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D.C. Circuit Upholds Decision Requiring Three Chinese Banks to Produce Documents Located in China to the U.S. Government

Court Finds that U.S. Investigative Interests Outweigh Violation of Chinese Law

On July 30, 2019, the U.S. Court of Appeals for the District of Columbia affirmed civil contempt orders by the D.C. District Court against three Chinese banks for their failure to produce documents in response to U.S. government subpoenas relating to an investigation of North Korea's financing of its nuclear weapons program. The 44-page opinion by D.C. Circuit Judges David S. Tatel, Patricia A. Millett and Cornelia T.L. Pillard, written for the court by Judge Tatel, was released publicly on August 6, 2019 with redactions of information that remains under seal.[1]

The Court of Appeals concluded that there was personal jurisdiction over all three banks because two of the banks consented to jurisdiction when they opened branches in the United States and the third bank's choice to maintain correspondent accounts in the U.S. was sufficient to sustain jurisdiction. The Court of Appeals further concluded that comity principles did not require that the subpoenas be quashed because the District Court exercised appropriate discretion in finding that the comity concerns identified by the banks—including that compliance with the subpoenas would put the banks in breach of Chinese law—were outweighed by the national security interests of the United States.

December 2017 Subpoenas to Three Chinese Banks

In December 2017, the U.S. Department of Justice ("DOJ") served subpoenas on three Chinese banks in connection with a grand jury investigation related to a Hong Kong-based front company for a North Korea state-run entity.[2] The subpoenas demanded production of certain bank records located in China—including signature cards, account statements, and transaction information—for accounts related to the front company.[3]

For two of the three banks, the DOJ utilized an investigative process known as a *Bank of Nova Scotia* subpoena. This type of subpoena—named after a case involving the Canadian bank—typically seeks bank records located abroad by serving the U.S. branch of the foreign bank.[4] The authority of the U.S. government to compel production of records in a foreign country, even when production of those records would violate the foreign country's laws, was upheld by the Court of Appeals for the Eleventh Circuit in *In re Grand Jury Proceedings Bank of Nova Scotia*, where the DOJ sought bank documents located in the Cayman Islands and the Bahamas by serving the Canadian bank's Miami branch.[5] Because the use of this type of subpoena can affect U.S. law enforcement's relationship with the foreign country, advance written

approval from DOJ's Office of International Affairs ("OIA") is required before a federal prosecutor can issue a *Bank of Nova Scotia* subpoena.[6] Since the Eleventh Circuit's 1984 decision in the *Bank of Nova Scotia* case, courts have upheld grand jury subpoenas for foreign bank records where the records were deemed necessary to serve an overriding U.S. interest.[7]

Because the third Chinese bank does not have a branch in the U.S., the subpoena issued to that bank was made pursuant to 31 U.S.C. § 5318(k)(3)(A), a USA Patriot Act provision.[8]

The grand jury investigation into a North Korea front company is consistent with the DOJ's focus in recent years on North Korea-related activity. In the past few years, the DOJ has brought a series of high-profile civil forfeiture actions targeting assets connected to North Korea.[9] Moreover, the DOJ's use of compulsory process in lieu of using the U.S.-China Mutual Legal Assistance Agreement ("MLAA") procedure in this case may be part of a broader effort to incentivize China to improve its responses to MLAA requests—a goal set forth in the DOJ's "China Initiative," announced in November 2018.[10]

Motion to Compel Decision by the District Court

In November 2018, after the three banks each failed to comply with the subpoenas, the DOJ filed a motion to compel compliance. The banks opposed the motion on the ground that they were not subject to the personal jurisdiction of the district court and therefore the subpoenas were unenforceable.[11] The banks further argued that, even if the court could exercise personal jurisdiction, the court should not compel production because such production would violate Chinese law and expose the banks to fines and other legal penalties by the Chinese government.[12] The banks argued that the DOJ should utilize the process set forth in the MLAA.[13] The China Ministry of Justice—the Chinese authority responsible for handling MLAA requests—also submitted letters to the court stating it would timely review a request made through the MLAA process.[14] The DOJ argued that U.S. national interests override the interest of China's banking secrecy laws, and that the MLAA process had proven to be impracticable.[15]

On March 18, 2019, Chief Judge Howell granted the DOJ's motion, holding that the court had jurisdiction over the three banks and ordering them to produce the documents within a prescribed timeframe.[16]

In deciding whether to exercise its authority to compel compliance with the subpoenas, the District Court engaged in an international comity analysis. It considered seven factors: (1) the importance to the investigation or litigation of the documents or other information requested; (2) the degree of specificity of the request; (3) whether the information originated in the United States; (4) the availability of alternative means of securing the information; (5) the extent to which noncompliance with the request would undermine important interests of the United States, or compliance with the request would undermine important interests of the state where the information is located; (6) hardship of the party facing conflicting legal obligations; and (7) whether that party has demonstrated good faith in addressing its discovery obligations.[17]

In balancing the factors, the court wrote that although "the records' Chinese origins, the slim chance of the banks suffering some hardship if forced to comply, and the banks' good faith through this process" all weighed against enforcement of the subpoenas, the "importance of the subpoenaed records, the specificity of the subpoenas, the lack of alternative channels for obtaining the records, and the risk of undermining a United States national security interest at the pinnacle of importance, all favor enforcement."[18] Notably, the court pointed out that "historical precedent" of China's responsiveness to MLAA requests "offers good reason for the United States to suspect that the MLAA, for records like those sought in this case, is not a real alternative." The court cited to the recent Southern District of New York civil case, *Nike* v. *Wu*, in which the U.S. District Court compelled six Chinese banks to produce transaction information related to accounts held by trademark infringers on the grounds that, among other things, document discovery through the Hague Convention was not practical in China and the Chinese banks are unlikely to suffer severe consequences for producing the information despite Chinese laws, given the role of the Chinese government in those institutions.[19] Finally, the court concluded that the most important factor in the comity analysis—the interests of both countries—firmly weighed in favor of enforcement as U.S. national security was at stake while no Chinese national interest would be compromised.[20]

April 10, 2019 Order of Civil Contempt

On March 22, 2019, one of the banks filed a notice of appeal from the March 18, 2019 order of compulsion.[21] On March 29, 2019, the DOJ moved for civil contempt because none of the three banks complied with the March 18, 2019 Order.[22] The three banks opposed the order of contempt on the grounds that each bank was disobeying the compulsion order in "good faith because Chinese law does not permit compliance."[23]

On April 10, 2019, the District Court found the banks to be in civil contempt and imposed a $50,000 daily fine on each bank for contempt and noted that it would increase the amount if needed.[24] However, the court stayed civil contempt sanctions against the banks pending their appeal to the D.C. Court of Appeals.[25]

The contempt order drew significant attention from the American press. The media speculated about what actions the U.S. government might take against a foreign bank without a branch or other presence in the United States (such as the third Chinese bank), including the use of a lesser-known USA Patriot Act authority that could limit or cut off a non-complying bank from the U.S. financial system.[26] Specifically, Section 319(b) of the USA Patriot Act provides the Treasury Secretary or Attorney General authority to provide a written notice to a covered financial institution (such as a bank or branch located in the U.S.) requiring it to terminate any correspondent relationship with a foreign bank within 10 business days, where the written notice finds that the foreign bank has failed to comply with a summons or subpoena issued under 31 U.S.C. § 5318(k)(3)(A) or failed to initiate proceedings in a U.S. court contesting such summons or subpoena.[27] Failure to terminate a correspondent relationship shall render the covered financial institution liable for a civil penalty of up to $10,000 per day until the correspondent relationship is terminated.[28] Despite these media accounts, there is no indication that the U.S. government was planning to use this authority or that it would be applicable under the circumstances.

The D.C. Circuit Court of Appeals' Affirmance

After accelerated consideration, on July 30, 2019, the D.C. Circuit Court of Appeals affirmed the District Court's orders. On the question of personal jurisdiction, the Court of Appeals agreed with the District Court that, in applying to open their U.S. branches, two of the banks executed agreements with the Federal Reserve in which they "consent[ed] to the jurisdiction of the federal courts of the United States…for purposes of any and all…proceedings initiated by…the United States…in any matter arising under U.S. Banking Law," which includes all federal criminal actions arising under the Bank Secrecy Act.[29]

The Court of Appeals rejected the banks' arguments that the government must show an actual violation of the Bank Secrecy Act, holding that "[w]hether a proceeding 'arises under' a particular law is a question about its subject matter at the outset, not a question about its outcome."[30] It also found that a federal court can require production of documents located in foreign countries so long as the court has personal jurisdiction over the person or entity in possession or control of the material.[31]

With respect to Bank 3, which did not have a U.S. branch or consent to personal jurisdiction, the Court of Appeals found that its contacts with the United States as a whole was the appropriate inquiry because the applicable service-of-process provision should be interpreted to authorize nationwide service anywhere in the United States where a foreign bank has a representative.[32] The Court further held that § 5318(k)(3)(A), a USA Patriot Act provision that authorizes the Attorney General and the Treasury Secretary to issue a "subpoena to any foreign bank that maintains a correspondent account in the United States and request records related to such correspondent account, including records maintained outside of the United States relating to the deposit of funds into the foreign bank," includes "records of transactions that do not themselves pass through a correspondent account when those transactions are in service of an enterprise entirely dedicated to obtaining access to U.S. currency and markets using a U.S. correspondent account."[33]

On the issue of comity, the Court of Appeals reviewed the District Court's findings for abuse of discretion. It emphasized that the District Court had undertaken "a thorough, considered analysis that frankly acknowledged the Banks' comity concerns."[34] The Court of Appeals recognized that the facts in many ways were similar to—or stronger than—*Sealed Case I*, 825 F.2d 494 (D.C. Cir. 1987), where the court found comity weighed against enforcement of the subpoena, but found there were two factors that distinguish this case: American national security interests surrounding North Korea's nuclear weapons program and the limitations of the MLAA process in obtaining the documents from China. Among other things, it noted the District Court's recognition of the government's pessimism regarding the effectiveness of the MLAA process in seeking to obtain bank records in China that relate to North Korea. Despite acknowledging that enforcing the subpoenas would require the banks to violate their own nation's laws, the Court of Appeals concluded that "[w]hether to enforce the subpoenas was a hard call, the district court made that call, and we have no reason to reverse its fact-bound conclusion."[35]

Conclusion

Now that the Court of Appeals has affirmed the District Court's decision, it remains to be seen whether the three Chinese banks will petition for *en banc* review or review by the U.S. Supreme Court, if they will comply with the subpoenas and produce the documents, or if they will decline to produce the subpoenaed documents and risk court penalties and potential action by the U.S. government for noncompliance.

Notably, in the *Nike* v. *Wu* civil action, in the face of fines for non-compliance, six Chinese banks—all of whom have U.S. branches—opted to comply with the third-party subpoenas by making productions with the assistance of the Chinese Ministry of Justice, rather than take an appeal to the Second Circuit.[36] Similarly, when Bank of China faced significant money penalties in another civil action, *Gucci America, Inc.* v. *Weixing Li*, it too opted to produce documents despite having argued that production would violate Chinese law (and despite submissions by the Ministry of Justice to that effect to the court).[37] The outcomes of those cases were cited by the District Court in this case to support its conclusion favoring enforcement of the subpoenas.

If no further review is obtained and the three banks comply with the subpoenas and produce the documents, the Court of Appeals' decision will have precedential effect in the D.C. Circuit (a commonly-used venue for the Money Laundering and Asset Recovery Section of the U.S. Department of Justice's Criminal Division) and it could serve as persuasive authority in other federal district and circuit courts. The decision will likely embolden the DOJ's use of its authorities to seek bank records located in China and other countries. Among other things, the D.C. Circuit's opinion provides an expansive reading of the scope of the U.S. government's subpoena authority pursuant to 31 U.S.C. § 5318(k), extending such authority in some circumstances to include overseas records related to funds transfers that did not pass through a U.S. correspondent account. While the D.C. Circuit based its holding on the fact that the records here pertained to a front company whose sole purpose was to obtain access to the U.S. financial system using a U.S. correspondent account, this decision may open the door to other theories for seeking production of documents relating to transactions that do not pass through a U.S. correspondent account.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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1 *See In re: Sealed Case*, No. 19-5068 (D.C. Cir. Aug. 6, 2019).

2 *In re Grand Jury Investigations of Possible Violations of 18 U.S.C. § 1956 and § 1705*, 381 F. Supp. 3d 37, 44 (D.D.C. Mar. 18, 2019).

3 *In re: Sealed Case*, No. 19-5068, at 20 (D.C. Cir. Aug. 6, 2019).

4 *See In re Grand Jury Proceedings*, 691 F.2d 1384 (11th Cir. 1982).

5 *In re Grand Jury Proceedings Bank of Nova Scotia*, 740 F.2d 817 (11th Cir. 1984).

6 U.S. Dep't of Justice, Criminal Resource Manual, 279: Subpoenas, available at https://www.justice.gov/jm/criminal-resource-manual-279-subpoenas.

7 *Matter of One Grand Jury Subpoena Returnable January 11, 1989,* Nos. N–89–7, N–89–6, 1989 WL 49165, at *1, *3 (D. Conn. Mar. 22, 1989) (U.S. government served a grand jury subpoena seeking signatures on a consent directive, and the court concluded that "on balance" the interest of the U.S. "in ensuring the effective enforcement of its criminal laws and integrity of grand jury proceedings" prevails over Cayman interest in preserving confidentiality of its financial industry); *Garpeg, Ltd.* v.

U.S., 583 F. Supp. 789, 796 (S.D.N.Y. 1984) (summonses ordering a bank to produce records from its Hong Kong branch pursuant to an investigation by the Criminal Division of the IRS should be enforced because the U.S. interest in obtaining the records outweighed Hong Kong's interest in preserving its bank secrecy laws).

8 *In re Grand Jury Investigations of Possible Violations of 18 U.S.C. § 1956 and § 1705*, 381 F. Supp. 3d at 47.

9 *See, e.g.*, Complaint, *United States* v. *All Funds In The Accounts Of Blue Sea Business Co., LTD., Fanwell, LTD., Fully Max Trading, LTD., Dandong Hongxiang Industrial Development Co., LTD., and Success Target Group, LTD. at China Merchants Bank et al.*, No. 2:16-cv-05903 (D.N.J. Sept. 26, 2016); U.S. Dep't of Justice, Press Release, *United States Files Complaint to Forfeit More Than $1.9 Million From China-Base Company Accused of Acting as a Front for Sanctioned North Korean Bank* (June 15, 2017), available at https://www.justice.gov/usao-dc/pr/united-states-files-complaint-forfeit-more-19-million-china-based-company-accused-acting; Complaint, *United States* v. *$6,999,925 Funds Associated with Velmur Mgmt. Pte Ltd.*, No. 1:17-cv-01705 (D.D.C. Aug. 22, 2017); Amended Complaint, *United States* v. $*4,083,935 Funds Associated with Dandong Chengtai Trading Ltd.*, No. 1:17-cv-01706 (D.D.C. Jan. 25, 2018); Complaint, *United States* v. *The Bulk Cargo Carrier Known as the "Wise Honest,"* No. 1:19-cv-04210 (S.D.N.Y. May 9, 2019).

10 U.S. Dep't of Justice, Attorney General Jeff Session's China Initiative Fact Sheet (Nov. 1, 2018), available at https://www.justice.gov/opa/speech/file/1107256/download.

11 *Id.* at 47, 49.

12 *Id.* at 74.

13 *Id.* at 47-48.

14 *Id.* at 48.

15 *Id.* at 71-72.

16 *Id.* at 78.

17 *Id.* at 65-67. The first five of these factors come from *Société Nationale Industrielle Aerospatiale* v. *U.S. Dist. Court for S. Dist. of Iowa*, 482 U.S. 522, 544, n.28 (1987). *See also* Restatement (Third) of Foreign Relations Law § 442(c)(1). The Court drew the latter two factors from *Linde* v. *Arab Bank, PLC*, 706 F.3d 92, 110 (2d Cir. 2013).

18 *In re Grand Jury Investigations of Possible Violations of 18 U.S.C. § 1956 and § 1705*, 381 F. Supp. 3d at 77.

19 *Id.* at 69-70. *See also Nike Inc.* v. *Wu,* 349 F. Supp. 3d 346, 366 (S.D.N.Y. 2018).

20 *In re Grand Jury Investigations of Possible Violations of 18 U.S.C. § 1956 and § 1705*, 381 F. Supp. 3d at 72-73.

21 *In re Grand Jury Investigations of Possible Violations of 18 U.S.C. § 1956 and § 1705*, Miscellaneous Case Nos. 18-175, 18-176 and 18-177, 2019 WL 2182436, at *1 (D.D.C. Apr. 10, 2019).

22 *Id.*

23 *Id.* at *4.

24 *In re Grand Jury Investigations of Possible Violations of 18 U.S.C. § 1956 and § 1705*, 2019 WL 2182436 at *5.

25 *Id.* at *7.

[26] *See, e.g.*, Spencer S. Hsu, WASHINGTON POST, *U.S judge upholds subpoenas to three large Chinese banks in N. Korea sanctions probe* (May 1, 2019), available at https://www.washingtonpost.com/local/legal-issues/us-judge-upholds-subpoenas-to-three-chinese-banks-in-n-korea-sanctions-probe/2019/05/01/d2fb170c-6b99-11e9-be3a-33217240a539_story.html?noredirect=on.

[27] USA PATRIOT ACT OF 2001, Pub. L. No. 107–56, 115 Stat. 272 (October 26, 2001).

[28] *Id.*

[29] *See In re: Sealed Case*, No. 19-5068, at 10.

[30] *Id.* at 11.

[31] *Id.* at 12.

[32] *Id.* at 14-17.

[33] *Id.* at 19 (quoting 31 U.S.C. § 5318(k)(3)(A)(i)); *id.* at 23-24.

[34] *Id.* at 42.

[35] *Id.*

[36] *See Nike, Inc.* v. *Wu*, 349 F. Supp. 3d 346 (S.D.N.Y. 2018); Letter addressed to Magistrate Judge Debra C. Freeman from David G. Hille re: the Banks' production of documents in response to subpoenas issued by Plaintiff-Assignee Next Investments and in accordance with Judge McMahon's November 19, 2018 Order, *Nike, Inc.* v. *Wu*, No. 1:13-CV-08012, Dkt. 184 (S.D.N.Y. Dec. 17, 2018).

[37] *See Gucci America, Inc.* v. *Weixing Li*, No. 10 Civ. 4974, 2011 WL 6156936 (S.D.N.Y. Aug. 23, 2011), *vacated by Gucci America, Inc.* v. *Weixing Li*, 768 F.3d 122 (2d. Cir. 2014); *Gucci America, Inc.* v. *Li*, No. 10-cv-4974, 2015 WL 7758872 (S.D.N.Y. 2015); Sneha Teresa Johny, REUTERS, Bank of China submits records in Gucci case after fines (Jan. 20, 2016), available at https://www.reuters.com/article/us-bank-of-china-gucci-idUSKCN0UZ0AF.