

Best Practices For Cos. Navigating US-China Investigations

By **Brad Bondi, Shaun Wu and John Tso** (October 30, 2023)

Recent law enforcement and regulatory trends in the U.S. underscore the need for companies with operations in China to be familiar with, and adhere to, U.S. Department of Justice and U.S. Securities and Exchange Commission enforcement policies and guidance.

For example, as an indication of the continuing geopolitical tension between the U.S. and China, on Aug. 9, President Joe Biden issued Executive Order No. 14105 authorizing the U.S. Department of the Treasury to restrict outbound U.S. investments in China involving artificial intelligence, semiconductors and microelectronics, and quantum information technologies.[1]

Notably, violations of the executive order may be referred to the DOJ for potential criminal prosecution.[2]

The DOJ and SEC likely will continue to be aggressive in investigating conduct involving Chinese companies, and they have adopted policies to incentivize companies to enhance their compliance programs and provide meaningful cooperation during investigations.

In view of recent enforcement trends and policies and the broad jurisdictional reach of U.S. laws,[3] companies with operations in China should take steps to enhance their compliance programs before they become aware of potential misconduct or become subject to a DOJ or SEC investigation.

Companies that are subject to investigations should be aware of recent DOJ and SEC enforcement priorities, guidance and expectations, especially with respect to the issues discussed below, so that they can resolve the investigation on the most favorable terms possible.

Recent Trends and Developments

DOJ and SEC Enforcement Trends

Although the DOJ in February 2022 rescinded the so-called China Initiative, which sought to counter Chinese national security threats and trade secret theft,[4] the DOJ remains focused on prosecuting alleged wrongdoing involving companies with operations in China.

The DOJ's current approach, known as the strategy for countering nation-state threats, makes clear that the DOJ will continue to focus on prosecuting economic espionage, export controls and similar offenses.[5]

With respect to China in particular, National Security Division Assistant Attorney General Matthew Olsen stated that China presents special risks for U.S. national security, and observed that the Chinese government continues to use "espionage, theft of trade secrets, malicious cyber activity, transnational repression, and other tactics to advance its



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interests." [6]

For its part, the SEC has indicated that it will use all the enforcement tools available to it, including bringing enforcement actions against gatekeepers, [7] requiring companies to admit to wrongdoing as a condition of settlement, imposing officer and director bars, and requiring independent compliance monitors. [8]

For example, in September 2022, the SEC brought an enforcement action against a gatekeeper when it charged the Chinese affiliate of Deloitte Touche Tohmatsu Ltd. with failing to comply with fundamental U.S. auditing requirements in its audits of U.S. issuers and its audits of foreign companies listed on U.S. exchanges. [9]

And, on Aug. 25, the SEC announced that 3M Co. had agreed to pay \$6.5 million to resolve allegations that conduct involving its wholly owned China subsidiary violated the Foreign Corrupt Practices Act. [10]

The SEC also has focused intensely on accounting and disclosure issues, especially with respect to China-based companies and the Holding Foreign Companies Accountable Act.

The HFCAA requires that the SEC identify any public companies that file annual reports with financial statements audited by an auditor located in a foreign jurisdiction where the Public Company Accounting Oversight Board has determined it is unable to inspect or investigate completely because of action by a foreign authority.

If the SEC identifies a company as meeting that criteria for two consecutive years, the SEC must apply certain trading prohibitions to that company's securities. [11]

In the first half of 2022, the SEC identified several dozen U.S.-listed Chinese companies that met those criteria — thus creating the possibility that the identified issuers would be subject to the trading restrictions and disclosure obligations required by the HFCAA. [12]

In August 2022, U.S. and Chinese authorities agreed to a protocol governing inspections and investigations of audit firms. And, in December 2022, the PCAOB reported that it had secured complete access to inspect and investigate registered public accounting firms headquartered in mainland China and Hong Kong. [13]

Whether Chinese authorities will continue to grant access to PCAOB inspections and investigations is uncertain, and the SEC's Office of the Chief Accountant has warned that issuers who try to evade the HFCAA's requirements by structuring their audit engagements to avoid the statute's consequences may be subject to SEC enforcement actions. [14]

DOJ and SEC Policy Trends

Companies with operations in China should be aware of recent significant changes to DOJ policies.

On Jan. 17, then-Assistant Attorney General Kenneth Polite Jr. announced several revisions to the DOJ's corporate enforcement policy. To incentivize more voluntary self-disclosures, Polite emphasized that the largest discounts for cooperation will be "reserved for companies that truly distinguish themselves and demonstrate extraordinary cooperation and remediation."

Polite explained that extraordinary cooperation must "go above and beyond the criteria for

full cooperation set in our policies." [15]

Even though extraordinary cooperation requires a case-by-case analysis, Polite pointed to a recent DOJ case against ABB Ltd., a Swiss-based global technology company, in which the company voluntarily made foreign-based employees available for interviews in the U.S. and produced relevant documents located outside the U.S. in ways that did not implicate foreign privacy laws. [16]

Due to the company's cooperation, the criminal monetary penalty imposed on the company reflected a 25% discount from a relevant range set forth in the U.S. sentencing guidelines. [17]

On March 3, Polite announced significant revisions to the DOJ Criminal Division's evaluation of corporate compliance programs to address the use of ephemeral messaging platforms, such as WhatsApp, Signal and WeChat.

Under the new standards, when evaluating corporate compliance programs, the DOJ will consider (1) how policies relating to personal devices and messaging applications are tailored to a company's risk profile, (2) how policies ensure that business-related data can be preserved and accessed, (3) how the policies are communicated to employees, and (4) how companies monitor and enforce compliance by employees. [18]

Similar to the DOJ, the SEC has indicated that companies that seek cooperation credit must do more than simply meet legal requirements to respond to subpoenas. [19]

Instead, to obtain cooperation credit, companies must take steps that enhance the SEC's investigation, allow the SEC to move quickly and help the SEC identify misconduct, such as by making documents and witnesses available on an expedited basis, identifying key documents, and making informative presentations. [20]

Best Practices for Responding to an Investigation

Companies with operations in China should consider reviewing the company's compliance policies to make sure they align with the recent DOJ and SEC enforcement trends, policies and guidance described above before they are the subject of an investigation.

These preventive measures also can help companies mitigate the likelihood of law enforcement and regulatory scrutiny.

Promptly investigate suspected or alleged misconduct.

After a company learns of suspected misconduct or learns that it is the subject of a DOJ or SEC investigation, the company should investigate the suspected misconduct promptly, while being mindful not to run afoul of Chinese laws relating to investigations.

The DOJ and SEC expect companies to take swift action to investigate potential misconduct, and the company's eligibility for cooperation credit could depend on how quickly it acts after learning of potential misconduct.

An appropriate measure for the company or the company's board of directors is to conduct an investigation. The company should determine an appropriate scope for the investigation by taking into consideration the persons involved in the conduct, the nature of the conduct, the significance and pervasiveness of the conduct, the need for remediation, and the

potential for sanctions by law enforcement and regulatory agencies.

Be aware of the benefits of self-reporting, cooperating and remediating.

As described above, the DOJ and SEC have cooperation programs to encourage companies to self-report misconduct, take steps to enhance DOJ and SEC investigations, and take remedial measures.

Companies should carefully consider the benefits of self-reporting and cooperation, taking into consideration all relevant facts and the most recent guidance from the DOJ and SEC.

As described above, in certain circumstances, the benefits of cooperating with the DOJ can be substantial. Similarly, cooperating with the SEC can have tangible benefits.

For instance, in January 2022, the SEC settled an enforcement action with HeadSpin Inc. without imposing a penalty. In announcing the settlement, the SEC applauded the company's cooperation and remedial measures, which included "not just its internal investigation ... but also repaying harmed investors and improving its governance."^[21]

Likewise, in the SEC's enforcement action against 3M, the SEC cited 3M's self-reporting, cooperation and remedial measures, which included promptly self-reporting the matter, making witnesses and other information available to the SEC, and disciplining or terminating employees who were involved in the alleged misconduct.^[22]

Carefully balance DOJ and SEC expectations against Chinese data protection and privacy requirements.

With the DOJ and SEC emphasizing the importance of proactively sharing evidence during ongoing investigations, companies with operations in China must balance DOJ and SEC expectations against Chinese data protection and privacy laws and regulations.

In particular, China's International Mutual Legal Assistance in Criminal Matters Law^[23] prohibits entities within China from providing evidentiary materials or assistance to foreign authorities in relation to any criminal proceedings without the necessary approvals from relevant Chinese authorities.

Separately, China's Cybersecurity Law,^[24] Data Security Law^[25] and Personal Information Protection Law^[26] restrict cross-border data transfers.

The DOJ recognizes that data privacy laws and blocking statutes may complicate the production of documents located in China. Nonetheless, companies seeking cooperation credit in such circumstances have the burden of demonstrating the existence of such restrictions and identifying reasonable alternatives to provide the requested facts and evidence.

The DOJ may not grant cooperation credit to companies that seek to use data privacy laws and similar statutes to shield misconduct.^[27]

Companies under investigation by the DOJ or SEC should consider the following factors when evaluating DOJ and SEC expectations and Chinese data protection laws.

Consider the necessity of the information and the potential legal exposure.

Assess the necessity of providing the materials and the potential consequence of not providing the materials. Also consider the potential exposure under local laws if the company provides the materials or information.

Understanding the importance of the requested information can help determine the appropriate course of action.

Consider alternative approaches.

Explore whether the same or similar information can be obtained from sources outside China, either directly or indirectly — e.g., whether requested emails or other documents exist outside China.

This analysis can help identify potential alternatives to fulfill the investigative requirements.

Consider redacting sensitive information.

Evaluate whether any redaction is necessary before providing the requested materials — e.g., to comply with local requirements related to personal information protection.

Protecting sensitive data and maintaining privacy is a significant consideration in cross-border data transfers.

Consider engaging with Chinese authorities.

Assess the feasibility of consulting and engaging with competent Chinese authorities. Where appropriate, seeking guidance and approvals from relevant Chinese entities can help navigate the complexities.

Consider other areas of potential conflict.

Potential conflicts between U.S. authorities' expectations and Chinese laws may exist in other areas.

For example, as mentioned above, the DOJ recently revised the evaluation of corporate compliance programs to address the need for companies to have policies that enable the collection and preservation of business communications, even with respect to ephemeral messaging platforms or personal devices.

In China, however, recent court cases have restricted companies' ability to review employees' data, even if the data is stored on company-issued devices.

These developments are consistent with the enactment of China's Personal Information Protection Law, which contains heightened protection for employees' personal information.

Conclusion

Cross-border DOJ and SEC investigations are complex and nuanced.

Companies with operations in China can be subject to the broad jurisdictional reach of U.S. laws and should pay particular attention to recent DOJ and SEC policy developments, including the emphasis on accounting and disclosure issues.

Companies should take prompt steps to enhance their compliance policies to prevent misconduct and to align with recent DOJ and SEC enforcement trends and policies.

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[1] Exec. Order No. 14,105, 88 Fed. Reg. 54,867 (Aug. 11, 2023), <https://www.federalregister.gov/documents/2023/08/11/2023-17449/addressing-united-states-investments-in-certain-national-security-technologies-and-products-in>. The restrictions cover investment by U.S. persons into businesses headquartered or formed in China and investments into entities owned by Chinese businesses or by Chinese citizens or permanent residents.

[2] *Id.* at 88 Fed. Reg. 54,871 ("The Secretary is authorized to . . . refer potential criminal violations of this order or the regulations issued under this order to the Attorney General.").

[3] Companies that are based in China or have operations in China may be subject to the laws of the United States if they issue securities in the United States, their securities are traded in the United States, or they conduct financial transactions that flow through the United States banking system.

[4] See U.S. Dep't of Justice Press Release, Assistant Attorney General Matthew Olsen Delivers Remarks on Countering Nation-State Threats (Feb. 23, 2022), <https://www.justice.gov/opa/speech/assistant-attorney-general-matthew-olsen-delivers-remarks-countering-nation-state-threats>.

[5] See *id.*

[6] See *id.*

[7] The term "gatekeepers" generally refers to the attorneys, accountants, auditors, fund directors and other board members and professionals who advise companies.

[8] Gary Gensler, Chair, Securities and Exchange Commission, Prepared Remarks at the Securities Enforcement Forum (Nov. 4, 2021), <https://www.sec.gov/news/speech/gensler-securities-enforcement-forum-20211104>.

[9] SEC Press Release 2022-176, Deloitte's Chinese Affiliate to Pay \$20 Million Penalty for Asking Audit Clients to Conduct Their Own Audit Work (Sept. 29,

2022) <https://www.sec.gov/news/press-release/2022-176>.

[10] In the Matter of 3M Company, Securities Exchange Act Release No. 98222 (Aug. 25, 2023), <https://www.sec.gov/files/litigation/admin/2023/34-98222.pdf>.

[11] SEC, Staff Statement on the Holding Foreign Companies Accountable Act and the Consolidated Appropriations Act, 2023 (Apr. 6, 2023), <https://www.sec.gov/news/statement/statement-hfcaa-040623> ("As initially enacted, the HFCAA required the Commission to prohibit trading in the securities of an issuer if it is a CII for three consecutive years. On December 29, 2022, Congress took action to shorten the timeframe before the Commission must impose an initial trading prohibition on a CII's securities to two consecutive years.").

[12] SEC, Holding Foreign Companies Accountable Act, (Apr. 10, 2023), <https://www.sec.gov/hfcaa>.

[13] PCAOB Fact Sheet, PCAOB Secures Complete Access to Inspect, Investigate Chinese Firms for First Time in History (Dec. 15, 2022) <https://pcaobus.org/news-events/news-releases/news-release-detail/fact-sheet-pcaob-secures-complete-access-to-inspect-investigate-chinese-firms-for-first-time-in-history>.

[14] See Paul Munter, Acting Chief Accountant, Securities and Exchange Commission, Audit Quality and Investor Protection under the Holding Foreign Companies Accountable Act (Sept. 6, 2022), <https://www.sec.gov/news/statement/munter-statement-audit-quality-and-investor-protection-090622> (discussing risks issuers face if they attempt to structure audit engagements "to avoid the potential of consecutive PCAOB HFCAA determinations and a resultant trading prohibition"); see also Gary Gensler, Chair, Securities and Exchange Commission, Statement on PCAOB's Determinations Regarding Public Accounting Firms in China, <https://www.sec.gov/news/statement/gensler-determination-statement-20221215> ("Chinese authorities will need to ensure that the PCAOB continues to have full access for inspections and investigations in 2023 and beyond. Each year, the PCAOB will determine whether it can inspect and investigate completely audit firms in China and Hong Kong.").

[15] Paul Hastings Client Alert, Bigger Carrots, More Sticks? DOJ Revises Its Corporate Criminal Enforcement Policy (Jan. 20, 2023), <https://www.paulhastings.com/insights/client-alerts/dojs-criminal-division-revised-its-policies-to-create-greater-incentives-for>.

[16] See U.S. Dep't of Justice Press Release, Assistant Attorney General Kenneth A. Polite, Jr. Delivers Keynote Address at the Global Investigations Review Live: DC Spring Conference (March 23, 2023), <https://www.justice.gov/opa/speech/assistant-attorney-general-kenneth-polite-jr-delivers-keynote-address-global>.

[17] U.S. Dep't of Justice Press Release, "ABB Agrees to Pay Over \$315 Million to Resolve Coordinated Global Foreign Bribery Case," Dec. 2, 2022, www.justice.gov/opa/pr/abb-agrees-pay-over-315-million-resolve-coordinated-global-foreign-bribery-case.

[18] U.S. Dep't of Justice Press Release, Assistant Attorney General Kenneth A. Polite, Jr. Delivers Keynote at the ABA's 38th Annual National Institute on White Collar Crime (March 3, 2023), <https://www.justice.gov/opa/speech/assistant-attorney-general-kenneth-polite-jr-delivers-keynote-aba-s-38th-annual-national>; U.S. Dep't of Justice, Evaluation of Corporate Compliance Programs (March 2023), <https://www.justice.gov/opa/speech/file/1571911/download>; see also Paul Hastings

Client Alert, DOJ's Approach to Ephemeral Messaging is Not Ephemeral: New Guidance on Messaging, Personal Devices (March 2023), <https://www.paulhastings.com/insights/client-alerts/dojs-approach-to-ephemeral-messaging-is-not-ephemeral-new-guidance-on>; Paul Hastings Client Alert, Ephemeral Messaging at the Office: Avoiding Pitfalls and Establishing Best Practices (Oct. 7, 2022), <https://www.paulhastings.com/insights/client-alerts/ephemeral-messaging-at-the-office-avoiding-pitfalls-and-establishing-best>.

[19] Gary Gensler, Chair, Securities and Exchange Commission, Prepared Remarks at the Securities Enforcement Forum (Nov. 4, 2021), <https://www.sec.gov/news/speech/gensler-securities-enforcement-forum-20211104>.

[20] See Gurbir S. Grewal, Director, Division of Enforcement, Remarks at Securities Enforcement Forum (Nov. 15, 2022), <https://www.sec.gov/news/speech/grewal-speech-securities-enforcement-forum-111522> (stating that "meaningful cooperation starts with self-policing and self-reporting," and also means "proactively cooperating with [SEC] investigations and remediating violations"); Gurbir S. Grewal, Director, Division of Enforcement, Remarks at Securities Enforcement West 2022 (May 12, 2022), <https://www.sec.gov/news/speech/grewal-remarks-securities-enforcement-forum-west-051222> (providing examples of "good cooperation," such as making documents or witnesses available on an expedited basis, highlighting "hot" documents, and making meaningful presentations to the SEC staff).

[21] SEC Press Release 2022-14, Remediation Helps Tech Company Avoid Penalties (Jan. 28, 2022), <https://www.sec.gov/news/press-release/2022-14>; see also SEC Press Release 2021-244, SEC Charges Oilfield Services Company and Former CEO With Failing to Disclose Executive Perks and Stock Pledges (Nov. 22, 2021), <https://www.sec.gov/news/press-release/2021-244> (crediting ProPetro's "significant cooperation with the [SEC's] investigation as well as its extensive remedial efforts," which included hiring new management, installing new directors, and developing new controls, policies, and procedures).

[22] In the Matter of 3M Company, Securities Exchange Act Release No. 98222 at 6 (Aug. 25, 2023), <https://www.sec.gov/files/litigation/admin/2023/34-98222.pdf>.

[23] Law of the People's Republic of China on International Mutual Legal Assistance in Criminal Matters (Order No. 13 of the President of the People's Republic of China) (《中华人民共和国国际刑事司法协助法》·中华人民共和国主席令第十三号), issued and effective on Oct. 26, 2018, Standing Committee of the National People's Congress of the People's Republic of China (official English version available at http://en.npc.gov.cn.cdurl.cn/2018-10/26/c_791384.htm).

[24] Cybersecurity Law of the People's Republic of China (Order No. 53 of the President of the People's Republic of China) (《中华人民共和国网络安全法》·中华人民共和国主席令第五十三号), issued on Nov. 7, 2016 and effective on June 1, 2017, Standing Committee of the National People's Congress of the People's Republic of China (official Chinese version available at <http://www.npc.gov.cn/npc/c30834/201611/270b43e8b35e4f7ea98502b6f0e26f8a.shtml>).

[25] Data Security Law of the People's Republic of China (Order No. 84 of the President of the People's Republic of China) (《中华人民共和国数据安全法》·中华人民共和国主席令第八十四号

), issued on June 10, 2021 and effective on Sept. 1, 2021, Standing Committee of the National People's Congress of the People's Republic of China (official English version available at <http://www.npc.gov.cn/englishnpc/c23934/202112/1abd8829788946ecab270e469b13c39c.shtml>).

[26] Personal Information Protection Law of the People's Republic of China (Order No. 91 of the President of the People's Republic of China) (《中华人民共和国个人信息保护法》·中华人民共和国主席令第九十一号), issued on August 20, 2021 and effective on November 1, 2021, Standing Committee of the National People's Congress of the People's Republic of China (official English version available at http://en.npc.gov.cn.cdurl.cn/2021-12/29/c_694559.htm).

[27] Lisa O. Monaco, Deputy Attorney General of the U.S. Dep't of Justice, Memorandum on Further Revisions to Corporate Criminal Enforcement Policies Following Discussions with Corporate Crime Advisory Group (Sept. 15, 2022), <https://www.justice.gov/opa/speech/file/1535301/download>.