

PROBLEMS OF ENFORCEMENT IN THE MULTINATIONAL SECURITIES MARKET

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1. INTRODUCTION

1.1. *Market Transaction Hypothetical*

An individual opens an account with a foreign bank or brokerage firm (foreign institution), which has no significant presence in the United States, and is domiciled in a country that has rigid bank secrecy or blocking statutes. Upon opening this account, the individual immediately places a large order to purchase securities of Company X, which is listed on the New York Stock Exchange. The transaction is executed

after the firm receives a telex from the foreign institution directing the trade and the amount of shares to be purchased. The foreign institution maintains and trades through an "omnibus" account held in its own name at the American brokerage firm.

Within several hours of the execution of the order, the announcement of a tender offer for the securities of Company X causes the price of the stock to rise by \$20 per share. Based upon the circumstances and timing of the purchase, the Securities and Exchange Commission (SEC or Commission) commences an investigation in the United States to determine whether the purchaser violated United States law by placing the order while the purchaser was in possession of material nonpublic information which related to the tender offer. The SEC learns from Company X that, during the two weeks prior to the announcement, critical acquisition negotiations were conducted, thus raising a suspicion that the purchaser may have traded while in possession of material nonpublic information.

In furtherance of its investigation, the SEC wishes to ascertain the identity of the purchaser and obtain relevant customer documents which are maintained by the foreign institution. The Commission also desires to take the depositions of (a) the purchaser; (b) the foreign institution's employees (to determine what the customer said at the time the account was opened and the order was placed); and (c) the individuals who participated in the merger negotiations (to determine whether the purchaser received nonpublic information about the merger). In the course of its investigation, the SEC might seek information from other sources, such as telephone companies, credit card issuers, and hotels.

Clearly, even the limited facts available to the SEC at this early stage suggest the strong possibility of insider trading,¹ in violation of several provisions of the United States federal securities laws, and of rules promulgated thereunder by the SEC.² Further inquiry by the Commission is both inevitable and appropriate.³

¹ For a discussion of the United States' prohibitions against insider trading, see *infra* notes 11-70 and accompanying text.

² Under the law of the United States, rules of the SEC which are validly promulgated and within the SEC's statutory authority have the force and effect of law.

³ Recent SEC enforcement actions underscore the broad magnitude of potential abuses that apparently have existed in the American and European capital markets. See, e.g., *United States v. Cecola*, No. 86 Crim. 1113 (S.D.N.Y. Dec. 22, 1986); *SEC v. Reich*, No. 86 Civ. 7775 (S.D.N.Y. Oct. 9, 1986); *SEC v. Brown*, No. 86 Civ. 7774 (S.D.N.Y. Oct. 9, 1986); *SEC v. Wilkis*, No. 86 Civ. 5182 (S.D.N.Y. July 1, 1986); *United States v. David*, No. 86 Crim. 454 (GLG) (S.D.N.Y. May 28, 1986); *SEC v. Levine*, No. 86 Civ. 3627 (RO) (S.D.N.Y. May 12, 1986). For a general discussion, see *Guinness PLC Made Secret Payments to Accounts of Swiss Bank Pictet & Cie.*, *Wall St. J.*, Jan. 28, 1987, at 32, col. 1; *Guinness Claims Two More Victims at Morgan Grenfell*, *Fin. Times*, Jan. 21, 1987, at 8, col. 1; *Guinness Fires Its Chief Execu-*
<https://scholarship.law.upenn.edu/jil/vol9/iss3/5>

1.2. *Additional Steps Necessary to Achieve the SEC's Investigative Goals*

Beyond obtaining the necessary information identified in the market transaction hypothetical, the SEC will also wish to ascertain

1. whether other customers of the foreign institution purchased Company X stock during the relevant period, and at whose initiative;
2. whether the foreign institution purchased as a principal, as well as an agent;
3. whether there were additional recipients of the material nonpublic information concerning the impending tender offer, or tippees, who traded in the securities of Company X while in possession of that information; and
4. the location of the proceeds of all illegal transactions in the securities of Company X.

The SEC must be able to investigate this matter and gather the necessary evidence in the most timely and least costly fashion. At the same time, however, care must be taken that, in its vigorous efforts to carry out its investigative and law-enforcement mandate, the SEC does not unnecessarily or unintentionally overstep legitimate foreign sovereignty concerns. Rather, the agency should proceed in a manner designed to lay the foundation for future cooperation between the governments involved.

1.3. *The SEC's Current Investigative Tools*

The SEC has the unfettered authority to obtain full and complete trading information from any broker or dealer registered in the United States or transacting business in securities through a registered broker or dealer.⁴ This information necessarily includes the identity of any

tive, Asks For Resignations of Two Directors, Wall St. J., Jan. 15, 1987, at 27, col. 1; Wolman, *The Guinness Affair: Out Come the Skeletons*, Fin. Times, Jan. 2, 1987, at 8, col. 3; Seelig *Quits Morgan Grenfell Over Role in Guinness Takeover*, The Times (London), Dec. 31, 1986, at 1; *Morgan Grenfell Bombshell Hits Hard*, Fin. Times, Dec. 31, 1986, at 5, col. 4; Lohr, *Guinness Adviser Severs Tie, Grenfell Quits Amid Inquiry*, N.Y. Times, Dec. 31, 1986, at D1, col. 3.

⁴ Section 17 of the Securities Exchange Act of 1934 (Exchange Act), as amended, provides, in pertinent part:

(a)(1) Every national securities exchange, member thereof, broker or dealer who transacts a business in securities through the medium of any such member, registered securities association, registered broker or dealer, . . . shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule prescribes as necessary or appropriate in the public interest, for

customers of the broker on whose behalf the suspicious trades were executed, the amounts of stock purchased, and the time or times of the subject transactions. Thus, at this important initial phase of its investigation, the staff of the SEC does not require a special grant of authority to reach this first level of information. Brokers and dealers, as regulated entities, must provide this information to the SEC under the express provisions of the Exchange Act.

In this instance, however, the SEC will not learn the identity of the ultimate purchaser by means of the information that would be available from the United States broker or dealer that executed the trade: the firm's customer is the foreign institution, which was acting as the intermediary for its customer, the actual purchaser.⁵ At this juncture, the SEC's staff should seek a formal order of private investigation, which would empower the staff to serve compulsory process or investigative subpoenas. This grant of authority would enable the staff to compel the production of documentary and testimonial evidence from nonregulated persons.⁶

Of equal significance to the success of a transnational investigation, however, is the SEC's ability to obtain evidence by means of negotiation and cooperation. As will be discussed below, the SEC has developed a healthy working relationship with certain foreign governments enabling the SEC to gather information pursuant to treaty or other bilateral agreements. This mechanism is most suitable both for promoting good relations between the United States and foreign governments, and for assuring the most rapid and least costly production of the evi-

the protection of investors, or otherwise in furtherance of the purposes of this chapter.

(b) All records of persons described in subsection (a) of this section are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission . . . as the Commission . . . deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter.

15 U.S.C. §§ 78q(a)(1), (b) (1982).

⁵ Indeed, the SEC is unlikely to know whether the foreign institution was acting as a principal or as an agent in connection with the trades in question.

⁶ The following provisions of the federal securities laws empower the Commission to compel the production of any testimonial and documentary evidence that it deems relevant or material to its investigation: section 19(a) of the Securities Act of 1933, 15 U.S.C. § 77s(a) (1982) (Securities Act); section 21(a) of the Exchange Act, 15 U.S.C. § 77u(a) (1982); section 18(a) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79r(a) (1982); section 321(a) of the Trust Indenture Act of 1939, 15 U.S.C. § 77uuu(a) (1982); section 42(a) of the Investment Company Act of 1940, 15 U.S.C. § 80a-41(a) (1982); and, section 209(a) of the Investment Advisers Act of 1940, 15 U.S.C. § 80-9(a) (1982). For a discussion of the breadth of the SEC's investigative authority, see *infra* notes 91-94 and accompanying text.

dence needed by the SEC in furtherance of its investigation.

1.4. Obstacles Associated With Seeking Evidence Located Abroad

When pursuing evidence located in foreign countries, the SEC often finds itself confronted with obstacles raised by the interests embodied in foreign nondisclosure laws. Different countries proscribe, to varying degrees, the disclosure of certain classes of financial, technical, or business information to foreign parties or governments. These prohibitions, which may appear either in the form of blocking or secrecy statutes, or as judicially-created nondisclosure principles,⁷ are often invoked by the recipients of SEC requests or subpoenas for the production of information arguably falling within the scope of such a nondisclosure law.

In the past, even assuming that jurisdiction could be obtained over persons having relevant information — an assumption that often proves incorrect⁸ — United States courts were unwilling to impose sanctions for noncompliance upon a person who asserted as a defense to a production order an obligation under foreign law to protect the confidentiality of such information. United States agencies seeking evidence located in a nondisclosure jurisdiction, therefore, often found their investigative efforts thwarted by the application of principles of comity to the conflict of laws emerging from the competing, inconsistent demands of the two states interested in the information.⁹ While United States courts more recently have begun to demonstrate greater readiness to enforce their own production orders and the compulsory process of federal agencies,¹⁰ the Commission still encounters considerable difficulties and delays in extraterritorial investigations.

This article will briefly analyze the United States prohibition against insider trading; examine the SEC's current ability to assert jurisdiction over fraudulent activities arising from transnational securities transactions; discuss the obstacles confronting the agency in such matters; and explore possible new procedures to facilitate the SEC's ability to carry out its mandate to investigate and prosecute securities fraud affecting the integrity of the United States capital markets.

⁷ See *infra* notes 111-63 and accompanying text.

⁸ As noted above, in the market transaction hypothetical posed here, the United States broker who executes the suspicious trade would identify the foreign institution as its customer. However, the SEC's capacity to obtain jurisdiction over the foreign institution may be problematic and/or counterproductive since the foreign institution may lack any significant presence in the United States.

⁹ See *infra* notes 174-81 and accompanying text.

¹⁰ See *infra* notes 194-204.

2. UNITED STATES PROSCRIPTIONS AGAINST INSIDER TRADING

Insider trading has recently drawn increasing attention from the United States government agencies which are charged with responsibility for prosecuting its perpetrators, as well as from the legislators and commentators. The upswing in mergers and acquisitions over the last several years, accompanied by the almost routine surges in trading of target company stocks just prior to the announcement of a bid or agreement (as in the market transaction hypothetical), gives rise to the appearance of rampant insider trading. Indeed, the revelations brought to light by recent Wall Street scandals give substance to the fear that much of this trading may have been neither fortuitous nor coincidental. One question, however, repeatedly recurs in analyzing whether a particular pattern of conduct breaches the prohibition against this brand of securities fraud: what are the boundaries of those activities that rise to the level of illegal trading on inside information?

2.1. *Definition of Insider Trading*

Nowhere in the federal securities laws does there appear a definition of insider trading. Rather, the SEC and the courts have shaped an evolving definition of the offense.¹¹ Numerous reasons have been advanced for declining to legislate a definition of insider trading.¹² Congress responded to this litany of problems that allegedly would emerge from such a definition by omitting from the Sanctions Act any defini-

¹¹ In proposing the legislation that ultimately became the Insider Trading Sanctions Act of 1984, Securities Exchange Act of 1934 § 21(d)(2), 15 U.S.C. § 78u (1984) (Sanctions Act), the Commission purposefully omitted any definition of the offense in an effort to avoid an interminable debate over the definition that could stall passage of the entire legislative package.

¹² In his testimony before Congress on the proposed Sanctions Act, the former director of the Commission's Enforcement Division identified five reasons why no statutory definition of insider trading was necessary:

1. [t]here are not great ambiguities in the law of insider trading, so there is no real need for a statutory definition;
2. [t]here is legitimate concern that a definition with new terms and its legislative history would create new ambiguities, thereby increasing rather than limiting uncertainty;
3. [a] definition of insider trading . . . may reduce the Commission's flexibility to prosecute evolving types of misconduct;
4. [a] poorly drafted definition may unduly restrict brokerage firms in block trading, arbitrage and other types of legitimate brokerage activity; and
5. [d]rafting a comprehensive definition is enormously difficult.

tional provision.¹³ The Sanctions Act, by its terms, applies only to purchases or sales of a security "while in possession of material non-public information."¹⁴

2.2. Why Regulate Insider Trading?

Two schools of thought reach opposite conclusions as to whether insider trading should be proscribed.¹⁵ Economists offer differing and contradictory arguments to support the conclusion that no harm flows from trading securities on the basis of material nonpublic information.¹⁶ SEC Commissioner Joseph Grundfest, however, has offered a different economic analysis of the efficient market theory that identifies the harm caused by insider trading. Commissioner Grundfest observed that "[t]here is an optimal point at which information should be disclosed and it can be inefficient if information is disclosed either too soon or too late."¹⁷ Thus, Grundfest argues that there are "sound economic

¹³ One of the authors, Mr. Pitt, recently testified before Congress that a statutory clarification of the law of insider trading was both necessary and achievable. See *Over-sight of The Securities and Exchange Commission and The Securities Industry, Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs.*, 100th Cong., 1st Sess. 89-104 (1987); *Insider Trading: Hearings Before the Subcomm. on Telecommunications, Consumer Protection, and Finance of the House Comm. on Energy and Commerce*, 99th Cong., 2d Sess., 67-78 (1986).

On June 17, 1987, legislation was introduced in the United States Senate to define the offenses of insider trading and tipping. S. 1380, 100th Cong., 1st Sess. (1987) [hereinafter S. 1380]; see *Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs.*, 100th Cong., 1st Sess. (1987). This proposed legislation, drafted by an ad hoc committee of securities lawyers chaired by Mr. Pitt at the request of the United States Senate, represents the first effort to define, in express statutory terms, type of conduct that constitutes unlawful insider trading and tipping. See *Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs.*, 100th Cong., 1st Sess. 1-2 (1987) (Statement of Harvey L. Pitt and John F. Olson).

On August 3, 1987 the SEC submitted proposed revisions of S. 1380 to the Securities Subcommittee, which heard further testimony concerning various proposals on August 7, 1987. See *Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs.*, 100th Cong., 1st Sess. (1987). At that time, the chairman of the Subcommittee requested that Mr. Pitt draft a consensus bill based on S. 1380. *Id.* at 75-77 (remarks of Sen. Donald W. Riegle).

¹⁴ 15 U.S.C. § 78u(d)(2)(A) (Supp. II 1984).

¹⁵ Compare Wu, *An Economist Looks at Section 16 of the Securities Exchange Act of 1934*, 68 COLUM. L. REV. 260 (1968) and MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966) with Wang, *Trading on Material Nonpublic Information on Impersonal Stock Markets: Who is Harmed and Who Can Sue Whom Under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217 (1981) (for discussion of differing schools of thought concerning the prohibition against insider trading).

¹⁶ Compare Wu, *supra* note 15, at 260 (an efficient market absorbs and reflects all information, thereby precluding any benefit to insider trading) with MANNE, *supra* note 15, at 132-44 (corporate executives should be permitted to benefit from trading on insider information as an incentive for them to engage in business).

¹⁷ J. Grundfest, *Remarks to National Investor Relations Institute in New York*

reasons” justifying the aggressive prosecution of insider trading offenses.¹⁸ Courts have repeatedly found that insider trading is simply unfair;¹⁹ it is generally accepted that the practice must be prohibited.²⁰ Concern has been voiced that the nation’s securities markets could suffer serious harm if public confidence in their integrity were eroded: investors may be deterred from participating in the market if they know that others are trading on information unavailable to the investing public.²¹

2.3. *Predicates for Insider Trading Liability Under the Federal Securities Laws in the Context of Changes in Corporate Control*

Insider trading liability under the federal securities laws flows essentially from four provisions: section 17(a) of the Securities Act,²² section 10(b) of the Exchange Act²³ (and Rule 10b-5²⁴ thereunder); section 14(e) of the Exchange Act²⁵ (and Rule 14e-3²⁶ thereunder); and secondary liability under either section 20(a) of the Exchange Act²⁷ or principles of aiding and abetting liability. A brief description of the elements of a cause of action under each of the above theories follows.²⁸

City (June 20, 1986), *reprinted in* 18 Sec. Reg. & L. Rep. (BNA) No. 26, at 936 (June 27, 1986).

¹⁸ *Id.*

¹⁹ See *Chiarella v. United States*, 445 U.S. 222, 245 (1980) (Burger, C.J., dissenting) (“Chiarella . . . misappropriated — stole to put it bluntly — valuable nonpublic information entrusted to him in the utmost confidence . . . [and] then exploited his ill-gotten informational advantage by purchasing securities in the market.”); see also *SEC v. Tome*, 638 F. Supp. 596, 599, *modified*, 638 F. Supp., 638 (S.D.N.Y. 1986) (“case reveals a crass abuse and betrayal of a personal and professional relationship of trust and confidence for personal gain”).

²⁰ See *1984 Hearings*, *supra* note 12, at 1 (remarks of Sen. D’Amato) (“the integrity of the market is the victim [of insider trading] since it is undermined”); *id.* at 16 (written statement of John Shad, Chairman, Securities and Exchange Commission).

²¹ Wang, *supra* note 15, at 1227.

²² 15 U.S.C. § 77q(a) (1982).

²³ 15 U.S.C. § 78j(b) (1982).

²⁴ 17 C.F.R. § 240.10b-5 (1986).

²⁵ 15 U.S.C. § 78n(e) (1982).

²⁶ 17 C.F.R. § 240.14e-3 (1986).

²⁷ 15 U.S.C. § 78t(a) (1982).

²⁸ Section 16(b) of the Exchange Act, 15 U.S.C. § 78p(b) (1982), contains a strict liability provision requiring the disgorgement of “short-swing” profits by corporate insiders who trade in the securities of their company. This provision will not be discussed in this article inasmuch as it addresses a *presumption* of insider trading, which attaches even in situations where the respondent neither traded on the basis of nor possessed any material nonpublic information.

2.3.1. *Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5*

The fundamental United States proscriptions against insider trading are found in section 17(a) of the Securities Act,²⁹ section 10(b) of the Exchange Act,³⁰ and Rule 10b-5³¹ promulgated by the SEC under the Exchange Act.³² In essence, there are eight elements to an insider trading case. Thus, by their terms, these provisions make it unlawful for (1) *any* person (2) to misstate or omit (3) a material, (4) nonpublic (5) fact (6) in connection with (7) the purchase or sale of a (8) security. By analyzing each of these elements in turn, the breadth of the "antifraud" provisions of the United States securities laws is manifest.

First, these provisions pertain to *any* person, and not just to so-called "insiders." Under applicable precedents, there are essentially four categories of "persons"³³ who may be subject to these broad an-

²⁹ Section 17(a) provides, in pertinent part:

It shall be unlawful for any person in the offer or sale of any securities . . . in interstate commerce . . . directly or indirectly

- (1) to employ any device, scheme or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact . . ., or
- (3) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a) (1982).

³⁰ Section 10(b) prohibits any person from using or employing "in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b) (1982).

³¹ Rule 10b-5 provides that it is unlawful for any person:

- (a) to employ any device, scheme, or artifice to defraud,
- (b) to make any untrue statement of a material fact or to omit to state a material fact . . . or
- (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security [in interstate commerce].

17 C.F.R. § 240.10b-5 (1986).

³² Section 17(a) is a self-contained prohibition against fraud in the offer or sale of securities. Section 10(b) applies the proscriptions against securities fraud to *both* sellers *and* purchasers of securities, but it is not self-contained; instead, section 10(b) makes it unlawful to commit fraud in the sale or purchase of securities in contravention of such rules as the SEC may adopt. Rule 10b-5 implements the basic rulemaking authority granted to the SEC by section 10(b) of the Exchange Act, and basically applies the language of section 17(a) of the Securities Act to both purchasers and sellers of securities.

³³ The term "person" is defined in the Securities Act to include, "an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organization, or a government or political subdivision thereof." 15 U.S.C. § 77b(2) (1982). The Exchange Act defines the term "person" to include "a natural person, company, government, or political subdivision, agency or instrumentality of a government." 15 U.S.C. § 77c(9) (1982).

tifraud proscriptions:

a. "true corporate insiders" — officers, directors, and employees of the corporation in whose securities the suspicious trading occurs;

b. "quasi-corporate insiders" — persons who assume a sufficient identity of interests with the corporation in whose securities the suspicious trading occurs to be treated as if they were "true corporate insiders." This group would include, under appropriate circumstances, underwriters of the company's securities, corporate accountants and attorneys, and other corporate agents;³⁴

c. "derivative corporate insiders" — persons who may have no connection with the company in whose stock suspicious trading occurred, but who have obtained inside information from true corporate insiders — so-called "tippees;"³⁵ and

d. "true outsiders" — persons wholly outside the corporation in whose securities suspicious trading may have occurred, but who nevertheless became privy to material, non-public information about the securities in question.³⁶

Second, the courts have suggested that three types of conduct may give rise to liability under these antifraud provisions:

a. affirmative misstatements and half-truths create liability. In essence, the utterance of a false statement or a half-truth where the false statement or the omitted information pertains to a material and nonpublic fact, in connection with the purchase or sale of any security, will create liability on the part of any of the four categories of persons potentially subject to these antifraud provisions;³⁷

b. false inducements to trade will also give rise to antifraud liability for each of the four categories of persons de-

³⁴ See *Dirks v. SEC*, 463 U.S. 646, 657 n. 14 (1983). The Supreme Court observed that a certain class of corporate outsiders such as accountants, underwriters and attorneys, among others, may become fiduciaries of the company where nonpublic corporate information properly has been entrusted to them. Before this duty will be imposed, however, the corporation must expect the information to be kept confidential and the relationship must imply that duty.

³⁵ See, e.g., *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

³⁶ *Dirks*, 463 U.S. at 663-666; H. PITT, PITT ON INSIDER TRADING: AN OUTLINE OF THE LAW, THE REGULATIONS, AND COUNSELLING STRATEGIES (to be published).

³⁷ H. PITT, *supra* note 36.
<https://scholarship.law.upenn.edu/jil/vol9/iss3/5>

scribed above;³⁸ and

c. finally, total silence on the part of a purchaser or seller of securities will give rise to liability if, and only if, the person who was silent had a duty to speak and breached that duty.³⁹ While true corporate insiders and quasi-corporate insiders will be presumed to have a duty to speak,⁴⁰ the law is still evolving as to the circumstances under which derivative insiders and true outsiders will be deemed to have breached some duty to speak.⁴¹

Third, the information around which an insider trading case revolves must be material. As defined by the Supreme Court,

[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.⁴²

Fourth, the material omission, misstatement, or half-truth must relate to information that is nonpublic. Although the SEC has been urged by the United States judiciary to prescribe rules as to when information will be deemed to have been publicly disseminated,⁴³ the SEC has, to date, been unable or unwilling to do so.

³⁸ *Id.*

³⁹ *Dirks*, 463 U.S. at 661-62.

⁴⁰ *Id.* at 658-59; *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

⁴¹ One such evolving theory has emerged from Supreme Court dicta in two recent cases, *Dirks*, 463 U.S. at 665, and *Bateman Eichler, Hill Richards Inc. v. Berner*, 472 U.S. 299, 313 n.22 (1985). In finding that the petitioner securities analyst had not illegally tipped his customers about the Equity Funding fraud, the Court in *Dirks* pointed out that the petitioner had not misappropriated or otherwise illegally obtained the information. 463 U.S. at 665. By contrast, the Court in *Bateman Eichler*, refused to find the defrauded plaintiff-tippee was *in pari delicto* with the tipping broker and observed that "[w]e have also noted that a tippee may be liable if he otherwise misappropriate[s] or illegally obtain[s] the information." 472 U.S. at 313 n.22. The misappropriation rule, which has been favored by the courts of appeal, *see, e.g.*, *SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985), will be before the Supreme Court during the 1987 term. *See United States v. Winans*, 612 F. Supp. 827 (S.D.N.Y.), *aff'd and rev'd in part sub nom.* *United States v. Carpenter*, 791 F.2d 1024 (2d Cir. 1985), *cert. granted*, 107 S. Ct. 666 (1986).

⁴² *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). The *Northway* case arose under section 14(a) of the Exchange Act, but the definition of materiality set forth in that decision has also been applied to cases brought under section 10(b) of the Exchange Act, and Rule 10b-5 and section 17(a) of the Securities Act.

⁴³ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 854 n.18 (2d Cir. 1968).

Fifth, the information omitted, misstated, or the subject of a half-truth, must constitute a "fact" and not rumor, projection, or surmise. Facts are objectively ascertainable; information that is not objectively ascertainable cannot form the predicate of an insider trading case.⁴⁴

Sixth, both section 10(b) and Rule 10b-5 require that the prohibited conduct occur *in connection with* the purchase or sale of a security. This requirement has been articulated by the Supreme Court as "an injury [suffered] as a result of deceptive practices touching [the] sale of securities,"⁴⁵ in holding that the misappropriation of the proceeds of a sale of securities would fall within the protection of section 10(b) if "the seller was duped into believing that it, the seller, would receive the proceeds," notwithstanding the fact that the transaction price represented full value and that the misappropriator was neither a purchaser nor seller.⁴⁶

Seventh, there must be an actual purchase or sale of a security in order for liability to attach under either section 17(a) of the Securities Act or Exchange Act Rule 10b-5.⁴⁷

Eighth, the insider trading proscriptions apply only to securities. For these purposes, debt instruments, equity securities, and derivative instruments (such as puts, calls, warrants, and American Depository Receipts) all qualify as statutory securities.

Apart from the eight elements of an insider trading action briefly outlined above, two additional factors are relevant. First, under applicable law, the mental state of the alleged violator is a relevant consideration. Under Exchange Act Rule 10b-5, and under certain subsections of Securities Act section 17(a), the alleged violator must have acted with *scienter* — a mental state embracing an intent to deceive or defraud.⁴⁸ Even where mere negligent behavior will suffice under certain

⁴⁴ H. PITT, *supra* note 36.

⁴⁵ Superintendent of Ins. of N.Y. v. Banker's Life & Casualty, 404 U.S. 6, 12-13 (1971).

⁴⁶ *Id.* at 9.

⁴⁷ See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); *Birnbaum v. Newport Steel*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

⁴⁸ The Supreme Court has interpreted section 17(a) of the Securities Act as embodying two separate standards of intent. First, section 17(a)(1) requires a showing of scienter, or of a deliberate intention to deceive. Sections 17(a)(2) and 17(a)(3) require only a showing of negligence. *Aaron v. SEC*, 446 U.S. 680, 687-702 (1980).

It should be noted that courts have held that recklessness satisfies the scienter requirement. See *A & K R.R. Materials, Inc. v. Green Bay & R.R.*, 437 F. Supp. 636, 642 (E.D. Wis. 1977) ("[k]nowledge of the falsity of the statement or *reckless disregard of the truth* may be sufficient [to show scienter]") (emphasis added); see also *Sunstrand Corp. v. Sun Chem.*, 553 F.2d 1033, 1044 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977). See generally L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 871, 886 (1983).

aspects of section 17(a) of the Securities Act, a mental state of scienter will be relevant in determining whether the Commission is entitled to any relief, even if the Commission can prove each of the eight elements of its insider trading cause of action.⁴⁹

In addition, under these provisions, the mere *possession* of material, nonpublic facts may not suffice to establish a violation of law.⁵⁰ The SEC may be required to show that the alleged wrongdoer actually *used or relied upon* the material, nonpublic facts in buying or selling the securities in question.⁵¹

2.3.2. Section 14(e) and Rule 14e-3

Section 14(e), which was added to the Exchange Act as part of the Williams Act in 1968, proscribes fraudulent acts in connection with tender offers.⁵² Pursuant to the broad rulemaking authority vested in the Commission by that section, the SEC promulgated Rule 14e-3. In contrast to the general language of Rule 10b-5, Rule 14e-3 explicitly addresses any “person who is in possession of material information” concerning a tender offer if that person “knows or has reason to know” it has been acquired directly or indirectly from: (1) the offering person; (2) the issuer of the securities that are the subject of the tender offer; or (3) any “officer, director, partner, or employer or any other person acting on behalf of the offering person or such issuer.”⁵³

Rule 14e-3 was adopted to bring to a halt conduct that “undermines the integrity of, and investor confidence in, the securities markets.”⁵⁴ The strictures of Rule 14e-3, however, have proven to be only partially effective as an enforcement mechanism against insider trading, as a result of limitations superimposed on the rule by the courts that

⁴⁹ See *Aaron*, 446 U.S. at 701.

⁵⁰ *Chiarella v. United States*, 445 U.S. 222, 231 (1980) (“use of [market information] was not a fraud under § 10(b) unless [petitioner] was subject to an affirmative duty to disclose it before trading”). Mr. Pitt was counsel to the Securities Industry Association, which submitted an amicus curiae brief to the Supreme Court in this matter.

⁵¹ *Chiarella*, 445 U.S. at 222, 228, 231 (1980).

⁵² Section 14(e) provides, in pertinent part, that

[i]t shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact . . . or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or offer for any tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

15 U.S.C. § 78n(e) (1982).

⁵³ 17 C.F.R. § 240.14e-3 (1986).

⁵⁴ Exchange Act Release No. 6239, 20 SEC Docket 1241 (Sept. 4, 1980).

have interpreted its application.⁵⁵

2.3.3. *Aiding and Abetting, and Secondary Liability*

Although the lower courts have taken for granted the validity of liability flowing from the aiding and abetting of violations of the federal securities laws,⁵⁶ the Supreme Court has left unanswered the question whether such liability properly attaches.⁵⁷ To the extent that the opinions of lower courts provide authority, three elements of an aiding and abetting claim have been articulated: (1) proof of a principal violation of the federal securities laws;⁵⁸ (2) proof that the defendant had knowledge of the conduct constituting the principal violation;⁵⁹ and (3) proof that defendant "rendered substantial assistance" to the perpetrator in connection with the latter's principal violation of the federal securities laws.⁶⁰

Similarly, an employer can be liable for its employees' violations of these antifraud proscriptions, under the doctrine of *respondeat superior*, where it can be proved that: (1) another party has committed a securities law violation; (2) the accused aider and abettor had a general awareness that its role was part of an overall activity that was improper; and (3) the accused aider and abettor knowingly and substantially assisted in the principal violation.⁶¹

2.4. *Effects of the Internationalization of Markets*

In comparison with the experience in the United States, insider

⁵⁵ Compare *SEC v. Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984) (court enjoined tippees who received and traded on inside information during period leading up to tender offers for companies whose securities were purchased by tippees) with *Camelot Industries v. Vista Resources*, 535 F. Supp. 1174, 1182-83 (S.D.N.Y. 1982) (court dismissed action against broker who received inside information about intended acquisition, absent evidence that he had *direct knowledge* of actual tender offer plan).

⁵⁶ See, e.g., *Brennan v. Midwestern United Life Ins.*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

⁵⁷ *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983); *Aaron v. SEC*, 446 U.S. 680 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

⁵⁸ *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); see also *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 95 (5th Cir. 1975); *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975); *Dahl v. Gardner*, 583 F. Supp. 1262, 1267 (D. Utah 1984).

⁵⁹ It should be noted that recklessness will satisfy this element where the defendant owed a fiduciary duty to others. *Rolf*, 570 F.2d at 47.

⁶⁰ This element may extend to active or passive conduct that prevented plaintiff from discovering the principal violator's fraud. *Id.* at 48.

⁶¹ *Investor Research v. SEC*, 628 F.2d 168, 173 (D.C. Cir.), *cert. denied*, 449 U.S. 919 (1980); see also *Deane v. Thomson McKinnon Sec.*, 586 F. Supp. 44 (D.D.C.), *aff'd*, 762 F.2d 137 (D.C. Cir. 1984), *cert. denied*, 106 S. Ct. 232 (1985).

trading in the capital markets of many other nations has historically been subject either to regulations rarely enforced, or to no regulation at all.⁶² In Europe, legislation governing the improper use of inside information exists only in the United Kingdom⁶³ and France,⁶⁴ with Switzerland expected to follow suit shortly.⁶⁵ In some nations, there simply has been no history of regulating insider trading, whereas in other countries insider trading, as defined in the United States, was a respectable activity traditionally engaged in by directors and officers.⁶⁶

The internationalization of the world's primary markets, together with the multiple listing of securities on the leading exchanges and the potential for continuous trading,⁶⁷ has also increased the potential for insider trading. As the Commission noted in a 1985 release, "[t]here

⁶² Carlton & Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 860 (1983).

⁶³ See Company Securities (Insider Dealing) Act, 1985, ch. 8.

⁶⁴ See Order No. 67-833 of Sept. 28, 1967, art. 10-1, 1967 Dalloz-Sirey *Législation* [D.S.L.] 373, 1967 Bulletin législatif Dalloz [B.L.D.] 659, as amended by Statute No. 70-1208 of Dec. 23, 1970, art. 4, 1971 D.S.L. 17, 1971 B.L.D. 17; 1983 Journal Officiel de la République Française [J.O.]. The authors acknowledge with gratitude the following translation of the statute provided by Robert Bordeaux-Groult, Esq. of Cleary, Gottlieb, Steen, & Hamilton:

A sentence of imprisonment for a period from two months to two years and a fine of from FFr 6,000 to FFr 5 million, which amount could be increased to the quadruple of the amount of the profit realized but in no event less than such profit, or by either fine or imprisonment alone, shall be imposed on persons mentioned in article 162-1 of the law of No. 66-537 of July 24, 1966, as amended, on commercial companies and on persons with access, as a result of the exercise of their profession or responsibilities, to privileged information on the prospects or situation of an issuer of securities or on the prospects for future trading of a security, which persons carry out, or permit to be carried out, on the securities market, either directly or indirectly, one or more transactions based upon such information before the public has knowledge of it.

In the case where such transactions are realized by a legal entity and not a natural person, the *de jure* and *de facto* managers of such entity will be criminally liable for the violations committed.

Also subject to criminal liability will be any person who consciously spread in the public by whatever means false or misleading information on the prospects or situation of an issuer or on the prospects of a security in order to affect the trading of such security.

Id.

⁶⁵ See generally Note, *Subject Matter Jurisdiction over Transnational Securities Fraud: A Suggested Roadmap to the New Standard of Reasonableness*, 71 CORNELL L. REV. 919 (1986) (discussion of insider trading legislation in various countries).

⁶⁶ Tunc, *A French Lawyer Looks at American Corporation Law and Securities Regulation*, 130 U. PA. L. REV. 757, 762 (1982) (tipping considered "a social duty . . . expected of relatives and friends" in France).

⁶⁷ As of Jan. 1, 1985, approximately 200 domestic companies listed on the New York Stock Exchange were also listed on the London Stock Exchange, 43 on the Paris Bourse and 6 on the Tokyo Stock Exchange. See Exchange Act Release No. 21,958, 32 SEC Docket 1241 (Apr. 25, 1985).

are few surveillance mechanisms in place to safeguard the integrity of securities trading conducted simultaneously in multiple international markets."⁶⁸ The increased liquidity and mobility of funds pose a potential threat to the integrity of foreign and United States markets alike.

These issues present a challenge to both the SEC and to regulators in foreign jurisdictions, the latter of whom have responded in several ways. First, the governments of a number of other jurisdictions have recently called for the strengthening of their own sanctions against insider trading.⁶⁹ In addition, in July 1986, representatives of fifty-eight countries attended a meeting which was sponsored by the International Association of Securities Commissions, at which a standing committee was established to promote greater assistance in securities law enforcement.⁷⁰ These developments alone suggest the growing consensus that international cooperation will be required to stem the tide of insider trading.

3. OVERVIEW OF JURISDICTIONAL ISSUES

3.1. *Jurisdictional Issues Raised by the Market Transaction Hypothetical*

The facially unlawful conduct described in the market transaction hypothetical presents three jurisdictional obstacles that the SEC must overcome if the agency is to reach the illegal activities and vindicate the United States interests it believes have been contravened.

First, the SEC must show that the United States possesses jurisdiction to prescribe a rule of law applicable to this conduct. To that end, it must be demonstrated that the conduct in question bears a sufficient nexus to the United States to justify invoking its laws.⁷¹

After the government establishes prescriptive jurisdiction, it must then show that the United States courts have "enforcement jurisdiction,"⁷² that is the power to apply the United States rule of law over

⁶⁸ *Id.*

⁶⁹ See, e.g., *Tougher Trading Laws*, MacLean's, Dec. 22, 1986, at 58 (proposed amendment to Ontario Securities Act increasing maximum penalties for illegal securities trading to fine of \$1.0 million or two years imprisonment); Company Sanctions (Insider Dealings) Act, 1985, ch. 8 (strengthening penalties for insider trading in United Kingdom).

⁷⁰ Mann, Sullivan & Koncick, *Current Issues in International Securities Law Enforcement* 68-69 (Jan. 10, 1987) (paper prepared for American Bar Association Institute on International Litigation and Arbitration) [hereinafter *Current Issues*].

⁷¹ For discussion of the scope of a state's prescriptive jurisdiction, see *infra* notes 74-84 and accompanying text.

⁷² For discussion of the scope of a state's enforcement jurisdiction, see *infra* notes 95-109 and accompanying text.

either the proposed respondent or the assets in question.⁷³

Both prescriptive and enforcement jurisdiction over a given set of facts may concurrently lie with more than one state. In such instances, as will be discussed below, the SEC may find itself confronted with a foreign nondisclosure law that impedes the exercise of United States enforcement jurisdiction by imposing upon the respondent a competing and inconsistent obligation not to disclose the information sought by the SEC. Thus, the SEC's third obstacle is to persuade the court that the exercise of its enforcement jurisdiction would be proper under such circumstances.

As will be discussed below, United States courts weigh a number of factors in seeking to balance the differing interests which underlie the competing rules of law which give rise to such a conflict.⁷⁴ The remainder of this section will discuss the bases of prescriptive and enforcement jurisdiction and analyze the processes by which courts resolve the conflicts of laws that emerge in the context of multinational disputes involving claims that arise under the United States federal securities laws.

3.2. *Prescriptive Jurisdiction*

The first level of jurisdiction that must be established before a United States court will reach the merits of a dispute that involves the possible extraterritorial application of the federal securities law is the authority of the United States to seek to regulate the conduct in question — in other words, whether the United States has jurisdiction to prescribe a rule of law governing the matter before the court. The concept of prescriptive jurisdiction in international law is analogous to domestic subject matter jurisdiction.

3.2.1. *Bases of Prescriptive Jurisdiction*

International law recognizes, to varying degrees, six bases of prescriptive jurisdiction. First, the *conduct* principle, which is the fundamental basis of a state's authority to regulate, permits the exercise of prescriptive jurisdiction over actions conducted within the state's terri-

⁷³ In some instances, the government may have no choice but to proceed against the illegal profits generated by an unlawful transaction. Such emergency relief and the appropriate circumstances for its application will be discussed later. See *infra* note 278 and accompanying text.

⁷⁴ For a discussion of the five factors identified in § 40 of the *Restatement (Second) of Foreign Relations Law of the United States* (1965), see *infra* notes 182-207 and accompanying text.

torial limits.⁷⁵ Second, the *effects* doctrine, an expansion of the conduct doctrine, allows a state properly to assert prescriptive jurisdiction beyond its own territorial limits over conduct that produces effects within that state's own territory.⁷⁶ While different states articulate this doctrine in various ways, the basic principle is widely accepted.⁷⁷ Third, it is universally recognized that a state has the authority to prescribe rules of law governing the conduct of its citizens, wherever they may be located, based upon their *nationality*.⁷⁸ Fourth, the *protective* principle of jurisdiction confers upon a state prescriptive jurisdiction with respect to

⁷⁵ Section 17 of the *Restatement (Second)* provides that:

- A state has jurisdiction to prescribe a rule of law
- (a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and
 - (b) relating to a thing located, or a status or other interest localized, in its territory.

RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 (1965).

The conduct doctrine is sometimes referred to as the territorial principle of jurisdiction.

⁷⁶ Section 18 of the *Restatement (Second)* provides that:

- A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if either
- (a) the conduct and its effect are generally recognized as constituent elements of a crime or tort under the law of states that have reasonably developed legal systems, or
 - (b) (i) the conduct and its effect are constituent elements of activity to which the rule applies;
 - (ii) the effect within the territory is substantial;
 - (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and
 - (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems.

Id. § 17.

The effects doctrine is sometimes referred to as the objective territorial principle of jurisdiction.

⁷⁷ See, e.g., Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1368 (1973). Prescriptive jurisdiction may be established by the application of the principles of either the conduct or the effects tests. Cf. *Continental Grain (Australia) Pty. v. Pacific Oil Seeds, Inc.*, 592 F.2d 409, 416 (8th Cir. 1979).

⁷⁸ Section 30(1) of the *Restatement (Second)* provides that:

- A state has jurisdiction to prescribe a rule of law
- (a) attaching legal consequences to conduct of a national of the state wherever the conduct occurs or
 - (b) as to the status of a national or as to an interest of a national, wherever the thing or other subject-matter to which the interest relates is located.

RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 30 (1965).

conduct threatening its national security or governmental operations.⁷⁹ Fifth, the *universality* principle of jurisdiction empowers any state having custody of an individual to assert its prescriptive jurisdiction over that individual with respect to a narrow class of universally recognized crimes, such as piracy.⁸⁰ Sixth and finally, the *passive personality* principle, specifically rejected by the *Restatement (Second) of Foreign Relations Law of the United States* as a proper jurisdictional principle,⁸¹ is asserted by some states as a basis for exercising prescriptive jurisdiction over conduct harming its citizens, regardless of either the locus of the conduct causing the injury or the location of the citizen when the harm is inflicted.⁸²

Of these various bases for a state's assertion of prescriptive jurisdiction, the conduct,⁸³ effects,⁸⁴ and nationality⁸⁵ principles bear most

⁷⁹ Section 33 of the *Restatement (Second)* provides that:

(1) A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct outside its territory that threatens its security as a state or the operation of its governmental functions, provided the conduct is generally recognized as a crime under the law of states that have reasonably developed legal systems.

(2) Conduct referred to in Subsection (1) includes in particular the counterfeiting of the state's seals and currency, and the falsification of its official documents.

Id. § 33.

⁸⁰ The *Restatement (Second)* which does not fully accept the universality principle, provides instead that

[a] state has jurisdiction to prescribe a rule of law with respect to piracy on the high seas and to enforce it in its territory or on the high seas, provided such action is consistent with international law as stated in the Convention on the High Seas of April 29, 1958.

Id. § 34.

Comment 2 to section 34, entitled "Crimes of Universal Interest," notes that, with the exception of slave trade, which is the subject of two conventions,

universal interest in the suppression of slavery and these other crimes [such as traffic in women for prostitution and traffic in narcotic drugs] has not as yet been carried to the point of recognizing, either in customary law or in international agreements, the principle of universal jurisdiction that obtains in the instance of piracy.

Id. § 34 comment 2.

⁸¹ Section 30(2) of the *Restatement (Second)* provides that "a state does not have jurisdiction to prescribe a rule of law attaching legal consequences to conduct of an alien outside its territory merely on the grounds that the conduct affects one of its nationals." RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 30(2).

⁸² Comment, *supra* note 77, at 1369.

⁸³ Early Supreme Court decisions analyzed this jurisdictional principle in terms of territoriality (the fundamental basis of a state's power to regulate). *See, e.g.*, *McDonald v. Mabee*, 243 U.S. 90, 91 (1917) (Holmes, J.) ("[T]he foundation of jurisdiction is physical power . . .").

More recent decisions articulate this same jurisdictional predicate as that of the conduct principle. *See* *AVC Nederland B.V. v. Atrium Inv. Partnership*, 740 F.2d 148,

strongly on the question of the extraterritorial application of the federal

153 (2d Cir. 1984) (“[t]he decisions make clear that foreign citizens are entitled to the benefits of United States securities laws with respect to activity in the United States involving American securities”); *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d 1103, 1108 (7th Cir. 1984) (“[W]hen the conduct occurring in the United States is material to the successful completion of the alleged scheme, jurisdiction is asserted.”); *Fidenas AG v. Compagnie Internationale Pour L’Informatique CII. Honeywell Bull S.A.*, 606 F.2d 5, 8 (2d Cir. 1979) (United States jurisdiction does not lie where conduct in United States was ancillary, secondary, and principally in the form of culpable nonfeasance); *Continental Grain Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 415 (8th Cir. 1979) (where a fraudulent scheme was devised in the United States by use of the mails and means of interstate commerce, conduct was significant enough to invoke United States jurisdiction); *United States v. Cook*, 573 F.2d 281, 283 (5th Cir. 1978) (where scheme is devised and carried out in United States, fact that victims are outside United States does not deprive courts of jurisdiction); *SEC v. Kasser*, 548 F.2d 109, 114 (3d Cir. 1977) (“[W]e are . . . skeptical that Congress wished to preclude all SEC suits for injunctive relief where the victim of a fraudulent scheme [carried out in the United States] happened to be foreign or where there was insubstantial impact on the United States.”); *Straub v. Vaisman & Co.*, 540 F.2d 591, 595 (3d Cir. 1976) (“Conduct within the United States is alone sufficient from a jurisdictional standpoint to apply the federal [securities] statutes.”); *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1976) (“We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export”); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 987 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975) (where United States activities are “merely preparatory” and in form of “culpable nonfeasance” there is no prescriptive jurisdiction); *SEC v. United Fin. Group, Inc.*, 474 F.2d 354, 356 (9th Cir. 1973) (United States has jurisdiction over fraudulent acts of offshore funds even though there were very few American victims: “jurisdiction may not be resolved by a mere tallying of domiciles of shareholders” (citing with approval *McGee v. Int’l Life Ins.*, 355 U.S. 220 (1957))); *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983) (where the only United States conduct was a misrepresentation repetitive of foreign misstatement, and such conduct was commerce, contacts were sufficient to confer subject matter jurisdiction); *IIT v. Cornfeld*, 462 F. Supp. 210, 223 (S.D.N.Y. 1978) (in predominantly foreign transaction, facts that defendants were American and offering circulars were prepared in the United States are insufficient for prescriptive jurisdiction); *SEC v. Gulf Intercontinental Fin.*, 223 F. Supp. 987, 995 (S.D. Fla. 1963) (“Where the scheme is one which necessarily must be accomplished in part by the use of the mails or [United States] interstate facilities . . . even though the offers were made entirely outside the nation . . . the remedial protection of these sections may be invoked.”); *Kook v. Crang*, 182 F. Supp. 388, 391 (S.D.N.Y. 1960) (absent some act in the United States in furtherance of the fraudulent extension of credit scheme, jurisdiction does not lie).

⁸⁴ See *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d 1103, 1108 (3d Cir. 1984) (fraudulent transactions from abroad on United States exchanges cause sufficient harmful effects to invoke United States prescriptive jurisdiction); see also *In re Marc Rich & Co., A.G.*, 707 F.2d 663, 667 (2d Cir.), *cert. denied*, 463 U.S. 1215 (1983); *Des Brisay v. Goldfield Corp.*, 549 F.2d 133 (9th Cir. 1977); *Schoenbaum v. Firstbrook*, 405 F.2d 200, *rev’d en banc*, 405 F.2d 214 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969); *Pac. Seafarers v. Pac. Far East Line*, 404 F.2d 804 (D.C. Cir. 1968), *cert. denied*, 393 U.S. 872 (1969).

⁸⁵ See *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1016 (2d Cir. 1975) (“[a]lthough the United States has power to prescribe the conduct of its nationals everywhere in the world . . . Congress does not often do so.”); *Pac. Seafarers v. Pac. Far East Line*, 404 F.2d at 814 n. 31 (“nationality is a recognized international basis for prescribing conduct.”).

securities laws.

3.2.2. *Application of Prescriptive Principles to the Market Transaction Hypothetical*

It would appear from the facts of the hypothetical that the activities outlined therein would suffice as the predicate for prescriptive jurisdiction based upon both the conduct and effects principles. The transactions in question were executed in the United States securities markets, by means of orders placed through an instrument of "interstate commerce."⁸⁶ This constitutes sufficient conduct within the United States' territorial limits to warrant invoking the protections of United States laws. It has been found that the use of the United States mails or telephones, standing alone, suffices to invoke the prescriptive jurisdiction of the United States.⁸⁷ The execution of trades on the United States markets, in and of itself, has been held sufficient conduct within the United States to allow the application of United States law.⁸⁸

Further, it is arguable under the facts provided in the hypothetical that the trades executed through the foreign institution resulted in a perceptible, and artificially premature, increase in the price of the target company's shares prior to the announcement of the tender offer. The impact of this trading activity on the United States' markets justifies the application of United States law to the conduct causing this market impact, based on the effects principle of prescriptive jurisdiction. As the court in *Tamari v. Bache & Co. (Lebanon) S.A.L.* observed,

⁸⁶ The Securities Act defines "interstate commerce" as:

trade or commerce in securities or any transportation or communication relating thereto among the several States or between the District of Columbia or any Territory of the United States and any State or other Territory, or between any foreign country and any State, Territory, or the District of Columbia, or within the District of Columbia.

15 U.S.C. § 77(b)(17) (1982).

The Exchange Act defines "interstate commerce" as:

trade, commerce, transportation, or communication among the several states, or between any foreign country and any state, or between any state and any place or ship outside thereof. The term includes intrastate use of (A) any facility of a national securities exchange or a telephone or other interstate means of communication, or (B) any other interstate instrumentality.

15 U.S.C. § 78c(a)(17) (1982).

See, e.g., *Parry v. Bache*, 125 F.2d 493, 495 (5th Cir. 1942) (securities orders placed by mail and telegraph constitute use of "interstate commerce").

⁸⁷ See *SEC v. Gulf Intercontinental Fin.*, 223 F. Supp. at 995.

⁸⁸ See, e.g., *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F. 2d at 1108.

[w]hen transactions initiated by agents abroad involve trading on United States exchanges, the pricing and hedging functions of the domestic markets are directly implicated, just as they would be by an entirely domestic transaction. If transactions are the result of fraudulent representations, unauthorized trading, or mismanagement of trading accounts, prices and trading volumes in the domestic marketplace will be artificially influenced and public confidence could be undermined.⁸⁹

To the extent that the trader, whose identity remains cloaked in secrecy, or perhaps his tipper, is a United States citizen, the nationality principle of jurisdiction would provide still a third basis for the United States to prescribe rules of law to govern that citizen's conduct, even if that citizen placed the order from a location beyond the United States' territorial limits.⁹⁰

Thus, application of the federal securities laws to the conduct described in the market transaction hypothetical comports with the three major principles of prescriptive jurisdiction recognized under international law.

It should be noted that once the SEC satisfies a court that prescriptive jurisdiction lies, great deference will be accorded to the agency's determination as to the proper scope of its investigation into possible violations of the federal securities laws. Courts have construed broadly the investigative authority of the Commission and other federal regulatory agencies.⁹¹ The Supreme Court recently had the occasion to observe that "Congress has vested the SEC with broad authority to conduct investigations into possible violations of the federal securities laws and to demand production of evidence relevant to such investigations."⁹²

This authority has been analogized to the broad fact-finding power of a United States grand jury.⁹³ Indeed, the Supreme Court, in sustaining the validity of an order of the Federal Trade Commission, admonished that:

⁸⁹ 730 F.2d at 1103.

⁹⁰ See *supra* notes 78 & 85 and accompanying text.

⁹¹ See, e.g., SEC v. Jerry T. O'Brien, Inc., 467 U.S. 735 (1984); *United States v. Morton Salt Co.*, 338 U.S. 632 (1950); SEC v. Arthur Young & Co., 584 F.2d 1018 (D.C. Cir. 1978); *Mines and Metals Corp. v. SEC*, 200 F.2d 317 (9th Cir. 1952).

⁹² SEC v. Jerry T. O'Brien, Inc., 467 U.S. at 741.

⁹³ See *United States v. Morton Salt Co.*, 338 U.S. at 642-43; *Boehm v. United States*, 315 U.S. 800, 808 (1942); SEC v. First Security Bank of Utah, 447 F.2d 166 (10th Cir. 1971); *Consol. Mines of Cal. v. SEC*, 97 F.2d 704 (9th Cir. 1938); *In re SEC*, 84 F.2d 316 (2d Cir. 1936).

[a]n administrative agency charged with seeing that the laws are enforced . . . has a power of inquisition . . . which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not.⁹⁴

Thus, it is vitally important that the Commission overcome any challenges to its prescriptive jurisdiction, in order that it may proceed apace with the unfettered exercise of its investigative mandate.

3.3. *Jurisdiction to Enforce Rules*

3.3.1. *Introduction*

The authority of a state to execute or enforce its rules of law is referred to as its enforcement jurisdiction.⁹⁵ States enjoy broad power to administer their laws, with the outer limits of that enforcement power, as defined by United States courts, circumscribed only by traditional principles of due process.⁹⁶ As will be discussed below, however, circumstances exist where a state possessed of the plenary power to enforce its rules of law nevertheless will exercise its discretion and refrain from doing so.⁹⁷

3.3.2. *Levels of Enforcement Jurisdiction Over Foreign Respondents*

Fundamental principles of due process, or "traditional notions of fair play and substantial justice,"⁹⁸ dictate that certain limitations circumscribe the ability of a state to impose the full weight of its prescrip-

⁹⁴ United States v. Morton Salt Co., 338 U.S. at 642-43.

⁹⁵ Section 20 of the *Restatement (Second)* provides that "[a] state has jurisdiction to enforce within its territory a rule of law validly prescribed by it." *RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES* § 20.

⁹⁶ See *infra* notes 98-105 and accompanying text.

⁹⁷ *RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES* §§ 39(1), 40. See *infra* notes 109-10 and accompanying text.

⁹⁸ *Asahi Metal Indus. v. Superior Ct.*, 107 S.Ct. 1026, 1033 (1987) (quoting *Miliken v. Meyer*, 311 U.S. 457, 463 (1940); *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945); see also *Shaffer v. Heitner*, 433 U.S. 186, 204 (1977); *Pennoyer v. Neff*, 95 U.S. 714, 733 (1877); *Federal Trade Comm'n v. Compagnie de Saint-Gobain-Pont-A-Mousson*, 636 F.2d 1300, 1319 (D.C. Cir. 1980).

For a discussion of the Supreme Court's decision in *Asahi Metal*, see Comment, *The Extraterritorial Application of State Long-Arm Statutes and The Impact on the International Commercial Community: A Comment and Suggested Approach* (to be published in volume 9, issue 4, *University Of Pennsylvania Journal of International Business Law*, fall 1987).

tive regulations upon persons beyond its territorial limits.⁹⁹ Thus, the reach of a state's enforcement jurisdiction over a foreign respondent will turn upon the nature and extent of the respondent's contacts with the forum state.

A state may exercise *general* enforcement jurisdiction over a foreign respondent whose contacts with the forum are "substantial," or "continuous and systematic."¹⁰⁰ Thus, as the court noted in *Wells Fargo & Co. v. Wells Fargo Express Co.*, "[i]f [a nonresident] corporation's activities in the forum are so 'continuous and systematic' that the corporation may in fact be said already to be 'present' there, it may . . . be served in causes of action unrelated to its forum activities."¹⁰¹

This standard vindicates the guarantee of due process, assuring that only those who have "purposefully avail[ed themselves] of the privilege of conducting activities in the forum, thereby invoking the benefits and protection of its laws"¹⁰² are held accountable to that state for the consequences of their activities therein.¹⁰³

A foreign party whose contacts with the forum state fall short of "substantial" or "continuous and systematic" conduct may nevertheless be subject to that state's *limited* enforcement jurisdiction; in those circumstances, a foreign party with lesser contacts with the forum will be amenable to actions arising out of its activities within the territorial limits of the forum.¹⁰⁴ American courts have construed expansively the reach of a state's limited enforcement jurisdiction, finding that even one business transaction that reaches into a state from beyond its borders is sufficient to invoke the forum state's limited enforcement jurisdiction.¹⁰⁵

⁹⁹ See *Shaffer v. Heitner*, 433 U.S. 186 (1977); *Fuentes v. Shevin*, 407 U.S. 67 (1972); *Int'l Shoe Co. v. Washington*, 326 U.S. 310 (1945); *Wells Fargo & Co. v. Wells Fargo Exp. Co.*, 556 F.2d 406 (9th Cir. 1977); *In re Marc Rich & Co. A.G.*, No. M-11-138, slip op. (S.D.N.Y. Dec. 13, 1983); *Zenith Radio v. Matsushita Elec. Indus.*, 402 F. Supp. 262 (E.D. Pa. 1975).

¹⁰⁰ See *Cannon Mfg. v. Cudahy Packing Co.*, 267 U.S. 333 (1925); *Data Disc, Inc. v. Systems Tech. Assoc.*, 557 F.2d 1280 (9th Cir. 1977); *Wells Fargo & Co. v. Wells Fargo Exp. Co.*, 556 F.2d at 406; *Gelfand v. Tanner Motor Tours*, 385 F.2d 116 (2d Cir. 1967); *United States v. Toyota Motor*, 561 F. Supp. 354 (D.C. Cal. 1983); *In re Grand Jury 81-2*, 550 F. Supp. 24 (W.D. Mich. 1982); *Crucible, Inc. v. Stora Kopparbergs Bergslags AB*, 403 F. Supp. 9 (W.D. Pa. 1975).

¹⁰¹ 556 F.2d at 413.

¹⁰² *Id.*

¹⁰³ See, e.g., *Data Disc, Inc. v. Systems Tech. Assoc.*, 557 F.2d at 1287 (citing with approval *Hanson v. Denckla*, 357 U.S. 235, 250-53 (1958)); *McGee v. Int'l Life Ins.*, 355 U.S. 220, 223 (1957).

¹⁰⁴ See, e.g., *McGee v. Int'l Life Ins.*, 355 U.S. 220 (1957); *Kramer Motors v. British Leyland, Ltd.*, 628 F.2d 1175 (9th Cir. 1980); *United States v. Toyota Motor*, 561 F. Supp. at 354; *Regie National des Usines Renault v. Superior Court*, 208 Cal. App. 2d 702, 25 Cal. Rptr. 530 (1962).

¹⁰⁵ See, e.g., *McGee v. Int'l Life Ins.*, 355 U.S. 220. The plaintiff in *McGee* had filed an action in California against a Texas insurance company seeking to collect on a

3.3.3. *Miscellaneous Issues Concerning Enforcement Jurisdiction*

In applying the general principles of enforcement jurisdiction discussed above, American courts sometimes emphasize certain factual distinctions to underscore the United States interests at stake.

3.3.3.1. *Citizenship*

In determining whether to assert enforcement jurisdiction over a party for an act committed outside the territorial limits of the United States, courts have found the citizenship of the respondent to be a dispositive factor.¹⁰⁶ With respect to an absent citizen, the United States courts have full authority to enforce domestic proscriptions.¹⁰⁷

3.3.3.2. *Location of Evidence*

Questions occasionally arise concerning the power of a United States court to order the production of evidence located outside the United States. In these cases, the appropriate inquiry is whether the person possessing control over the documents properly is within the court's authority, and not whether the evidence is stored or located beyond the United States border.¹⁰⁸ Thus, an individual in the United States properly can be compelled to produce documents that are found

life insurance policy issued to a California resident. The defendant company did not maintain an office, employ agents, or solicit business in California (other than the policy in question). The defendant also was not served process in California; instead, it received notice by registered mail at its Texas office. This form of service was permitted under the California insurance statute. After prevailing in California, plaintiff sought the assistance of the Texas court, where she filed suit on the judgment. The Texas court denied relief, holding that this form of service of process failed to give the California court jurisdiction over defendant. The Supreme Court, in ordering that plaintiff's judgment rendered by the California courts be given full faith and credit by the Texas courts, admonished that "[i]t is sufficient for purposes of due process that the suit was based on a contract which had substantial connection with that State." 355 U.S. at 223 (emphasis added); see also *Kramer Motors v. British Leyland, Ltd.*, 628 F.2d at 1178 ("even a single contact . . . may support personal jurisdiction over a defendant in an action arising out of that particular contact.").

¹⁰⁶ See, e.g., *Gillars v. United States*, 182 F.2d 962, 979 (D.C. Cir. 1950) ("[t]he Constitution does not forbid the application of the criminal laws of the United States to acts committed by its citizens abroad.").

¹⁰⁷ See, e.g., *Blackmer v. United States*, 284 U.S. 421, 436 (1932) (United States citizen living abroad is subject to punishment in the United States courts for disobedience to United States law through conduct abroad).

¹⁰⁸ See, e.g., *In re Marc Rich & Co., A.G.*, 707 F.2d at 667 (where the court stated, "the witness [may not] resist the production of documents on the grounds that the documents are located abroad The test for the production of documents is control, not location."); see also *In re Uranium Antitrust Litigation*, 480 F. Supp. 1138, 1144-45 (N.D. Ill. 1979).

outside the country's borders.¹⁰⁹

3.3.4. *Conflicts of Law Arising Out of the Exercise of Enforcement Jurisdiction*

Notwithstanding a demonstration that both prescriptive and enforcement jurisdiction properly exist, courts in some instances will undertake a third level of jurisdictional analysis before reaching the merits of a dispute. Where the exercise of properly invoked enforcement jurisdiction would compel a violation of a rule of law of another state, courts must decide whether, in the interest of comity among nations, to exercise their discretion and decline to adjudicate the controversy. It should be noted that such a decision is purely discretionary, inasmuch as conflicts of laws do not operate as an absolute bar to the exercise of enforcement jurisdiction.¹¹⁰

In the market transaction hypothetical, a conflict may arise between the foreign institution's obligation to respond to a SEC investigative subpoena, and its obligations under a nondisclosure law in its own jurisdiction. The remainder of this section will survey a representative sample of such foreign nondisclosure laws, and analyze the approach of United States courts to conflicts arising from such laws.

3.4. *Survey of Foreign Nondisclosure Laws*

Nondisclosure laws fall into two categories: secrecy and blocking provisions. Secrecy laws protect the right of private entities to maintain the confidentiality of information.¹¹¹ Bank secrecy laws, in particular,

¹⁰⁹ See, e.g., *Federal Maritime Comm'n v. DeSmedt*, 366 F.2d 464, 471 (2d Cir. 1966) ("[C]ongress has said plainly enough for all to understand [that] regulatory agencies, and the federal courts, can require a resident by subpoena to produce documents under his control *wherever they are located* . . .") (emphasis added); *SEC v. Minas de Artemisa, S.A.*, 150 F.2d 215, 217 (9th Cir. 1945); *Int'l Soc'y for Krishna Consciousness v. Lee*, 105 F.R.D. 435, 438 (S.D.N.Y. 1984).

¹¹⁰ See, e.g., *United States v. First Nat'l Bank of Chicago*, 699 F.2d 341 (7th Cir. 1983); *United States v. Bank of Nova Scotia*, 691 F.2d 1384 (11th Cir. 1982); *United States v. Field*, 532 F.2d 404 (5th Cir.), *cert. denied*, 429 U.S. 940 (1976); *United States v. First Nat'l City Bank*, 396 F.2d 897 (2d Cir. 1968); *Int'l Soc'y for Krishna Consciousness v. Lee*, 105 F.R.D. at 435; *In re Grand Jury 81-2*, 550 F. Supp. 24 (W.D. Mich. 1982); *In re Uranium Antitrust Litigation*, 480 F. Supp. at 108; *In re First Nat'l City Bank*, 285 F. Supp. 845 (S.D.N.Y. 1968).

The *Restatement (Second)* also recognizes this principle of jurisdiction, providing that, "[a] state having jurisdiction to prescribe or to enforce a rule of law is not precluded from exercising its jurisdiction solely because such exercise requires a person to engage in conduct subjecting him to liability under the law of another state having jurisdiction with respect to that conduct." *RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES* § 39(1).

¹¹¹ For instance, Article 147 of the Swiss Banking Law represents one such se-

prohibit the disclosure of account records and other information which would identify bank customers to a third party. Information subject to such laws generally cannot be produced without the consent of the private entity which possesses the privilege.

Blocking laws, by comparison, assert a national interest in the confidentiality of certain types of information. The precise scope of these blocking laws varies from country to country. Some of the statutes and regulations restrict information and documents that relate to particular industries,¹¹² or to economic competition in general;¹¹³ by contrast, other statutes apply more broadly to all kinds of commercial,¹¹⁴ or, in some cases, all types of information.¹¹⁵ Many statutes empower an executive official to issue orders prohibiting the production of certain information; these statutes are inoperative in the absence of such an order.¹¹⁶ Other statutes impose blanket restrictions which automatically apply unless a waiver is obtained.¹¹⁷

Foreign secrecy and blocking laws may create a significant impedi-

crecy law. For a discussion of this provision, see *infra* notes 139-49 and accompanying text. For a survey of foreign secrecy laws, see SENATE COMM. ON GOVERNMENTAL AFFAIRS, CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES, S. REP. NO. 130, 99th Cong., 1st Sess. app. 3, at 178 (1985) [hereinafter OFFSHORE BANKS REPORT].

¹¹² See, e.g., Canadian Uranium Information Security Regulations, CAN. CONS. REGS. ch. 366 (1970), amended by Can. Gaz. 3513 (Sept. 12, 1981); Royal Decree of Mar. 27, 1969, *Moniteur Belge* [M.B.], June 17, 1969, amended by, Royal Decree of Feb. 6, 1979, M.B., Mar. 6, 1979 (relating to disclosure of information concerning air and sea transport); Law of June 16, 1967, No. 3, *Norges Lov* [N.L.] 1726 (Nor.) (empowering the government to prohibit shipowners from providing information to foreign authorities); South African Atomic Energy Act of 1967, No. 90, §§ 30, 31.

¹¹³ See the Netherlands' Economic Competition Act of 1956, §. 39 (June 28, 1956), as amended (July 16, 1958).

¹¹⁴ See, e.g., Protection of Trading Interests Act, 1980, ch. 11 (United Kingdom); Business Records Protection Act, Ont. Stat. ch. 10 (1947), amended by ONT. REV. STAT. ch. 54 (1970) (Ontario); Business Concerns Records Act, Qué Stat. ch. 42 (1958), amended by QUE. REV. STAT. ch. D-12 (1977) (Quebec); Protection of Business Act, No. 99 (S. Afr. 1978), amended by Protection of Businesses Amendment Act, No. 114 (S. Afr. 1979); SCHWEIZERISCHES STRAFGESETZBUCH [STGB], act. 273; CODE PÉNAL SUISSE [Cp], act. 273; CODICE PENALE SVIZZERO [Cp], art. 273 (Switz.).

¹¹⁵ See Foreign Proceedings (Excess of Jurisdiction) Act, 1984 Austl. Acts No. 3; Law No. 80-538, 1980 *Journal Officiel de la République Française* [J.O.] 1799 (France); see also Herzog, *The 1980 French Law on Documents and Information*, 75 AM. J. INT'L L. 382 (1981). For a general review of blocking legislation, see Petit and Styles, *The International Response to Extraterritorial Application of United States Antitrust Laws*, 37 BUS. LAW. 697 (1982); Note, *Shortening the Long Arm of American Antitrust Jurisdiction: Extraterritoriality and the Foreign Blocking Statutes*, 28 LOY. L. REV. 213 (1982).

¹¹⁶ See, e.g., Protection of Trading Interests Act, 1980, ch. 11 (U.K.); Foreign Proceedings (Excess of Jurisdiction) Act, 1984 Austl. Acts, No. 3.

¹¹⁷ See, e.g., Law No. 538, 1980 J.O. 1799 (Fr.); Economic Competition Act, Law of June 28, 1956, 1958 *Staatsblad van het Koninkrijk der Nederlanden* [S.], No. 413, amended by Law of June 29, 1977, 1977 S., No. 403.

ment to the prosecution of an investigation or injunctive proceeding by the SEC, since the recipient of a request for information from the agency may face criminal and civil sanctions for noncompliance. The latitude granted to the recipient of a SEC request in a nondisclosure jurisdiction, however, depends upon several factors: (1) the content of the particular secrecy or blocking laws; (2) the likelihood of prosecution or civil liability for violating the law; and (3) the availability of other means for the production of evidence. Accordingly, we examine several such nondisclosure laws in greater detail below.

3.4.1. Secrecy Laws

As noted above, secrecy laws protect the right of private entities to maintain the confidentiality of information which has been entrusted to third parties. Secrecy laws find expression both in common law and in specific statutory provisions.

For example, in the United Kingdom, bank secrecy has important underpinnings in British common law and has been adopted by virtually all present or former British colonies.¹¹⁸ In a recent decision in the Queen's Bench Division, this common law duty of confidentiality was described as

arising from an implied term of the contract governing the relationship of banker and customer and as being that, subject to certain qualifications, which it may be material to consider, a banker shall not without the consent of the customer disclose to any other person any document or other information obtained by the banker in the course of that relationship.¹¹⁹

The common law duty of confidentiality, enforceable through private lawsuits brought by injured bank customers, has at times represented the sole source of bank secrecy laws in certain jurisdictions such as those of Hong Kong and Germany.¹²⁰

On the other hand, many common law nations have strengthened existing traditions of bank secrecy by enacting criminal statutes that punish unauthorized disclosures of customer information by the imposi-

¹¹⁸ OFFSHORE BANKS REPORT, *supra* note 112, at 30. The landmark British case in this regard is *Tournier v. Nat'l Provincial and Union Bank of England*, [1924] 1 K.B. 461.

¹¹⁹ *X AG v. A bank*, [1983] 2 All E.R. 464.

¹²⁰ *See, e.g., United States v. First Nat'l City Bank*, 396 F.2d 897, 903 (2d Cir. 1968) (German bank secrecy limited to common law privilege of customer); *Garpeg, Ltd. v. United States*, 583 F. Supp. 789, 796 (S.D.N.Y. 1984) (holding that no statute in Hong Kong expressly protects bank secrecy).

tion of fines and terms of imprisonment.¹²¹ The criminal statutes supplement, rather than supplant, private causes of action.¹²²

In addition, the sources of bank secrecy in civil law countries are found in statutory codifications. Separate code or statutory provisions in such countries may establish the rights to personal privacy, the confidentiality of the contractual relationship between banks and their customers, and the penal sanctions imposed on violators of banking secrecy.

Regardless of whether bank secrecy laws are common law or statutory in nature, they appear to serve primarily three separate but related goals. First, bank secrecy laws foster and preserve the confidential relationship between bankers and their customers. In this regard, it is significant that in comparison to the United States, where the general tendency is to view the banker-client relationship as an ordinary debtor-creditor relationship, many jurisdictions with nondisclosure laws perceive the banker as a logical repository of client confidences.¹²³

Second, bank secrecy laws may serve to protect the financial assets of bank customers against unwarranted governmental expropriation. During the Third Reich, the Nazis vigorously confiscated the assets of German Jews and other "enemies of the state," and adopted a law making it a crime, punishable by death, for an individual to hold assets in a foreign country.¹²⁴ In enacting Article 47 of the Banking Law of 1934,¹²⁵ which made punishable by fine or imprisonment the disclosure

¹²¹ See, e.g., The Banks and Trust Companies Regulation Act, No. 64 (Bahamas 1965), *as amended*, No. 3 (1980) (maximum fine of \$15,000 and two years' imprisonment); Confidential Relationships (Preservation) Law, No. 26 (Cayman Islands 1979) (authorizing fines and terms of imprisonment).

¹²² The Bahamian statute, for example, provides in relevant part that "[n]othing contained in this section shall . . . prejudice or derogate from the rights and duties subsisting at common law between a licensee and its customer." The Banks and Trust Companies Regulation Act, No. 64 (Bahamas 1965), *as amended*, Act No. 3 (1980) (Bahamas).

¹²³ See Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 NEW ENG. L. REV. 18, 21 (1978) ("[p]ossessing a deeper insight into the financial affairs of his customer than the government, or the client's family, the banker is considered a person of confidence and trust, much in the same way as a clergyman, physician, or lawyer.").

¹²⁴ Comment, *The Conflict Between United States Securities Laws on Insider Trading and Swiss Bank Secrecy Laws*, 7 NW. J. INT'L L. & BUS. 318, 329 (1985).

¹²⁵ The Federal Law Relating to Banks & Savings Banks of Nov. 8, 1934, *as amended* by Federal Law of Mar. 11, 1971, provides:

Anyone who in his capacity as an officer or employee of a bank, or as an auditor or his employee, or as a member of the banking commission or as an officer or employee to its bureau, intentionally violates his duty to observe silence or his professional rule of secrecy; or anyone who induces or attempts to induce a person to commit any such offense, shall be liable to a fine of up to SF 50,000 or imprisonment for up to six months, or both

of confidential information acquired in the course of providing banking services, the Swiss Parliament was attempting to discourage cooperation with Nazi agents seeking to learn the identity of holders of Swiss bank accounts. In more recent times, a significant number of Europeans and South Americans, fearing political upheavals in their home countries, have established accounts at banks in offshore jurisdictions that have bank secrecy laws.¹²⁶

Particularly in those nations without a long history of banking secrecy, a third purpose served by the adoption of secrecy provisions is the promotion of banking activity in the local jurisdiction. Within the last two decades, the banking and financial services sectors of many Caribbean states have grown dramatically, and it is not unreasonable to attribute a large portion of this increase to the enactment of bank secrecy laws.

Two years prior to the adoption of the Banks and Trust Companies Regulation Law of 1966, the Cayman Islands, for example, had only one or two banks and virtually no offshore business.¹²⁷ By 1983, over 425 banks were operating in the Caymans (a nation with a resident population of 17,000) and initial and annual licensing fees accounted for approximately 20 percent of the colony's budget.¹²⁸ The financial sector of the economy is also crucial to the growth of the Bahamas; between 1973 and 1981, employment in banks and trust companies increased 25 percent and average salaries increased 43 percent. In addition, the average salary for bank and trust company employees was \$13,296 in 1979, whereas per capita income in other sectors was \$4,650.¹²⁹

As a matter of policy, the United States recognizes that bank secrecy laws reflect a different perception of the banker-customer rela-

. . . if the offender acted with negligence, he shall be liable to a fine up to SF 30,000.

Art. 47(b), 1971 Sammlung der Eidgenössischen Gesetze [AS] 819 (Switz.) the "Banking Law of 1934").

¹²⁶ OFFSHORE BANKS REPORT, *supra* note 111, at 10. Of course, European and South American nations have legitimate concerns that offshore banks are being used by their respective citizens to evade the laws of their home countries, including regulations governing revenue collection and currency control.

¹²⁷ *Id.* at 30.

¹²⁸ *Id.* at 30-31.

¹²⁹ *Id.* at 59. A 1979 International Monetary Fund study, however, concluded that, aside from the major offshore banking centers such as the Bahamas, the Cayman Islands and Panama, the national budgets of few countries were significantly supplemented by offshore banking activity. The study, discussed in the OFFSHORE BANKS REPORT, *supra* note 111, at 148, emphasized that the banks offered limited employment opportunities and generated revenues only from licensing fees, since most offshore jurisdictions imposed no tax on deposits.

tionship than that which prevails in the United States, and may therefore serve otherwise valid purposes.¹³⁰ The United States is painfully aware, however, that bank secrecy laws have been used by citizens of the United States and other nations as a subterfuge to engage in violations of the federal tax and securities laws. As a congressional report noted in 1970,

[s]ecret foreign bank accounts and secret foreign financial institutions have permitted a proliferation of 'white collar' crime . . . [and] have allowed Americans and others to avoid the laws and regulations concerning securities and exchanges . . . The debilitating effects of the use of these secret institutions on Americans and the American economy are vast.¹³¹

Accordingly, while encouraging the growth of the professional sector in offshore jurisdictions, the United States does not believe that such expansion should be occasioned by activities violating laws of the United States.

With this background in mind, we turn to an examination of the bank secrecy laws of three representative jurisdictions: The Bahamas, the Cayman Islands, and Switzerland.

3.4.1.1. *The Bahamas*

Bank secrecy in the Bahamas is based both on common and statutory law. As a former British colony, the Bahamas subscribe to the common law duty of confidentiality owed by a banker to his customers, as expressed in the landmark *Tournier* opinion.¹³² Under the British common law tradition, the duty of secrecy is not absolute; it is subject to four qualifications or exceptions: "(a) where disclosure is under compulsion by law; (b) where there is a duty to the public to disclose; (c) where the interests of the bank require disclosure; and (d) where the disclosure is made by the express or implied consent of the customer."¹³³

¹³⁰ As Senator William B. Roth, Jr. (R-Del.) observed during congressional hearings on the criminal uses of offshore banks and companies, "[w]e disdain bank and corporate secrecy to the degree it is practiced elsewhere, whereas secrecy is exalted and protected in other countries — many of them our friends and allies," OFFSHORE BANKS REPORT, *supra* note 111, at 4.

¹³¹ H.R. REP. NO. 975, 91st Cong., 2d Sess. 12, reprinted in 1970 U.S. CODE CONG. & ADMIN. NEWS 4394, 4397.

¹³² See *Barclay's Bank Int'l v. McKinney*, No. 474 (Bahamas S. Ct.) (Feb. 16, 1979) ("[t]he general law of the Bahamas as to the circumstances in which a Bank is justified in disclosing a customer's account, is the same as the common law of England.").

¹³³ *Tournier v. Nat'l Provincial and Union Bank of England*, [1924] 1 K.B. 461,

While these qualifications could be interpreted as providing banks subject to a duty of secrecy with a justification for disclosure upon receipt of a SEC subpoena, they have nevertheless been narrowly construed by British courts and would likely receive a similar reading in the courts of the Bahamas.¹³⁴

Common law protections in the Bahamas were supplemented in 1965 by the adoption of the Banks and Trust Companies Regulation Act. Section 10(1) of the Act, amended in 1980, provides that, with limited exceptions, no employee or other agent of a licensed bank shall, without the customer's express or implied consent, "disclose to any person any . . . information relating to the identity, assets, liabilities, transactions [or] accounts of a customer." Disclosure is authorized, however, when it is required by a court of competent jurisdiction within the Bahamas, or by the provisions of any law thereof. Violations of the act are punishable by a maximum fine of \$15,000 and/or two years' imprisonment.

In addition, section 19(1) of the Banks and Trust Companies Regulation Act provides that,

[e]xcept for the purpose of the performance of his duties or the exercise of his functions under this Act or when lawfully required to do so by any court of competent jurisdiction within the Colony or under the provisions of any law, no person shall disclose any information relating to the affairs of a bank or of the customer of a bank which he has acquired in the performance of his duties or the exercise of his functions under this Act.¹³⁵

This section, however, has been construed by the Bahamian courts as applying exclusively to the bank's auditor and agents of the government who come into possession of information that relates to the affairs of a bank, rather than to the bank officers themselves.¹³⁶

3.4.1.2. *Cayman Islands*

As a British Crown colony, the Cayman Islands adhere to the

473.

¹³⁴ See, e.g., *X AG v. A bank*, [1983] 2 All E.R. 464, where the Queen's Bench determined that the limitations on bank secrecy set forth in *Tournier* did not authorize the London branch of an American bank served with a grand jury subpoena to disclose account documents in connection with an investigation of possible violations of the United States antitrust laws.

¹³⁵ Banks and Trust Companies Regulation Act ch. 96, (1965), *as amended*, Act No. 3 (1980) (Bahamas).

¹³⁶ See *Barclay's Bank Int'l v. McKinney*, No. 474.

common law principles of bank secrecy as set forth in the *Tournier* decision, but have also adopted legislation imposing criminal sanctions for disclosure of banking information. Section 10 of the Banking and Trust Law of 1966 made it a crime, punishable by a fine of £1,000 and/or a year's imprisonment, for any person to disclose information relating to the affairs of banks or trust companies and their customers. Disclosure was authorized in limited circumstances, including when required by a court of competent jurisdiction within the Cayman Islands.

In 1976, the Cayman legislature enacted the Confidential Relationships (Preservation) Law, which replaced the 1966 bank secrecy law with a sweeping blocking statute generally applicable to business information. The passage of the act was apparently motivated in large measure by the Fifth Circuit's decision in *United States v. Field*,¹³⁷ where the court refused to modify a grand jury subpoena requiring testimony from the managing director of a Cayman bank, notwithstanding objections on grounds of bank secrecy.

Section 3A of the statute, as amended in 1979, requires persons requested or subpoenaed to give evidence in a foreign proceeding to notify the Attorney General and to "apply for directions" from the Grand Court of the Cayman Islands. In determining the disposition of the foreign request, the court is directed to consider three factors: first, whether such order could operate as a denial of the rights of any person in the enforcement of a just claim; second, whether any offer of compensation or indemnity was made to any person desiring to enforce a claim by any person having an interest in the preservation of secrecy under the law; and third, the requirements of the interests of justice in any criminal case. The Attorney General may appear as *amicus curiae* at the hearing of any such application.

Except as provided in section 3A of the statute, any person who divulges confidential information or willfully obtains or attempts to obtain confidential information to which he is not entitled is subject to criminal fines and terms of imprisonment. The penalties prescribed are increased if the individual who violated the statute is a professional, or received a reward for committing the violation. Finally, section 5 of the act provides that the statute does not limit civil remedies otherwise available to bank customers for breaches of the common law duty of confidentiality expressed in *Tournier*.

3.4.1.3. *Switzerland*

Swiss bank officers, employees and agents are required to main-

tain the secrecy of information relating to customer accounts. The legal bases for Swiss banking secrecy are fourfold: first, the right to personal privacy granted by the Swiss Civil Code (SCC); second, the banker's implied contractual duty to maintain the confidentiality of client records; third, a provision of the 1934 Banking Law which specifically criminalizes violations of bank secrecy; and fourth, various sections of the Swiss Penal Code (SPC) which criminalize violations of business secrecy in general.¹³⁸

Under Swiss civil law, the breach of a banker's duty of confidentiality owed to a customer is deemed an invasion of the latter's personal privacy, and is subject to redress. Article 28 of the SCC¹³⁹ expressly authorizes individuals whose privacy has been invaded to sue for damages and injunctive relief; this provision is frequently deemed applicable to violations of banking secrecy.¹⁴⁰

Swiss contract law provides the second basis for banking secrecy. The confidentiality of the contractual relationship between bank and customer is governed by the Swiss Code of Obligations. The banker's duty of confidentiality survives the termination of the account relationship, and remains in effect as long as required to protect the former customer's interests.¹⁴¹ Unauthorized disclosure is an actionable breach of contract, provided that the customer establishes damages proximately resulting from the banker's indiscretion.¹⁴²

Article 47 of the Banking Law of 1934 augments civil remedies by prescribing criminal penalties for the disclosure of confidential information acquired in the course of providing banking services, as well as attempts to induce bank personnel to disclose such confidential information.¹⁴³ In either case, the maximum penalty is six months' imprisonment and/or a fine of SFr 50,000. The tasks of defining the precise contours of banking secrecy and of administering Article 47 are left primarily to the Swiss cantonal courts.

In addition to the foregoing, Article 162 of the SPC provides that disclosure of a manufacturing or business secret which an individual has a legal or contractual obligation to safeguard is punishable by fine

¹³⁸ See generally, Frei, *Swiss Secrecy Laws and Obtaining Evidence from Switzerland* (paper prepared for American Bar Association program on "Transnational Litigation: Practical Approaches to Conflicts and Accommodations") (March 8-9, 1984).

¹³⁹ SCHWEIZERISCHES ZIVILGESETZBUCH [ZGB], art. 28, CODE CIVIL SUISSE [Cc], CODICE CIVILE SVIZZERO [Cc], art. 28.

¹⁴⁰ See Frei, *supra* note 138, at 5.

¹⁴¹ Comment, *supra* note 124, at 326-27.

¹⁴² SCHWEIZERISCHES OBLIGATIONENRECHT [OR], arts. 42-44, 99; CODE DES OBLIGATIONS [Co], arts. 42-44, 99; CODICE DELLE OBLIGAZIONI [Co], arts. 42-44, 99.

¹⁴³ For a translation of relevant portions of Article 47, see *supra* note 125.

or imprisonment. Article 273 of the SPC further applies to the disclosure of banking information to foreign courts or authorities.

Under Article 273, a Swiss entity required by foreign process to provide confidential information must obtain the permission of the interested third party prior to disclosure. If authorization is not forthcoming, or if other Swiss interests are at stake, the entity is prohibited from disclosing the requested information. Swiss authorities have no discretion under the article to override this requirement, although resort may otherwise be made to bilateral or international agreements that relate to the exchange of information.¹⁴⁴

While this array of nondisclosure laws suggests that Swiss bank secrecy is impenetrable, recent highly publicized events demonstrate that limitations on the doctrine exist.¹⁴⁵ In the first instance, the right to financial privacy may be waived if the client authorizes the bank to release information to the Swiss government or to a third party. Bank secrecy may also be overcome to collect debts or to conduct bankruptcy proceedings.¹⁴⁶ Third, Swiss federal and cantonal law obligates bankers to provide testimony and documentary evidence in connection with Swiss criminal and certain civil proceedings.¹⁴⁷ Finally, international and bilateral agreements for the production of evidence, to which Switzerland is a party, may override considerations of bank secrecy in particular instances.¹⁴⁸

3.4.2. Blocking Laws

In comparison with bank secrecy laws, which often reflect longstanding policies rooted in civil and common law, blocking statutes are more recent in origin. The vast majority of such statutes were adopted within the past three decades in direct response to alleged or actual extraterritorial application of the substantive laws and discovery proce-

¹⁴⁴ Frei, *supra* note 138, at 9.

¹⁴⁵ See, e.g., *\$2.1 Million Penalty in Insider Case*, N.Y. Times, Aug. 8, 1986, at D1, col. 3 (Swiss authorities providing United States authorities with name of individual purchasing RCA stock through Geneva office of the Union Bank of Switzerland); *The Swiss Stop Keeping Secrets*, N.Y. Times, June 1, 1986, § 3, at 4, col. 3 (Switzerland voluntarily freezing assets controlled by Ferdinand Marcos).

¹⁴⁶ See Federal Law Concerning the Execution of Debts and Bankruptcy, Systematische Sammlung des Bundesrechts [SR], 281.1, arts. 222, 224, 228; Recueil systematique du droit fédéral [RS], 281.1, arts. 222, 224, 228; Raccolta sistematica del diritto federale [RS], 281.1, arts. 222, 224, 228 (1889).

¹⁴⁷ Article 47(4) of the Banking Law of 1934 provides that “[f]ederal and cantonal regulations concerning the obligation to testify and furnish information to a government authority shall remain reserved.” Art. 47(4), 1971 AS 819.

¹⁴⁸ For a discussion of these agreements, see *infra* notes 229-68 and accompanying text.

dures of the United States.¹⁴⁹

Two principal types of blocking statutes have emerged. The first group includes laws which were enacted to foreclose entirely discovery that related to certain areas which were the focus of litigation or investigation in the United States at the time the statutes were promulgated. West Germany¹⁵⁰ and the United Kingdom¹⁵¹ passed such legislation in response to a 1960 United States grand jury investigation of the shipping industry. Private commercial litigation in the 1970s that was related to the activities of an alleged international uranium cartel precipitated the enactment of similar statutes in Australia,¹⁵² Canada,¹⁵³ and South Africa.¹⁵⁴

The second group of blocking statutes, exemplified by legislation adopted in 1980 by France¹⁵⁵ and the United Kingdom,¹⁵⁶ operates with a broader brush. Such statutes generally require foreign parties seeking discovery to comply with the home forum's procedural mechanisms, or with international treaties to which the enacting jurisdiction is a signatory. In turn, the home forum's procedures and treaties as ratified place severe restrictions on the information to be made available.

In general, blocking laws are intended to serve two purposes. First, they assert a national interest in maintaining the confidentiality of certain types of information against disclosure to foreign persons or entities. Second, they reflect the foreign jurisdictions' antipathy toward American pre-trial discovery rules, which are far more liberal than their foreign counterparts. Many common law and civil law jurisdictions condemn such pre-trial investigations as "fishing expeditions." Other jurisdictions may also consider American production orders to be an invasion of their sovereignty, or an attempt to gain economic advantage for American firms.¹⁵⁷

With this background in mind, we provide an overview of signifi-

¹⁴⁹ See generally Note, *Compelling Production of Documents in Violation of Federal Law: An Examination and Re-evaluation of the American Position*, 50 *FORDHAM L. REV.* 877 (1982).

¹⁵⁰ *Bundesgesetzblatt*, Teil 2 [BGB2] 835 (W. Ger.).

¹⁵¹ Protection of Trading Interests Act, 1980, ch. 11.

¹⁵² Foreign Proceedings (Prohibition of Certain Evidence) Act, 1976 Austl. Acts No. 1125, *repealed* by Foreign Proceedings (Excess of Jurisdiction) Act, 1984 Austl. Acts No. 3.

¹⁵³ Uranium Information Security Regulations, CAN. CONS. REGS. ch. 366 (1970), *amended* by Can. Gaz. 3513 (Sept. 12, 1981).

¹⁵⁴ Atomic Energy Act, 1967, No. 90, § 30A, *amended* by Atomic Energy Amendment Act, 1978, No. 46 (S. Africa).

¹⁵⁵ Law No. 80-538, 1980 J.O. 1799 (Fr.).

¹⁵⁶ Protection of Trading Interests Act, 1980, ch. 11 (U.K.).

¹⁵⁷ OFFSHORE BANKS REPORT, *supra* note 111, at 44-45.

cant blocking statutes enacted in Canada, France, and the United Kingdom.

3.4.2.1. *Canada*

The Foreign Extraterritorial Measures Act¹⁵⁸ authorizes the Attorney General of Canada to prohibit the disclosure of information from Canada, the seizure of records, and requires individuals within Canada to provide notice of a production order which has been issued by a foreign court, and prohibits compliance by such persons with such orders.¹⁵⁹ Section 5(1) of the Act requires the Attorney General to determine, prior to taking such measures, that:

a foreign state or foreign tribunal has taken or is proposing or is likely to take measures affecting international trade or commerce of a kind or in a manner that has adversely affected or is likely to adversely affect significant Canadian interests in relation to international trade or commerce involving business carried on in whole or in part in Canada, or that otherwise has infringed or is likely to infringe Canadian sovereignty

The Act further prescribes criminal sanctions for failure to comply with the statute's requirements. The SEC, however, has received assurances from the Ontario Securities Commission (OSC) that the blocking statute is unlikely to be invoked to prohibit the exchange of information between the OSC and the Commission.¹⁶⁰

3.4.2.2. *France*

In 1968, France enacted a blocking statute which limited the transmission of information concerning the shipping industry. It was later decided to extend that measure to include information relating to air transport; during deliberations in the French Senate, the scope of the statutory prohibitions was expanded considerably.

In its current form, the French blocking statute contains four sections. Article 1 declares it unlawful, subject to international agreements, for a French national to disclose to foreign authorities any business information which might impair France's sovereignty, security, or "essen-

¹⁵⁸ 1984-85 Can. Stat. ch. 49.

¹⁵⁹ *Id.* §§ 3-8.

¹⁶⁰ See Mann & Sullivan, *Current Issues in International Securities Law Enforcement: An Update* 469 (paper prepared for Practising Law Institute's Securities Enforcement Institute) (June 19-20, 1986).

tial" economic interests. Article 1*bis* of the act provides that it is unlawful for any person to seek business information from French sources for use in foreign judicial or administrative proceedings, except as provided for by international agreement or other French law.

Articles 1 and 1*bis* of the act create broad and automatic barriers to pre-trial discovery requests and administrative subpoenas emanating from the United States. The qualifications to the scope of the articles do not create significant windows of opportunity for American litigants and agencies, since France has neither subscribed to international agreements, nor enacted laws on its own initiative, which create mechanisms for obtaining evidence during the pre-trial stage. Most significantly, in ratifying the Convention on the Taking of Evidence Abroad in Civil or Commercial Matters,¹⁶¹ France made an election authorized by section 23 of the treaty not to be bound by other provisions of the treaty that govern cooperation on pre-trial discovery matters.

The remaining sections of the statute are less significant. Article 2 requires any person within the scope of Articles 1 and 1*bis* to notify the relevant French ministers of any request for information. Finally, Article 3 establishes criminal sanctions applicable to a violation of the statute: a maximum of six months' imprisonment and/or fine of FFf 120,000 is authorized. The legislative history of the act, however, indicates that Article 3 was never intended to operate against French nationals. Rather, the provision was expressly included to provide French entities with a basis for justifying noncompliance with American discovery orders when they were threatened with sanctions in United States courts.¹⁶²

3.4.2.3. *United Kingdom*

The Protection of Trading Interest Act was enacted several months before the French blocking statute. In comparison with the French statute, the British act is broader in its scope but less automatic in its operation.

The preamble to the British statute indicates that the Act was designed "to provide protection from requirements, prohibitions and judgments imposed or given under the laws of countries outside the United Kingdom and affecting the trading or other interests of persons in the United Kingdom." Section 2 of the statute authorizes the Secre-

¹⁶¹ March 18, 1970, United States-France, 23 U.S.T. 2555, T.I.A.S. No. 7444.

¹⁶² For a general review of the legislative history of the French blocking statute, see Batista, *Confronting Foreign "Blocking" Legislation: A Guide to Securing Disclosure from Non-Resident Parties to American Litigation*, 17 INT'L LAW. 61, 65-67 (1980).

tary of State to prohibit persons or corporations in the United Kingdom from furnishing commercial information or producing commercial documents for use in a foreign country. The Secretary of State has broad discretion to prohibit compliance with foreign compulsion under the Act; section 2(3), however, specifically provides that the Secretary of State may deem a foreign demand for documents objectionable

- (a) if it is made otherwise than for purposes of civil or criminal proceedings which have been instituted in a foreign country; or
- (b) if it requires a person to state what documents relevant to any such proceedings are or have been in his possession, custody or power or to produce for the purposes of any such proceedings any documents other than particular documents specified in the requirement.

Violations of directions of the Secretary of State pursuant to section 2 are punishable by fine.

By its terms, the statute would authorize the Secretary of State to prohibit compliance with a SEC investigative subpoena or pre-trial discovery in civil litigation. The Secretary of State's willingness to exercise his powers under the Act was demonstrated in the *Laker Airways* litigation, where an order was issued restraining British Airlines from complying with any requirements imposed by a United States district court in connection with a pending antitrust suit.¹⁶³

3.5. *Judicial Analysis of Cases Involving Foreign Nondisclosure Laws*

3.5.1. *Introduction*

Our previous analysis of jurisdictional bases concluded that, under the facts of the market transaction hypothetical, a United States court will almost certainly determine that prescriptive jurisdiction exists over the conduct in question. Accordingly, a conflict is likely to arise between the court's exercise of enforcement jurisdiction and the application of foreign secrecy or blocking laws. This section examines the efforts of United States courts to address such conflicts in the absence of bilateral or multinational agreements for the exchange of information.¹⁶⁴

¹⁶³ For a review of the history of the litigation both in the United Kingdom and the United States, see *Laker Airways v. Sabena, Belgian World Airlines*, 731 F.2d 909 (D.C. Cir. 1984).

¹⁶⁴ For an examination of existing bilateral and international agreements for the
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Conflicts between foreign nondisclosure laws and United States investigative subpoenas and pre-trial discovery are presented in a variety of contexts. Most frequently, the issue arises in cases involving alleged antitrust violations,¹⁶⁵ commercial litigation,¹⁶⁶ the enforcement of Internal Revenue Service (IRS) summonses,¹⁶⁷ and SEC subpoenas.¹⁶⁸

The manner in which United States' courts confront such conflicts has been the subject of an enormous amount of academic research,¹⁶⁹ professional concern among the members of American legal organizations¹⁷⁰ and intense judicial scrutiny.¹⁷¹ Notwithstanding the foregoing, the approach taken by the courts to address conflict between American discovery and foreign nondisclosure laws is far from uniform. In part, the lack of uniformity stems from the fact that the only Supreme Court case that squarely confronts such a dilemma, *Societe Internationale v. Rogers*,¹⁷² was decided over twenty-five years ago and before the advent of many blocking and secrecy statutes. Moreover, the Court in *Societe Internationale* narrowly confined its holding to the facts of the particular case, thus failing to provide clear guidance for future decisions.

exchange of information, see *infra* notes 229-68 and accompanying text.

¹⁶⁵ See, e.g., *Laker Airways v. Sabena, Belgian World Airlines*, 731 F.2d 909 (D.C. Cir. 1984); *United States v. First Nat'l City Bank*, 396 F.2d 897 (2d Cir. 1968); *In re Uranium Antitrust Litigation*, 480 F. Supp. 1138 (N.D. Ill. 1979).

¹⁶⁶ See, e.g., *In re Westinghouse Elec. Corp. Uranium Contracts Litigation*, 563 F.2d 992 (10th Cir. 1977); *Ings v. Ferguson*, 282 F.2d 149 (2d Cir. 1960); *Compagnie Francaise D'Assurance v. Phillips Petroleum Co.*, 105 F.R.D. 16 (S.D.N.Y. 1984); *Graco v. Kremlin, Inc.*, 101 F.R.D. 503 (N.D. Ill. 1984).

¹⁶⁷ See, e.g., *United States v. Vetco, Inc.*, 644 F.2d 1324 (9th Cir. 1981); *In re Grand Jury Proceedings, United States v. Field*, 532 F.2d 404 (5th Cir.), *cert. denied*, 429 U.S. 940 (1976); *First Nat'l City Bank v. Commissioner*, 271 F.2d 616 (2d Cir. 1959), *cert. denied*, 361 U.S. 948 (1960); *Garpeg, Ltd. v. United States*, 538 F. Supp. 789 (S.D.N.Y. 1984).

¹⁶⁸ See, e.g., *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981); *SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of, Santa Fe Int'l Corp.*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,424 (S.D.N.Y. Nov 13, 1981).

¹⁶⁹ McKay, *Compelling Discovery and Disclosure in Transnational Litigation: Selected Bibliography*, 16 N.Y.U. J. INT'L L. & POL'Y 1217 (1984) (containing a compilation of the large body of scholarship in the area).

¹⁷⁰ For the past several years, the American Law Institute (ALI) has been preparing a proposed revision of the *Restatement (Second)*. As approved on May 14, 1986 by the ALI, the revision includes a section specifically applicable to the resolution of conflicts between United States discovery requests abroad and foreign nondisclosure laws, a topic addressed only indirectly by section 40 of the current *Restatement (Second)*. See RESTATEMENT (REVISED) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 437 (Tent. Draft No. 7, Apr. 10, 1986).

¹⁷¹ See, e.g., *Laker Airways v. Sabena, Belgian World Airlines*, 731 F.2d 909 (D.C. Cir. 1984) (51-page opinion devoted to addressing issues raised by the conflict between discovery and antitrust laws of the United Kingdom and the United States, respectively).

¹⁷² 357 U.S. 197 (1958).

Two distinct but related questions arise in the context of cases involving foreign nondisclosure laws. First, should the court issue an order pursuant to Rule 37 of the Federal Rules of Civil Procedure (FRCP) to compel discovery, notwithstanding the existence of a foreign nondisclosure law creating potential civil or criminal sanctions in the event of compliance? Second, if the court has issued an order compelling compliance pursuant to FRCP 37, should the court further impose sanctions on the person or corporation so ordered in the event of continued noncompliance? The three approaches adopted by the courts to resolve these questions — the “comity” approach, the “balancing test” approach and the “good faith” approach — are examined in more detail later in this section.

It is difficult to predict with any degree of certainty whether the United States courts would ultimately compel compliance with a SEC subpoena issued to the foreign bank during the course of its investigation of trading in the securities of Company X, or enforce such an order through sanctions. The results reached in the majority of recent cases suggest that a United States court might well answer these questions in the affirmative, inasmuch as the judiciary has displayed sympathy to the efforts of the government to protect the nation’s securities markets against fraud, whether directed from within or outside the nation’s borders.¹⁷³ These recent cases, however, have been decided in the lower federal courts, rather than by the Supreme Court; as a result, the law remains unsettled.

3.5.2. *Modes of Judicial Analysis*

In the introduction to this section, the three modes of analysis commonly employed by courts in cases involving conflicts with foreign nondisclosure laws were mentioned briefly. These approaches are now examined in greater detail, with an eye toward their application to the market transaction hypothetical.

3.5.2.1. *Comity*

In three cases arising in the Court of Appeals for the Second Circuit between 1959 and 1962, the court stated that production should not be compelled if it would violate applicable foreign law.¹⁷⁴ In each

¹⁷³ Conversely, the cases also suggest that the judiciary is less disposed to exercise its enforcement discretion on behalf of private litigants. *See, e.g., In re Westinghouse Elec. Corp. Uranium Contracts Litigation*, 563 F.2d 992 (10th Cir. 1977).

¹⁷⁴ *In re Chase Manhattan Bank*, 297 F.2d 611 (2d Cir. 1962); *Ings v. Ferguson*, 282 F.2d 149 (2d Cir. 1960); *First Nat’l City Bank v. Commissioner*, 271 F.2d 616 (2d

case, the court emphasized that, under principles of international comity, it would not order such action if it would cause a violation of the laws of a friendly neighbor.¹⁷⁵ Additionally, emphasis was placed on the use of diplomatic channels to obtain evidence.¹⁷⁶

The court's decision in *Ings v. Ferguson*¹⁷⁷ is illustrative of the international comity approach. In *Ings*, the trustee of an American company in reorganization sought documents relevant to a pending shareholder's derivative suit from the Canadian branches of two Canadian banks. The banks objected to production on the grounds that disclosure of the documents would violate a Quebec statute; the trustee countered with an affidavit to the opposite effect from Canadian counsel.¹⁷⁸

Rather than attempting to interpret the Quebec statute, the court suggested that the trustee first seek to secure the production of documents through the issuance of letters rogatory to the provincial court. If the Canadian court failed to honor the request, however, the court opined that the motion to quash the outstanding subpoena should be granted "because the exception of illegality under foreign law would have been met."¹⁷⁹

Assuming that the foreign jurisdiction in our hypothetical had adopted nondisclosure laws, how would the international comity approach embodied in *Ings* and the other Second Circuit decisions apply? In the first instance, it is likely that the court would require resort to existing procedures for the production of evidence and agreements between the foreign country and the United States. If such agreements did not exist, or did not provide for the discovery of evidence sought by the SEC during a preliminary investigation, the court would probably decline to enforce a SEC subpoena.

It is not clear, however, that a federal court would reach such conclusions today. While the federal courts continue to recognize that the legitimate interests of sovereign foreign states can and do differ from those of the United States, they do not automatically defer to the former on grounds of "comity." Two factors favoring the abandonment of the international comity standard can be readily identified. First, the approach fails to give recognition to any interest of the United States

Cir. 1959), *cert. denied*, 361 U.S. 948 (1960).

¹⁷⁵ See *In re Chase Manhattan Bank*, 297 F.2d at 613; *Ings v. Ferguson*, 282 F.2d at 152-53; *First Nat'l City Bank v. Commissioner*, 271 F.2d at 619.

¹⁷⁶ See *In re Chase Manhattan Bank*, 297 F.2d at 613; *Ings v. Ferguson*, 282 F.2d at 152-53.

¹⁷⁷ 282 F.2d 149 (2d Cir. 1960).

¹⁷⁸ *Id.* at 151.

¹⁷⁹ *Id.* at 153.

other than that of the maintenance of good relations with its neighbors. Second, the standard gives other jurisdictions an incentive to promulgate nondisclosure laws in order to ensure that the United States will defer to their legislative judgments.

The Court of Appeals for the Second Circuit essentially overruled the comity standard in 1968 by adopting the “balancing” approach first set forth in 1965 by the *Restatement (Second)* in determining whether to impose sanctions for failure to comply with production orders.¹⁸⁰ From the late 1960s to the present, these balancing factors, analyzed in greater detail below, became the primary judicial means by which to weigh the competing interests involved in both the order and sanctions stages of non-production cases.¹⁸¹

3.5.2.2. *Balancing of Interests*

Section 39 of the *Restatement (Second)* provides that the possession of jurisdiction by one state to prescribe or enforce a rule of law does not preclude another state also possessing jurisdiction from prescribing or enforcing a contrary rule. Section 40 of the *Restatement (Second)*, however, requires each state to consider moderating the exercise of its enforcement jurisdiction in light of five factors: first, the vital national interests of each of the states; second, the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person; third, the extent to which the required conduct is to take place in the territory of the other state; fourth, the nationality of the person; and fifth, the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

In deciding whether to issue production orders and to enforce such orders through sanctions, the courts have frequently endorsed the balancing approach set forth in section 40 of the *Restatement (Second)*.¹⁸² The courts have not accorded equal importance to each of the five criteria set forth in section 40, but instead have emphasized the first two factors.¹⁸³

¹⁸⁰ See *United States v. First Nat'l City Bank*, 396 F.2d 897 (2d Cir. 1968).

¹⁸¹ Note, *Strict Enforcement of Extraterritorial Discovery*, 38 STAN. L. REV. 841, 854 (1986).

¹⁸² See, e.g., *United States v. Bank of Nova Scotia*, 691 F.2d 1384 (11th Cir. 1982); *United States v. Vetco, Inc.*, 644 F.2d 1324 (9th Cir. 1981); *United States v. Field*, 532 F.2d 404 (5th Cir.), cert. denied, 429 U.S. 940 (1976); *United States v. First Nat'l City Bank*, 396 F.2d 897 (2d Cir. 1968); *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981).

¹⁸³ See, e.g., *Garpeg, Ltd. v. United States*, 583 F. Supp. 789, 795 (S.D.N.Y. 1984) (where the court stated that “[t]he first two factors are of critical importance,

In addition, the courts have weighed certain factors *not* set forth in section 40 in determining the appropriate exercise of their enforcement jurisdiction. For example, the district court in *In re Uranium Antitrust Litigation*¹⁸⁴ emphasized the importance of the American policies underlying the case of the party seeking discovery, the importance to the case of the documents at issue and the degree of flexibility in the foreign nation's execution of its nondisclosure law.¹⁸⁵

In determining whether to compel production or to impose sanctions for noncompliance, the courts have also examined the status of the respondent. Notwithstanding contrary obligations imposed by nondisclosure laws, the courts are far more disposed to impose such obligations and penalties on the targets of United States investigations and defendants in private litigation than on the neutral third-party repositories of the information sought.¹⁸⁶

Section 40 of the *Restatement (Second)* was intended as a general conflicts provision, and does not specifically address the conflict between American discovery requests and foreign nondisclosure laws. This approach may account for the divergence between the factors set forth in section 40 and the criteria actually applied by the courts under a balancing approach. In an effort to provide specific guidance, the *Restatement (Revised) of the Foreign Relations Law of the United States* adds a completely new section addressing the problem of conflicting discovery and nondisclosure laws.¹⁸⁷ The new section has received a hostile reception from the SEC¹⁸⁸ and certain commentators.¹⁸⁹

Section 437 of the *Restatement (Revised)* distinguishes between the factors to be considered prior to the issuance of a production order and those governing the imposition of sanctions. With regard to the former, the *Restatement (Revised)* requires the balancing of five factors: first,

[and] the last three appear to be less important.”)

¹⁸⁴ 480 F. Supp. 1138 (N.D. Ill. 1979).

¹⁸⁵ *Id.* at 1148. See also *United States v. Field*, 532 F.2d 404, 408 (5th Cir.), *cert. denied*, 429 U.S. 940 (1976) (where the court, in ordering compliance with a production order notwithstanding the Cayman Islands bank secrecy law, noted that under the law of that jurisdiction, Cayman government officials would be able to obtain information concerning the bank's operations during the course of investigations authorized under Cayman Islands law); see also *supra* note 137 and accompanying text.

¹⁸⁶ See *United States v. First Nat'l Bank of Chicago*, 699 F.2d 341, 346 (7th Cir. 1983); *Ings v. Ferguson*, 282 F.2d 149, 152 (2d Cir. 1960); *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 114 (S.D.N.Y. 1981).

¹⁸⁷ See *supra* note 170 and accompanying text.

¹⁸⁸ See Goelzer, Stillman, Walter, Sullivan & Michael, *The Draft Revised Restatement: A Critique from a Securities Regulation Perspective*, 19 INT'L LAW. 431 (1985).

¹⁸⁹ See, e.g., Note, *supra* note 181, at 861 (terming the *Restatement (Revised)* “poorly drafted” and retaining “fundamental flaws which require revision”).

the importance to the investigation or litigation of the documents or other information requested; second, the degree of specificity of the request; third, whether the information originated in the United States; fourth, the extent to which compliance with the request would undermine important interests of the state where the information is located; and fifth, the possibility of alternative means of securing the information.¹⁹⁰ Section 437 does not indicate the weight to be assigned to each of these factors; as a result, the courts would retain flexibility to emphasize the importance of the United States' interest in obtaining information necessary to investigate alleged violations of the federal securities laws.¹⁹¹

With respect to the imposition of sanctions, however, the *Restatement (Revised)* suggests that courts not impose the sanctions of contempt, dismissal, or default on a non-complying party or witness subject to a nondisclosure law unless the latter either failed to make a good faith effort to secure permission from foreign authorities to make the information available or deliberately concealed the information in a nondisclosure jurisdiction.¹⁹² This test is broadly consistent with the Supreme Court's holding in *Societe Internationale*.¹⁹³ Compared with section 40 of the *Restatement (Second)*, however, relatively few cases have examined the *Restatement (Revised)* in any detail.

Accordingly, the cases which have focused on the first two factors of section 40 of the *Restatement (Second)* provide the most guidance to date as to the balancing test a court would likely apply to our hypothetical. We examine these factors in turn.

3.5.2.2.1. *Vital National Interests*

The first factor which section 40 sets forth to assist in determining whether to modify or decline the exercise of enforcement jurisdiction is the vital national interests of each of the states. In the context of conflicts between foreign nondisclosure laws and discovery in cases involving alleged violations of the federal antitrust, tax, and securities laws, the courts of the United States have more often than not concluded that the interests of the United States outweigh those of the foreign

¹⁹⁰ RESTATEMENT (REVISED) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 437(1)(c) (Tent. Draft No. 7, Apr. 10, 1986).

¹⁹¹ Section 437 would, however, depart from the Federal Rules of Civil Procedure by generally prohibiting foreign discovery without pre-issuance review by the court.

¹⁹² RESTATEMENT (REVISED) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 437(2)(a)-(b).

¹⁹³ *Societe Internationale v. Brownell*, 243 F.2d 254 (D.C. Cir. 1957), *rev'd sub nom.* *Societe Internationale v. Rogers*, 357 U.S. 197 (1958).

jurisdiction.¹⁹⁴

In general, the courts have concluded that cases arising under the antitrust,¹⁹⁵ revenue,¹⁹⁶ and securities¹⁹⁷ laws implicate vital national interests of the United States. Furthermore, the federal courts have also recognized that the United States has a general interest in affording litigants in American courts effective discovery.¹⁹⁸

By comparison, even when purporting to balance the respective national interests, the federal courts rarely engage in an extended analysis of the interests that lie behind foreign nondisclosure laws. Certain trends in analysis, however, can be discerned. With respect to bank secrecy laws, the courts have suggested that statutory nondisclosure laws reflect a stronger governmental interest in secrecy than do common law principles alone.¹⁹⁹ Courts have also suggested that bank secrecy provisions which cannot be waived by the customer reflect weightier concerns than privileges that belong solely to the client.²⁰⁰

With respect to foreign blocking statutes, some courts have recognized that such statutes reflect a strong governmental interest in protecting domestic financial or business information against disclosure to foreign parties or authorities.²⁰¹ Few American courts have held, however, that such interests outweigh the interests of the United States government in cases arising under the federal antitrust, tax, or securities laws. In *United States v. First National Bank of Chicago*,²⁰² however,

¹⁹⁴ See *infra* notes 195-97 and accompanying text. Not surprisingly, foreign tribunals adjudicating similar conflicts have reached opposite conclusions after weighing the respective interests. See, e.g., X AG v. A bank, [1983] 2 All E.R. 464 (holding that British interest in preserving bank secrecy outweighed speculative benefits of discovery to United States grand jury).

¹⁹⁵ See, e.g., *United States v. First Nat'l City Bank*, 396 F.2d 897, 903 (2d Cir. 1968) (antitrust laws "have long been considered cornerstones of this nation's economic policies.").

¹⁹⁶ See, e.g., *Garpeg Ltd. v. United States*, 583 F. Supp. 789, 796 (S.D.N.Y. 1984) (stating "[t]he vital interest of the United States . . . in enforcement of its tax laws is unquestionable").

¹⁹⁷ See, e.g., *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 117 (S.D.N.Y. 1981) (noting "[t]he strength of the United States interest in enforcing its securities laws to ensure the integrity of its financial markets cannot seriously be doubted").

¹⁹⁸ See, e.g., *Graco v. Kremlin, Inc.*, 101 F.R.D. 503, 513 (N.D. Ill. 1984) (Pre-trial discovery is an "important part of the system of [the] private enforcement" of public laws.).

¹⁹⁹ See, e.g., *United States v. First Nat'l City Bank*, 396 F.2d at 901; *Garpeg, Ltd. v. United States*, 583 F. Supp. at 796.

²⁰⁰ *United States v. First Nat'l Bank of Chicago*, 699 F.2d 341, 346 (7th Cir. 1983).

²⁰¹ See, e.g., *In re Westinghouse Elec. Corp. Uranium Contracts Litigation*, 563 F.2d 992, 998 (10th Cir. 1977).

²⁰² 699 F.2d 341 (7th Cir. 1983).

the court refused to impose sanctions for noncompliance where the government had failed to demonstrate the importance to the IRS of documents held by a Greek bank.

In a number of recent cases, federal courts have disclaimed the desire or competence to balance directly competing national interests.²⁰³ As the court stated in *In re Uranium Antitrust Litigation*,

Aside from the fact that the judiciary has little expertise, or perhaps even authority, to evaluate the economic and social policies of a foreign country, such a balancing test is inherently unworkable in this case. The competing interests here display an irreconcilable conflict on precisely the same plane of national policy.²⁰⁴

Rather than deferring to the foreign nondisclosure laws, however, the courts in each of these cases have attempted to effectuate the interests of the United States.

3.5.2.2.2. *Extent of Hardship*

The other factor set forth in section 40 which courts have emphasized in cases involving conflicts with foreign nondisclosure laws is the extent and nature of the hardship that inconsistent enforcement actions would impose upon the person subject to conflicting obligations. In this regard, the fact that disclosure may subject a party or witness subject to a subpoena to civil or criminal sanctions generally has not deterred United States courts from issuing production orders or from imposing sanctions.²⁰⁵

This attitude on the part of American courts stems from the perception that certain states such as France never intended to enforce their nondisclosure laws against their own nationals. Instead, the courts have assumed that such laws were enacted to provide foreign parties with an excuse in American courts for noncompliance with production orders.²⁰⁶ Accordingly, federal courts have discounted the threat of civil or criminal liability in the foreign jurisdiction.

Applying a balancing approach to our hypothetical, a court might support the SEC in its attempts to obtain evidence from the foreign

²⁰³ *Laker Airways v. Sabena, Belgian World Airlines*, 731 F.2d 909 (D.C. Cir. 1984); *Graco v. Kremlin, Inc.*, 101 F.R.D. 503 (N.D. Ill. 1984); *In re Uranium Antitrust Litigation*, 480 F. Supp 1138, 1149 (N.D. Ill. 1979).

²⁰⁴ 480 F. Supp. 1138, 1148 (N.D. Ill. 1979).

²⁰⁵ See, e.g., *Garpeg, Ltd. v. United States*, 583 F. Supp. 789, 797 (S.D.N.Y. 1984) (bank subject to conflicting laws must choose between obligations thereunder).

²⁰⁶ See *supra* note 162 and accompanying text.

institution or its employees. The SEC would have little difficulty in establishing the importance of the institution's documents and testimony to its investigation, and the court would probably find that the interest of the United States in ensuring the integrity of its financial markets outweighed the interests of the foreign jurisdiction in adopting secrecy or blocking laws. In the absence of evidence of previous cases in which liability was imposed under the nondisclosure laws, the specter of civil or criminal prosecution in the foreign jurisdiction might not dissuade the court from imposing sanctions for continued noncompliance.²⁰⁷

3.5.2.3. Good Faith

The final approach used by the courts to evaluate non-production is a "good faith" standard, derived from the Supreme Court's holding in *Societe Internationale v. Rogers*.²⁰⁸ In *Societe Internationale*, the plaintiff, a Swiss holding company, sought to recover assets seized by the United States during World War II under the Trading with the Enemy Act. Challenging the plaintiff's assertion that it was not an "enemy" within the meaning of the Act, the government requested that the plaintiff produce its Swiss banking records.

The plaintiff moved to be excused from production of the documents on the grounds that production would expose the company to liability under Swiss secrecy laws.²⁰⁹ After the district court denied the motion, the company secured waivers for the release of some, but not all, of the requested documents. Because full compliance with the production order was not forthcoming, the district court dismissed the plaintiff's action. This decision was affirmed by the court of appeals.²¹⁰

The Supreme Court upheld the propriety of the production order, but reversed the decision of the lower courts, in holding that the sanction of dismissal was unwarranted where the plaintiff's failure to comply was due to inability on its part, rather than to willfulness or bad faith.²¹¹ The Court adopted a two-step approach to determining good

²⁰⁷ See, e.g., *In re Grand Jury Proceedings, Bank of Nova Scotia*, 740 F.2d 817 (11th Cir. 1984), cert. denied, 469 U.S. 1106 (1985) (bank held in civil contempt and fined \$1.8 million).

²⁰⁸ 357 U.S. 197 (1958).

²⁰⁹ Upon notification of the government's request, the Swiss Federal Attorney determined that production would violate Swiss law and forbade the release of the documents. *Societe Internationale v. Rogers*, 357 U.S. at 200-01.

²¹⁰ *Societe Internationale v. Brownell*, 243 F.2d 254 (D.C. Cir. 1957), rev'd sub nom. *Societe Internationale v. Rogers*, 357 U.S. 197 (1958).

²¹¹ The Court suggested, however, that other sanctions, such as the drawing of inferences adverse to the plaintiff during the trial, would be appropriate. *Societe Internationale*, 357 U.S. at 213.

faith. First, the party resisting production must have made efforts “to the maximum of [its] ability” to achieve compliance. Second, it must not have “deliberately courted legal impediments” to the production of documents.²¹²

The Supreme Court expressly limited its holding in *Societe Internationale* to the facts of the case.²¹³ Accordingly, the factual findings of the magistrate below that the company had acted in good faith took on added significance. In cases subsequent to *Societe Internationale*, however, the federal courts have generally upheld the imposition of sanctions for noncompliance with production orders through adverse factual findings on the issue of good faith.²¹⁴

For example, consistent with the Court’s language in *Societe Internationale*, the lower courts have held that the deliberate secreting of documents in a jurisdiction where they cannot be produced legally constitutes bad faith.²¹⁵ In *SEC v. Banca Della Svizzera Italiana*,²¹⁶ however, the district court took a more aggressive position. The court held that a Swiss bank placing purchase orders from Switzerland for the purchase of securities on the Philadelphia and New York Stock Exchanges deliberately took advantage of Swiss bank secrecy laws, and thereby acted in bad faith.

The *Banca Della Svizzera Italiana* decision reflects the tension generated between the good faith approach and the interests of the United States in discovery in insider trading cases. On the one hand, the good faith standard is “intended to do justice in the individual situation and to provide a less offensive approach from the international perspective.”²¹⁷ On the other hand, as applied in cases such as *Banca Della Svizzera Italiana*, the standard implies that any party basing its conduct on a foreign law at odds with a law of the United States does so in bad faith. This suggestion detracts from, rather than serves, no-

²¹² *Id.* at 208-09, 211-12.

²¹³ *See id.* at 213 (“[W]e decide only that on this record dismissal of the complaint with prejudice was not justified.”).

²¹⁴ *See, e.g.*, *United States v. Vetco, Inc.*, 644 F.2d 1324 (9th Cir. 1981); *Civil Aeronautics Bd. v. Deutsche Lufthansa Aktiengesellschaft*, 591 F.2d 951 (D.C. Cir. 1979); *Ohio v. Arthur Andersen & Co.*, 570 F.2d 1370 (10th Cir.), *cert. denied*, 439 U.S. 833 (1978); *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981). *But cf. In re Westinghouse Elec. Corp. Uranium Contracts Litigation*, 563 F.2d 992, 996 (10th Cir. 1977) (holding that district court abused its discretion in concluding that non-party witnesses had not made a good faith showing of inability to comply with subpoena).

²¹⁵ *See, e.g.*, *United States v. Vetco, Inc.*, 644 F.2d 1324, 1332 (9th Cir. 1981) (maintenance solely in Switzerland of records also required by IRS to be kept in United States demonstrates bad faith).

²¹⁶ 92 F.R.D. 111 (S.D.N.Y. 1981).

²¹⁷ Note, *supra* note 181, at 871.

tions of international comity.

As applied to our market hypothetical, the good faith standard as generally interpreted would not arise with respect to the issuance of a production order, but only at the sanctions stage. If the foreign institution asserted nondisclosure laws as a defense to the imposition of sanctions, the court might initially require the institution to identify with some degree of precision the documents protected against disclosure by the foreign law.²¹⁸ Second, the court might require the institution to demonstrate that it had sought a waiver of applicable bank secrecy provisions from its customer, as well as a waiver of criminal bank secrecy or blocking statutes from foreign authorities.

If the foreign institution satisfied these initial tests, however, the court would further attempt to ascertain whether it had "deliberately courted legal impediments" to the production of documents. The *Banca Della Svizzera Italiana* case suggests that, in the context of an insider trading investigation, any foreign institution executing trades on United States markets may be deemed to have courted such impediments if it resists discovery by invoking nondisclosure laws. The court might reach this conclusion even in the absence of any allegation that the institution traded Company X's stock for its own account (or for the account of other customers of the foreign institution), or that it was aware that its customer possessed material, nonpublic information concerning a tender offer.²¹⁹ Accordingly, the court might proceed to issue sanctions for noncompliance.

3.5.3. Summary

Courts in the United States have employed several modes of analysis to address conflicts between foreign nondisclosure laws, on the one hand, and investigative subpoenas and pre-trial discovery on the other. Regardless of the approach adopted, the lower federal courts are unlikely to curtail the exercise of their enforcement jurisdiction significantly in a case involving allegations of insider trading on United States

²¹⁸ See *Ohio v. Arthur Andersen & Co.*, 570 F.2d 1370 (10th Cir.), cert. denied, 439 U.S. 833 (1978) (sanctions upheld where respondent had invoked Swiss secrecy provisions without first identifying documents subject to nondisclosure laws).

²¹⁹ See *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 117 (S.D.N.Y. 1981) (where the court stated:

BSI [Banca Della Svizzera Italiana] acted in bad faith. It made deliberate use of Swiss nondisclosure law to evade in a commercial transaction for profit to it, the strictures of American securities law against insider trading. Whether acting solely as an agent or also as a principal . . . BSI invaded American securities markets and profited in some measure thereby.).

markets. The results in decisions such as *Banca Della Svizzera Italiana* suggest that many courts have reached the tacit, if unstated, conclusion that *no* foreign interest in nondisclosure can outweigh the interests of the United States in safeguarding its securities markets against fraud.

Notwithstanding the favorable results it has obtained in federal courts, the SEC best serves national interests in diplomacy, as well as its own legislative mandate, by pursuing, to the extent feasible, existing bilateral and multinational arrangements for the production of evidence.²²⁰ At the same time, the increasing tendency of United States courts to uphold contempt sanctions against foreign entities for noncompliance with production orders may provide foreign jurisdictions with an incentive to negotiate agreements they might not otherwise possess.²²¹

4. OPTIONS AVAILABLE TO THE SEC

The SEC has a number of options at its disposal in its attempt to obtain evidence from abroad in connection with an investigation of potential insider trading. In broad terms, these options fall into four categories: first, to rely upon the voluntary cooperation of individuals and corporations from which the SEC seeks information; second, to pursue existing multinational and bilateral agreements for the production of evidence; third, to attempt to negotiate new procedures for the production of evidence during the course of its investigation; and fourth, to invoke the judicial processes of the courts of the United States. During the course of an investigation, it may ultimately work to the SEC's advantage to pursue a *combination* of these strategies. For example, the SEC may initially avail itself of existing bilateral agreements for the exchange of information, but ultimately resort to the compulsory processes of the federal court if such efforts prove futile.

For purposes of analytical clarity, however, we examine these options in turn as applied to the market transaction hypothetical.

²²⁰ The ill-will engendered by what are perceived as unilateral attempts by American governmental authorities to gather evidence in foreign jurisdiction relevant to United States investigations cannot be seriously doubted. *See, e.g.,* OFFSHORE BANKS REPORT, *supra* note 111, at 69 (discussing Bahamian government's attack on conduct of Justice Department during *Bank of Nova Scotia*, 469 U.S. 1106 (1985), case as invasion of Bahamian sovereignty).

²²¹ *See* Note, *supra* note 181, at 882 (discussing British negotiations with respect to providing American narcotics officials access to Cayman Islands bank records following imposition of contempt sanctions by United States courts).

4.1. *Voluntary Cooperation*

Notwithstanding the proliferation of foreign nondisclosure laws, discovery from foreign parties in litigation in the United States frequently proceeds without the need for judicial intervention.²²² In a similar vein, the SEC could attempt to obtain the voluntary cooperation of those located abroad with evidence pertinent to its inquiry. By no means, however, is such cooperation assured, or even likely, under the facts suggested by the hypothetical.

4.1.1. *Foreign Institution*

The SEC's most important source of information located abroad, of course, is the foreign institution and the employees responsible for opening the customer's account and for executing his trades in the securities of Company X. If, as we assume, the institution is operating in a jurisdiction which has bank secrecy and/or blocking laws, the institution will at least initially prove extremely reluctant to disclose any information relating to the customer's account or identity. At this stage, the threat of civil or criminal liability in the foreign jurisdiction, as well as the desire to maintain the institution's reputation for secrecy, may discourage cooperation on the institution's part.

The foreign institution has other interests, however, which may gravitate in favor of voluntary cooperation. If the foreign institution has assets on deposit at a correspondent bank in the United States, it would like to avoid the freezing of these assets. The foreign institution's employees would also prefer not to risk being served with a subpoena upon their entering the United States.²²³ Additionally, the institution may conclude that the transactions under investigation by the SEC are not subject to bank secrecy,²²⁴ or, alternatively, that disclosure of information relating to a single customer's account best ensures the continued confidentiality of the accounts of other customers.

If the jurisdiction in which the foreign institution operates has a blocking statute in addition to bank secrecy laws, the institution may be able to persuade governmental authorities not to exercise the right to forbid the release of the information.²²⁵ Alternatively, the foreign insti-

²²² See Struve, *Discovery from Foreign Parties in Civil Cases Before U.S. Courts*, 16 N.Y.U. J. INT'L L. & POL'Y 1101, 1102-05 (1984).

²²³ See, e.g., *United States v. Field*, 532 F.2d 404 (5th Cir.), cert. denied, 429 U.S. 940 (1976).

²²⁴ See *supra* notes 133-34 and accompanying text for a discussion of common law limitations placed on the principle of bank secrecy.

²²⁵ This might be the case if the blocking statute were similar to the British Protection of Trading Interests Act, 1980, ch. 11, discussed at *supra* note 163 and accompanied by <https://scholarship.law.upenn.edu/jil/vol9/iss3/5>

tution might elect to ignore the literal strictures of the blocking statute if it concluded the statute would not be enforced under the circumstances.²²⁶

In addition, there are a number of compromises the SEC and the foreign institution might reach to make the SEC's request for information more palatable to the latter. The SEC and the institution might agree that information identifying any customer of the foreign institution could be withheld until such time as the institution has received assurances from the foreign government that it can reveal the customer's identity without violating foreign law. Were such an arrangement reached, the SEC would likely reserve the right to resort to United States compulsory processes if the information were not obtained within a predetermined time period.

The SEC could agree to limit the scope of its request in additional ways. The information provided to the SEC could be limited to pretender offer purchases of the securities of Company X and any corresponding sales. The SEC could also disclaim any intention of discovering the identity of any customers of the foreign institution whose accounts were managed entirely by that institution. The SEC, however, may prove reluctant to accept such limitations without receiving some form of proffer or affidavit from the institution to establish that the information proposed to be excluded from the SEC's information request be of no consequence to the staff's investigation.

The foreign institution, on the other hand, may be unwilling to provide even limited information to the SEC without written assurance that the SEC will not bring an enforcement action against the institution or its employees in connection with the trading in Company X. While the negotiation of mutually agreeable procedures for the production of evidence may prove time-consuming, the benefits of such arrangements to both the foreign institution and the SEC may outweigh the immediate costs.

panying text, and not automatic in operation. If the blocking statute were similar to the French statute discussed at *supra* notes 161-62 and accompanying text, however, this option would be unavailable. *But see infra* note 226.

²²⁶ See, e.g., *Adidas Ltd. v. S.S. Seatrain Bennington*, No. 80 Civ. 1922, slip op. at 8 (S.D.N.Y. May 29, 1984) (where the court stated in concluding that the French plaintiffs faced no threat of prosecution for violating the French blocking statute:

It is inconceivable that Law No. 80-538 is to be taken at face value as a blanket criminal prohibition against exporting evidence for use in foreign tribunals. For if it were, French nationals doing business abroad would be at the mercy of their business counterparts: they would be unable to redress breaches and frauds committed against them by suit in foreign courts since they would be barred from supporting their claims with their documents.).

4.1.2. *Other Parties*

In addition to the foreign institution and its employees, the SEC may seek records from telephone and credit card companies, as well as from hotels and other businesses. Information from these entities may prove particularly valuable if the SEC suspected that a particular individual engaged in insider trading, but had theretofore failed to obtain relevant account documents from the foreign institution. While such records are not as useful to the SEC as are documents and testimony from the foreign institution and its employees, they may contain probative circumstantial evidence of insider trading.²²⁷

For example, hotel records indicating that the foreign institution's customer stayed in the same hotel as Company X officials during merger negotiations would tend to support a suspicion that the customer received material, nonpublic information before the tender offer was announced. Moreover, such circumstantial evidence could support the issuance of a temporary restraining order in a United States court freezing the proceeds of the customer's trades in Company X.²²⁸

To the extent relevant documents are located in the United States, the SEC may subpoena their production. If the information is located in a foreign jurisdiction, however, the possessors of such information are unlikely to release the documents voluntarily due to considerations of privacy and confidentiality. While secrecy and blocking laws are less likely to apply to these documents than to the foreign institution's records, the SEC has less leverage over these other establishments. Accordingly, the SEC will probably want to resort to other bilateral agreements, such as letters rogatory, in its attempt to gain access to this information.

4.2. *Existing Multinational and Bilateral Agreements*

4.2.1. *Hague Convention*

The United States is a signatory to the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters (Convention)²²⁹ which provides for three of the most common methods of for-

²²⁷ See, e.g., *Insider Trading: How the SEC Broke Huge Stock Case*, Los Angeles Times, April 11, 1986, at 1, col. 1 (value of circumstantial evidence to SEC in pursuing investigation of insider trading in securities of Santa Fe International).

²²⁸ See *Podesta v. Calumet Indus.*, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,433 (N.D. Ill. 1978) (circumstantial evidence sufficient basis for issuance of preliminary injunction).

²²⁹ March 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444, 847 U.N.T.S. 231 [hereinafter the Convention]. A list of signatory nations to the Convention appears at 7 MARTINDALE-HUBBELL LAW DIRECTORY, pt. 7, at 14-15 (1986).

eign discovery: letters rogatory, evidence-taking by a consular official and by private commissioners. The Convention can only be used in connection with actual litigation and, accordingly, is of no assistance to the SEC during an investigation.

The SEC has in the past taken advantage of the procedures of the Convention, however, in connection with pending litigation.²³⁰ In particular, the SEC has made use of the provisions governing letters of request. The Convention provides that execution of the request may not be denied simply because the recipient of the letter does not recognize a cause of action similar to that underlying the request.²³¹ A contracting state need not comply with the request, however, if execution of the request is outside the power of its judiciary or if the state believes the request would prejudice its sovereignty or security.²³²

A more significant limitation on the availability of letters rogatory is contained in Article 23 of the Convention, which provides that signatories may elect to refuse to execute letters rogatory for the purpose of pre-trial discovery of documents.²³³ In these nations, the Convention remains available for the pre-trial taking of testimony, if intended for use at trial.²³⁴

Legislation adopted by some signatory nations creates further obstacles to effective discovery in insider trading cases. For example, the Evidence Proceedings in Other Jurisdictions Act²³⁵ (Foreign Evidence Act) adopted by the United Kingdom in 1975 governs the execution of letters of request pursuant to the Convention. Provisions of the Foreign Evidence Act require British courts to narrow discovery requests to particular documents²³⁶ and authorize the Secretary of State to prevent entirely the execution of letters rogatory for national security reasons.²³⁷

As might be expected in light of the limited discovery available through the Convention, foreign litigants have taken the position in United States courts that the Convention represents either the exclusive

²³⁰ See SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of, Santa Fe Int'l Corp., [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,424 (S.D.N.Y. Nov. 13, 1981) (SEC applied to British courts for assistance in obtaining documents and testimony from third-party witnesses).

²³¹ See Convention, *supra* note 229, at Ch. I, art. 12.

²³² *Id.*

²³³ See *id.* at Ch. III, art. 23.

²³⁴ See *id.* at Ch. I, art. 1 (“[a] letter shall not be used to obtain evidence which is not intended for use in judicial proceedings, commenced or contemplated.”).

²³⁵ Evidence (Proceedings in Other Jurisdictions) Act, 1975, ch. 34.

²³⁶ See, e.g., *id.* § 2(4)(b); see also Asbestos Ins. Coverage Cases, [1985] 1 All E.R. 716; Rio Tinto Zinc Corp. v. Westinghouse Elec. Corp., [1978] 1 All E.R. 434 (both cases preventing execution of letters of request for broad categories of documents).

²³⁷ See Evidence (Proceedings in Other Jurisdictions) Act, 1975, ch. 34, § 3(3).

mechanism for discovery against them or, alternatively, the mechanism of first resort. While a number of federal appellate courts have rejected such arguments,²³⁸ the Supreme Court is expected to rule on the issue later this term.²³⁹

Assuming that the SEC had initiated a lawsuit in federal court, it could attempt to obtain documents and testimony pursuant to the Convention. The SEC's experience to date, however, suggests that this process would prove expensive and time-consuming.²⁴⁰ Parties and witnesses resisting discovery can exhaust rights of appeal in foreign tribunals, while such tribunals may lack the power to impose sanctions for noncompliance.²⁴¹

4.2.2. *Mutual Assistance in Criminal Matters Treaties*

The United States is currently a party to three treaties providing for mutual legal assistance in criminal matters,²⁴² and has concluded negotiations with other countries concerning similar treaties not yet in force.²⁴³ These treaties may assist the SEC in gathering evidence located abroad related to its investigation of trading in the securities of Company X.

The bulk of the SEC's experience with mutual assistance treaties to date has been with the Treaty on Mutual Assistance in Criminal

²³⁸ See, e.g., *Daimler-Benz Aktiengesellschaft v. United States Dist. Court*, 805 F.2d 340 (10th Cir. 1986); *In re Messerschmitt Bolkow Blohm, GmbH*, 757 F.2d 729 (5th Cir. 1985), cert. granted sub nom. *Messerschmitt Bolkow Blohm v. Walker*, 106 S. Ct. 1633 (1986); *In re Anschuetz & Co., GmbH*, 754 F.2d 602 (5th Cir.), petition for cert. filed sub nom. *Anschuetz & Co., GmbH v. Mississippi River Bridge Auth.*, 106 S.Ct. 52 (1985).

²³⁹ *Societe Nationale Industrielle Aerospatiale v. United States District Court*, 782 F.2d 120 (8th Cir. 1986), vacated, 107 S. Ct. 2542 (1987).

²⁴⁰ See *Mann, Sullivan & Koncick*, supra note 70, at 61-63 (describing efforts over three-year period to obtain testimony of witnesses in France pursuant to Convention).

²⁴¹ In connection with letters rogatory issued in *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981), for example, the Praetor's Court of Milan refused to compel production of documents because compulsion was unavailable under the Italian law implementing the Convention. See *Mann, Sullivan & Koncick*, supra note 70, at 64.

²⁴² Treaty on Mutual Legal Assistance in Criminal Matters, June 12, 1981, United States-Netherlands, T.I.A.S. No. 10,734; Treaty on Extradition and Mutual Assistance in Criminal Matters, June 7, 1979, United States-Turkey, 32 U.S.T. 3111, T.I.A.S. No. 9891; Treaty on Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302 [hereinafter *Swiss-U.S. Treaty*].

²⁴³ Among the significant agreements recently negotiated are the Treaty Concerning the Cayman Islands and Mutual Legal Assistance in Criminal Matters, July 3, 1986, United States-United Kingdom, 26 I.L.M. 536, and the Treaty on Mutual Legal Assistance in Criminal Matters, Mar. 18, 1985, United States-Canada, 24 I.L.M. 1092.

Matters between the United States and Switzerland.²⁴⁴ The fact that the SEC is an administrative agency seeking information primarily for use in civil proceedings does not preclude the availability of the Swiss treaty, as long as the SEC's investigation relates to the subject of a potential criminal action.²⁴⁵ The SEC's investigation of alleged insider trading in the securities of Company X would satisfy this requirement.

The Swiss Treaty does contain two requirements, however, which limit its usefulness to the SEC. First, Article 5 provides that information received pursuant to the treaty must be used as evidence in a criminal proceeding before it can be used in a civil proceeding, unless otherwise agreed by diplomatic note.²⁴⁶ This requirement strikes a compromise between the American view that information furnished under the treaty should be generally available for law enforcement purposes and the Swiss position that information so obtained should be limited to the matter for which it was originally furnished.²⁴⁷

The second major limitation contained in the Swiss Treaty is the stipulation that information will be provided only in connection with offenses deemed criminal in both the United States and Switzerland. This "dual criminality" requirement creates a significant impediment to obtaining information in insider trading cases from Switzerland, because insider trading is not punishable per se in Switzerland.²⁴⁸

Under current Swiss law, a corporate insider does not violate the law by personally trading on the basis of material, nonpublic information. If, however, the insider provides such information to a third-party "tippee" who trades, both the insider and the tippee may be deemed to have violated Article 162 of the SPC.²⁴⁹ The dual criminality requirement will be satisfied only in the latter event. Since the SEC is unlikely, when confronted with circumstantial evidence of insider trading

²⁴⁴ Swiss-U.S. Treaty, *supra* note 242.

²⁴⁵ See Judgment of Jan. 26, 1983, Tribunal fédéral (Federal Court), Switzerland, *reprinted in* 222 I.L.M. 785; *see also* Mann, Sullivan & Koncick, *supra* note 70, at 41.

²⁴⁶ See Swiss-U.S. Treaty, *supra* note 242, at Ch. I, art. 5.

²⁴⁷ Mann, Sullivan & Koncick, *supra* note 70, at 41.

²⁴⁸ Legislation to criminalize insider trading in Switzerland has been presented to the Swiss Parliament. The bill passed the Upper House and is expected to become effective in 1987. *Swiss Banking 3: In the Banker's Chair*, *Fin. Times*, Dec. 10, 1986, *Financial Times Survey*, at III, col. 6.

²⁴⁹ See *supra* notes 144-45 and accompanying text. In addition, liability for insider trading could arguably be based on Articles 148 and 159 of the Swiss Penal Code, which govern fraud and unfaithful management, respectively. See Memorandum of Understanding between the Government of the United States of America and the Government of Switzerland to establish Mutually Acceptable Means for Improving International Law Enforcement Cooperation in the Field of Insider Trading. (Aug. 31, 1982), 22 I.L.M. 1 [hereinafter Swiss MOU] at art. II (3)(b).

through foreign institutions, to know either the identity of the traders or the manner in which the traders obtained information, the dual criminality requirement may delay or frustrate the SEC's efforts to obtain evidence pursuant to the Swiss Treaty.²⁵⁰

Requests under the Swiss Treaty are actually handled between the United States Department of Justice and the Swiss Department of Justice and Policy. If the United States Justice Department determines that a Swiss request is within the terms of the treaty, it will execute the request immediately. In ratifying the treaty, however, the Swiss enacted implementing legislation which creates rights of appeal on behalf of individuals who oppose the execution of requests by the United States.²⁵¹ This legislation does not alter the SEC's ultimate access to information under the Swiss Treaty, but introduces the potential for significant time delays.

While the mutual assistance treaties recently negotiated with Canada and the Cayman Islands have not yet entered into force, several distinctions between these treaties and the Swiss Treaty which will facilitate assistance in insider trading cases deserve mention. The treaty between the United States and the Cayman Islands expressly defines insider trading as a criminal offense for which assistance is available under the treaty.²⁵² The treaty between the United States and Canada does not expressly provide for assistance in insider trading cases, but neither does the treaty require dual criminality as a precondition.²⁵³ The experience of the SEC under these new treaties should prove instructive.

²⁵⁰ The Commission's experience in the *Santa Fe* case is instructive. The SEC first submitted a request for assistance under the Swiss Treaty on March 22, 1982. On January 26, 1983, the Swiss Federal Court denied the SEC's request for failure to demonstrate that the facts alleged demonstrated a violation of Swiss law. See 22 I.L.M. 785 (1983). The Commission renewed its request under the treaty on July 27, 1983, at which time the SEC adduced additional facts demonstrating that the traders were tippees rather than corporate insiders. Accordingly, the Swiss Federal Court granted the SEC's request for information in an unpublished opinion dated May 16, 1984, although the production of evidence was delayed an additional nine months as a result of further appeals by the defendant of the court's decision to grant access. Mann, Sullivan & Koncick, *supra* note 70, at 43-45.

²⁵¹ Federal Law on the Treaty with the United States of America on Mutual Assistance in Criminal Matters (entered into force Oct. 3, 1975), Ch. I, arts. 16-19.

²⁵² Insider trading is defined in the treaty as, "the offer, purchase, or sale of securities by any person while in possession of material nonpublic information directly or indirectly relating to the securities offered, purchased, or sold, in breach of a legally binding duty of trust or confidence." *Id.* at art. 19.

²⁵³ See *id.* at art. II (4).

4.2.3. *Memorandum of Understanding*

If, as is usually the case during the preliminary stages of a formal commission investigation, the SEC has neither initiated actual litigation nor identified the customer of the foreign institution who purchased Company X securities immediately prior to the tender offer announcement, the Convention and mutual assistance treaties modeled on the Swiss Treaty are of limited benefit. If available, however, the SEC can take advantage of a Memorandum of Understanding (MOU) specifically intended to facilitate the sharing of information in investigations of securities fraud and insider trading.²⁵⁴

The advantages of MOUs from the SEC's viewpoint are significant. First, a MOU can establish detailed procedures governing specific areas of concern. Second, a MOU can establish a timetable governing the handling of the SEC's request, and place reasonable limitations on customers' rights to appeal decisions to grant the SEC access. In addition, a MOU need not be formally ratified by the United States Senate and the corresponding body in the foreign jurisdiction, which permits the SEC to invoke the MOU's provisions at an earlier date. From the perspective of foreign jurisdictions, MOUs offer hope that the SEC will refrain from invoking the compulsory processes of the United States court which are viewed as a challenge to the sovereignty of the foreign jurisdiction.

With regard to insider trading, the most significant MOU to date is the MOU between the United States and Switzerland,²⁵⁵ signed on August 31, 1982. The Swiss MOU recognizes the need "to establish mutually acceptable means for improving international law enforcement cooperation in the field of insider trading,"²⁵⁶ and acknowledges that the use of Swiss banks to effect trades on United States stock exchanges by persons in possession of material, nonpublic information is detrimental to the interests of both nations.²⁵⁷ The Swiss MOU does not itself set forth the criteria under which customer information will

²⁵⁴ See Memorandum of Understanding on Exchange of Information Between the United States Securities and Exchange Commission and the United Kingdom Department of Trade and Industry in Matters Related to Securities and Between the United States Commodities Futures Trading Commission and the United Kingdom Department of Trade and Industry in Matters Relating to Futures (Sept. 23, 1986) [hereinafter United Kingdom MOU]; Memorandum of the United States Securities and Exchange Commission and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information (May 23, 1986) [hereinafter Japanese MOU]; Swiss MOU, *supra* note 249.

²⁵⁵ See Swiss MOU, *supra* note 249.

²⁵⁶ See *id.* at art. I(1).

²⁵⁷ See *id.* at art. I(4).

be released to the SEC in insider trading investigations, but instead refers to the terms of the accompanying private agreement among members of the Swiss Bankers' Association (SBA).²⁵⁸

Ironically, although the Swiss MOU represents the SEC's most important tool to obtain information from Switzerland in insider trading cases, the language of the Swiss MOU and the SBA Agreement suggests that the Swiss MOU is a stop-gap measure rather than a significant achievement in itself. In this regard, the Swiss MOU states that it is available only in cases in which necessary information cannot be obtained under the Swiss Treaty.²⁵⁹ Similarly, the SBA Agreement provides for its own termination in the event that legislation criminalizing insider trading is enacted.²⁶⁰

If the SEC determined to request access to customer information under the Swiss MOU, its request would be directed to a three-member commission of inquiry appointed by the SBA.²⁶¹ As part of a threshold review, this commission is instructed to review the SEC's request to determine that the activity in question concerns the purchase or sale of securities within twenty-five days of a proposed business combination or the acquisition of at least ten percent of the issuer's securities.²⁶² These threshold conditions are intended to satisfy the commission that the SEC has reasonable grounds for its request.

The SBA Agreement further provides that the commission shall promptly request from the bank a report on the transactions under scrutiny. Simultaneously, the bank is under an obligation to provide the customer with an opportunity to respond to the SEC's allegations.²⁶³ If the threshold criteria discussed above are met, the bank is also required to freeze the customer's account up to the amount of the profit realized in the transaction pending resolution of the inquiry.²⁶⁴

Within forty-five days of the receipt of the SEC request, the bank

²⁵⁸ Agreement XVI of the Swiss Bankers' Association with Regard to the Handling of Requests for Information from the Securities and Exchange Commission of the United States on the Subject of Misuse of Inside Information, July 14, 1982, 22 I.L.M. 7 (1983) [hereinafter SBA Agreement].

²⁵⁹ Art. II(2) of the Swiss MOU states that "[t]he parties understand that the 1977 Treaty . . . should be used to the extent feasible." Swiss MOU, *supra* note 249, at art. II(2).

²⁶⁰ SBA Agreement, *supra* note 258, at art. 11.

²⁶¹ *Id.* at arts. 2-3.

²⁶² *Id.* at art. 1. In addition, the SBA Agreement also requires the SEC to establish to the Swiss Commission's satisfaction that (i) material price or volume movements have occurred with respect to the securities at issue during the relevant 25-day period or (ii) there are other material indications that the transactions under investigation violate U.S. prohibitions against insider trading. *Id.* at art. 3(4).

²⁶³ *See id.* at art. 4(2).

²⁶⁴ *Id.* at art. 9.

is required to forward its report to the three-member commission, which may ultimately transmit the document, along with a report of its own, to the SEC. If, however, the bank or the customer demonstrates to the Swiss commission's satisfaction that the customer either did not place the trades under investigation or is not an "insider" as defined in the SBA Agreement, the commission will not transmit the report to the SEC.²⁶⁵

The SEC recently made use of the Swiss MOU in a case involving allegations of insider trading in the securities of RCA Corporation.²⁶⁶ In the *Katz* case, the SEC alleged that a former analyst of Lazard Freres & Company provided material, nonpublic information concerning the pending merger of RCA with the General Electric Company to his father, who in turn passed the tip to another relative, who ultimately purchased RCA stock through the Geneva branch of the Union Bank of Switzerland.²⁶⁷ The SEC's experience in the *Katz* case supports the conclusion that the SEC is able to gather evidence under the Swiss MOU on a timely basis: the SEC obtained disclosure of the customer's identity within six months after first approaching the SBA with a request.

The Swiss MOU does not address several situations in which the SEC may seek information from a Swiss bank. First, the Swiss MOU is not available in cases involving trades made in advance of announcements of significant corporate events not involving a proposed "Business Combination" or "Acquisition" within the terms of the SBA Agreement. In addition, the Swiss MOU's provisions cannot be invoked if information is sought from a Swiss brokerage entity not a member of the SBA. Nevertheless, the SEC's success under the Swiss MOU in the *Katz* case, as well as in negotiating MOUs with Japan and the United Kingdom, suggests that it is an approach worth pursuing with other nations which have nondisclosure laws.²⁶⁸

4.3. Appeals to Foreign Governments

In some instances, the SEC may be unable to secure the voluntary cooperation of a party or a witness on mutually agreeable terms, and

²⁶⁵ *Id.* at arts. 5, 7.

²⁶⁶ See *SEC v. Katz*, 18 Sec. Reg. & L. Rep. (BNA) 1157 (S.D.N.Y. 1986).

²⁶⁷ *\$2.1 Million Penalty in Insider Case*, N.Y. Times, Aug. 8, 1986, at D1, col. 3.

²⁶⁸ The recently signed United Kingdom MOU and the Japanese MOU differ from the Swiss MOU in that the former represent general agreements among governmental regulators to exchange information relating to the securities markets, rather than detailed provisions related to insider trading investigations.

the multinational and bilateral agreements to which the particular foreign jurisdiction is a signatory offer limited assistance to the SEC. In such cases, the SEC may believe it has no alternative but to resort to the compulsory processes of the United States courts. For its part, the target of the SEC's request may feel constrained by applicable nondisclosure laws.

Before the SEC files papers in court to compel production and the recipient of the SEC's request prepares for extended litigation, however, both parties should consider whether ad hoc appeals to foreign governmental authorities could remove a primary obstacle to the production of the desired information — the threat of prosecution under foreign secrecy and blocking laws. The SEC's recent experience with the Attorney General of the Bahamas in connection with the SEC's case against former investment banker Dennis Levine suggests such an approach may achieve the SEC's goals far more rapidly than would a more adversarial posture.²⁶⁹

During the SEC's investigation of Levine, the SEC sought documents and other information from Bank Leu International Ltd. (BLI), the Bahamian subsidiary of a Swiss financial institution at which Levine maintained trading accounts.²⁷⁰ The disclosure of documents and testimony identifying Levine as the customer of BLI who directed the trading under investigation, however, arguably would have exposed BLI and its employees to civil and criminal liability under Bahamian bank secrecy laws.²⁷¹

In another case prior to the commencement of the Levine investigation, the SEC had sought a court order in the Bahamas requiring the production from a Bahamian bank of customer identifying information.²⁷² The basis of the SEC's argument in *Guaranty Trust* was that a securities transaction was not a banking transaction for purposes of Bahamian bank secrecy and, accordingly, that secrecy should not shield the bank customer's identity. The case was dismissed, however, on the ground that the SEC lacked standing to seek a declaratory judgment. This decision was ultimately affirmed by the court of appeals.²⁷³

²⁶⁹ See *SEC Wins TRO Against Drexel Burnham Executive in \$12 Million Insider Scheme*, 18 Sec. Reg. & L. Rep. (BNA) No. 20, at 709 (May 16, 1986) (discussing *SEC v. Levine*, S.D.N.Y. May 12, 1986).

²⁷⁰ Mann, Sullivan & Koncick, *supra* note 70, at 66. Mr. Pitt was counsel to BLI in connection with the SEC's investigation and prosecution of Levine. The discussion of the investigation contained herein, however, is based solely upon publicly available information.

²⁷¹ *The SEC's Hot Pursuit of Traders*, Nat'l L. J., Dec. 29, 1986 at 1.

²⁷² *In re Guar. Trust Co.*, No. 423 (Bahamas S. Ct.) (May 22, 1985), *aff'd*, No. 19 (Bahamas Ct. App.) (July 4, 1986).

²⁷³ Mann, Sullivan & Koncick, *supra* note 70, at 63-64.

In light of its experience in the *Guaranty Trust* case, the SEC opted not to revisit the Bahamian courts during the Levine investigation. Instead, the SEC determined to approach the Attorney General of The Bahamas directly to argue that disclosure of documents identifying Levine would not run afoul of Bahamian secrecy law.²⁷⁴ The Attorney General accepted the Commission's arguments and subsequently provided BLI with a written opinion that the transactions effected by Levine through BLI were not banking transactions and that criminal sanctions would not apply to the release of the subpoenaed documents.²⁷⁵ Armed with this opinion, BLI thereupon provided the SEC with the requested documents that identified Levine as the customer who directed the trading under investigation.

The government of The Bahamas, cognizant of the major limitation that the Attorney General's ruling appeared to place on the scope of bank secrecy in the Commonwealth, subsequently issued a press release clarifying that the ruling was limited to the facts presented, and reaffirming allegiance to principles of bank secrecy.²⁷⁶ While the press release may have diminished the ruling's value as a precedent to the SEC in future investigations, the SEC nevertheless obtained the information it sought on an expedited basis, in comparison with other recent cases of alleged insider trading.²⁷⁷ From the vantage point of foreign institutions, the SEC's course of conduct with respect to the Bahamian Attorney General can be cited as support for the proposition that the SEC should be required to exhaust avenues of appeal with foreign government officials prior to seeking a production order in a United States court.²⁷⁸

4.4. *Recourse to United States Judicial Processes*

The SEC may seek to avail itself of two types of judicial assistance in cases such as the market transaction hypothetical. Where the SEC's evidence strongly suggests a violation of the law but does not yet point to any one particular suspect, the agency can proceed against property representing the illegal profits from transactions within the prohibitions

²⁷⁴ *The SEC's Hot Pursuit of Traders*, *supra* note 271, at 1.

²⁷⁵ Mann, Sullivan & Koncick, *supra* note 70, at 66.

²⁷⁶ See Statement of the Government of the Commonwealth of the Bahamas (Sept. 4, 1986), reprinted in Appendix C, this issue, pp. 545-47.

²⁷⁷ See *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 113.

²⁷⁸ See *Ings v. Ferguson*, 282 F.2d 149 (2d Cir. 1960) (requiring exhaustion of diplomatic means to obtain evidence in nondisclosure jurisdiction). *But cf. In re Grand Jury Proceedings, United States v. Field*, 532 F.2d 404 (5th Cir.), *cert. denied*, 429 U.S. 940 (1976) (application to foreign judiciary not required prior to issuance of compulsory process by United States court).

of the federal securities laws. Additionally, where sufficient evidence has identified a target but the SEC staff is confronted by obstacles erected by the potential respondent, courts may provide relief in the form of orders compelling cooperation on the part of the respondent.

4.4.1. *Proceedings Against Property*

Notwithstanding its inability to identify the perpetrator of an insider trading offense, the SEC is not without recourse. If, as is the case in the market transaction hypothetical, the SEC can locate the illegal proceeds of the fraudulent trades, it may be able to seek emergency relief in the form of an order freezing the assets in question.²⁷⁹ This type of order would most likely be sought in the case where the SEC was able to identify the entity executing the trade as agent for an undisclosed principal, or the entity possessed assets in the United States equal to (or greater than) the alleged illegal profits. Such an action could yield these benefits: the beneficial owner of the assets (i.e., the customer of the foreign institution) could come forward to defend his property, thus, of necessity, revealing his identity; the SEC could prevent the trader from dissipating the proceeds or from removing them from the reach of the court; and, at the least, the SEC could eventually use the frozen funds to redress the financial wrong suffered by those who were on the other side of the illegal trader's transactions. Indeed, to commence the process, the SEC need only present sufficient circumstantial evidence to persuade a court that preliminary relief is warranted.

The market transaction hypothetical illustrates a perfect example of a situation in which emergency relief in the form of a judgment against specific property may well be the SEC's best and only hope for penetrating the barrier of a foreign nondisclosure law that protects one who has traded on inside information.

4.4.2. *Proceedings Against Persons*

To date, the SEC has sought this type of assistance from the courts in the form of two types of orders: compelled waivers of the protection of foreign nondisclosure laws, and injunctions against maintaining suits in the nondisclosure jurisdiction to invoke the protection of its laws.

²⁷⁹ See, e.g., *SEC Wins TRO Against Drexel Burnham Executive in \$12 Million Insider Scheme*, *supra* note 269, at 709 (discussing *SEC v. Levine*, S.D.N.Y. May 12, 1986); *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981).

4.4.2.1. *Compelled Waivers*

The SEC and other prosecutorial agencies of the United States have enjoyed some success in their efforts to compel targets to execute waivers of the protection provided by foreign secrecy laws.²⁸⁰ Indeed, in the only reported case in which a court denied the government's request for a compelled waiver of rights by a United States citizen,²⁸¹ the proposed order submitted by the government suffered from a drafting defect that rendered the document unconstitutional — a factor that contributed to, but was not dispositive of, the court's decision to deny the government's request.²⁸² Otherwise, each of the cases in which orders were granted compelling the waiver of the protection of a secrecy law has survived constitutional challenge before the lower courts.²⁸³

On the facts presented in our hypothetical, then, if the testimony of the individuals who participated in the acquisition negotiations leads the SEC to believe it has identified a probable suspect, the agency could pierce the cloak of foreign secrecy by invoking the processes of the United States courts and by requesting an order compelling the waiver of the protection of the foreign secrecy law.²⁸⁴

²⁸⁰ See, e.g., *United States v. Davis*, 767 F.2d 1025 (2d Cir. 1985); *United States v. Ghidoni*, 732 F.2d 814 (11th Cir.), *cert. denied*, 469 U.S. 932 (1984); *United States v. Quigg*, 679 F.2d 874 (2d Cir. 1981); *SEC v. Levine*, 18 Sec. Reg. & L. Rep. (BNA) 709 (S.D.N.Y. 1986); *SEC v. Musella*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,516 (S.D.N.Y. 1983); *Traboulsi v. Shearson Loeb Rhoades*, 671 F.2d 493 (S.D.N.Y. 1981).

²⁸¹ *In re Grand Jury Investigation, John Doe*, 599 F. Supp. 746 (S.D. Tex. 1984). *But see Garpeg, Ltd. v. United States*, 583 F. Supp. 789 (S.D.N.Y. 1984) (court denied motion to compel waiver of secrecy rights by Hong Kong corporation that was neither a defendant nor a target of investigation).

²⁸² The language of the order proposed by the government was so broad and all-encompassing as to constitute incriminating testimony on the part of the signatory of the document. See *John Doe*, 599 F. Supp. at 748 nn.4-5. The court also based its ruling on a finding that the information that would be yielded following the execution of such a waiver could provide the government with the details necessary to secure an indictment. The court admonished that "[t]his is 'precisely [the] sort of fishing expedition that the fifth amendment was designed to prevent.'" *Id.* at 748 (quoting *United States v. Fox*, 721 F.2d 32, 38 (2d Cir. 1983)).

²⁸³ See *United States v. Davis*, 767 F.2d at 1039-40 (carefully drafted order compelling waiver of bank secrecy provided that execution of waiver could not be used as any form of admission, thereby obviating any claim of testimonial compulsion); *United States v. Ghidoni*, 732 F.2d at 816-817 (execution of waiver does not constitute testimonial communication, and contents of bank records enjoy no fifth amendment privilege); *United States v. Quigg*, 679 F.2d at 874 (no expectation of privacy recognizable under fourth amendment for bank records located in a secrecy jurisdiction) (citing with approval *United States v. Payner*, 447 U.S. 727 (1980)); *SEC v. Musella*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) at ¶ 99,516 (compelled execution of waiver "would not do violence to [the] privileges secured by the fifth amendment.").

²⁸⁴ It must be noted that this procedure would not offer any relief where the non-disclosure principle takes the form of a blocking statute or other nonwaivable rule of law. See *supra* notes 150-164 and accompanying text.

4.4.2.2. "Anti-Suit" Injunctions

The courts of the United States are vested with the plenary power to order an American citizen to terminate litigation instituted in the courts of another state that is designed to frustrate, or has the effect of frustrating, the processes of the United States government.²⁸⁵ This power is based upon the absolute authority of the United States to prescribe the conduct of its nationals.²⁸⁶ Thus, where an American citizen has sought to thwart a government effort to secure evidence located abroad by commencing an action in the foreign state prohibiting the disclosure of that evidence, the United States courts have, albeit reluctantly,²⁸⁷ ordered the defendant to refrain from pursuing the foreign litigation.²⁸⁸ This remedy, if predicated on a proper assertion of in personam jurisdiction over the individual, should not be offensive to the foreign state, inasmuch as the order obtained would not directly restrain the foreign judiciary but would only bind the individual, who is not a citizen of that state.

The market transaction hypothetical is typical of the sort of situation in which an individual who sees the government closing in on him is likely to spare no effort in seeking to maintain the anonymity afforded by a foreign secrecy law. Should the inside trader in the fact pattern commence an action on an anonymous or undisclosed basis in the nondisclosure jurisdiction to enjoin the foreign institution from revealing his identity, the SEC has at its disposal the extraordinary remedy of an "anti-suit" injunction.

5. POSSIBLE SOLUTIONS

5.1. *Problems Encountered in Foreign Discovery*

In seeking a solution to the questions of international law and foreign relations that emerge from this conflict of laws, a degree of parochialism and inflexibility emerges from both sides of the issue. The general view in the United States appears to start from the presumption that common law and statutory secrecy principles are the hallmark of fraud. Yet, the enactment of the Right to Financial Privacy Act of

²⁸⁵ See *United States v. Davis*, 767 F.2d at 1036-39.

²⁸⁶ See *supra* notes 78, 85 and accompanying text.

²⁸⁷ See *United States v. Davis*, 767 F.2d at 1039 (anti-suit injunction "is an extraordinary remedy which may be used only in very limited circumstances — and only after other means of obtaining the records have been explored.").

²⁸⁸ See *United States v. Davis*, 767 F.2d at 1039 (affirming order of district court); *United States v. Johnpoll*, No. 83 Crim. 82 (S.D.N.Y. June 29, 1983), *aff'd on other grounds*, 739 F.2d 702 (2d Cir.), *cert. denied*, 469 U.S. 1075 (1984); *United States v. Meros*, 613 F. Supp. 8 (M.D. Fla. 1984).

1978 (RFPA)²⁸⁹ constitutes a clear statement by the United States that an individual's business with a financial institution is not the proper concern of the federal government, absent a proper investigative purpose. The customer challenge provisions of the RFPA bestow a ready means for testing the legitimacy of the asserted basis for the desired invasion of an individual's financial privacy. Clearly, then, both sides in the debate over the degree of deference to be accorded to nondisclosure laws recognize the concept of financial privacy to varying degrees. The question thus becomes whether an accommodation can be reached between the conflicting demands of two states' laws.

In fashioning an appropriate mechanism by which the SEC could seek information to which it believes it is entitled, we must first recognize the dilemma faced by foreign entities which may sincerely wish to cooperate with United States government agencies' fact-finding investigations. To these entities, it seems fundamentally unfair for the United States courts to determine whether they have jurisdiction over conduct in the United States by foreign actors, because a finding of jurisdiction in the United States court inevitably leads to that court's interpreting and deciding the obligations of the institution under the foreign nondisclosure law. The courts of the United States seem even less appropriate a forum for this determination in view of their routine application of domestic choice of law and jurisdictional principles in reaching their decision. When these jurisdictional issues arise, United States courts, in balancing the interests of two sovereigns, almost invariably find that the interests of the United States prevail over the interests of the foreign state. Indeed, the courts seldom even articulate the criteria for these decisions and simply draw the conclusion without providing its analytical underpinnings.²⁹⁰

Similarly, in balancing the competing interests that come into conflict when the SEC or other instrumentalities of the United States government seek information that is protected by a foreign nondisclosure law, courts are equally vague about the analytical route that leads them to the conclusion that American interests should prevail. Orders for the production of information in violation of such nondisclosure laws, and sanctions for noncompliance with such orders, are routinely entered

²⁸⁹ 12 U.S.C. §§ 3401-22 (1982).

²⁹⁰ This failure to articulate reasons for finding United States interests to prevail over foreign concerns in these cases may be attributable to the juxtaposition of the parties, interests, and forum. Typically these cases, heard in the federal courts, involve a U.S. government plaintiff seeking the assistance of a United States government employee with a federal court judge vindicating an alleged harm to U.S. national interests, in opposition to a defendant foreign entity which probably does not believe that it is subject to the forum's jurisdiction.

without an analysis of the means by which the weighting of the competing interests was undertaken.²⁹¹ This visceral approach to international conflicts of law fails to protect adequately the foreign interests embodied in the nondisclosure principles.

Additionally, foreign entities are at a serious disadvantage when they must present a defense in the context of these proceedings. In most instances, the only rebuttal to an allegation that the entity is the repository of the information pursued by the Commission requires a breach of the nondisclosure principle sought to be protected.

At the same time, however, it must be recognized that the SEC has been confronted with considerable delay, expense, and other obstacles in seeking information from foreign institutions subject to nondisclosure obligations. In these cases, we are confronted with more than the clichéd notion of justice delayed equalling justice denied. Where the abuses in a case are serious enough, the SEC should not be forced to wait for years on end before it can obtain access to the much-needed information. The delay imposed by foreign nondisclosure laws that often impedes SEC investigations can have the effect of protecting illegal activities for long periods of time during which potential witnesses may become forgetful or unavailable for testimony and the proceeds of the allegedly violative trades may be dissipated or moved beyond the reach of any court that has jurisdiction over the matter. Thus, any mechanism devised for facilitating the SEC's discovery of information located outside the United States must reduce the lengthy delays that typically accompany the SEC's investigative efforts in cases which involve foreign trading.

As we explore possible new mechanisms to enhance the SEC's foreign discovery capabilities, we should bear in mind that any new procedures that are developed must be perceived as balanced and fair by both domestic and foreign participants in the United States markets. It is not in the United States' economic interest to discourage foreign institutions from trading in the nation's markets, nor is it in the United States' economic interest to encourage the international financial community to believe that the American markets are unfair. A principal reason that the American markets are perceived as being fair and efficient is based upon the perception, fostered by the enactment of the

²⁹¹ Indeed, if United States government plaintiffs routinely prevail at this stage of the proceedings and persuade courts to impose substantial fines for each day of non-compliance with an order to disclose protected information, neither the SEC nor any other domestic law enforcement instrumentality would need additional enforcement tools or authority; the coercive effect of such monetary sanctions would likely compel compliance by foreign entities with assets in the United States in almost every instance.

federal securities laws, that the abuses of the early 1900s have been addressed in a manner that will prevent a recurrence of the rampant fraud and manipulation that characterized the American capital market in the early part of this century. It is very much in the national interest to preserve this perception of the market's integrity by means of an effective and balanced enforcement program.

At present, there are five procedures available to the SEC for securing evidence located outside the United States. Information may be sought pursuant to treaties, memoranda of understanding, application to foreign courts, application to United States courts and negotiations with foreign governments. Most of these procedures are limited by exceptions and exclusions that minimize their utility to the SEC with respect to the type of insider trading investigations that would stem from the facts of our market transaction hypothetical.

Application for the assistance of United States courts, as noted, is of limited utility to the SEC due to jurisdictional problems. While appropriate relief has been ordered in some cases, its successful execution is by no means assured.

Application for the assistance of foreign courts, pursuant to the 1970 Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, is limited by the escape clause of Article 23. A significant number of contracting states have made the Article 23 election thereby making the letter of request procedure unavailable to the SEC in many instances. The Convention is further limited by the requirement that the information requested be sought in connection with actual litigation, thus precluding its use at the investigative stage.

The 1982 Memorandum of Understanding between the governments of the United States and Switzerland, which has proven to be most effective in dealing with requests for information in matters such as our hypothetical, is narrowly limited to insider trading cases. Thus, the SEC is left with recourse only to the other foreign discovery mechanisms, subject to the limitations we have already noted, in conducting investigations into possible false or misleading disclosure matters, market manipulations or other violations of the federal securities laws.

Finally, intergovernmental negotiation, by definition, involves a degree of uncertainty as to its result, thus leaving no single effective mechanism that would apply in all circumstances to facilitate the SEC's foreign discovery efforts in appropriate cases.

Additionally, while each of these procedures carries its own peculiar attributes, all of them share the common characteristic of substantial delay following the initiation of a request for the discovery of information before the ultimate disclosure is made.

5.2. *New Mechanisms for Foreign Discovery*

As a threshold matter, the SEC should be provided with greater statutory authority for service of its compulsory power. Specifically, Congress should legislate a grant of power that would enable the SEC to serve its investigative subpoenas beyond the territorial limits of the United States in accordance with appropriate procedures and subject to the supervision of the United States courts. Precedent for such a grant of authority is found in section 20(c)(6)(b) of the Federal Trade Commission Act²⁹² which governs civil investigative demands (added by section 13 of the Federal Trade Commission Improvements Act of 1980)²⁹³ and in section 1312(d) of the Antitrust Civil Process Act,²⁹⁴ which confers similar civil investigative demand authority upon the Department of Justice. These statutes authorize the agency lawfully to serve its compulsory process abroad by registered mail, in accordance with the requirements of the foreign service of process provisions of the Federal Rules of Civil Procedure. Although, as a practical matter, proper service abroad of United States compulsory process would have no impact on the effect of a foreign nondisclosure law, once a plaintiff has determined to invoke the jurisdiction of the courts of the United States, all requisite procedural processes must be followed. Service of notice is one of the first of these procedural requirements.²⁹⁵ Where this service cannot be effected because the foreign state involved attaches criminal sanctions to such acts,²⁹⁶ service of notice within the United States should be undertaken to commence this action.

Once proper service of process has been effected, and a party or respondent has identified a conflicting legal obligation that impedes his ability to disclose the information demanded, procedures should be provided to guide the courts in the resolution of the conflict. In the first instance, the SEC should be required to establish an objective prima

²⁹² 15 U.S.C. §§ 41-51 (1982).

²⁹³ Federal Trade Commission Improvement Act of 1980, Pub. L. No. 96-252, 94 Stat. 374 (codified as amended at 15 U.S.C. §§ 41-57 (1982)).

²⁹⁴ 15 U.S.C. §§ 1311-14 (1982).

²⁹⁵ While, as noted, these jurisdictional needs must be balanced against competing foreign interests served by the nondisclosure law and the attendant invasion of sovereignty that results from requiring the production of protected information, it must be remembered that foreign institutions that enter the United States markets to seek and engage in profitable trading activities do so freely and presumably with full awareness of a comprehensive federal regulatory scheme. Thus, notice in this context should not be construed as notifying an entity of legal obligations of which it should already be aware.

²⁹⁶ See, e.g., Article 271 of the Swiss Penal Code which makes it a violation of Swiss sovereignty for any foreign government to request a Swiss resident to carry out acts within Swiss borders without the express permission of the Swiss government. StGB art. 271, CP art. 271, Cp art. 271.

facie showing that there is probable cause to believe that there has been a violation of the federal securities laws by someone without regard to either the information or to any inferences about the information that would be reached through breaching the foreign nondisclosure law. This showing must suffice to persuade foreign states that, prior to any invasion of the interests embodied in their nondisclosure principles, the SEC is not merely off on a "fishing expedition" but is examining the conduct in question because it has compelling reasons to believe that the federal securities laws in fact have been violated. The balancing of interests called for will require the SEC to show the existence of a strong indication that the prohibitions of the federal securities laws have been breached *and* that United States interests consequently were harmed.

Cases in which the alleged violation of the United States securities laws takes the form of insider trading or market manipulation would be presumed, as a matter of law, to demonstrate substantial harm to United States interests, by artificially affecting the markets on which the securities in question are traded. Thus, the situation described in the market transaction hypothetical provides an example of facts which tend strongly to suggest both a violation of the federal securities law and harm to the United States securities markets. By contrast, the requisite showing would not be satisfied when facts were available to the SEC that would suggest the occurrence of only a minor, technical violation in the form of a curable defect in a filed document.

When international conflicts of law are at issue, the authority to determine whether the SEC has a legitimate investigative interest must be separated from the agency and vested in the United States courts, since the SEC, as an independent regulatory agency, sets its own agenda and may investigate almost anything that piques its interest, notwithstanding the impediments of foreign nondisclosure laws. While this healthy curiosity historically has been supported by the courts that have addressed the scope of the SEC's domestic investigative authority, once international conflicts of law and foreign relations enter the picture, courts should no longer indulge so freely the SEC's inquisitive interests. At this threshold level, then, the SEC should have to satisfy a two-pronged test: first, the agency must present *prima facie* evidence that a violation of the federal securities laws has been committed; and second, there must be a reasonable basis for a court to find that piercing the protection of the foreign nondisclosure law would yield probative evidence of the violation that the SEC has alleged.

The determination as to the first part of this standard should not turn into a full-blown trial on the merits, but rather is intended to call

for a showing similar to that required under current case law for the SEC to obtain a temporary restraining order.²⁹⁷ Thus, as applied to the market transaction hypothetical, a second transaction in the securities of Company X — the sale of the securities at the increased, post-announcement price — would provide a sufficient indication that the violative activity was likely to be repeated to satisfy this standard.²⁹⁸

Of particular importance is the necessity of reaching these determinations in a summary fashion that would both protect all the various interests at stake and preclude the commencement of protracted litigation.

If the court is not satisfied that an adequate showing has been made, the SEC should then be precluded from exerting further compulsion in an effort to reach the protected information, such as by serving additional investigative subpoenas upon the same party or going to another forum to seek sanctions for noncompliance.²⁹⁹ Diplomatic and other consensual efforts, of course, should not be foreclosed, as negotiation is an approach to be encouraged in resolving conflicts of this sort.

If, however, the court finds that the SEC has satisfied both of these requirements, then, prior to the issuance of any order compelling disclosure in violation of the foreign nondisclosure law, the foreign institution should be given the opportunity to dispel the belief that it is the repository of the information sought by the SEC. At this juncture, further legislative measures would be necessary to enable the foreign institution to appear for the limited purpose of rebutting the SEC's allegations without thereby creating a broader basis for an assertion of jurisdiction. This appearance would be analogous to the former domestic United States law procedure for entering a special appearance for

²⁹⁷ The SEC is authorized by statute to seek permanent or temporary injunctive relief for violations of the Securities Act and the Exchange Act "upon a proper showing." 15 U.S.C. §§ 77t(b), 78y(d) (1982). Further, the SEC, unlike private plaintiffs, need not show that lack of an adequate remedy at law or failure to issue the order would cause irreparable injury: once the SEC shows that a person "is engaged or about to engage" in violative conduct, the statutory predicate for an injunction has been established. *See SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 807-09 (2d Cir. 1975), and cases cited therein.

²⁹⁸ To this end, it should be provided, by statute, that United States district court determinations as to these matters be subject to the procedural rule against interlocutory appeals.

²⁹⁹ This determination as to preclusion, however, should not be given *res judicata* effect beyond the specific facts alleged in the proceeding. If the SEC subsequently secured additional evidence in the course of its investigation that tended to suggest that the showing discussed above had been satisfied, the opportunity should be available for the agency to return to the original tribunal with its new information, in order to seek once again the evidence it believes to be located abroad. Interests of expedience would suggest that the same judge or magistrate who ruled on the Commission's original request should hear any such additional requests.

the sole purpose of contesting jurisdiction, without making a full appearance that would constitute consent to the tribunal's assertion of in personam jurisdiction. Thus, if, for example, the institution could produce an employee-witness who had sufficient knowledge of the facts to be able to testify, for example, that he entered the orders in question on behalf of foreign customers or that he ordered the trades for the entity and never spoke with anyone in or from the United States, the institution would be free to produce its witness without either the individual or the institution being deemed to have submitted to the full in personam jurisdiction of the United States courts.

By establishing a requirement that the SEC make this bifurcated showing, which must survive rebuttal by the foreign institution, prior to ordering testimony or production of documents that would violate the foreign nondisclosure law, courts would both ensure that vital United States interests are in fact at stake, and at the same time limit the affront to foreign interests to only those instances in which the intrusion is most likely to be justified; such an approach would prevent the protection created by foreign law from being improperly invoked to shelter fraudulent conduct from the reach of legitimate law enforcement proceedings. There can be no proper purpose for allowing foreign law to be used to shield illegal acts committed in the United States through foreign conduits.

This initial set of determinations should be properly delegated to the United States federal courts since the issues they embrace are peculiarly those of the United States. In exercising this authority, however, the United States courts must pay due respect to principles of comity. Findings that the interests of the United States must prevail over the precepts that underlie a foreign nondisclosure statute must not be couched in conclusory terms. Specific circumstances must be identified in which a United States court will or will not defer to another state's sovereign interests.

The next phase of adjudication which will constitute an avenue of appeal for the foreign institution, will be better left to foreign courts, inasmuch as the issues raised therein will require the expertise of the courts of the nondisclosure jurisdiction. After giving due deference to the determination of the United States court, the foreign tribunal should determine whether, under its law, overriding interests of its sovereignty (as opposed to the interests of the customer or the institution) require preservation of the nondisclosure principle, notwithstanding the SEC's showing of a probable violation of the United States securities laws.

While each nondisclosure jurisdiction will have to develop its own

body of decisional principles to govern these matters, two guidelines seem essential to realizing effective and fair adjudication. First, the SEC must have standing in the foreign tribunal to raise issues that arise from the applicable nondisclosure principle. If other foreign courts were to follow the precedent set last summer by the Supreme Court of The Bahamas³⁰⁰ (denying the SEC's request for relief due to lack of standing), the framework proposed today would fail to gain the acceptance of the United States. Standing to address claims that arise under foreign nondisclosure laws is essential if this new mechanism for resolution of international conflicts of laws is to succeed at the multinational level.

Second, courts involved in adjudicating the various levels of conflict resolution must recognize that, if a *prima facie* showing has been made that the foreign institution itself is a wrongdoer and has traded for its own account while in possession of inside information, no protection should be extended to that institution under the nondisclosure principles of its own jurisdiction. Foreign secrecy and blocking laws must not be invoked to shield foreign entities that enter the United States capital markets and transact their businesses in violation of the federal securities laws. Similarly, where the foreign institution has traded only for the account of its customer, but with full knowledge that the customer entered the order while in possession of inside information concerning the subject securities, the institution, as a willing aider and abettor of the customer's violation, should not be permitted to conceal either its customer's primary or its own secondary violation behind the screen of a nondisclosure principle.

Where, however, the foreign institution is only an unknowing conduit for the illegal transactions of a customer, and the foreign court, notwithstanding due deference to the United States court's determination as to the United States interests involved, finds that a countervailing interest of the foreign state outweighs the United States interests, the foreign court should then proceed to the next level of analysis: the court should examine whether, in view of all the facts and circumstances of the matter at hand, there is any possible exception to the nondisclosure law that would provide the SEC with some, if not all of the information it seeks. For example, it may be possible to provide information such as the citizenship of the customer in question, the legal status of the customer (i.e., whether that customer is a natural person or a corporation), and the date of the opening of the account through which the allegedly violative trades were placed, both without

³⁰⁰ See *supra* note 272 and accompanying text.

actually identifying the customer in question, thus preserving the integrity of the nondisclosure law. While this information would not get the SEC as far along as would the name and address of the customer who ordered the suspicious transactions, it would certainly help identify other possible avenues that the agency could explore, which might yield the desired information.

Additionally, if the foreign court does not order that the actual account identifying information be disclosed, courts in secrecy jurisdictions should order the institution to seek from its customer a voluntary waiver of the nondisclosure protection.

Once the two-prong test has been satisfied, and the foreign court, if its opinion is sought, has ruled that some measure of disclosure is to be made, the SEC should be provided with a rapid and effective vehicle for ascertaining whether the foreign institution possesses information that does in fact constitute evidence of the alleged violation of the federal securities laws. Care must be taken, however, to assure that this procedure will provide to the SEC only that information which is relevant to the specific matter at hand; such precautionary measures would minimize the degree of affront to the interests embodied in the foreign nondisclosure law.

In those instances where a United States court finds that the SEC has made the requisite showing, but the foreign tribunal determines that no information will be disclosed to the SEC, it must be clearly understood that the SEC will not be foreclosed from proceeding *in rem* against any assets of the foreign institution that are located in the United States. By proceeding in this fashion and by attaching funds that can be used to make whole those persons harmed by the illegal trading, the SEC will at least be able to seek vindication of the economic interests thereby harmed. Only where a United States court finds that the SEC has not satisfied the requirements discussed above would the agency be precluded from an *in rem* proceeding.

This proposed mechanism for resolving conflicts between foreign nondisclosure laws and the SEC's need for information concerning illegal trading in the United States securities markets requires a measure of restraint on the part of all courts involved in the process. Considerable attention must be paid to the potential consequences before the courts of any country, including those of the United States, determine that another state's interests are not to be carried out in the context of a particular dispute. Notwithstanding the balancing of interests by courts of both jurisdictions, this carefully tailored framework will, in some instances, still result in a diminution of the protection provided by the nondisclosure laws. Foreign institutions, however, will have to accept

this result as part of the price of entering the United States trading markets. Nondisclosure jurisdictions also recognize that information which would otherwise be protected may occasionally have to be provided to law enforcement authorities, in order to vindicate the rights of the public.

In those matters where a satisfactory result cannot be reached by proceeding through the courts in the above fashion, the only remaining possibility for discovering the identity of customers of these foreign institutions will continue to be by means of intergovernmental negotiations. While these diplomatic efforts are invariably slow and laborious, it is anticipated that under this new system of conflict resolution, only the most intractable problems in the most serious cases would be incapable of resolution by means of the adjudicatory procedure outlined above. Indeed, in this sort of case it may be more appropriate to resolve the conflict of laws at the highest levels of both governments that are involved in the matter, rather than to relegate such important issues to the courts.

In the final analysis, the instrumentalities of the United States government, including its courts and regulatory agencies, will have to adjust to the changing contours of the internationalized capital markets. The SEC and other United States agencies will have to be prepared to give credence to determinations made by foreign courts if they wish those courts to pay deference to the decisions of United States tribunals. Cooperation and respect for judicial processes require reciprocity at the multinational level. Regardless of any formal mechanisms that may be put into place, there will continue to be a significant role for diplomatic and other negotiated efforts in the resolution of the tension between the enforcement of the United States securities laws and foreign nondisclosure principles.