U.S. Justice Department's Extraterritorial Tools for Sanctions Enforcement: What Chinese Banks and Companies Should Know About Overseas Subpoenas and Asset Seizures

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Recent actions by the United States Department of Justice ("DOJ") against Chinese companies in the technology sector made headlines. In March 2017, ZTE Corporation entered a **guilty plea** with the DOJ for violating U.S. sanctions by illegally shipping items of U.S. origin to Iran and obstructing justice. ZTE agreed to pay the U.S. Government a total penalty of US$ 892 million, of which US$ 430 million was paid to DOJ. Shortly after, the U.S. Department of Commerce's Bureau of Industry and Security ("BIS") imposed denial of export privileges against ZTE for seven years, generally prohibiting the company from sourcing U.S. components. A **settlement** was eventually reached in early June with ZTE agreeing to a US$ 1.4 billion penalty, management change and the strictest BIS compliance requirements in history in order to be taken off the BIS restriction list. In April 2018, DOJ's investigation of Huawei for violations of Iran-related sanctions was **made public**. This followed the U.S. Government's designation of various Chinese and Hong Kong entities in January and February 2018 for transacting with North Korean entities in violation of U.S. sanctions. DOJ has also recently issued subpoenas to Chinese entities seeking information regarding U.S. sanctions compliance.

These developments highlight the role that DOJ can have in sanctions enforcement at a time when the U.S. Government is increasingly focused on Chinese banks' and companies' business dealings with North Korea and Iran.[1] Part I of this memorandum summarizes the means by which DOJ can obtain information held by Chinese banks outside of the United States concerning their customers and transactions. Part II of this memorandum discusses DOJ's use of civil forfeiture proceedings in U.S. courts to indirectly seize the non-U.S. assets of Chinese companies through correspondent banking accounts maintained at U.S. banks or U.S. branches of Chinese banks.

Part I. Means by Which DOJ Can Obtain Records From Banks Outside the United States

U.S. law enforcement agencies increasingly take the view that effective criminal enforcement requires access to records held in foreign jurisdictions. As discussed below, apart from request for voluntary disclosure of information, DOJ's request for information in a foreign jurisdiction can be achieved (1) through government-to-government channels, (2) by issuance of a subpoena under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT Act") to a foreign bank where the investigation target's account is held, so long as that bank maintains a correspondent banking relationship in the United States or (3) by issuance of a so-called *Bank of Nova Scotia* subpoena directly to a U.S. branch of a foreign bank, provided that the branch is within a U.S. court's personal jurisdiction. Each of these three approaches requires the approval of the Office of International Affairs ("OIA"), which is part of DOJ's Criminal Division responsible for assisting prosecutors and law enforcement in securing information from foreign countries for use in criminal investigations.

[1] See **here** for Davis Polk's May 11, 2018 client memorandum discussing the U.S. reinstatement of secondary sanctions against Iran and the impact on Chinese entities. See **here** for our February 23, 2018 client memorandum discussing the scope of U.S. sanctions against North Korea and the U.S. focus on China, including OFAC designations against Chinese entities and individuals, in that context.

Government-to-government requests

Where available, formal requests by DOJ are effectuated through making a transnational "request for assistance" pursuant to a bilateral Mutual Legal Assistance ("MLA") agreement between the United States and the foreign country. **MLA agreements** are legally binding negotiated commitments, which seek to facilitate the two-way exchange of evidence and information in criminal matters. Each Party designates a central authority which makes and receives requests pursuant to the agreement. For the United States, DOJ's OIA is the default designated central authority to make and implement any incoming or outgoing requests. OIA will transmit the requests directly to the foreign Party's central authority which will oversee its execution according to its own domestic framework.

In practice, relying exclusively on government-to-government requests under the MLA agreement framework may be difficult and may entail protracted negotiations between the two governments—particularly when such records are subject to local data protection or secrecy laws that prohibit export. In China's case, any such request will formally be made as a "request for assistance" directed to the Chinese Ministry of Justice pursuant to the **2001 U.S.-PRC Mutual Legal Assistance Agreement** ("U.S.-PRC MLAA"). Although the thrust of any MLA agreement is to enhance cooperation in criminal matters and facilitate requests that do not violate domestic law, the U.S.-PRC MLAA permits either Party to refuse such requests with reasons provided but on broad discretionary grounds, and requires that any disputes be resolved through diplomatic channels. As such, there is no recourse for DOJ to penalize against the Chinese government or financial institution for denial of such a request.

USA PATRIOT Act subpoena and proposed legislation to expand this subpoena power

The USA PATRIOT Act enacted in 2001, which amended and enhanced the AML provisions in the Bank Secrecy Act of 1970, granted U.S. authorities the power to unilaterally and directly subpoena a foreign bank to produce records held overseas, so long as that bank maintains a correspondent banking relationship in the United States. Under the USA PATRIOT Act, DOJ and the U.S. Treasury Department **may issue a subpoena or summons** to any foreign bank that maintains a **correspondent account**, defined as an account established to receive deposits from, make payments or handle other transactions on behalf of a foreign financial institution in the United States. Through this means, DOJ can obtain records relating to that account—including records maintained abroad—or to obtain records relating to the deposit of funds into the foreign bank. This broad grant of "extraterritorial reach" is unprecedented and is one of the more controversial provisions of the USA PATRIOT Act.

The subpoena or summons may be served on the foreign bank in the United States if the foreign bank has a representative in the United States, or in a foreign country pursuant to any MLA treaty, multilateral agreement, or other request for international law enforcement assistance. The USA PATRIOT Act permits foreign banks to challenge such a subpoena or summons in a U.S. court. If the foreign bank fails to comply with the subpoena or challenge that subpoena in a U.S. court, DOJ and the Treasury Department may direct U.S. bank(s) to terminate any correspondent relationships with that foreign bank.

In May 2016, DOJ also submitted **proposals** for legislative amendments to Congress that included measures to enhance U.S. law enforcement's authority to access foreign bank records. In particular, DOJ's proposed legislation would expand its authority to issue USA PATRIOT Act subpoenas to foreign banks that maintain a correspondent account in the United States to include not only records relating to that account, but also records pertaining to *any* related account at the foreign bank, including records maintained outside the United States, that are the subject of any investigation of a criminal violation of U.S. law or a civil forfeiture action. The U.S. Attorney General may invoke the aid of a court to compel compliance with such a subpoena. Provisions very similar to this DOJ proposal were included in **a draft bill pending in Congress**. Although it could be enacted in the future, it is currently in the early stages of the legislative process.

"Bank of Nova Scotia" subpoena

U.S. agencies have also obtained bank or business records located abroad by serving federal subpoenas, commonly referred to as the *Bank of Nova Scotia* subpoenas (after the **eponymous case**), on U.S. branches or affiliates of foreign financial institutions or corporates. As with USA

PATRIOT Act subpoenas discussed above, federal prosecutors must obtain **written approval from the OIA** before issuing such a subpoena but there is no prerequisite that the subpoenaed entity itself be a target of the investigation.

If, on the other hand, the recipient asserts that it would be exposed to liability abroad for complying with the U.S. subpoena, courts apply the *Bank of Nova Scotia* balancing test weighing the dueling sovereignty interests of the United States and the foreign country. U.S. courts generally find that branches of foreign companies take advantage of U.S. law by conducting business in the United States, and are therefore similarly bound by the burdens of U.S. law.

While the U.S. court may not be able to penalize the overseas parent for failure to comply with a *Bank of Nova Scotia* subpoena, it can penalize the U.S. branch or affiliate within its jurisdiction. Where a bank has failed to produce documents in response to a subpoena, courts have levied significant daily fines continuing until the contempt is purged by compliance with the subpoena. Bank officials subject to the U.S. court's jurisdiction may also be held personally responsible for non-compliance with a subpoena directed solely to the bank.

As a preliminary matter, a bank which receives a *Bank of Nova Scotia* subpoena should scrutinize the subpoena that it receives from the U.S. government to determine whether it has been directed to the appropriate entity within the bank's corporate family and issued following the required procedures under U.S. law and DOJ policy.

It should be noted that because of the significant logistical and diplomatic challenges inherent in effectuating the USA PATRIOT Act and *Bank of Nova Scotia* subpoenas, they remain relatively uncommon.

Part II. Seizure of Non-U.S. Assets of Overseas Sanctions Violators Through U.S. Correspondent Accounts

DOJ has in recent years expanded its toolkit for U.S. sanctions enforcement against overseas persons by relying on civil forfeiture proceedings in U.S. courts. Through those proceedings, DOJ may indirectly seize the overseas assets of sanctions violators that do not have any nexus to the United States.

Under **Section 319 of the USA PATRIOT Act**, if funds are deposited into a non-U.S. account at a non-U.S. bank, and that non-U.S. bank has a correspondent banking account at a U.S. bank or U.S. branch of a non-U.S. bank, the funds *shall be deemed to have been deposited* into that U.S. correspondent banking account. A civil forfeiture *in rem* proceeding may be taken against the property deposited into the foreign account and the U.S. bank can be forced to forfeit funds in the non-U.S. bank's correspondent account, up to the value of the funds deposited into the account at that non-U.S. bank.

- In September 2016, the DOJ unsealed **criminal charges** against, and OFAC imposed sanctions on, Dandong Hongxiang Industrial Development ("Dandong Hongxiang"), a China-based trading company, and four Chinese company officials for allegedly conspiring to evade U.S. sanctions against North Korea, money laundering and the violation of U.S. regulations against the support of designated WMD proliferators. The DOJ also filed for **civil forfeiture** *in rem* of all funds—totaling over US$ 74 million—contained in 25 Chinese bank accounts located in China that belong to Dandong Hongxiang. The DOJ complaint stated that as part of the scheme, the conspirators transmitted U.S. dollars through correspondent banking accounts maintained at financial institutions located in the State of New Jersey.
- In June 2017, the DOJ filed for **civil forfeiture** of over US$1.9 million from Mingzheng International Trading Limited ("Mingzheng"), a company based in northeastern China. The complaint alleged that Mingzheng was involved in laundering U.S. dollar on behalf of North Korean entities and conspired to evade U.S. sanctions against North Korea by facilitating prohibited transactions through the United States.
- In August 2017, the DOJ **filed** for the seizure of approximately US$7 million associated with Velmur Management Pte. Ltd. ("Velmur"), a company based in Singapore, in a civil forfeiture action *in rem*. The DOJ action relates to funds that were transferred through different front

companies used by the North Korean sanctioned entities to Velmur to be remitted to a Russian supplier sanctioned by the United States for selling petroleum products to North Korea. Velmur was found to be involved in seven illicit wire transfers in U.S. dollars which were routed through its bank's correspondent banking accounts in the United States.

- In **August 2017** and **January 2018**, the DOJ filed civil forfeiture claims for an aggregate amount of US$4,583,935 from a Chinese company Dandong Chengtai Trading Co., Ltd ("Dandong Chengtai") and its owner Chi Yupeng for selling North Korean coal and purchasing nuclear and missile components for North Korea in violations of U.S. sanctions laws. The DOJ claim alleged that Dandong Chengtai defrauded U.S. financial institutions by concealing the true identity of the North Korean counterparties to the U.S. dollar transactions.

As several of these DOJ actions noted, to obtain goods and services in the international market place, as North Korea does, it needs access to U.S. dollars and the U.S. financial system. Correspondent banks are able to support international wire transfers for customers in a currency that the customers do not hold on reserve. Correspondent banks in the United States facilitate these wire transfers by allowing foreign banks, located exclusively overseas, to maintain correspondent accounts in the United States. In each of the cases discussed above, there were no allegations of wrongdoing by the U.S. correspondent banks or foreign banks that maintain these accounts. Nevertheless, the civil forfeiture procedure allows DOJ to seize the proceeds from sanctions violations sitting in foreign banks through their U.S. correspondent accounts. It is then up to those foreign banks to make themselves whole by debiting the non-U.S. accounts of the sanctions violators.

In connection with DOJ's investigation of Dandong Chengtai, the government filed eight applications for anticipatory warrants, also known as "damming" seizure warrants, to impose freeze at eight U.S. banks on all incoming funds to certain correspondent accounts known to be linked to transactions involving Dandong Chengtai during a 14-day period while preventing any funds from exiting those correspondent accounts.

With the heightened focus of the U.S. Government on North Korea and Iran sanctions and transactions between those regimes and Chinese entities, DOJ can be expected to further utilize its subpoena powers and the asset forfeiture mechanism to obtain records and indirectly seize funds belonging to sanctions violators outside the United States.

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