
Hughes Hubbard & Reed

The DOJ's New "China Initiative" Places Chinese Companies at Risk

Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

Attorney advertising. Readers are advised that prior results do not guarantee a similar outcome. No aspect of this advertisement has been approved by the Supreme Court of New Jersey. For information regarding the selection process of awards, please visit <https://www.hugheshubbard.com/legal-notices-methodologies>.

November 20, 2018 - On November 1, 2018, then-U.S. Attorney General Jeff Sessions announced the Department of Justice ("DOJ") would create a "China Initiative" in response to allegations of economic espionage and related efforts to acquire sensitive U.S. technology through various sophisticated means, including investments in U.S. companies. The China Initiative, as described in a [Fact Sheet](#), sets out ten goals intended to prioritize enforcement and resource allocation in order to counter alleged Chinese interference with U.S. economic interests. The most immediate result of this initiative will be: (i) targeted enforcement activity pertaining to trade secrets, foreign corruption, the acquisition of controlled U.S. technology, computer intrusions, and foreign agent influence campaigns; (ii) increased scrutiny of Chinese investment by U.S. regulators; and (iii) a new specific focus on technology transfer via "non-traditional" collection in labs, universities, and the defense industrial base.

Summary of the China Initiative

Five of the China Initiative's stated priorities encourage prosecutors to investigate and prosecute Chinese companies for economic espionage, cooption of U.S. technology, and Foreign Corrupt Practices Act violations:

- Identify priority trade secrets cases involving Chinese companies and nationals and ensure that the investigation and prosecution of those cases is appropriately resourced;
- Develop an enforcement strategy related to researchers in labs and universities that are being coopted into transferring technology to China contrary to U.S. interests;
- Apply the Foreign Agents Registration Act to bring enforcement actions against unregistered Chinese agents seeking to advance China's political agenda in the United States;
- Identify Foreign Corrupt Practices Act ("FCPA") cases involving Chinese companies that compete with U.S. business internationally; and
- Increase efforts to improve Chinese responses to requests under the Mutual Legal Assistance Agreement ("MLAA") with the United States.

The first three of these goals fit squarely with the Trump Administration's frequent complaints regarding the theft of trade secrets by Chinese companies. The focus on FCPA violations by Chinese companies addresses a

common complaint by U.S. businesses regarding practices of Chinese competitors in the international market. Ultimately, the success of efforts to identify and prosecute these cases may depend on the success of the fifth goal –increasing cooperation by the Chinese government with American criminal investigations of Chinese entities and individuals. Particularly for foreign corruption cases, key evidence is often located in the country where a company is based, and it can be difficult for U.S. prosecutors to obtain that evidence without assistance from the company’s home jurisdiction.

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

- Implement the Foreign Investment Risk Review Modernization Act (“FIRRMA”) at the DOJ (including working with the Treasury Department 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.

FIRRMA became law in August 2018 (see [here](#)) and includes landmark reforms to the process used by the Committee on Foreign Investment in the United States (“CFIUS”) to review foreign acquisitions and investments in the United States. Prior to FIRRMA, CFIUS only had jurisdiction to review foreign investment transactions that would result in foreign control, and providing pre-closing notice of the transaction to CFIUS was voluntary. Under FIRRMA and the Treasury Department’s implementing regulations, certain types of foreign investment that fall short of control but would allow the foreign investor to access “critical technology” now require pre-closing notice to CFIUS (although notice for non-qualifying investments remains voluntary). (See [here](#) for a more detailed explanation.)

Legislators have made no secret that the motivation behind FIRRMA’s expansion of CFIUS’s jurisdiction is Chinese investment in the United States.

Potential Impact

Even before the China Initiative, the Trump Administration aggressively pursued investigations of Chinese companies. In [2017](#) and [2018](#), U.S. regulators reached a deal with China’s ZTE that included a fine of more than \$1 billion for violating U.S. sanctions and export controls. The same day that Sessions rolled out the China Initiative, DOJ [announced](#) a grand jury indictment of a Chinese government-controlled company accused of stealing trade secrets from an American microelectronics technology company. Less than a month before that, DOJ [announced](#) the arrest of a Chinese intelligence officer alleged to have stolen trade secrets related to aviation.

Notably, Chinese state owned enterprises (“SOEs”) have not been spared from this enforcement focus. In August 2017, for example, it was [reported](#) that China Petroleum & Chemical Corp. (Sinopec), one of the largest Chinese SOEs, was under investigation by U.S. authorities for potential FCPA violations in connection with a project in Nigeria.

It remains to be seen how the DOJ will carry out the China Initiative (which survives the resignation of AG Sessions), but Chinese companies should anticipate increased attention from U.S. regulators going forward. The China Initiative names a dedicated team of senior DOJ officials with the clear goal of increasing enforcement against Chinese business practices deemed unfair or illegal, and this should serve as a warning to all Chinese companies working or competing with U.S. companies in their international operations that they are at increased risk of investigation or prosecution by U.S. regulators.

In the FCPA context, although a large number of DOJ's past enforcement actions involved misconduct in China by foreign companies, FCPA enforcement against Chinese companies operating abroad has been far less frequent. With the institution of the China Initiative, that may change. As Chinese companies, including Chinese SOEs, continue to expand into the international market, the U.S. connections that can trigger FCPA jurisdiction will be more firmly established, and U.S. prosecutors have now been specifically instructed to focus their energies and resources accordingly.

As the Fact Sheet's reference to "increased workflow" suggests, Chinese companies seeking to invest in the U.S., especially in businesses involving "critical technology," should expect increased regulatory scrutiny. FIRRMA defines "critical technology" to include "emerging and foundational technologies." The term "emerging and foundational technologies" is not defined by FIRRMA. Although the Department of Commerce has not yet proposed a definition, it is widely expected that the definition will include fields such as 5G technology. The Fact Sheet's specific prioritization of the supply chain for telecommunications and the emerging 5G network underscore the Administration's concern for this sector.

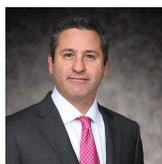
Potential Mitigating Measures

Given the increased attention and added resources from the China Initiative, Chinese companies with international operations would be wise to take measures to ensure that investment or operations in the U.S. 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 (against, e.g., Russia, Iran, and North Korea).

In addition, 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 CFIUS. These could include limiting access to certain facilities or information to U.S. citizens, ensuring that decision making regarding "critical technologies" 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.

At a minimum, Chinese companies are advised to perform an assessment of their risk of becoming a target of U.S. investigators in the areas highlighted by the China Initiative. Depending on the result of that assessment, companies might also consider that tailored measures, developed with qualified counsel, may mitigate potential exposure to U.S. regulators pursuant to the China Initiative.

Related People



Kevin T. Abikoff



Ryan Fayhee



Laura N. Perkins



Michael A. DeBernardis



Tyler Grove



Jiaxing Hao



Michael R. Silverman

Related Areas of Focus

Sanctions, Export Controls & Anti-Money Laundering

Anti-Corruption & Internal Investigations