EXTRATERRITORIAL

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
GENERAL COUNSEL

6-6

July 11, 1984

The Honorable Rex E. Lee
Solicitor General of the
United States
United States Department of Justice
Washington, D.C. 20530

Re: Club Mediterranee v. Dorin, No. 83-461 (S.Ct.)

Dear Mr. Lee:

The Securities and Exchange Commission submits this letter to express its position on issues raised by the pending appeal to the Supreme Court in Club Mediterreanee v. Dorin, No. 83-461. As you know, the Court has requested the views of the United States.

This appeal raises the question of whether a discovery order of a New York state court violated the Supremacy Clause of the U.S. Constitution by directing a French corporation subject to that court's jurisdiction to answer interrogatories, where the information necessary for such answers was obtainable only in France, rather than requiring the use of the provisions of the Hague Convention on Taking Evidence Abroad ("Hague Convention"). Appellants argue that the Hague Convention, as a treaty of the United States, restricts the authority of this country's courts to obtain evidence from within signatory countries to the methods prescribed in the Convention.

The Commission expresses no view on whether the Supreme Court should accept jurisdiction in the case. However, should you determine to address the merits of the issues presented by the appeal, the Commission believes that the government should urge that the state court's order be affirmed.

As discussed more fully below, it appears that this Commission is the only government agency which has had any direct experience in its own actions in obtaining evidence abroad pursuant to the Hague Convention. Although the Commission's experience under the Hague Convention has generally proved successful, the Convention's procedures are often time consuming and provide opportunities for dilatory tactics by persons resisting discovery. In addition, the type of information obtain-

able through the Convention is more limited than that available under the Federal Rules of Civil Procedure.

Because a decision by the Supreme Court holding that the Convention is the exclusive means of obtaining evidence from within a signatory country could apply in the Commission's own litigation, as well as in private securities litigation, the Commission believes it is important that the government express the view that the procedures specified in the Hague Convention are not exclusive and thus do not preempt state and federal discovery procedures. Nor do principles of international comity require that the treaty procedures be exhausted before traditional discovery devices are employed. Rather, a court is only required, as a matter of international comity, to consider the availability of the Convention, along with other factors, in determining whether to impose sanctions for failure to comply with a discovery request, and, in exceptional circumstances, at the stage that it entertains a motion to order production.

It is important to differentiate two types of situations. In instances where the court lacks personal jurisdiction over the witness from whom information is sought and the court therefore cannot compel compliance with its discovery orders, resort to the Hague Convention may well be helpful. The position we urge in this letter is, of course, not applicable in that situation. Where, on the other hand, the witness is subject to United States jurisdiction, the Convention would hinder, rather than facilitate, litigation, and accordingly the availability of the convention should ordinarily be taken into account only in determining whether to impose sanctions.

Background

The Hague Convention of 1970, to which the United States subscribed in 1972, represented an attempt to accommodate the liberal discovery procedures of the United States, and of other common law countries, with the procedures of the civil law countries. In the United States, pretrial discovery is ordinarily conducted by the parties with a minimum of judicial oversight. In contrast, civil law countries regard the taking of pretrial evidence as exclusively a judicial function; when evidence is taken without the participation or consent of officials of the civil law host country, the "judicial sovereignty" of the host country is considered to have been violated. 1/ Thus, prior to the Hague Convention, civil law countries regarded American pretrial discovery within their borders as affronts to their judicial sovereignty.

1/ Edwards, Taking of Evidence Abroad in Civil or Commercial Matters, 18 Int'l & Comp. L. Q. 646, 647 (1969).

The Hague Convention adopts three methods of obtaining evidence abroad in civil or commercial matters. It provides for the issuance of a letter rogatory, pursuant to which a foreign court will use its compulsory power to gather evidence (Article 10). Second, a diplomatic officer or consular agent of the requesting country may take evidence, but not necessarily with the benefit of compulsion (Article 18). Third, the Convention provides for the appointment of a private commissioner to procure documents or obtain testimony, but also without a guarantee of compulsion (id.).

Article 23 of the Hague Convention permits any contracting state to declare that it will not execute letters rogatory issued for the purpose of obtaining pretrial discovery of documents, but the contracting states apparently must permit pretrial taking of testimony. France, like almost all other civil law signatories to the Convention, has exercised the right not to provide for pretrial discovery of documents.

In addition, France recently passed a comprehensive statute dealing with the release of commercial information. One section of that statute prohibits -- subject, however, to treaties or international agreements -- any French citizen or corporation from providing information intended to serve as evidence in a foreign judicial or administrative proceeding (App. 89a). 2/ France has interpreted the interplay of its "blocking" statute and its participation in the Hague Convention to limit any foreign requests for evidence to the convention methods (App. 94a-95a).

Discussion

(1) The Traditional Power of the Courts to Require Production of Evidence From Abroad

Traditionally, American courts have held that, if they have personal jurisdiction over a foreign party or witness, they have the authority to require that party or witness to comply with a discovery request under penalty of sanctions such as those available under Rules 37 and 45 of the Federal Rules of Civil Procedure. 3/ Indeed, the federal courts have held that the same authority exists to enforce administrative subpoenas, which have been construed as having a far broader geographic

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2/ "App." refers to the Appendix to the Jurisdictional Statement filed by the appellants in the Club Med case.

3/ See generally, Volkswagenwerk v. Superior Court, 176 Cal. Rep. 874, 884 (1st Dist. 1982).

reach for document production than subpoenas issued through the federal courts:

> [R]egulatory agencies, and the federal courts, can require a resident by subpoena to produce documents under his control wherever they are located, and, * * * unlike the courts, the agencies can require their production at a place far from home.

FMC v. DeSmedt, 366 F.2d 464, 471 (2d Cir. 1966); see also SEC v. Minas de Artemisa, 150 F.2d 215, 218-19 (9th Cir. 1945). The only questions considered by the courts in ordering production are whether the witness is within the jurisdiction of the court and, if a subpoena duces tecum is at issue, whether the documents are subject to control of the witness. Marc Rich & Co. v. United States, 707 F.2d 663 (2d Cir.), cert. denied, 103 S. Ct. 3555 (1983).

Traditionally, the only limit on discovery powers of federal courts appears to have been one of due process. In Societe Internationale v. Rogers, 357 U.S. 197 (1958), the Swiss government had impounded documents sought by the United States in a suit where a Swiss holding company petitioned the U.S. government to obtain property seized by the Alien Property Custodian during World War II. The Supreme Court held that the complaint could not be dismissed under Rule 37 because of the petitioner's noncompliance with a pretrial order to produce the documents "when it has been established that failure to comply has been due to inability, and not to willfulness, bad faith, or any fault of petitioner." Id. at 212. 4/ The courts, in applying the Societe Internationale principle, have generally placed the burden on the witness or party from whom discovery is sought to demonstrate a good faith effort to comply with the discovery request. CAB v. Lufthansa, 591 F.2d 951, 953 (D.C. Cir. 1979); Ohio v. Anderson, 570 F.2d 1370, 1374-75 (10th Cir. 1978). See also Marc Rich & Co. v. United States, Nos. 1256-56 (2d Cir., June 11, 1984).

Of course, the authority to require production presupposes that the court has jurisdiction over the witness. If the court lacks personal jurisdiction over a witness, even one who should be a party, it is limited to the Hague Convention or other international means to obtain evidence. Pain v. United Technologies, Inc., 637 F.2d 775 (D.C. Cir. 1980); see FTC v. Compagnie

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4/ Accord, National Hockey League v. Metropolitan Hockey Club Inc., 427 U.S. 639 (1976) (decision allowing a district court to dismiss a complaint on the grounds of "flagrant bad faith in pre-trial discovery by a party").

de Saint-Gobain-Pont-a-Mousson, 636 F.2d 1300, 1311-24 (D.C. Cir. 1980).

(2) The Hague Convention Does Not Preempt State and Federal Discovery Procedures.

Whether the Hague Convention displaces the traditional discovery procedures is a question of federal law to be determined by the intent of Congress in approving this treaty. Doe ex rel. Dem v. Braden, 16 How. 635, 57 U.S. 674 (1853). See Caltagirone v. Grant, 629 F.2d 639, 745 (2d Cir. 1980). The legislative history of Senate approval makes plain that the provisions of the Convention were understood to supplement, rather than restrict, the ability of American courts to obtain evidence abroad.

The Hague Convention was approved by the United States Senate in 1972. In presenting the Convention for approval, the Department of State said,

> it makes no major changes in United States procedure and requires no major changes in United States legislation or rule. On the other front, it will give United States courts and litigants abroad enormous aid by providing an international agreement for the taking of testimony, the absence of which has created barriers to our courts and litigants.

S. Exec. Rep. No. 92-25 at 5 (92d Cong. 2d Sess, June 6, 1972) (emphasis supplied). The Senate was also informed, in a report to the President by the Secretary of State recommending that the Convention be submitted to the Senate for approval, that

> [a] significant aspect of the Evidence Convention is the fact that although it requires little change in the present procedures in the United States[,] it promotes changes, in the direction of modern and efficient procedures, in the present practices of many other states.

Id. at XI (emphasis supplied). It thus appears that the Senate did not intend any significant changes in United States discovery procedures when it approved the treaty. It is likely that, if the Senate had intended to deprive the courts of their traditional powers to compel evidence from abroad, it would have made that purpose clear. Graco v. Kremlin, No. 81 C 3636 (N.D. Ill., April 13, 1984).

Several court decisions have likewise concluded that the Convention is not exclusive. "We do not find, therefore, that the Hague Convention has in any way superseded the discovery provisions of the Federal Rules of Civil Procedure. The existence of federal jurisdiction over a foreign entity subjects that entity like any other litigant, to the Federal Rules of Civil Procedure." Lasky v. Continental Products, 569 F. Supp. 1227, 1228 (E.D. Pa. 1983); see generally Graco v. Kremlin, No. 81 C 3636 (N.D. Ill., April 13, 1984); Volkswagenwerk Aktiengesellschaft v. Superior Court, 176 Cal. Rep. 874 (1st Dist. 1982). Of the reported cases on point, only one holds that the Hague Convention preempts traditional discovery methods. Volkswagenwerk v. Superior Court, 109 Cal. Rep. 219 (3d Dist. 1973). 5/

Private litigants currently arguing for the exclusivity of the Hague Convention have cited the amicus curiae brief filed in the Supreme Court by the United States in Volkswagenwerk A.G. v. Falzon, No. 82-1888. That brief stated, without citation to any legislative history or other source, that "[t]he parties to the Convention contemplated that procedures not authorized by the Convention would not be permitted"; the brief concluded that the Convention must be "interpreted to preclude any evidence taking proceeding in the territory of a foreign state party if the Convention does not authorize it and the host country does not otherwise permit it." The Supreme Court declined to review the case, in accordance with the position urged by the government.

In our view, as the foregoing discussion suggests, the position expressed by the government in the Falzon brief is not only contrary to the legislative history and the position of the American courts, but it is highly detrimental to the interests of the Commission and private litigants. Although the Hague Convention does not purport to apply to governmental actions because civil law countries consider those actions to be administrative in character (see FTC v. Compagnie de Saint-Gobain-Pont-a-Mousson, 636 F.2d at 1324, note 136), in several cases the Commission has succeeded in persuading foreign authorities that it is pursuing private as well as public interests in obtaining disgorgement in insider trading cases, and therefore is

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5/ A few unreported opinions also adopt that view, but they are more in the nature of orders, and do not set forth their reasoning. A few reported opinions, Philadelphia Gear v. American Pfauter Corp., 100 F.R.D. 58, 61 (E.D. Pa. 1983), and Schroeder v. Lufthansa, 18 Av. Cas. 17, 222 (N.D. Ill. 1983), would defer to the Convention as a matter of comity.

entitled to use the procedures of the Hague Convention. 6/ While government agencies that have not utilized the Convention in their own activities probably need not fear a holding that the Convention is preemptive, 7/ the Commission may not be able to avoid being bound by a ruling requiring exclusive use of the Convention's procedures, particularly where the Commission is seeking disgorgement. This result could significantly impair the Commission's ability to obtain evidence abroad.

Although the Commission has been able to employ "common law procedure", i.e., verbatim transcripts, questioning and cross-examination by counsel, and objections based upon American rules of evidence in proceedings in execution of letters rogatory under the Hague Convention, the Commission has still found the procedures complicated, dilatory and expensive. It has not been unusual for execution of letters rogatory to require up to a year or more; it has been necessary to retain foreign counsel, even in Canada and Great Britain; and the Commission has had to litigate jurisdictional challenges in Great Britain.

The position that the treaty is preemptive is particularly troublesome since most of the signatories, including France, have exercised their right under Article 23 of the Convention not to obligate themselves to cooperate with requests for pre-

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6/ The Commission most recently used the Hague Convention in Great Britain to compel evidence from two English bankers who were third party witnesses in the Santa Fe case, not subject to United States jurisdiction. SEC v. Certain Unknown Purchasers et al., 81 Civ. 6553 (WCC) (S.D.N.Y.). Execution of the Commission's letters rogatory was opposed by the witnesses. The English court held that the Commission's action was a "civil" action which sought relevant evidence for use at trial, as required by the Convention. The court enforced the letters rogatory and required that the witnesses testify, ruling against the bankers' British and Luxemberg bank secrecy law claims.

The Commission is in the process of seeking letters rogatory in France in the Santa Fe case. This matter is pending before the Ministry of Justice. There the Commission is arguing that the case is "civil" and not "administrative" and that the French blocking statute does not apply. The Commission has also used letters rogatory on numerous occasions in Canada, a signatory to the Hague Convention.

7/ Other government agencies, however, may be affected by a holding that principles of comity require resort to the Hague Convention (see infra page 9).

trial discovery of documents. 8/ But even if pretrial document discovery procedures are made available, the Convention is no substitute for discovery under Rule 26, F.R.C.P., as a means of obtaining information. The Convention's procedures are designed more to put evidence into a form admissible at trial than to reveal new sources of information in discovery. We strongly believe that the government should avoid any position which would restrict the full use of all the discovery tools provided under the federal rules.

The Commission's use of Hague Convention procedures has been beneficial primarily because the evidence obtained would not otherwise have been available to the Commission, since the particular witnesses were out of reach of administrative or judicial subpoenas. In cases where the witness is subject to United States jurisdiction, however, the Hague Convention would not facilitate litigation; quite to the contrary, Commission discovery efforts could be hindered if the Commission were limited to Convention procedures.

The Commission's experience under the Hague Convention is also shared by private litigants. Judge Wilkey, in Pain v. United Technologies Corp., 637 F.2d 775, 788-90 (D.C. Cir. 1980), noted that a state's international obligation arising under the Convention is subject to numerous exceptions and is severely limited in terms of the breadth of evidence it may produce. The operation of the Convention may allow for broader privileges, such as those created by bank secrecy laws, than recognized in either American or host courts, and "the cost to litigants of employing * * * [Convention] procedures would be exceedingly high." Id. at 790. For these reasons, we believe limiting discovery abroad to the Convention procedures would not only hinder the Commission, but private litigants as well.

We are sensitive to the fact that, in order to express the view that the treaty is not exclusive, the United States would have to retreat from the position the government expressed less than a year ago to the Supreme Court in the Falzon case. That position, however, is contrary to what the Senate understood at the time the treaty was approved. To stay with the Falzon position and to concede that requiring production of documents or information from overseas violates the Convention would greatly hinder the Commission and private litigants. Therefore, we urge that the government not adhere to the Falzon position.

8/ The Convention nevertheless is available under Article 27(b) and (c) as a means to request such cooperation.

(3) Principles of International Comity Do Not Require Courts to Direct Parties to Exhaust the Procedures of the Hague Convention Before Employing More Traditional Forms of Discovery.

Certain of the comments provided to your Office from Divisions of the Department of Justice as well as from the Department of State suggest that, as a matter of comity, courts should first be required to exhaust the procedures of the Hague Convention before resorting to more traditional means of discovery abroad which may offend the foreign government. The comity concerns arise where production of the information would violate either foreign law or a clearly articulated policy of the foreign government. Principles of comity presumably are implicated in Club Med, since requiring answers to the interrogatories could violate the French blocking statute.

The position that principles of comity require in all instances that the courts first direct the parties to exhaust the Convention procedures ignores the realities of litigation. As a practical matter, as the court observed in Graco v. Kremlin, No. 81C 3636 (N.D. Ill., April 13, 1981), "[r]equiring that such discovery be processed through foreign authorities would work a drastic and very costly change in the handling of this type of litigation." As we have seen, experience with the Hague Convention demonstrates that its procedures are time consuming and the results can be unsatisfactory. Requiring litigants to first exhaust those procedures in all instances would create the same type of unacceptable burdens on the Commission and private litigants that would arise from a holding that the Convention procedures are exclusive. Indeed, while it is unclear whether a holding that the Hague Convention is exclusive would directly affect Commission enforcement actions since the Convention was intended to cover only private actions, under the international comity analysis the courts may be persuaded to require the Commission (as well as other government agencies) to attempt to use the Convention procedures in the first instance in all cases; comity concerns are equally implicated whether it is the government or a private party seeking the information. For these reasons, we recommend that the government urge that international comity does not require exhaustion of the Convention procedures.

The position which we recommend that the government adopt is that principles of comity do no more than require the courts to balance all the relevant factors, including the feasibility of resort to the Hague Convention, in ruling upon discovery requests or in determining whether to impose sanctions for failure to comply with a discovery order. This is the position generally adopted by the American courts.

In determining whether a party must provide information protected by foreign law, courts have often considered the factors set forth in Section 40 of the Restatement (2d) of Foreign Relations Law. The most significant of those factors, as set forth in SEC v. Banca Della Svizzera Italiana, 92 F.R.D. 111, 117-19 (S.D.N.Y. 1981), are the vital national interests at stake, the relative hardships to the parties, including the respondent's good faith, and, of lesser importance, the place of performance, the nationalities of the parties, and the extent to which enforcement of the discovery order would comply with the law of the foreign state. As part of this analysis, more recent decisions have also looked to the availability of the Hague Convention or other alternative means of discovery. 9/ American courts, however, have often been unpersuaded as to the usefulness of foreign judicial assistance, either under foreign law or by treaty. 10/

9/ See Graco v. Kremlin, No. 81 C 3636 (N.D. Ill., April 13, 1984, Getzendanner, J.) (French corporation was required to respond to interrogatories after balancing of factors, in which the court determined that the response to the interrogatories would occur in the United States, and the balance of other Section 40 factors favors use of traditional court authority under Rule 37 rather than the Hague Convention).

10/ In United States v. Bank of Nova Scotia, 722 F.2d 633 (11th Cir.), the court found that it was not compelled on grounds of comity to defer to a foreign bank secrecy law urged upon it, because the procedures suggested to the court would not be a realistic alternative to the grand jury:

> Applying for judicial assistance * * * is not a substantially equivalent means for obtaining production because of the costs in time and money and the uncertain likelihood of success * * * [and judicial assistance] does not afford due deference to the United States' interests.

In United States v. Vetco Inc., 644 F.2d 1324 (1981), the Ninth Circuit considered alternatives (to the discovery ordered by the district court) urged upon it by the appellants, including a tax treaty and various informal means of accommodating Swiss law. The court, applying the factors set forth in the Restatement, determined that "none of the proposals constitutes a substantially equivalent alternative" to compliance with the summons. Id. at 1332.

Where it can be adequately shown at the production stage that the mere ordering of compliance with a discovery request would infringe on vital foreign interests, then the relevant factors arguably should be weighed at the point where the court is considering whether to direct compliance. See United States v. Chase Manhattan Bank, No. M-18-304 (S.D.N.Y., March 27, 1984, Goettel, J.) and Garpeg v. United States, No. 84 Civ. 0435 (RWS) (S.D.N.Y., March 23, 1984, Sweet, J.) (companion IRS summons enforcement cases which determined, despite the existence of a preliminary injunction in Hong Kong against compliance with the IRS summons, to order compliance because consideration of Section 40 factors favored the American law). 11/

However, because the procedures provided by the Convention in most cases will be inadequate, and it is not always clear whether the information requested can be obtained without offending the host country, the courts normally should not consider the availability of alternative approaches in determining whether to order production. Moreover, the mere necessity of litigating the adequacy of alternative procedures at the production stage of the proceeding could unduly delay discovery. Ordinarily, only when the party or witness has failed to comply with a court order requiring discovery and a determination must be made whether to impose sanctions, is there an adequate record to make a determination with respect to the need to resort to the Hague Convention.

Additionally, it is important to provide every incentive for the party from whom discovery is sought to obtain a waiver of secrecy laws or arrange other methods to provide the information. The burden is properly placed on the party asserting a conflict of law to attempt to resolve the dilemma; the courts have had little trouble concluding that parties or witnesses that choose to do business under the laws of two sovereigns bear the burden of reconciling any conflicts between those

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11/ In Volkswagenwerk A.G. v. Superior Court, 176 Cal. Rep. 874, 885 (1st Dist., 1982), a California appellate court, while postponing full consideration of conflicts of sovereignty to the sanction stage, stated that "the initial discovery order must appear to take into account the ascertainable requirements of the foreign state and adopt the procedures which are least likely to offend that state's sovereignty."

sovereigns. 12/ This is the approach adopted by the Tenth Circuit, which has held that it is only when the court is evaluating the party's good faith under Societe Internationale at the sanction stage, that the availability of other procedures and the Restatement's various factors should be relevant. Arthur Anderson & Co. v. Finesilver, 546 F.2d 338, 341-42 (1976). 13/

Thus, we recommend that the government adopt the position that ordinarily the Convention procedures need not be taken into account unless the witness has made reasonable, but unsuccessful, efforts to attempt to reach an accommodation with an objecting foreign government. In that event, if the Convention or other international channels are adequate to serve the purposes of the American courts, they should then be employed.

The position the Commission recommends that the government adopt -- that American courts are free to order persons over whom they have jurisdiction to comply with discovery orders which may offend foreign nations -- may well give rise to foreign relations concerns. In addition, by not deferring to foreign law, the courts may be placing parties and witnesses -- often innocent stakeholders -- in the difficult position of being subject to conflicting demands in the countries in which they do business. To defer to the Convention, however, would mean that, in large part, American courts would lose control of their processes in cases with foreign elements since the Convention leaves much to the willingness of the foreign government and witness to voluntarily cooperate with pretrial discovery demands, particularly with respect to discovery of documents. Foreign nations would be permitted to determine what type of discovery will be available in the American proceedings. Excessive deference to comity concerns would also provide a privileged status to foreign nationals who choose to do business in this country, but seek not to be subject to the same discovery demands as United States businesses with whom they compete.

12/ See e.g., CAB v. Deutsche Lufthansa A.G., 591 F.2d 951, 953 (D.C. Cir. 1979); United States v. First National Bank City Bank, 396 F.2d 897; First National City Bank of New York v. I.R.S., 271 F.2d 616, 620 (2d Cir. 1959), cert. denied, 361 U.S. 948 (1960); SEC v. Minas de Artemisa, supra, 150 F.2d at 217. See also United States v. First National Bank of Chicago, 699 F.2d 341 (7th Cir. 1983).

13/ See In re Uranium Litigation, 563 F.2d 992, 996-99 (10th Cir. 1977) (applying Societe Internationale and setting aside a finding of contempt because corporation made a diligent effort to produce materials not subject to Canadian regulation and also sought a waiver from the Canadian government).

Thus, the courts have properly placed the burden on the person asserting a conflict with foreign law or policies to resolve the conflict. If the courts were to defer to foreign sensibilities whenever a conflict is asserted, all requests for information located abroad would be met by purported conflicts, which in most instances would quickly dissipate if the party were ordered to comply with the discovery request.

Accordingly, the courts must ordinarily be free to use traditional discovery procedures in the first instance; and only when compliance with those procedures is effectively frustrated by foreign law, through no fault of the person subject to the discovery order, should alternative means of discovery become relevant.

If you need any additional information concerning the Commission's position, or if we can be helpful to you in anyway, please do not hesitate to contact me or my staff. We look forward to participating in any meeting in this matter with the interested agencies and offices to arrive at a position to present to the Supreme Court.

Sincerely,

Daniel L. Goelzer
General Counsel

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