

Subpoenas Against 3 Banks Boost DOJ's China Initiative

By **Ryan Fayhee and Ashley Hodges** (July 1, 2019, 2:05 PM EDT)

On March 18, 2019, Chief Judge Beryl A. Howell of the United States District Court for the District of Columbia issued an opinion ordering three Chinese banks to comply with subpoenas in the investigation of a now-defunct Hong Kong-based front company for facilitating transactions on behalf of a North Korean entity, in violation of international sanctions. A redacted version of the opinion was unsealed on April 30, 2019, revealing the first instance of a U.S. court ordering Chinese banks to comply with subpoenas in a sanctions investigation.

Howell's opinion marks a key milestone that will support the U.S. Department of Justice's China Initiative, which was announced in November 2018 and aims to strategically prioritize countering perceived national security threats posed by China. In recent years, the U.S. government has increasingly imposed sanctions on Chinese entities — like the Hong Kong front company targeted in the investigation underlying Howell's opinion — for facilitating transactions on behalf of North Korea.

In sanctions investigations, a critical key to uncovering violations is the ability to “follow the money,” and evidence of illicit conduct is routinely found in bank records. Often, sanctioned individuals or entities establish accounts with Chinese banks that maintain correspondent accounts in the U.S., thus giving the sanctioned individuals and entities access to the U.S. and international financial systems.

Howell's opinion provides U.S. prosecutors with an important tool that could require Chinese banks that process transactions on behalf of North Korean individuals and entities to hand over pivotal evidence in sanctions investigations.

Background: The Chinese Banks, the Transactions and the Subpoenas

The court's opinion refers to the banks in question as Bank One, Bank Two and Bank Three; the Chinese government has an ownership interest in each. Banks One and Two have opened at least one branch in the U.S., whereas Bank Three does not maintain a U.S. branch.

All three maintain correspondent accounts in the U.S. It was through these correspondent accounts that the three banks, from October 2012 to January 2015, allegedly processed transactions totaling



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\$105,339,483.59 on behalf of a now-defunct Hong Kong entity under investigation for sanctions, money laundering and Bank Secrecy Act violations.

In December 2017, the U.S. Attorney's Office for the District of Columbia served Bank One and Bank Two each with a grand jury subpoena and Bank Three with an administrative subpoena. All three subpoenas sought transaction records for the Hong Kong entity, which purportedly acted as a North Korea state entity's front company to evade sanctions.

All three banks refused to comply with the subpoenas, maintaining that the only way for them to produce documents requested in the subpoenas was through mechanisms detailed in the mutual legal assistance agreement, or MLAA, the U.S. and China entered into in 2000, which required the requests to be routed through the Chinese Ministry of Justice, or MOJ, for review and subsequent handling.

The banks also asserted that should they comply with the subpoenas without approvals by relevant Chinese government bodies, they would be subject to fines and penalties pursuant to domestic legal authorities. Notably, the Chinese government backed the banks' position.

On Nov. 29, 2018, after nearly a year of noncompliance (during which time officials from the U.S. Department of Justice visited China twice to discuss China's repeated failure to respond to MLAA requests), the U.S. Attorney's Office moved to compel each bank's compliance with their respective subpoenas. Briefing and a hearing were submitted on the matter, and on March 18, 2019, the court issued its memorandum opinion granting the motion to compel with respect to each subpoena.

The Court's Opinion

In granting the U.S. government's motion to compel, the court held that the subpoenas are enforceable, and that enforcement is reasonable as a matter of international comity.

The Court's Jurisdiction

As a preliminary step in assessing the subpoenas' enforceability, the court found that each bank is subject to the court's personal jurisdiction. Banks One and Two consented to the exercise of personal jurisdiction when they applied to the Federal Reserve to open their U.S. branches. Alternatively, by availing themselves of the U.S. banking system to process hundreds of transactions totaling more than ten million U.S. dollars, all three banks have established sufficient minimum contact with the United States to provide a basis for personal jurisdiction.

The court further found that overall, exercising personal jurisdiction over these banks did not offend traditional notions of fair play and substantial justice. Additionally, with respect to the administrative subpoena issued to Bank Three, the court held that the Patriot Act duly authorizes issuance of subpoenas for records from a foreign bank that maintains a correspondent account in the U.S., and found that the scope of the administrative subpoena was not overly broad.

Seven-Factor Test Weighs in Favor of Compelling Banks' Compliance

In undertaking its international comity analysis, the court began by acknowledging that compelling the banks to comply with the subpoenas would create a "true conflict" between domestic and foreign laws. The court also noted the U.S. government's concession that complying with the respective subpoenas would expose each bank to legal penalties in China.

Accordingly, the court proceeded to analyze whether this “true conflict” should cause it to abstain from exercising its authority, applying a seven-factor balancing test:

- Importance to the investigation of the requested information;
- Specificity of the request for information;
- Origin of the information;
- Alternative means of obtaining the information;
- Interests of sovereigns in conflict;
- Hardship on the party facing conflicting obligations; and
- Good faith.

The court found the seven factors to be of uneven weight, with the most important factor being the interests of sovereigns in conflict that “could not fall more firmly in favor of enforcement” because the interest at issue is the national security of the United States.

At most, only three out of the seven factors favored the banks: The documents originated in China; the banks acted in good faith; and the banks faced potential hardship for complying with the subpoenas. With respect to potential hardship, the court found it unlikely that the banks would be subject to heavy fines, suspension or revocations of banking licenses, or other civil or criminal penalties or sanctions by Chinese authorities for complying with the order of a U.S. court.

In contrast, the court found that other factors weighed overwhelming in favor of compelling the banks to comply with the subpoenas: The requested information is irreplaceable and not otherwise obtainable for the investigation; the request for information was specifically tailored; the national security interest favors compliance; and the MLAA is not a viable alternative to the subpoenas.

In rejecting the MLAA process as a viable alternative, the court referred to historical precedent demonstrating the MLAA’s ineffectiveness, noting that over the last decade, the U.S. has made approximately 50 MLAA requests to China for banking records, and only 15 have produced responses, which were often incomplete, untimely and not admissible in a U.S. court. Further, under the International Criminal Judicial Assistance Law, or ICJA, that became effective in October 2018, the MOJ is not the last level of Chinese review, which undermines the MOJ’s commitment to promptly process an MLAA request without commitment from other Chinese authorities capable of rendering final decisions for requests.[1]

The ICJA is commonly referred to as a blocking statute promulgated by the Chinese government to assert judicial sovereignty, and the court noted that “[w]hether China might use this law to stall any response to an MLAA request is, at best, unknown.” According to the court, “China should not be allowed to hold United States’ law enforcement priorities hostage under the pretense of anticipated MLAA compliance.”

Practical Considerations for Chinese Banks and Practitioners

In this case, the banks must appeal or comply with the court's order.[2] Failure to do so could result in the banks being held in contempt of court, and ultimately putting themselves at risk of isolation from the U.S. financial system — potentially spelling the end of the banks in question.

With an uptick in U.S. sanctions enforcement as a tool to combat perceived national security threats posed by Chinese entities and individuals that service North Korea, the implications of the court's decision are far-reaching. Significantly, an articulated goal of the DOJ's China Initiative is to improve Chinese responses to U.S. requests under the MLAA, and the court's order will motivate China toward this end, while also offering a viable MLAA workaround for U.S. prosecutors.

As a preliminary matter, practitioners representing Chinese banks served with similar subpoenas should carefully scrutinize the subpoenas to determine if they seek materials inaccessible from the U.S. or are otherwise over broad and thus unenforceable. More specifically, practitioners should critically consider each of the surrounding facts and circumstances to determine whether jurisdiction can be established and the proper weight that should be accorded to each of the seven factors outlined in the court's balancing test.

While the present case ultimately resulted in an order requiring the Chinese banks to comply with the subpoenas, the decision nonetheless turned on a fact-specific inquiry. Under other circumstances, the factors might have been weighted differently and resulted in a balance in the other direction.

Following this important decision, subpoenas will likely be used as the go-to tool to obtain critical information from Chinese banks in support of sanctions, money laundering and other cross-border investigations by the U.S. government. In order to adhere with applicable laws and limit exposure of U.S. dollar transactions to any potential indirect and unintended connections to sanctioned destinations, Chinese banks would be well-advised to ensure that compliance protocols are up to date and represent best practices.

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[1] The ICJA effectively supersedes all MLAA's, including the one between the U.S. and China, leaving application of an MLAA to only technical aspects of a request for judicial assistance, such as the request's format. Under the ICJA's two-tier review system, the MOJ conducts a preliminary review as a "Foreign Affairs Liaison Authority," and the ultimate decision on the request for judicial assistance falls on relevant "Competent Authorities" (the National Supervisory Commission, the Supreme People's Court, the Supreme People's Procuratorate, the Ministry of Public Security and the Ministry of State Security, as designated under the ICJA).

[2] As the docket in this case is under seal, it is unknown whether the banks have appealed or taken steps to comply with the court's order.