5-1-2012

Using Second Circuit Precedent to Fundamentally Change Multinational Corporations' Global Foreign Corrupt Practices Act Internal Investigations

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USING SECOND CIRCUIT PRECEDENT TO FUNDAMENTALLY CHANGE MULTINATIONAL CORPORATIONS’ GLOBAL FOREIGN CORRUPT PRACTICES ACT INTERNAL INVESTIGATIONS

Travis Robert-Ritter

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1 Executive Editor, University of Miami Inter-American Law Review; J.D. Candidate 2012, University of Miami School of Law; B.B.A. 2009, University of Miami School of Business. This article is dedicated to Terence J. Anderson, James R. Gailey, and Stephen M. Diamond who have all been invaluable to my development as an attorney. The author has previously published Achilles’ Heel: How the ATS and NAFTA Have Combined to Create Substantial Tort Liability for US Corporations Operating in Mexico, 42 U. Miami Inter-Am. L. Rev. 443 (2011).
INTRODUCTION

This Article has the potential to fundamentally change the way law firms perform internal investigations to determine whether a corporation has violated the Foreign Corrupt Practices Act (“FCPA” or “Act”). To put the economic impact of such a statement into perspective, in 2008 the Department of Justice (“DOJ”) and Securities and Exchange Commission (“SEC”) reached a roughly $1.6 billion FCPA settlement with a German company and three of its subsidiaries.2 The internal investigation performed by the company’s law firm ultimately cost $1 billion.3 And although billion-dollar FCPA investigations are unusual, they generally cost anywhere between $2 and $20 million.4 Such economic reality not only makes potential FCPA violations a high priority for companies not wanting to violate the Act, but because these investigations are often performed by law firms, makes such corporations extremely profitable clientele.5

This Article will highlight a 1997 Second Circuit case—overlooked by all FCPA scholarship—as affording U.S. law firms the ability to use a new attorney-client privilege that can prevent corporations from violating international blocking statutes during internal investigations.6 The case will further be shown to prevent the SEC from subpoenaing documents, brought to the U.S. by a law firm performing a global internal investigation, when the documents were undiscoverable while in a foreign country.7 It therefore has the potential to significantly impact U.S. law firms competing with foreign firms, sometimes outside the subpoena jurisdiction of the SEC, as well as U.S. mergers and acquisitions practice groups who must regularly perform FCPA due diligence for merger agreements.8 Thus, the new use of this scarcely cited Second Circuit case has the ability to fundamentally change the way internal FCPA investigations are undertaken.

Over the years, the number of FCPA enforcement actions brought by the SEC has increased to a significant extent, becoming one of the more dangerous operational risks faced by multinational

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3 Id. at 208–209.
6 See Section V of this article.
7 See Sections III and IV of this article.
corporations. The impact of increased enforcement has been so widespread due in part to the ability of the SEC to enforce the statute against entirely extraterritorial activity. This effect is intensified by the fact that corporations worry not only about their operations throughout the world, but also the operations of their many subsidiaries whose violation of the FCPA can result in large penalties for both the subsidiary and its parent corporation.

Greater FCPA risk due to increased SEC enforcement actions has accordingly led to large corporate expenditures in an effort to avoid multimillion-dollar fines.

In recent years, corporations have spent hundreds of millions of dollars hiring U.S. law firms for FCPA related matters, of which many were employed to perform internal investigations to determine FCPA compliance. During these investigations, in order to stay competitive with foreign law firms, it is of utmost importance to protect both themselves and their corporate clientele from the sometimes harmful legal problems that arise out of the interaction of a regulatory agency in the U.S., a parent corporation in a different country, and its subsidiary in another. If law firms ignore potential legal problems that arise during these global internal investigations, they could subject both themselves and their clients to foreign criminal and financial penalties. Moreover they could bring documents normally outside the SEC’s jurisdictional reach within the SEC’s subpoena power. If at all possible, law firms and corporations should work to prevent such outcomes.

This Article analyzes major legal obstacles to global internal investigations that until now have been entirely overlooked by FCPA scholarship. A very important aspect of internal investigations is that a parent corporation and its law firm may violate blocking statutes over the course of an investigation. At this point in FCPA scholarship, no article has extensively detailed U.S. courts’ stance on blocking statutes and their potential effect on law firms and parent corporations undertaking such

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11 See Section IV of this article.
12 Anjali Cynthia Das, Das Article on U.K. Bribery Act on Front Page of PLUS Journal, WILSONELSER (Jul. 21, 2011), http://www.wilsonelser.com/NewsPubs/detail.aspx?news=415 (“To date, companies have spent hundreds of millions of dollars in responding to claims and investigations by the government, regulators, and shareholders alike with respect to purported acts of bribery under the FCPA.” Much of this is spent on internal investigation. See Sections III through IV of this article.).
13 See Section III of this article.
14 Tarun, supra note 2, at 208–209.
15 See, e.g., Denise E. Backhouse, French Blocking Statute Still Gets No Respect from U.S. Court, MORGAN LEWIS (Dec. 15, 2009), http://www.morganlewis.com/index.cfm/fuseaction/publication/detail/publicationID/d5a96eff-9359-44f8-bb64-d1eb9ed6be5f (A party can face “potential criminal and civil penalties in France for noncompliance with the Blocking Statute.”).
investigations.\textsuperscript{16} Plainly, the effects of these statutes should not be ignored.\textsuperscript{17} Corporations and law firms in violation of a blocking statute face financial and criminal penalties in combination with bad publicity for being charged with ignoring foreign law.\textsuperscript{18} In addition to being the first FCPA article to offer a unique tool to prevent corporations and law firms from violating foreign blocking statutes, it will also be the first to highlight that such tool can prevent the SEC from reaching foreign documents sent to a U.S. law firm hired to conduct an internal investigation.\textsuperscript{19} Thus, it will analyze and offer tools to combat major legal obstacles to FCPA internal investigations.

To better illustrate how blocking statutes and the SEC’s regulatory power combine to negatively impact entities involved with carrying out internal investigations, this Article presents a hypothetical. It will assume a parent corporation is located in Russia, its subsidiary that violated the FCPA is in France, and the law firm performing the internal investigation is based in the U.S. Under such circumstance the law firm’s and parent corporation’s decision to provide documents, obtained from a French corporation, to U.S. regulatory or legal proceedings will subject both the law firm and parent corporation to the criminal and civil penalties of France’s blocking statute.\textsuperscript{20} As is sometimes presented in FCPA cases, we will also assume that the French subsidiary is outside the reach of an SEC subpoena such that allowing a U.S. law firm to bring documents into the U.S. to investigate FCPA charges may well bring otherwise unreachable documents within the SEC’s subpoena power.\textsuperscript{21} Doing so places the parent corporation at an unnecessary tactical disadvantage in potential SEC litigation.\textsuperscript{22} The question, therefore, necessarily arises whether there is judicial precedent that can be employed to prevent both corporate clients from being

\textsuperscript{16} A 10/03/2011 search on Westlaw using the following search terms (“blocking statutes” or “blocking statute”) & (“foreign corrupt practices act”) returns 21 results of which no article provides an in-depth discussion of blocking statutes’ effect on FCPA internal investigations.


\textsuperscript{18} Florian A. Stamm, \textit{The Foreign Corrupt Practices Act, Keeping All Hands On The Table}, SMITH, GAMBRELL & RUSSELL (Spring 2006), http://www.sgrlaw.com/resources/trust_the_leaders/leaders_issues/ttl15/836/ (“[C]ompanies found to have violated the FCPA are bound to receive negative publicity.”).

\textsuperscript{19} The case that will be used to prevent corporations from violating blocking statutes is \textit{In re Sarrio, S.A.}, 119 F.3d 143 (2d Cir. 1997). A search of “FCPA & “In re Sarrio” turns up no results on Westlaw, LexisNexis, Google, or Bing.

\textsuperscript{20} French Penal Code Law No. 80-538.


\textsuperscript{22} Id.
subject to the threat of penalties from blocking statutes as well as the SEC from obtaining documents sent to the U.S. for legal review. This Article offers a unique solution to such problems using an infrequently cited case out of the Second Circuit Court of Appeals, In re Sarrio, S.A.23

Part I of this Article details the history of the FCPA, while Part II highlights the statute’s requirements and complexity. This will allow the reader to understand why investigations to determine FCPA compliance often cost millions of dollars. Recent cases involving FCPA internal investigations will then be highlighted in Part III, allowing readers to grasp the types of cases that could be affected by new FCPA scholarship. Part IV establishes the various ways liability can arise and explains how this Article can have a significant effect on FCPA investigations, such as merger and acquisition practice groups performing FCPA due diligence for merger agreements. Part V will explain how blocking statutes negatively affect internal investigations, and detail U.S. courts’ stance on nonproduction of documents due to compliance violating a blocking statute. Part VI will offer a solution, unexamined by current FCPA scholarship, to both the effect of blocking statutes on internal investigations and the ability of the SEC to reach documents when brought to the U.S. by a law firm performing an investigation. Ultimately, these new tools have the potential to change the way law firms perform internal investigations in a variety of legal contexts.

I. HISTORY OF THE FOREIGN CORRUPT PRACTICES ACT

The Foreign Corrupt Practices Act was passed in an era of publicized corruption.24 Around the time of the Watergate scandal, many U.S. corporations were surveyed to determine if they were bribing governments for business.25 Among the many corporations that responded, the surveyors discovered several were bribing foreign officials for contracts worth millions of dollars.26 Further investigation revealed that “over 400 U.S. businesses had made questionable payments to foreign officials...[and that] Lockheed [Martin] alone admitted to spending more than $22 million in bribes to foreign officials.”27

After results of the investigation were made public, the U.S. Congress passed legislation forbidding, inter alia, corporations from such acts as bribing government officials, allowing the SEC and DOJ to
impose civil or criminal penalties for violations.\textsuperscript{28} At first, this statute was rarely enforced, but in 2005 the SEC and DOJ ramped up their prosecution of bribery around the world.\textsuperscript{29} This, as one article published in 2010 noted, resulted in “more criminal enforcement actions in the last four years than in the previous 29 of the statute’s existence.”\textsuperscript{30} Indeed the size and amount of such enforcement efforts has been enormous.\textsuperscript{31} For example, on December 2008, the DOJ and the SEC reached a roughly $1.6 billion FCPA settlement with a German company and three of its subsidiaries.\textsuperscript{32}

\section{Requirements and Complexity of the Foreign Corrupt Practices Act}

The FCPA includes two major requirements. One forbids corporations from bribing a foreign governmental official and the other requires corporations to follow certain accounting principles.\textsuperscript{33} The statute imposes these requirements on many corporations, including all the corporations listed on a U.S. securities exchange.\textsuperscript{34} Unfortunately, it is often difficult to determine if a corporation has actually violated the FCPA.\textsuperscript{35} Because the bribery provision in particular complicates this determination, it will be examined to better understand why companies pay exorbitant amounts of money to ferret out potential violations.\textsuperscript{36}

The anti-bribery provision “expansively prohibit[s] U.S. corporations and nationals [and companies listed on a U.S. exchange] from paying or giving, or offering or promising to pay or give directly or indirectly, money or any other thing of value to any foreign governmental official, foreign political party or candidate for foreign political office for the purpose of obtaining or retaining business or some other unfair advantage.”\textsuperscript{37} The statute defines a foreign official as “any officer or employee of a foreign government or department, agency, or

\begin{footnotesize}
\begin{enumerate}
\item Athanas, supra note 24, at 383.
\item Id.
\item Taran, supra note 2, at 161.
\item Id.
\item Baker, supra note 10, at 648.
\item Id.
\item Taran, supra note 2, at 159–161.
\item Id.
\end{enumerate}
\end{footnotesize}
instrumentality thereof, or of a public international organization, or any person in an official capacity for or on behalf of any such government or department.\textsuperscript{38}

Put simply, the provision forbids companies listed on a U.S. exchange from bribing government officials for business,\textsuperscript{39} and its application is expansive. The statute does not require a violation to have a nexus with the United States but instead is enforceable for entirely extraterritorial activity.\textsuperscript{40} As one scholar noted, the FCPA “governs prohibited conduct of individuals and corporations while acting entirely outside U.S. territory.”\textsuperscript{41} Indeed, “recent FCPA enforcement actions demonstrate the willingness to prosecute U.S. companies and executives for business activity occurring entirely abroad despite U.S. based personnel’s lack of knowledge and participation.”\textsuperscript{42}

Making matters more complex, the type of officials to which the FCPA disallows payments has been broadened to include “not only government officials and agents, but also employees of state-owned and state-controlled entities.”\textsuperscript{43} Thus, determining who is and is not a government official creates problems for corporations with subsidiaries in countries such as China.\textsuperscript{44} This is just one reason why it is challenging for U.S. companies to know whether their subsidiaries are violating the FCPA, as a parent can be liable for any bribes given to a hard-to-define class of government officials.\textsuperscript{45}

Much like other provisions of the FCPA, of the statute’s two affirmative defenses, the first is also difficult to interpret. This is because it contains ambiguities that make it difficult for corporations to know whether they fall within the purview of the defense.\textsuperscript{46} The first defense provides that an “offer or promise of anything of value [that] is lawful under the laws and regulations of the foreign official’s country” will not be a violation of the FCPA.\textsuperscript{47} The second defense allows a company to escape prosecution under the FCPA if an offer or promise of value was a “reasonable and bona fide expenditure . . . directly related to (A) the promotion, demonstration, or explanation of products or services; or (B) the execution or performance of a contract with a foreign

\textsuperscript{38} Baker, supra note 10, at 649–50.
\textsuperscript{39} Tarun, supra note 2, at 159–161.
\textsuperscript{40} Baker, supra note 10, at 649–50.
\textsuperscript{41} Id.
\textsuperscript{42} Id.
\textsuperscript{43} Id. at 660.
\textsuperscript{44} Daniel Pines, Amending the Foreign Corrupt Practices Act to Include a Private Right of Action, 82 CALIF. L. REV. 185, 201 (1994).
\textsuperscript{47} Id. at 357.
government or agency thereof." The difficulty with the first defense is that it challenges corporations to interpret the local laws of the countries wherein they operate, making it sometimes unclear whether an action actually violates the FCPA. As one scholar highlighted, “in its current form, the FCPA contains many ambiguities making compliance difficult.” Indeed, it is not only difficult to determine if an action violates the FCPA, but it is also economically burdensome to do so. Due to such difficulty the cost of internal investigations and government sanctions can be unexpectedly high.

III. RECENT CASES INVOLVING FOREIGN CORRUPT PRACTICES ACT INVESTIGATIONS

The trend for a number of years has been for corporations to bear the financial and organizational burdens of conducting internal investigations, and the costs can be enormous. As one scholar noted, “. . . FCPA regulation resulting from ramped-up, public enforcement ‘has enabled the government to put pressure on companies to self-evaluate and to spend company resources in gathering evidence overseas and turning that information over to the government.’” As a result, “the number of internal investigations, compliance enhancements, disciplinary actions, and remedial steps voluntarily taken by the private sector dwarfs the number of FCPA enforcement actions.” This is partly due to the incentive to independently perform internal investigations, because, “voluntarily disclosing violations to the government can often avoid prosecution as well as the reputational damage likely to be incurred in litigating an FCPA case.” This regulatory reality, however, is made financially difficult in light of the high cost associated with conducting an internal investigation. For example, the total cost of the German corporation Siemens’s internal investigation ultimately reached

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48 Id.
49 Kovacich, supra note 46, at n.39.
50 Klich, supra note 35, at 147.
51 Grimm, supra note 4, at 278-80.
54 Grimm, supra note 4, at 278.
55 Tarun, supra note 2, at 208-09.
$1 billion dollars. Although this is an unusually high example of the costs associated with an internal investigation, generally such investigations cost companies anywhere between $2 and $20 million. To put the gravity of internal investigations and the importance for law firms to attract these lucrative clients in perspective, below are two examples of the types of cases that arise out of the regulatory reality of the FCPA:

A. Avon

Avon began investigating its Chinese operations “over an allegation of improper expenses for items like travel and entertainment on behalf of a Chinese government official.” Almost a year later, the corporation widened its investigation to include review of potential FCPA violations in other countries. The company is currently cooperating with the DOJ and SEC with regard to its international internal investigation, which will ultimately be enormous. As one attorney noted, “it will be expensive, not only in relation to fines, but the cost of the investigation.” One of the available reports indicates Avon has paid roughly $35 million in investigative costs since 2009. And the company anticipates paying $95 million for the total internal investigation. Its first quarter earnings dropped $74.8 million, and it has lost roughly $10 million worth of profits from its Chinese operations.

B. Team Inc.

The internal investigation of the company Team Inc. is an example of the massive internal investigation costs that can arise out of even small bribes. The Texas based company began investigating what it believed to be $50,000 worth of bribes. It had estimated that they occurred over a five-year period, paying Trinidadian officials roughly $10,000 a year for business deals. Indeed the business the bribes

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56 Id.
57 Grimm, supra note 4, at 278 (citing Susan F. Friedman, Mission Possible: Developing in-House Counsel’s Role in the Fight against Global Corruption, 239 N.Y. L. J. 23 (2008)).
59 Id.
60 Id.
61 Id.
62 Id.
64 Grimm, supra note 4, at 278.
created apparently amounted to “just one-half of one percent of Team’s
global revenues.”66 Nevertheless, the costs associated with the firm’s
internal investigation have been massive, amounting to an estimated $3.2
million dollars of investigatory costs.67

Ultimately, the examples of Avon and Team Inc. show what
makes FCPA cases so relevant to corporations and law firms: the fines
and internal investigations involve enormous sums of money. With this
understanding, it is important to highlight what sort of corporate
activities instigate such massively expensive, and for law firms, lucrative
investigations. This is not only relevant for the purposes of
understanding the FCPA’s regulatory nature, but also to fully realize the
value associated with one’s ability to prevent blocking statutes from
harming corporations’ and law firms’ bottom line.

IV. PARENT SUBSIDIARY RELATIONSHIP AS WELL AS MERGERS &
ACQUISITIONS SPUR INTERNAL INVESTIGATIONS

Internal investigations are instituted for a variety of reasons. One
of the most common catalysts “typically result[s] from discovery—by
the Company, the media, an external auditor, or a whistleblower—of
circumstances that raise a serious concern of potential liability or
financial misconduct.”68 Although the SEC can spend resources to
perform internal investigations, the burden is generally borne by a
suspected corporation.69

Global internal investigations also arise due to a subsidiary’s
violation of the FCPA.70 Because the FCPA allows for the imposition of
penalties against a parent corporation for its subsidiary’s violations,
investigations into a subsidiary are sometimes instigated and then
managed by a parent corporation.71 This is due to the ease with which
liability can be imposed on a parent.72

The FCPA requires parent corporations who own a fifty percent
or less interest in a subsidiary to “proceed in good faith to use its

66 Id.
67 Mike Koehler, Archive for the Team Inc., FCPA PROFESSOR (Aug. 11, 2011),
68 David Brodsky, Recommended Practices for Companies and Their Counsel in Conducting
69 Grimm, supra note 4, at 278-80.
70 Danforth Newcomb, Recent Trends and Patterns in FCPA Enforcement, SHEARMAN & STERLING,
at 3 (Aug. 10, 2011), http://www. shearmans.com/ files/upload/FCPA_Trends.pdf (“In the cases of
Vetco and ABB, the prosecution was of both foreign and domestic subsidiaries of a foreign parent
corporation.”).
71 H. Lowell Brown, Parent-Subsidiary Liability Under the Foreign Corrupt Practices Act, 50
BAYLOR L. REV. 1, 20 (1998); Mike Koehler, Johnson & Johnson Enforcement Action Focuses on
Health Care Providers As “Foreign Officials”, FCPA PROFESSOR (Aug. 10, 2011),
72 Id.
influence” to force the subsidiary into compliance with the FCPA.\textsuperscript{73} Even if a corporation proceeds in good faith to prevent a violation, the corporate veil between the parent and subsidiary can nevertheless be pierced, allowing liability to be imposed on the parent corporation.\textsuperscript{74} As one scholar noted, “[T]he corporate veil may be pierced, resulting in criminal and civil liability being imputed to the parent, where the parent so dominated the affairs of the subsidiary that the subsidiary is found to be the mere ‘alter ego’ of the parent.”\textsuperscript{75} Again, such legal relationship makes it likely a parent corporation will institute an internal investigation into its subsidiary, particularly because some are “organized under the laws of another country, the subsidiary itself [being] exempt from the requirements and prohibitions of the FCPA [and] as a result, the U.S. parent may face liability under the FCPA for the acts of a subsidiary, which is itself immune from prosecution.”\textsuperscript{76}

Expensive investigations also frequently occur during the due diligence phase of large financial transactions such as mergers and acquisitions.\textsuperscript{77} In fact “[i]n 2009, ‘more than one-third of the corporate FCPA enforcement actions … implicated successor liability issues arising from M & A deals.”\textsuperscript{78} The importance of such due diligence cannot be overstated. For example, where a company represented that it was compliant with the FCPA in one of the clauses of its merger agreement, the SEC used this to force the company into a roughly $15 million dollar settlement when it was discovered such representation was false.\textsuperscript{79} In light of the fact that discovering FCPA violations after a merger can “erase any value the deal added to the company's books,” it has become extremely important for companies to perform internal investigations.\textsuperscript{80}

In the merger and acquisition context, it would be a particularly useful tool for corporations to prevent the SEC from obtaining documents brought to the US for legal review. During the FCPA due diligence phase of a merger, a corporation may obtain documents from a subsidiary over which the parent lacks control.\textsuperscript{81} Because the parent does

\textsuperscript{73} Id. at 21.
\textsuperscript{75} Brown, supra note 71, at 21.
\textsuperscript{76} Id. at 2.
\textsuperscript{77} Grimm, supra note 4, at 253.
\textsuperscript{78} Id. (quoting F. Joseph Warin et al., Nine Lessons of 2009: The Year-in-Review of Foreign Corrupt Practices Act Enforcement, 38 SEC. REG. L.J. 19, 41 (2010)).
\textsuperscript{79} Id. at 250-251.
\textsuperscript{80} Lindsey, supra note 8, at 960.
\textsuperscript{81} There are no reported cases involving a government agency issuing a subpoena against a parent corporation seeking documents held by its subsidiary. There are, however, many cases analyzing the issue in the context of private civil litigation. These courts look to rule 34(a) of the Federal Rules of Civil Procedure (FRCP) to determine whether production should be required. The analysis of these
not control the subsidiary, the SEC generally cannot subpoena the parent for documents held by its subsidiary. Therefore, bringing documents into the U.S. for legal review sometimes makes undiscoverable information discoverable. Under such circumstances, the added cost of bringing documents within the SEC’s reach creates the possibility of multimillion-dollar sanctions and the violation of foreign blocking statutes. These economic drawbacks become transactional costs associated with a potential deal, reducing the expected bottom line for both companies such that the deal may become unprofitable. As a result, it is extremely important to find a solution that would prevent the SEC from reaching documents sent to the U.S. for legal review and would prevent blocking statutes from putting U.S. law firms and their clients at risk. However, before a solution can be presented as credible, it must be determined whether U.S. courts view blocking statutes as a legitimate excuse for not complying with an SEC subpoena.

V. BLOCKING STATUTES: FRANCE AS A TEST CASE

A number of nations have enacted blocking statutes, including Australia, Canada, the United Kingdom, and France. Many such statutes are violated when documents involved in an internal investigation are given to the SEC. These statutes essentially “prevent evidence

82 First National City Bank v. Internal Revenue Service, 271 F.2d 616, 618 (2d Cir. 1959).

gathering under U.S. law in foreign jurisdictions. A blocking statute forbids the communication of information [to U.S. courts and regulatory proceedings] except as provided by treaty or international agreement.\textsuperscript{84}

As one scholar aptly explained, “Blocking statutes take many forms, but in general they operate to prohibit a resident of country A from producing evidence within that country to a court or enforcement agency in country B in response to some form of compulsory process issued by country B.”\textsuperscript{85} Thus, when a foreign corporation falling under the jurisdiction of a blocking statute receives a subpoena from the SEC, it must decide whether to violate the demands of the U.S. subpoena or the blocking statute.\textsuperscript{86} For corporations in such a legal dilemma, the consequences of violating a blocking statute can be enormous.\textsuperscript{87} By way of example, Canada’s blocking statute can impose a “$10,000 fine and/or imprisonment for a term not exceeding five years,”\textsuperscript{88} while France’s blocking statute can levy a “€18,000 [fine] or six months imprisonment.”\textsuperscript{89} Unfortunately, many countries where internal investigations may arise have similar blocking statutes that are violated over the course of an investigation.\textsuperscript{90}

Thus, the question of whether a court will allow an entity to refuse to comply with an SEC subpoena when compliance would violate a foreign blocking statute must be answered before determining whether a tool to prevent law firms and parent corporations from violating them is valuable. Among the many blocking statutes that exist, it is likely that France’s statute is the broadest.\textsuperscript{91} Therefore, the analysis and conclusion reached under this statute would apply equally to other blocking statutes around the world.

A. History and Provisions of France’s Blocking Statute

\textsuperscript{84}Id. at 911.


\textsuperscript{86} Karmel, supra note 83, at 911-912.

\textsuperscript{87} Mark A. Warner, Decisions of Foreign Courts, 88 A.J.I.L. 532, 533 (1994).

\textsuperscript{88} Id.

\textsuperscript{89} French Penal Code Law No. 80-538.

\textsuperscript{90} “[N]o less than 15 countries adopted so-called blocking statutes restricting the release of documents pursuant to an order from a court or agency in another country and forbidding compliance with American judicial discovery orders.” Phillip I. Blumberg, The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities, 28 CONN. L. REV. 295, 338 (1996).

France’s blocking statute was passed in 1980 and prohibits French corporations and their representatives from providing information about such corporations in foreign administrative or judicial proceedings. As previously noted, if the statute is violated, French authorities can pursue a fine of €18,000 and six months imprisonment. To legally obtain documents falling under the restrictions of the statute, American litigants must use the discovery rules set forth in the Hague Convention. As a result, the statute criminalizes production of documents pursuant to a U.S. criminal, civil, or administrative subpoena.

Although French authorities have enforced the statute only once since its passage, the potential for fines and imprisonment is nevertheless present and hangs ominously over law firms investigating French corporations. Indeed, recent corporate agreements for internal investigations performed by the SEC and DOJ have taken the effects of France’s blocking statute into account, implementing measures attempting to avoid its violation. The question therefore remains: whether courts will allow parties performing internal investigations to not produce documents requested by the SEC because production violates foreign law.

B. Blocking Statutes in U.S. Courts

Societe Nationale Industrielle Aerospatiale v. United States Dist. Court for S. Dist., 482 U.S. 522, 543-544 (U.S. 1987), provides the judicial framework to determine whether a litigant can ignore a U.S. discovery request because compliance violates foreign law. The Court was asked to determine when litigants can ignore a U.S. subpoena under the Federal Rules of Civil Procedure (“FRCP”) and instead produce in a way that does not violate a blocking statute. It highlighted five guiding principles that the Court asserted should be used when deciding such a question:

1. the importance of the documents to the litigation,
2. the specificity of the discovery request,
whether the information originated in the United States,
the availability of alternative means of securing the
information, and
the extent to which noncompliance with the request would
undermine important interests of the United States or of the
state where the information is located.100

The Court further noted that these factors cannot “require resort to
[another method of discovery such as the] Hague Convention without
prior scrutiny in each case of the particular facts, sovereign interests, and
likelihood that resort to those procedures will prove effective.”101
However, because the Court remanded the case and did not highlight a
specific mode of analysis for lower courts to employ, the circuits have
adopted two slightly different tests to determine whether noncompliance
with a subpoena is proper: the Five-Factor Test and the Three-Prong
Test.

1. The Five-Factor Test

Some courts use the five factors listed in an Aerospatiale
footnote to determine whether a blocking statute is a valid reason for not
producing documents pursuant to a FRCP subpoena.102 Although there
are no cases applying these five factors to an SEC subpoena for
documents restricted by France’s blocking statute, the outcome of the
test applied to the hypothetical, presented earlier, would favor
production.

The first factor—the importance of the documents to the
litigation—would likely favor production of at least some of a law firm’s
and corporation’s investigation documents so long as the subpoena is
tailored towards discovering relevant information.103

The second factor—the specificity of the discovery request—is
difficult to evaluate until a subpoena is received from the SEC.
However, to the extent the subpoena requests relevant documents, this
factor also favors production.104

100 Id. at 544 n.28.
101 Id. at 544.
102 See, e.g., Compagnie Francaise d’Assurance Pour le Commerce Exterieur v. Phillips Petroleum
Co., 105 F.R.D. 16, 29 (S.D.N.Y. 1984); In re Global Power Equip. Group Inc., 418 B.R. 833, 847-
Credit Lyonnais, S.A., 249 F.R.D., at 440.
The third factor—whether the information originated in the United States—would weigh in favor of nonproduction because documents falling under the blocking statute emanated from France.\(^{105}\)

The fourth factor—the availability of alternative means of securing the information—would favor production. Courts evaluating this factor have typically favored the lower cost and efficiency in producing documents under the FRCP as opposed to alternative international discovery methods such as the Hague Convention.\(^{106}\) Under the present hypothetical, however, the SEC has two channels to obtain a corporation’s documents in a way that does not violate France’s blocking statute: The Hague Convention and a Memorandum of Understanding (MOU) between the SEC and The Commission des Operations de Bourse of France (COB).\(^{107}\)

Courts almost always hold that obtaining documents under The Hague Convention is less efficient and more costly than discovery under the FRCP.\(^{108}\) Consequently, courts almost always conclude that this factor favors production.\(^{109}\) The procedure for obtaining documents through an MOU would also probably be more time-consuming and expensive than the FRCP.\(^{110}\) At least one scholar has described the process as “painfully slow and makes it difficult for the SEC or other securities commissions.”\(^{111}\) The SEC must send a request for documents to the COB who must then approve the submission before the documents can legally be obtained, a bureaucratic step the FRCP would circumvent. As a result, this factor would probably also favor production of a corporation’s documents pursuant to an SEC subpoena.

The fifth factor—the extent to which noncompliance with the request would undermine important interests of the United States or of the state where the information is located—favors production of investigation documents pursuant to an SEC subpoena. When applying this factor, courts consider the United States’ interest in requiring production under the FRCP against France’s interest in requiring

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\(^{108}\) See In re Aspartame Antitrust Litigation, 2008 WL 2275531, at 4 (Hague Convention time consuming and less certain than FRCP); In re Vitamins Antitrust Litig., 2001 WL 1049433, at 4-5 (same); Societe Nationale Industrielle Aerospatiale, 482 U.S., at 542 (Hague Convention frequently unduly time consuming, expensive, and less certain to produce needed evidence than FRCP).


\(^{110}\) Blumberg, supra note 90, at 338.

\(^{111}\) Id.
production to occur through a method that does not violate its blocking statute. With respect to the United States’ interest, courts have repeatedly held that the U.S. has an interest in enforcing its securities laws, and that when the United States is “itself part of the litigation, the national interest” to compel production under the FRCP is great. Courts have also held that the U.S. can only achieve its interests by “fully and fairly adjudicating matters before its courts,” a goal courts hold the FRCP helps accomplish. Thus, a court would probably rule that the SEC has an important interest in obtaining discovery through the FRCP. A court would then weigh these interests against France’s interest to require production under a method that does not violate its blocking statute.

It is also very likely a U.S. court would give little weight to France’s interest in having production not violate its blocking statute. A majority of courts have concluded, after analyzing the statute’s legislative history, that its purpose was to create a bargaining chip for French corporations to use in foreign discovery proceedings. Courts have almost always found that this interest is “dwarfed by [more legitimate] American interests.” Therefore, courts would not find France has an interest in preventing production so its blocking statute is not violated.

Under the Five-Factor Test, although some of the factors would favor non-production, many courts have noted that the fifth factor is viewed as the most important. And under the present hypothetical, the most important factor favors production of a corporation’s documents. Moreover all but one court applying Aerospatiale’s reasoning to documents located in France have held that the documents should be produced under the FRCP notwithstanding France’s blocking statute.

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112 Strauss 249 F.R.D. at 443.
116 In re Air Cargo Shipping Services Antitrust Litigation, 2010 WL 1189341, at *3.
117 Id. at *4 (fifth factor most important among the five); Madanes v. Madanes, 186 F.R.D. 279, 286 (S.D.N.Y. 1999) (same); Strauss, 249 F.R.D. at 444 (same).
118 See In re Air Cargo Shipping Services Antitrust Litigation, 2010 WL 1189341, at *4 (fifth most important under the five factor test); Strauss, 249 F.R.D. at 444 (same); Madanes v. Madanes, 186 F.R.D. at 286 (same).
119 In In re Perrier Bottled Water Litigation, the court held that France’s joining of the Hague Convention is “an expression of France’s interests and weighs heavily in favor of the use of those procedures.” 138 F.R.D. 348, 354 (D. Conn. 1991). The decision is the only reported case to hold
Therefore, under the Five-Factor Test a court would almost certainly conclude that documents should be produced under the FRCP pursuant to an SEC subpoena.120

2. The Three-Prong Test

Other courts have employed a three-prong test derived from *Societe Nationale*, involving analysis of (1) a case’s facts, (2) the sovereign interests of the involved countries, and (3) the likelihood that resort to alternative means of production will prove effective.121 Due to the substantial similarity between the Five-Factor and Three-Prong tests, the outcome would probably be the same under either. Indeed, almost every federal court to employ the Three-Prong Test has determined that discovery should proceed under the FRCP rather than an alternative means.122 It is therefore almost certain that if a parent corporation or U.S. law firm performing an internal investigation attempted to resist a subpoena from the SEC for documents falling under France’s blocking statute, a court would force compliance.

Not only would a court resist allowing a party to not comply with a subpoena due to compliance violating France’s blocking statute, but this conclusion is also almost certainly applicable to other blocking statutes around the world. Although the interests may have slight variations depending on the penalties and consequences associated with a blocking statute’s violation, the strong and often dispositive U.S. interest in requiring discovery to take place under the FRCP will almost always prevent a party from using such statutes as an excuse for non-production of documents. Because violating blocking statutes in the process of performing an internal investigation should be avoided, if at all possible, finding a way to prevent such violations and still comply with U.S. law is of prime importance for both law firms and their corporate clients.

VI. IN RE SARRIO, A TOOL FOR PARENT CORPORATIONS AND LAW FIRMS

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Ultimately, the tool to prevent the SEC from forcing both a company to violate a foreign blocking statute and a law firm to turn over documents brought to the U.S. for legal review lies in an infrequently cited case out of the Second Circuit Court of Appeals: *In re Sarrio, S.A.*, 119 F.3d 143 (2d Cir. 1997).\(^{123}\)

The Second Circuit Court of Appeals is one of the few circuits to face the perplexing result of requiring U.S. law firms to produce documents undiscoverable in the hands of their foreign client.\(^{124}\) In *In re Sarrio*, the Court supplied law firms with exciting dictum that strongly suggests it would not require U.S. law firms to produce documents held for legal review if they came from a foreign corporation outside the jurisdictional purview of a U.S. discovery subpoena.\(^{125}\) Interestingly there is little legal precedent in favor of such a proposition outside *In re Sarrio*.\(^{126}\) Accordingly, if the dictum of the case is tested and the result favorable to U.S. law firms, states falling under the judicial purview of the Second Circuit would become an extremely attractive place for law firms to perform corporate clients’ internal investigations.

If the Second Circuit is directly faced with the question of whether a U.S. law firm must comply with a discovery request aimed at obtaining documents undiscoverable in the hands of the firm’s client, it will almost certainly rule in favor of quashing the subpoena. Although sending documents to an attorney for legal review, without more, does not furnish a basis for resisting a subpoena,\(^ {127}\) as stated by *In re Sarrio, S.A.*, “The Supreme Court’s discussion in *Fisher v. United States*, 425 U.S. 391 (1976), seems to provide principled authority, although in dicta,

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\(^{123}\) The SEC has broad power to investigate and issue subpoenas against security issuers and to subpoena other entities in the United States that have knowledge relating to its investigations. Negative consequences can arise out of such power when a foreign corporation hires a U.S. law firm to perform an internal investigation into its foreign subsidiary. When the law firm manages the internal investigation of the foreign subsidiary, both the firm and the corporation managing storage and operational aspects of document review for the law firm are at risk of being forced to comply with a discovery request from the SEC. Where documents are undiscoverable outside the U.S. and sent to a U.S. law firm for review (for example, if held by the subsidiary or a related corporation outside the jurisdictional purview of 15 U.S.C. § 78u-(a)(2)(B)), the SEC may choose to issue a subpoena against the investigating law firm or parent corporation rather than the subsidiary. In the event the law firm is judicially forced to comply with the subpoena, such a result can severely damage the firm’s reputation, damage the firm’s ability to attract foreign clients, and allow government agencies to reach documents that otherwise may have been undiscoverable. Furthermore, if the documents emanated from a country with a blocking statute, such as France, judicially required discovery compliance can result in U.S. law firms and corporations violating blocking statutes. This outcome is clearly unacceptable for law firms looking to attract or currently working with foreign corporations investigating allegations that subsidiaries have violated the FCPA. *In re Sarrio* can be employed to prevent these results.

\(^{124}\) *In re Sarrio, S.A.*, 119 F.3d 143 (2d Cir. 1997).

\(^{125}\) Id.

\(^{126}\) Using Westlaw to Keycite *In re Sarrio, S.A.* provides only Kestrel Coal Pty. Ltd. v. Joy Global, Inc., 362 F.3d 401 (7th Cir. 2004), which references *In re Sarrio, S.A.* for a point irrelevant to U.S. law firms attempting to not comply with U.S. discovery requests because documents are undiscoverable in the hands of its foreign client.

\(^{127}\) Ratliff v. Davis Polk & Wardell, 354 F.3d 165, 170 (2d Cir. 2003).
for recognizing attorney-client privilege” when documents are undiscoverable in the hands of a law firm’s foreign client and only in the U.S. for the purposes of legal review. The Court further noted that in Fisher the Supreme Court reasoned that:

[t]he purpose of the privilege is to encourage clients to make full disclosure to their attorneys. If discovery of documents could be obtained more easily from attorneys than from their clients, clients would hesitate to show their documents to their attorneys and it would be difficult to obtain fully informed legal advice. Accordingly, where documents unobtainable by subpoena while in the possession of the client are transferred to a lawyer to obtain legal advice, making the documents available to the process would defeat the purposes of the attorney-client privilege.

The Court went on to articulate how Fisher was applicable, stating “[Fisher’s] reasoning would seem to apply where the documents are not amenable to subpoena duces tecum because they lie outside the statutory limits of the court’s power to compel production,” and highlighting that the attorney-client privilege would be “jeopardized if documents unreachable in a foreign country became discoverable because the person holding the documents sent them to a lawyer in the United States for advice.” Ultimately, however, these assertions would only amount to dicta because the law firm’s client waived its right to privilege with respect to documents sent to the U.S. for legal review. It nevertheless remains clear that if a firm presents a strategically chosen set of facts in the Second Circuit, the Court would almost certainly hold that a firm would not have to produce documents that are undiscoverable in the hands of the law firm’s foreign client. In fact, the Court has gone on to comment on this newly created privilege in addition to expressing when it may be waived in the context of securities litigation.

In addition to creating a new attorney-client privilege for foreign clients, the Second Circuit has also indicated when such a right will be considered waived. In Ratliff v. Davis Polk & Wardwell, 354 F.3d 165 (2d Cir. 2003), the Court revisited the attorney-client privilege created by In re Sarrio, noting that “exposing documents—not otherwise subject to

128 In re Sarrio, S.A., 119 F.3d at 146-150.
129 Id. (quotations omitted).
130 Id.
131 Id.
132 Id.
133 Ratliff v. Davis Polk & Wardwell, 354 F.3d 165, 168-69 (2d Cir. 2003).
134 Id.
production—to discovery demands after delivery to one’s attorney whose office was located within the sweep of a subpoena would produce a curious and unacceptable result. [It] would not only chill open and frank communications between attorneys and their clients, it would disenfranchise local counsel from representing foreign entities” (emphasis added). The Court went on to warn law firms to be careful about discovery arrangements between their clients and government agencies, expressing such arrangements could destroy attorney-client privilege. The Court explained that where a law firm agrees with the SEC to provide any documents it reviews to the SEC, the In re Sarrio attorney-client privilege is waived and the SEC can subpoena any documents held by the U.S. firm. This principle, the Court noted, will also destroy attorney-client privilege where the law firm agrees to provide documents to any third party that would not be required to comply with the attorney-client privilege. Therefore, U.S. law firms have to be careful about how they word arrangements with the SEC with respect to whether the agency is authorized to obtain internal investigation documents. If a U.S. firm creates an agreement with the SEC that states its client is only willing to produce documents that are not privileged, they can base their operations in the Second Circuit’s jurisdiction and potentially protect harmful documents from coming within the SEC’s reach. Otherwise, the potential protection that the Second Circuit provides law firms and their international clients could be unnecessarily waived.

VII. CONCLUSION

Ultimately, In re Sarrio has the potential to dramatically change the way law firms perform internal investigations in a variety of legal contexts. In addition to being one of the few ways U.S. law firms can compete with foreign law firms outside the SEC’s subpoena jurisdiction, it allows firms headquartered under the Second Circuit’s jurisdiction to have an unusual comparative advantage against U.S. firms outside the Circuit’s jurisdictional purview. This may result in other circuits adopting the Second Circuit’s viewpoint, affording U.S. law firms outside the Second Circuit the ability to assert a new attorney-client

135 Id. at 169.
136 Id. at 170.
137 “Even if we assume that, when the documents were sent by E & Y to Davis Polk to secure the firm’s legal advice, they were entitled to protection, such protection was lost when E & Y voluntarily authorized David Polk to send the documents to the SEC. E & Y might be entitled to protection if it sends documents to its law firm to obtain legal advice. But any such protection does not continue when the client voluntarily discloses the documents to a third party, here a government agency.” Id.
138 Id.
139 Id.
privilege. Until that point is reached, by successfully testing the dictum of *In re Sarrio*, firms in the Second Circuit’s jurisdiction will not only be able to compete with international law firms, but also be better able to attract foreign clients over their domestic competitors. Thus, the new application of *In re Sarrio* has the potential to fundamentally alter the landscape of many legal practice groups.