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LESSONS FROM THE GUCCI CASE:
CHINESE BANKS INCREASINGLY SUBJECT TO U.S. JURISDICTION

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In 2010 and 2011, the New York branch of the Bank of China ("BOC") was served with two subpoenas relating to a lawsuit for trademark infringement brought by luxury goods companies Gucci, Balenciaga, Yves Saint Laurent, Bottega Veneta and others. They sought all documents – including those located in China – relating to BOC accounts belonging to the defendant counterfeiters. BOC protested that compliance with these requests would cause it to violate PRC law protecting bank customers from unauthorized disclosure of their account information. In April, BOC's five-year battle to maintain its customers' privacy and remain in compliance with Chinese law came to an end. In that time, BOC filed two appeals, was found in contempt of court twice, and filed its own lawsuit in China. In November 2015, the District Court for the Southern District of New York raised the cost of noncompliance. It issued an order imposing a coercive fine of $50,000 U.S. dollars per day until BOC complied with the subpoenas. By January 20, 2016, the fine had reached $1 million, and BOC capitulated. It produced over 7,000 pages from its Chinese offices. Despite contesting BOC's claims of privilege over certain documents, Gucci notified the court on April 8, 2016 that it had resolved its dispute with BOC.

The Gucci case offers some insight as to what to expect from U.S. courts going forward. It appears probable that U.S. courts will continue to demand the production of information protected from disclosure outside the U.S., and will assert jurisdiction when lawsuits or subpoenas relate to an entity's deliberate use of a U.S. correspondent bank account.

Foreign Banks Are Routinely Ordered to Produce Records in Violation of Home Country Laws

U.S. courts have long-held that a foreign entity may be required to produce information in violation of its home country's bank secrecy laws. In fact, BOC has been before U.S. courts on numerous occasions, and subjected to discovery orders with which it complied. In 2008, BOC was required to produce documents in a nearly identical case about counterfeit handbags. In *Gucci America, Inc. v. MyReplicaHandbag.com*, 07-cv-2438 (JGK) (S.D.N.Y.), BOC was served with a subpoena as part of Gucci's effort to enforce a judgment it had obtained against counterfeiters who once had accounts at BOC. BOC provided Gucci with some information voluntarily, and resisted more burdensome requests. However in that case, BOC did not engage in a protracted battle over the disclosures, nor did it suffer any repercussions. In 2013, in *Wultz v. Bank of China Ltd.*, 61 F.Supp.3d 272 (S.D.N.Y. 2013), BOC lost its opposition to disclosing information relating to an account maintained by an alleged terrorist, as well as its internal reports and communications with the Chinese government about the individual. And, even in this Gucci case, BOC produced documents located in China as early as September 2011, after the

court's initial ruling. Thus, while the Gucci case has been the subject of some controversy because of the coercive fine imposed, the underlying facts of the case are not unusual.

The result in the Gucci case does not necessarily dictate what other U.S. courts will do going forward. U.S. federal district courts are not bound by each other's rulings: ICBC and BOC prevailed – once – in a similar discovery dispute seeking account records of defendant counterfeiters. In *Tiffany (NJ) LLC v. Qi Andrew*, 276 F.R.D. 143 (S.D.N.Y. 2011), the court was persuaded that Chinese law would prohibit the disclosure of customer records, and could result in civil and criminal penalties levied by the Chinese government on the bank.

But more often, U.S. courts have issued a different ruling on the same Chinese laws. Why? U.S. courts are no longer convinced that there is a credible threat of punishment for violating the PRC bank secrecy laws. When a discovery order conflicts with the laws of foreign jurisdiction, U.S. courts will weigh the foreign country's interest in enforcing its laws, and the risk to the entity being asked to violate them, against the interests of the party seeking the discovery in the case and U.S. interests. While foreign laws purport to prohibit disclosure, governments generally do not impose penalties on their banks for complying with U.S. court orders. Seeing no real risk of punishment, U.S. courts tend to find in favor of disclosure.

The recent Gucci case was no exception. The judge observed that BOC "could point to no case where a Chinese bank was subjected to liability for disclosing the type of bank account information sought by Gucci." The People's Bank of China and the CBRC addressed a letter to the court in 2011 in support of BOC's motion for reconsideration of the Gucci court's decision ordering BOC's production of Chinese documents. They informed the court that they had issued a "severe warning" to BOC, and were investigating to "determine the appropriate sanctions." As the Gucci court observed in 2015, such sanctions were never imposed. Unless the Chinese government begins to impose civil or criminal penalties for a breach of the banking secrecy laws, it is unlikely that a U.S. court will recognize a credible threat of punishment to Chinese banks in future cases.

It is worth noting that most PRC banks are state-owned enterprises and to date, the US courts have only dealt with the issue of the likelihood of penalty in this context. The analysis may change as private banks gain a stronger foothold in the PRC market. We can expect the PRC government to be more aggressive in imposing fines against private banks. Also, the account holder may be a material fact in assessing whether to preclude disclosure or to fine disclosure. Here, the account holders were alleged counterfeiters of luxury handbags. A PRC bank's disclosure of the account details of a major state-owned enterprise or a senior government official, by way of examples, might trigger serious repercussions. Cases involving Chinese state-owned enterprise or officials would involve claims of sovereign immunity, making the analysis more complex. The sovereign immunity defense would be the first hurdle to overcome

before any private litigant could attempt to access discovery from a bank in relation to the accounts of an SOE or an official.[1]

U.S. Jurisdiction Over Foreign Banks with U.S. Branches Becomes More Predictable

The Gucci case usefully illustrates how U.S. jurisdiction can work with respect to foreign banks. The basis for the Gucci court's jurisdiction over BOC actually changed during the course of BOC's first appeal. The shift in legal doctrine arose out of a 2014 Supreme Court case that narrowed the scope of jurisdiction over foreign entities. In that case, *Daimler AG v. Bauman*, 134 S. Ct. 746 (2014), the Supreme Court found that a foreign corporation may not be subject to general jurisdiction – that is, jurisdiction for the purpose of any lawsuit, wherever the claim arose – simply because they have U.S. subsidiaries. Only entities incorporated or domiciled in the United States are subject to general jurisdiction.

In 2010, when Gucci sought to compel compliance with its subpoena, it assumed that BOC was subject to general jurisdiction in New York because it maintained a branch office there, and had real estate holdings. The Gucci appellate court, considering BOC's appeal after the *Daimler* decision, said that the district court was wrong. After *Daimler*, there is no general jurisdiction over BOC. If the Gucci court was going to assert jurisdiction over BOC, it would have to be specific jurisdiction.

Thus, the Gucci court's 2015 decision, and the decisions of federal judges going forward, will be based on findings of specific jurisdiction over foreign banks with U.S. branches. This means that U.S. courts will exercise power over an entity where the claim at issue arises out of a foreign entity's specific activities in the United States. Gucci received documents from JP Morgan Chase and Wells Fargo showing that the counterfeiters wired proceeds from their operations from BOC's U.S. correspondent accounts into their Chinese BOC accounts. The Gucci court found that BOC's repeated use of the U.S. correspondent accounts to transfer proceeds of the counterfeiters to their Chinese accounts was sufficiently deliberate and connected to the U.S., to compel BOC to produce documents related to those accounts, even if those documents were in China. In so ruling, the court noted that BOC had advertised its U.S. correspondent account to customers, seeking to attract them on the basis that BOC's New York branches are the "principal U.S. dollar clearing channel of [BOC] worldwide" and that it is "the first choice of U.S. dollar wire transfers to and from China."

A March 2016 decision suggests that, at least in New York, specific jurisdiction may arise from a single use of a U.S. correspondent account, even if the entity has no U.S. presence. In *Official Committee of Unsecured Creditors of Arcapita, Bank B.S.C. v. Bahrain Islamic Bank*, 2016 WL 1276459 (S.D.N.Y.), a Bahraini bank (BisB) and Bahraini corporation (Tadhamon) sent three transfers through U.S. correspondent accounts on behalf of a Bahraini client (Arcapita). BisB

[1] There are exceptions to the sovereign immunity defense. For instance, an SOE may not claim immunity for purely commercial activities undertaken in the United States.

used its own correspondent account once, and then sent the money directly to a London broker to make an investment on behalf of Arcapita. Tadhamon did not have its own correspondent account—it used its Bahraini bank account to send two transfers through New York, which then were returned to Tadhamon's account in Bahrain and used to purchase Bahraini securities on Arcapita's behalf. BisB and Tadhamon refused to return the funds upon the maturity of Arcapita's investments in satisfaction of other unpaid debts owed by Arcapita.

The *Arcapita* court found that it could exercise specific jurisdiction over BisB and Tadhamon for the purposes of a U.S. lawsuit to recover the investments on behalf of creditors. The court observed that BisB and Tadhamon had deliberately availed themselves of the New York banking system in directing the transfers, and had chosen to do the transaction in U.S. dollars. Thus the court concluded it was fair and foreseeable that they could be held accountable in New York for claims arising out of those specific transfers, despite the fact that the funds were only briefly in the U.S., and neither BisB or Tadhamon had any U.S. presence. It remains to be seen to what extent the reasoning of *Arcapita* is applied in future cases.

Assessing Your Exposure to U.S. Subpoenas

To protect against U.S. civil subpoenas, the best measure is to avoid doing transactions in U.S. dollars through New York banks. This is not always practical, and does not alleviate other U.S. legal obligations imposed on U.S. branches of foreign banks, such as the obligation to respond to subpoenas issued by the U.S. government and to maintain compliance with U.S. anti-money laundering laws. However, U.S. courts are most inclined to require disclosure where it is a customer's decision, not a bank's decision, to conduct a transaction in U.S. dollars and through a U.S. correspondent account. If a foreign bank is a passive recipient of funds in a transaction, and is not actively encouraging the use of a U.S. correspondent account in the service of a customer, a court may decline to find the deliberation and purposefulness required for a finding of specific jurisdiction.

The Benefits of Reciprocity

It is possible that the PRC government will be disinclined to impose penalties for disclosures in violation of Chinese bank secrecy laws. The U.S. and Chinese governments are working together on anti-corruption efforts. Just as U.S. courts have forced the disclosure of account records from BOC, Chinese courts or the government may require disclosure from U.S. banks concerning the illegal assets of corrupt Chinese officials. Thus, while U.S. discovery laws may sometimes require a violation of Chinese law, reciprocity in disclosure of such information could be helpful to the Chinese government in other circumstances. This may give rise to some leniency on the part of the Chinese government when it comes to obeying U.S. court orders.

Chinese banks should be aware that they, too, can force disclosure of documents from U.S. entities in support of their own efforts to bring lawsuits in China. U.S. law allows its courts to provide assistance to foreign litigants engaged in or contemplating litigation in a foreign court.

Any foreign entity, including a governmental investigative body, may request a U.S. court to issue a subpoena for evidence located in the United States, including U.S. bank account records, accounting records, invoices, and transactional documents, that may belong to customers in default on their Chinese bank loans. Perhaps if Chinese banks avail themselves of the liberal (albeit, coercive) discovery laws of the United States, compliance with civil subpoenas every so often may seem like less of a burden.

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