist but rather assess the risk areas and strategize with the company and with counsel on how to best identify and test the transaction areas to determine whether there have been activities that would subject the company to the above-mentioned exposures.

Conclusion

For companies that are operating under both U.S. and Chinese laws, it is becoming increasingly challenging with respect to the record-keeping and the sharing of information to the different government authorities once a company is under investigation. To be properly prepared for life under the China Initiative, companies should undertake a risk assessment of their day-to-day operations, and especially while navigating through a deal.

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[1] "Attorney General Jeff Sessions Announces New Initiative to Combat Chinese Economic Espionage," DOJ, Nov. 1, 2018. <https://www.justice.gov/opa/speech/attorney-general-jeff-sessions-announces-new-initiative-combat-chinese-economic-espionage>

[2] "Attorney General Jeff Session's China Initiative Fact Sheet," DOJ, Nov. 1, 2018. <https://www.justice.gov/opa/speech/file/1107256/download>

[3] See "Attorney General Jeff Session's China Initiative Fact Sheet," DOJ, Nov. 1, 2018. <https://www.justice.gov/opa/speech/file/1107256/download>

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[4] Foreign Investment Risk Review Modernization Act of 2018, FIRRMA, Pub. L. No. 115-232, tit. XVII, §§ 1701-1728 (codified as amended at 50 U.S.C. § 4565) (2018).

[5] US Treasury Department, Interim Rule, "Determination and Temporary Provisions Pertaining to a Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies," 31 CFR Part 801 (as reported in the Federal Register, Oct. 11, 2018). https://home.treasury.gov/system/files/206/FR-2018-22182_1786904.pdf