

E-ALERT | International Trade Controls

December 10, 2012

CHINESE STATE-OWNED COMPANY PLEADS GUILTY TO U.S. EXPORT CONTROL VIOLATIONS AGREES TO PAY \$3 MILLION IN PENALTIES FOR REEXPORTING PRODUCTS TO PAKISTANI NUCLEAR PLANT

On December 3, 2012, China Nuclear Industry Huaxing Construction Co., Ltd. (“Huaxing”) [pleaded guilty](#) in U.S. federal court to one count of conspiracy to violate U.S. export control laws and three counts of unlawful exports or attempted exports. The guilty plea stemmed from the company’s involvement in efforts to reexport epoxy paint coatings from the United States through China to Pakistan for use in construction of a nuclear power plant there. The case is believed to be the first time that a Chinese company has pleaded guilty to violating U.S. export control laws.

Huaxing also agreed to pay a combined \$3 million in fines to the U.S. Department of Justice (“DOJ”) and the U.S. Department of Commerce’s Bureau of Industry and Security (“BIS”). Under its settlement agreement with BIS, the company further agreed to implement an export controls compliance program, complete two external audits of its compliance program, and serve a five-year probationary period in order to avoid designation as a “Denied Person,” which would severely limit its ability to participate in transactions involving items subject to U.S. export controls.

BACKGROUND ON U.S. EXPORT CONTROL LAW

BIS regulates the export, reexport, and transfer of a broad variety of U.S.-origin items and other items that are subject to U.S. export control jurisdiction that have both commercial and military applications. Specifically, BIS administers the Export Administration Regulations (“EAR”), which impose different levels of control on the export, reexport, or transfer of items subject to the EAR depending on (1) the sensitivity of the item; (2) the item’s ultimate country of destination; (3) the item’s end-use; and (4) the ultimate end-user of the item. For instance, export, reexport, or transfer of even the least-sensitive items subject to the EAR – which are designated “EAR99” – may require a license if they are to be shipped to certain embargoed countries or if the end-user is on a U.S. government list of parties of concern to the United States.

SCHEME TO EXPORT EPOXY COATINGS FOR PAKISTANI NUCLEAR REACTOR

Huaxing is a Chinese state-owned construction company based in Nanjing that specializes in nuclear power plant construction, both in China and abroad.

According to the BIS Charging Letter and the DOJ criminal information, Huaxing was a contractor involved in the construction of the Chashma II nuclear power plant in Pakistan, with particular responsibility for applying epoxy coatings certified for use in a nuclear reactor. Accordingly, Huaxing entered into a contract in January 2006 to procure certified epoxy coatings for use in construction of Chashma II from PPG Paints Trading (Shanghai) Co., Ltd. (“PPG Paints Trading”), which would, in turn, acquire the epoxy coatings from a U.S. manufacturing facility operated by its U.S. parent corporation, PPG Industries, Inc. (“PPG Industries”).

The U.S.-origin epoxy coatings that Huaxing sought to purchase from PPG Paints Trading are classified under U.S. export controls laws as “EAR99,” meaning that they are subject to BIS export controls, but are not identified as sensitive products and generally do not require a license for export, reexport, or transfer. However, even EAR99 items destined for an end-user on BIS’

Entity List cannot be exported, reexported, or transferred without a license. Because Chashma II is a project of the Pakistan Atomic Energy Commission (“PAEC”), and PAEC and its subordinate nuclear reactors are on BIS’s Entity List, U.S.-origin epoxy coatings could not be exported, reexported, or transferred for use in the construction of Chashma II without an export license from BIS.

According to DOJ and BIS, Huaxing, PPG Paints Trading, and PPG Industries were all aware of the obligation to obtain an export license from BIS before sending epoxy coatings to Pakistan for use in the construction of Chashma II. However, in June 2006, BIS denied PPG Industries’ application for a license to export epoxy coatings to Pakistan for use in construction of Chashma II on the grounds that such an export would be inconsistent with U.S. nuclear nonproliferation policy.

According to DOJ and BIS, following the denial of PPG Industries’ export license application, Huaxing and PPG Paints Trading conspired to procure from PPG Industries the same epoxy coatings through a third-party Chinese distributor, who would then transfer the epoxy coatings to Huaxing for use in construction of Chashma II in Pakistan. Between June and December 2006, Huaxing and PPG Paints Trading carried out the conspiracy by causing the reexport to Pakistan, without a license, of U.S.-origin epoxy coatings for use in construction of Chashma II. Specifically, PPG Paints Trading placed three separate orders for epoxy coatings with PPG Industries in the United States. On each occasion, PPG Paints Trading falsely asserted that the epoxy coatings would be used in construction of a Chinese nuclear power plant for which no export license was required. In reality, the shipments of the epoxy coatings were not for use in construction of a Chinese nuclear power plant, but rather were to be transshipped from China to Pakistan for use in construction of Chashma II.

PLEA AGREEMENT AND SETTLEMENT TERMS

On December 3, 2012, Huaxing became the third party to plead guilty in connection with the conspiracy to export epoxy coatings to be used in construction of Chashma II in Pakistan in circumvention of U.S. export control law. PPG Paints Trading pleaded guilty in December 2010, and together with its U.S. parent PPG Industries, paid \$3.75 million in criminal and civil fines. In November 2011, a senior executive of PPG Paints Trading also pleaded guilty for her role in the conspiracy and agreed to cooperate in the Government’s investigation. It is not clear whether DOJ and BIS are also investigating the unnamed third-party Chinese distributor that worked with Huaxing and PPG Paints Trading to facilitate the reexport of epoxy coatings to Pakistan.

In addition to pleading guilty to the four counts charged in DOJ’s criminal information, Huaxing entered into a settlement agreement with BIS, thus resolving both the civil and criminal dimensions of the U.S. government’s enforcement efforts in this matter. Together, the DOJ plea agreement and [BIS Order implementing the settlement agreement](#) require Huaxing to:

- pay a \$1 million civil penalty;
- pay a \$2 million criminal penalty;
- implement an export controls compliance program, which must include specific instructions on compliance with U.S. export control laws;
- complete two external audits of its export controls compliance program, each of which must cover exports, reexports, transshipments, and transfers by or on behalf of Huaxing that are subject to the EAR, including particularly any such transactions involving an entity on BIS’s Entity List; and
- accept a five-year probationary period during which Huaxing must (1) fully and timely pay its civil penalty; (2) implement its export controls compliance program; (3) complete and submit to BIS the two external audits; and (4) commit no other EAR violations. In exchange for Huaxing’s successful completion of the probationary period, DOJ would waive half of the \$2 million criminal penalty, and BIS would not place Huaxing on its

“Denied Persons List,” a designation that would severely limit the company’s ability to engage in transactions involving items subject to the EAR for a five-year period.

IMPLICATIONS AND COMPLIANCE LESSONS

Huaxing’s December 3 guilty plea is particularly noteworthy because it is believed to mark the first time that a Chinese corporation has pleaded guilty in a U.S. criminal export control matter, and demonstrates the willingness of the U.S. government to enforce its export control laws even against non-U.S. companies, including those owned or controlled by non-U.S. governments.

The case reiterates several export control compliance lessons:

- Because even non-sensitive U.S. products require licenses to certain end-users and end-uses, a proper understanding of end-users and end-uses in a transaction is crucial, including checking that end-users are not on U.S. watchlists.
- U.S. export control laws apply not just to exports, but also to reexports – transactions that occur between two non-U.S. countries involving items subject to U.S. export control jurisdiction. Some reexports may require licensing from the U.S. government.
- Vigilance is necessary to ensure that non-U.S. affiliates are not circumventing export control compliance programs.
- U.S. export control laws apply to non-U.S. companies that handle items subject to those laws.

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