

US COURT RULING AGAINST CHINESE BANKS IN SANCTIONS CASE REAFFIRMS GOVERNMENT SUBPOENA AUTHORITY TO REQUIRE NON-US BANKS TO PRODUCE DOCUMENTS AND INFORMATION HELD OVERSEAS

A recent US court ruling reinforces the well understood rule that non-US banks with branches or correspondent accounts in the US must comply with US government subpoenas regardless of their own country's laws. Under the US PATRIOT Act, non-compliance risks access to the US financial system.

BACKGROUND

On 18 March 2019, the US District Court for the District of Columbia (the District Court) unsealed a memorandum opinion ordering three Chinese banks to comply with law enforcement subpoenas issued in part under the US PATRIOT Act. Two months later, on 15 May 2019, the Court unsealed a separate memorandum opinion and order holding the Chinese Banks in contempt and fining them US\$50,000 per day for failing to comply with a 28 March 2019 deadline for responding to the subpoenas. The District Court's decision is currently stayed pending appeal to the DC Circuit Court of Appeals.

According to the District Court's March opinion, in December 2017, two of the Chinese Banks (referred to as Bank One and Bank Two) received grand jury subpoenas, while the third (referred to as Bank Three) received an administrative subpoena. The subpoenas sought records relating to a Hong Kong-based company suspected of acting as a front company for North Korea (the HK Customer).

Following the issuance of the subpoenas, between January and August 2018, the Chinese Banks and the US Department of Justice (DOJ) consulted with the Chinese government and were informed that responses to the subpoenas could only be made through the process established under a Mutual Legal Assistance Agreement (the MLAA). After the MLAA process failed to produce the records sought by the DOJ, the US government filed a motion seeking to compel the Chinese Banks to comply notwithstanding Chinese law.

In reviewing the government's motion, the District Court considered the following three issues: the court's jurisdiction over the banks, the DOJ's authority to issue the administrative subpoena to Bank Three, and whether enforcing the subpoenas would be reasonable under the principle of

Key issues

- Non-US banks must comply with US government subpoenas even if the documents are held outside the US.
- The key trigger is whether the non-US banks have branches in the US or use US correspondent accounts.
- The court found that US national security interests (in this case involving sanctions) overruled Chinese interests in maintaining bank secrecy and the potential that the Chinese Banks could face penalties for failing to use MLAA process.

international comity. Key points from the District Court's comprehensive opinion are set out below.

Jurisdiction

The District Court found that Bank One and Bank Two had expressly consented to jurisdiction when they opened branches in the US. Moreover, Bank Three had sufficient contacts through its US-based correspondent account to satisfy the traditional test for establishing a US court's jurisdiction.

DOJ Authority

In short, the District Court held that the DOJ had not exceeded its authority, because information about the HK Customer's activities outside the US was directly relevant to the DOJ's investigation.

Reasonableness

The District Court found there was a bona fide conflict between US and Chinese laws because the Chinese Banks could face penalties in China for failing to utilise the MLAA process. However, the District Court decided that the records sought by the DOJ were important to the investigation and that the information could only be obtained from China. The District Court also held that the MLAA process was unlikely to produce the records sought by the DOJ. Finally, the District Court held that the US national interest in investigating the HK Customer outweighed China's interest in maintaining bank secrecy.

POTENTIAL IMPACT OF NON-COMPLIANCE

If the Chinese Banks continue to refuse to comply with the subpoenas and the District Court's subsequent orders, the US government, could theoretically invoke the US PATRIOT Act to prohibit or restrict the Chinese Banks' access to US-based correspondent or payable-through accounts. The District Court's US\$50,000 daily penalty will also take effect unless overruled by the DC Circuit Court of Appeals.

LESSONS FOR OTHER NON-US BANKS

Non-US banks with correspondent accounts or branches in the US are subject to information disclosure requirements pertaining to their non-US activities. It is also clear that non-US banks are also prohibited from processing transactions involving money laundering or US sanctions violations through their US-based correspondent accounts. Even when the target of an investigation is a customer, US law requires the bank to cooperate in that investigation. Failure to comply with such requests can invite a range of measures designed to compel disclosure.

Some commentators and media have tried to frame the District Court's opinion in terms of ongoing US-China trade tensions. A more sensible (and legally accurate) view is that the District Court's decision is a straightforward, albeit impactful, application of case law. The Chinese Banks are not the first foreign banks to refuse to comply with US government subpoenas and likely won't be the last. It must also be noted that the investigation involving the HK Customer started well before the Trump administration.

This case further emphasises that compliance with US law enforcement subpoenas is not optional. The US government will use the full extent of the law and its leverage over the US financial system to investigate and prosecute matters of national security—especially sanctions. Does that mean that non-US banks with US branches and correspondent accounts are expected to

breach their home laws? Not necessarily. The US government routinely exchanges information with foreign governments through mutual legal assistance treaties and is (usually) open to compromise when a bank cooperates in good faith. In this case, the District Court found the Chinese MLAA process inadequate to meet the US government's needs. Now it's up to the Chinese Banks or the Chinese government to navigate toward a workable solution.

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