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Secrecy and Blocking Laws: A Growing Problem as the Internationalization of Securities Markets Continues

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NOTES

SECRECY AND BLOCKING LAWS: A GROWING PROBLEM AS THE INTERNATIONALIZATION OF SECURITIES MARKETS CONTINUES

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I. INTRODUCTION

National securities markets are rapidly becoming international markets; the establishment of an integrated worldwide capital market system is only a few years away.[1] Consequently, each country's domestic securities markets will increasingly become affected by conduct initiated outside its borders.[2] Currently, United States courts recognize the extraterritoriality of United States securities laws in situations in which fraudulent activity conducted outside the United States affects investors on United States markets or in which the United States is used as a base for fraudulent activity that occurs abroad.[3] Although the limits of the extraterri-

1. *See infra* notes 10-28 and accompanying text.

2. Thomas, *Extraterritoriality in an Era of Internationalization of the Securities Markets: The Need to Revisit Domestic Policies*, 35 RUTGERS L. REV. 453, 455 (1983) [hereinafter cited as Thomas].

3. United States courts have generally applied United States securities laws extraterritorially "only when there has been some conduct occurring within the United States or some significant impact on United States investors or on the United States securities markets." Larose, *Conflicts, Contacts, and Cooperation: Extraterritorial Application of the United States Securities Laws*, 12 SEC. REG. L.J. 99, 102 (1984) [hereinafter cited as Larose] (quoting Hacker & Rotunda, *The Extraterritorial Regulation of Foreign Business Under the U.S. Securities Laws*, 59 N.C. L. REV. 643, 648 (1981)). To determine the existence of subject matter jurisdiction, courts have used either the "conduct" test or the "effects" test. Much case law and commentary exists on the extraterritorial reach of

torial application of domestic securities laws are unclear, United States courts may enforce domestic securities laws when a person contracts with a foreign financial intermediary[4] to initiate transactions in United States markets.[5]

Even when a foreign transaction is subject to United States securities laws, conflicts between legal systems often make enforcement of United States laws difficult for the Securities and Exchange Commission (SEC). A major difficulty which has confronted the SEC and other United States government agencies for decades has been the policing of transactions effected through foreign institutions in countries with secrecy and blocking laws.[6]

United States securities laws. For more information on this debate, see Larose, *supra*, at 99; Thomas, *supra* note 2, at 453; Comment, *Securities Regulation—Extraterritorial Application—Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 4 N.Y.L. SCH. J. INT'L & COMP. L. 187 (1982).

4. Many of these foreign intermediaries are banks. Unlike United States banks which are prohibited from involvement in securities activities under the Glass-Steagall Act, banks in a number of foreign nations may play an intermediary role for clients in securities transactions. Swiss banks, for example, may act as stockbrokers, underwriters, and mutual fund managers. Note, *Banking Secrecy and Insider Trading: The U.S.-Swiss Memorandum of Understanding on Insider Trading*, 23 VA. J. INT'L L. 605, 611 (1983). *See* Letter from the law firm of Baker & McKenzie to Shirley E. Hollis, Acting Secretary, Securities and Exchange Commission 9 (November 29, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") (German banks also function as stock brokers) [hereinafter cited as Baker & McKenzie].

5. *See* Fedders, Wade, Mann & Beizer, *Waiver by Conduct—A Possible Response to the Internationalization of the Securities Markets*, 6 J. COMP. BUS. & CAP. MKT. L. 1, 3-4 (1984) [hereinafter cited as *Waiver by Conduct*]; Note, *The Effect of the U.S.-Swiss Agreement on Swiss Banking Secrecy and Insider Trading*, 15 LAW & POL'Y INT'L BUS. 565, 605 (1983).

In some situations, a "significant subsidiary" of an American-based multinational corporation which is located outside the United States may be automatically subject to United States securities laws. *See Waiver by Conduct*, *supra*, at 5.

6. Enforcement problems associated with secrecy and blocking laws are not unique to the SEC. Nondisclosure laws often hinder other federal agencies' investigations of narcotics trafficking, tax fraud, tax evasion schemes, antitrust violations, and other frauds committed through foreign banks secrecy and blocking jurisdictions. *See* Fedders, *Foreign Secrecy: A Key to the Lock*, N.Y. Times, Oct. 16, 1983, § 2, at 2, col. 3. Congress has held several hearings in the past decade concerning the use of banks in secrecy jurisdictions to facilitate criminal activity in the United States. *See, e.g., Crime and Secrecy: The Use of Offshore Banks and Companies: Hearings Before the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs*, 98th Cong., 1st Sess. 1 (1983).

Secrecy and blocking laws enable a person to circumvent United States securities laws by conducting securities transactions through financial entities in nondisclosure jurisdictions; neither the individual's identity nor other information pertaining to the transaction will be available to the SEC for enforcement purposes. Generally, the only effective means by which the SEC can obtain this information is time-consuming litigation which may damage relations between the nations involved.[7] Thus the growing internationalization of the world securities markets is likely to add to the SEC's enforcement problems with foreign nondisclosure laws and jeopardize relations between the United States and foreign countries with secrecy and blocking laws. Furthermore, such failure to enforce United States securities laws may ultimately impugn the perceived fairness and integrity of United States markets.

In response to the increasing enforcement problems, the SEC issued a Release for Comments on July 30, 1984.[8] In the Release, the SEC proposed for legislation a "waiver by conduct" concept in which the purchase or sale of securities listed on United States markets would constitute an implied consent to the disclosure of relevant information to the SEC. Thus, entering into such a transaction would waive the applicability of foreign secrecy laws. Although the Release specifically sought comments on this approach, it emphasized that the purpose of the Release was to create a "neutral forum" for the discussion of the enforcement problems caused by foreign secrecy and blocking laws, and it requested other proposals for addressing these problems. The SEC wanted to obtain responses with "analytical evaluations of the factual, legal and policy questions that are relevant to determining how the [SEC] can best police the internationalized United States capital markets."[9]

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7. Fedders, *Policing Internationalized U.S. Capital Markets: Methods to Obtain Evidence Abroad,* 18 INT'L LAW. 89, 90 (1984) [hereinafter cited as *Policing Internationalized U.S. Capital Markets*]. *See infra* notes 85-116 and accompanying text.

8. Request for Comments Concerning a Concept to Improve the Commission's Ability to Investigate and Prosecute Persons who Purchase or Sell Securities in the U.S. Markets from Other Countries, Release No. 21186, File No. S7-27-84, July 30, 1984, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. (BNA) 1305 (Aug. 3, 1984) [hereinafter cited as Release].

9. *Id.* at 3, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1305. At the time the Release was issued, the SEC had not endorsed the waiver by conduct

This Note examines the problems recently faced by the SEC in policing securities transactions effected by foreign financial institutions in jurisdictions with secrecy and blocking laws, and it proposes both a short-term solution and a long-term solution to the SEC's enforcement problems. Part II of the Note outlines the problems confronting the SEC, specifically addressing the growing internationalization of securities markets and the effects on United States markets. This section also examines the problems confronting the SEC as a result of secrecy and blocking laws, and it suggests that unless new enforcement procedures are developed, these problems will increase when a fully integrated capital market system is established. Part III discusses the means the SEC currently uses to pierce secrecy and blocking laws and the difficulties and frustrations associated with the utilization of those methods. While Part IV examines the waiver-by-conduct concept and evaluates its potential effects, Part V looks at other possible alternatives. Finally, Part VI analyzes the role of secrecy and blocking laws in securities markets and the issues confronting nations that attempt to resolve these enforcement problems; Part VII concludes with a suggested approach.

II. THE PROBLEM

A. Internationalization of Securities Markets

Capital markets throughout the world are rapidly becoming internationalized. Shares of more than 500 major corporations currently are being traded upon at least one exchange other than a home country exchange.[10] Also, the number of transnational securities transactions has increased greatly. Although lack of coordination among national stock exchanges and securities firms has

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proposal because of "factual, legal and policy questions that require further evaluation." *Id.* at 2, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1305.

10. Thomas, *Securities Regulators Grapple with Extraterritoriality,* Legal Times, Jan. 17, 1983, at 20. *But see* Summer, *Notable Achievements Mark SEC's History,* Legal Times (Supplement: The SEC at 50), Oct. 8, 1984, at A-8, col. 4(stating that at least 236 corporations in the world have actively traded stock in at least one foreign market and that 84 of these companies are from the United States).

One example is British Telecommunications PLC, which, as a result of a global offering, has stock in five markets in London, New York and Tokyo. *As Global 24-Hour Trading Nears, Regulators Warn of Market Abuses,* Wall St. J., Feb. 11, 1985, at 25, col. 4 [hereinafter cited as *Global Trading Nears*].

limited present global trading to only a few investment professionals,[11] some securities industry officials have predicted that an integrated international trading market could be established within five years.[12]

The acceleration of the internationalization of world securities markets has resulted from technological advances in the telecommunications field and increased availability of rapid international travel.[13] Other factors encouraging internationalization include increased liquidity and trading volume in major securities markets,[14] the creation of capital markets in developing countries, and the lenient securities regulations governing many of the markets.[15] Consequently, major banks and securities firms, including several based in the United States, have expanded their international operations and encouraged more companies to list their stocks on foreign exchanges.[16]

Stock exchanges are also establishing international trading links between markets. The SEC has already approved the establishment of two sets of electronic trading linkages, one between the American Stock Exchange and the Toronto Stock Exchange, and another between the Boston Stock Exchange and the Montreal Stock Exchange.[17] Securities analysts are predicting that the next linkage to be established will be between the New York

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11. *Global Trading Nears, supra* note 10, at 25, col. 4.

12. John S.R. Shad, SEC Chairman, suggests that an integrated global system could be established within the next two years. *Global Trading Nears, supra* note 10, at 25, col. 5.

13. *Global Trading Nears, supra* note 10, at 25, col. 4; *Policing Internationalized U.S. Markets, supra* note 7, at 105.

14. These markets include New York, Tokyo, London, Zurich, Osaka, and Toronto. *Waiver by Conduct, supra* note 5, at 1. *See id.* at 40 n.1.

15. *Global Trading Nears, supra* note 10, at 25, col. 4; Fedders, *"Waiver by Conduct" Idea Deserves Closer Look,* Legal Times, Sept. 3, 1984, at 10, cols. 3-4 [hereinafter cited as *Waiver by Conduct Idea*]. Currently, thirty-five developing countries have equity exchanges. *Id.*

16. *Global Trading Nears, supra* note 10, at 25, col. 5.

17. Address by Michael D. Mann, Chief, Office of International Legal Assistance, Division of Enforcement, U.S. Securities and Exchange Commission, in Zurich, Switzerland 2 (Nov. 12, 1985) [hereinafter cited as Mann]. The Boston Stock Exchange requested the SEC's permission to establish an electronic trading link with the Montreal Stock Exchange shortly after the Commodities Exchange Commission approved the formation of a link between the Chicago Mercantile Exchange and the Singapore International Exchange. *Inside: The SEC,* Wash. Post, Sept. 7, 1984, at A-15, col. 1.

Stock Exchange and the London Stock Exchange.[18] Such links would allow investors to trade twenty-four hours a day, seven days a week, in any nation or market.[19]

The increase in the number of markets and of transnational trading may promote liquidity, efficiency, competition, and innovation in national markets.[20] Due to the availability of global twenty-four hour trading, investors will be able to react quickly to news which may affect their investments.[21] Also, integrated markets may encourage investors to invest in foreign companies.[22]

Unless nations with securities markets intensify their enforcement efforts, internationalization of capital markets may also increase the opportunities for securities fraud which could have adverse transnational effects. First, integrated markets and increased trading volume may hinder greatly the policing efforts of market regulators.[23] Compounding this problem are the the differing laws of and the intensity of regulation by nations.[24] Actions which may be legal in some nations may be prohibited in other countries. For example, a few nations have expressly banned insider trading.[25] Thus, shares legally traded on insider

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18. Mann, *supra* note 17, at 2. London has surpassed Switzerland as the leading financial center in Europe. In 1984, London handled nearly 80% of new international bond issues. Switzerland, which had previously dominated the market, handled only 12% of the issues. *See Switzerland's Banking Gnomes Aren't the Magnet They Once Were for International Cash Hoards,* Wall St. J., Jan. 31, 1985, at 32, col. 1 [hereinafter cited as *Switzerland's Banking Gnomes*].

19. Although probably no market would remain open for 24 hours, the hours of the stock exchange in the United States, Japan, and London will overlap. *SEC to Take Up Waiver by Conduct by Early Spring 1985, Fedders Says* [July-Dec.] 16 SEC. REG. & L. REP. (BNA) 1960 (July 14, 1984) [hereinafter cited as *SEC to Take Up Waiver by Conduct*].

20. Fedders & Mann, *Waiver by Conduct vs. Fraud,* Wall St. J., Dec. 21, 1984, at 18, col. 4.

21. *See Global Trading Nears, supra* note 10, at 25, col. 5-6.

22. *Id.* at col. 6.

23. Hawes, *Swiss Insider Trading Bill Brings Lively Debate,* Legal Times, July 16, 1984, at 19, col. 1.

24. *See Global Trading Nears, supra* note 10 at 19, col. 6. For example, disclosure requirements in the United States are far more comprehensive than requirements in any other nation.

25. Sweden and Switzerland have recently proposed legislation prohibiting this activity. *See Swedish Government Proposes Bill to Make Insider Trades Illegal,* Wall St. J., Feb. 19, 1985, at 39, col. 1. *See infra* note 170 and accompanying text; Letter from Mary Condeelis, Executive Director, Bankers' Association for Foreign Trade 4 (Nov. 30, 1984) (Comment on SEC Release No. 21186,

information in one country could adversely affect stock on an exchange in a country in which insider trading is illegal. Last, as national markets increase their liquidity, the incidents of fraud and market manipulation will probably increase, particularly if enforcement of these markets remains minimal.[26] If others perceive that investors in a particular market are immune from market regulation, that market may lose its perceived fairness and integrity and may ultimately collapse.[27] Once one market loses its integrity, the integrity of every market may be in jeopardy.[28]

The internationalization of securities markets is rapidly approaching its fruition. Although internationalization may bring many benefits to investors, issuers, and to the market system, it may also affect the fairness and integrity of capital markets. The scope of such a problem and the potential solutions must be considered before an integrated securities market is established.

B. Internationalization and Its Effects on United States Securities Markets

The SEC and other United States securities analysts are greatly concerned about the effect of the impending integration of securities markets upon domestic markets.[29] Some analysts be-

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File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Bankers' Association for Foreign Trade]; Letter from Andreas F. Lowenfeld 6 (Nov. 26, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Lowenfeld]. Denmark, France and Great Britain have specifically enacted legislation banning insider trading. Norway requires the registration of a transaction involving a company's shares if top executives in that company are "involved" in the transaction. Germany and the Netherlands regulate insider trading through rules of professional ethics. Capitani, *Response to Fedders "Waiver by Conduct,"* 6 J. COMP. BUS. & CAP. MKT. L. 331 (1984).

26. *See* Note, *supra* note 5, at 566-67. For example, the London markets are beginning to experience problems with fraud, particularly in the largely unnegotiated Eurobond market. The London Stock Exchange has also been considering means of improving investor protection. Letter from J.R. Knight, Chief Executive, The London Stock Exchange 1, 3 (Nov. 9, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as The London Stock Exchange].

27. The demise of the $290 billion Kuwaiti securities market has been cited as an example of a stock market which collapsed after its integrity was questioned. *SEC to Take Up Waiver by Conduct, supra* note 19, at 1960.

28. *Policing Internationalized U.S. Capital Markets, supra* note 7, at 91; *Waiver by Conduct Idea, supra* note 15, at 10, col. 3-4.

29. *See infra* notes 38-40 and accompanying text.

lieve that the United States possesses the most predominant capital market system in the world.[30] The large volume in trading and confidence in the integrity of the United States markets have attracted growing numbers of foreign investors.[31] In 1983 purchases of United States securities by foreign persons and institutions totalled approximately $133 billion.[32] Also, foreign investors own approximately ten percent of the stocks listed on the New York Stock Exchange.[33]

While foreign investors are purchasing United States stocks listed on domestic securities markets, a growing number of foreign issuers are making public offerings on United States markets. In 1983 foreign issuers had registered approximately $6 billion of securities with the SEC. That same year, forty-seven foreign corporations raised $2.8 billion of equity capital on United States markets.[34] By June 30, 1984, 273 foreign issuers had registered with the SEC to trade on United States markets, and an additional 518 foreign issuers were exempt from registering their offerings in accordance with Rule 12g 3-2(b) of the Securities Exchange Act of 1934.[35]

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30. John S. R. Shad, Chairman of the SEC, has stated that the United States has "by far the best capital markets the world has ever known—the broadest, the most active and efficient, and the fairest." *Waiver by Conduct, supra* note 5, at 2.

31. In 1983, foreign transactions on the U.S. markets totaled $540 billion. *Inhousekeeping: Comments of the American Corporate Counsel Association (ACCA)*, Legal Times, Nov. 12, 1984, at 13, col. 3-4.

32. Foreign purchases of U.S. corporate stock and bonds tripled over a period of five years, increasing from $23.6 billion in 1978 to $79.8 billion in 1983. During this period, foreign purchases of marketable treasury bonds and notes increased from $32.4 billion to $129.8 billion. Foreign purchases of securities issued by U.S. government corporations and federal agencies increased from $4.5 billion to $14 billion between 1978 and 1983. *Waiver by Conduct Idea, supra* note 15, at 13, col. 1. *But see* Letter from Sam Scott Miller, Vice President, General Counsel and Secretary, Paine Webber Group Inc. 5 (Dec. 12, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Paine Webber]. In 1983, 73% of all foreign purchases of shares issued by U.S. corporations came from five Western European nations and Canada. *Id.* at 3-4.

33. *Waiver by Conduct Idea, supra* note 15, at 14, col. 3 n.10.

34. *Id.* at 14, col. 3 n.11.

35. *Id.* at 14, col. 3 n.12. Foreign government issuers filed with the SEC 14 registration statements pertaining to offerings totalling $5.3 billion in 1983. In the first six months of 1984, foreign government issuers filed eight registration statements. *Id.* at 13, col. 1-2.

The issuance and trading of foreign securities on United States securities markets benefits investors by requiring more disclosure of information about foreign companies than that required in other nations. Other advantages include greater investment opportunities, reduced transactional expenses, more intensive research provided by United States brokers, and lower risks associated with investment in foreign companies.[36]

The SEC has actively encouraged foreign participation in United States securities markets by enacting regulations which facilitate registration for foreign issuers. Since disclosure and registration requirements in the United States are generally stricter than requirements in other countries, the SEC has developed new rules which would accommodate foreign issuers without compromising investor protections. Some of these new regulations provide for the integration of registration and reporting requirements and the availability of short-form statements. The regulations also provide easier reconciliation of foreign financial statements to the required GAAP practice used by domestic corporations, and they require that foreign corporations listed on the NASDAQ Quotation System be placed on a regulatory scale similar to those corporations listed on United States exchanges.[37]

United States securities analysts, the SEC, and other government officials are concerned that the present acceleration in the internationalization of securities markets could affect the United States securities markets in two related ways. First, many officials believe that the integration of markets could increase the potential for fraud and thereby impugn the integrity of the United States market system.[38] Second, United States government officials also fear that internationalization could increase competition between securities markets and thereby threaten their country's dominance.[39] Thus, to permit both foreign and domestic investors

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36. Thomas, *Internationalization of the Securities Markets: An Empirical Analysis*, 50 GEO. WASH. L. REV. 155, 167-75 (1982)[hereinafter cited as *Empirical Analysis*].

37. For more information on the SEC's efforts in this area, see Thomas, *supra* note 2, at 468-71; *Empirical Analysis, supra* note 36, at 155-59.

38. *Waiver by Conduct Idea, supra* note 15, at 10, col. 4; *Policing Internationalized U.S. Capitalized Markets, supra* note 7, at 91. Other countries whose markets are not as regulated as the U.S. markets believe that the intense regulation actually turns off investors, and the "extra integrity it allegedly produces [is] an illusion." *Conduct unbecoming?*, THE ECONOMIST, Jan. 5, 1985, at 62.

39. Senator William Proxmire (D.-Wis.) has suggested that the SEC begin

and issuers to reap the benefits of the United States markets and to ensure that the United States system remains competitive, fair and efficient, the SEC must police the market.[40]

Increased foreign participation in United States securities markets has already caused problems for the SEC, particularly the policing of transactions occurring in the United States but ordered or initiated in other countries with secrecy and blocking laws. Any conduct within the United States which violates domestic securities laws, whether initiated in the United States or in a foreign jurisdiction, threatens the integrity of United States markets.[41] Thus, in order for the SEC to police transactions originating in other countries, new enforcement mechanisms are needed.

C. The Laws

1. *Secrecy Laws*

The increase in foreign participation in United States securities markets includes a growing number of securities transactions initiated by financial institutions located in countries with secrecy or blocking laws.[42] According to one estimate, approximately 100% of foreign purchases of stocks and bonds in United States markets in 1983 were conducted by institutions which are protected by secrecy or blocking laws; twenty-five percent of these transactions originated in Switzerland.[43]

Bank secrecy laws protect the confidentiality of information held by financial institutions. These laws prohibit the disclosure of bank customer identity, business records, and other details re-

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planning for the rapidly approaching integration of securities markets by establishing an advisory committee which would consider "the effects of technological developments on off-the-floor trading, the need for greater international cooperation in market surveillance and enforcement, the design of a world-wide clearing system for securities transactions and the SEC's future role." *SEC Begins Securities Industry Talks on Global Trading Within 2 Years,* Wall St. J., Jan. 4, 1985, at 4, col. 2.

40. 42 Fed. Reg. 3312, 3313 (1977) (synopsis of an amendment to Rule 17a-3(a)(9)).

41. *Policing Internationalized U.S. Capitalized Markets, supra* note 7, at 90.

42. *Id.* at 91.

43. Editorial, *A Question of Conduct,* Wall St. J., Nov. 19, 1984 at 32, col. 1. "In 1984, Swiss participation in the U.S. market accounted for almost one-sixth of foreign trading, over $20 billion." *Mann, supra* note 17, at 1-2.

lating to a customer's bank account. Any disclosure of this information without the customer's permission may subject the offender to criminal prosecution, civil liability, or both.[44]

Approximately twenty nations maintain some form of bank secrecy limitation. Determining the precise number of nations having secrecy laws is difficult since bank secrecy protection is not always enacted in explicit statutes. Instead, secrecy protection may be granted in common law, in statutory or constitutional provisions pertaining to privacy, or in contract or tort law.[45]

Nations with secrecy laws generally view confidentiality as a fundamental right.[46] The protections accorded by bank secrecy laws have been compared to the attorney-client privilege in the

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44. Note, *Foreign Bank Secrecy and the Evasion of United States Securities Laws*, 9 N.Y.U. J. INT'L L. & POL. 417 (1977). Most bank secrecy statutes impose criminal liability for violations of the statute. For example, the Bahamas bank secrecy statute imposes a prison term of up to two years, a maximum fine of $15,000 or both. Both Switzerland and Liechtenstein's bank secrecy statutes provide for a prison term, fine or both if violation of the statute is willful while violations deemed to be negligent are punished by the levy of a fine. For other examples, see *Waiver by Conduct, supra* note 5, at 33.

45. The following jurisdictions have enacted bank secrecy statutes: Switzerland, the Federal Republic of Germany, Austria, El Salvador, Greece, the Cayman Islands, the Bahamas, Costa Rica, Liechtenstein, and Panama. The following jurisdictions maintain a tradition of bank secrecy but have not enacted a bank secrecy statute: the United Kingdom, the Netherlands, Israel, Anguilla, Antigua, Barbados, Bermuda, Montserrat, St. Vincent, and the Turks and Caicos. Letter from James D. Cockwell, Chairman, Institute of Foreign Bankers, Inc. 4 n.3 (Dec. 1, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Cockwell Letter]. *See Waiver by Conduct, supra* note 5, at 30. *But see* Note, *supra* note 44, at 422 n.24 (which states that 27 countries have some sort of bank secrecy laws); and Release, *supra* note 8, at 11, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1307 (which states that 15 nations have secrecy laws).

Because not all bank secrecy laws are found in a bank secrecy statute, determining the scope of information covered by bank secrecy prohibitions is very difficult. Even if the prohibition is statutory, many of these statutes do not define the scope of the provision. *See Waiver by Conduct, supra* note 5, at 32; Letter from James E. Buck, Secretary, New York Stock Exchange 4 (April 29, 1977) (Response to SEC Release No. 34-13149 on Records with Respect to Beneficial Ownership of Accounts Carried by Brokers and Dealers, Amendment to Rule 17a-3(a)(e)).

46. Bank secrecy principles originated in early Roman and Germanic law as an aspect of the right to privacy. Many civil law jurisdictions since have considered financial privacy to be "an integral part of liberty and personal independence." Note, *supra* note 4, at 607-08.

United States since "[b]oth restrict discovery of information in order that principles perceived as more fundamental [might be] upheld."[47] Nevertheless, nations with secrecy laws generally permit disclosure if a customer waives his right to the confidentiality protections accorded to him under law. While some countries require the waiver to be expressly made, other countries in certain circumstances permit implied waiver.[48] Also, some countries require disclosure of information for inheritance, tax fraud, and bankruptcy proceedings if ordered by a domestic court or in other prescribed circumstances.[49]

One purpose of developing bank secrecy laws was the desire of some countries to protect bank customers from oppression by both foreign and domestic governments. For example, Switzerland enacted its bank secrecy statute in response to Nazi Germany's attempts to obtain the identity of German Jews who had fled Germany and opened bank accounts in Switzerland; the Swiss government was concerned that some Swiss bank employees were cooperating with the Nazis.[50] Another purpose of bank secrecy laws is to attract foreign capital.[51] Switzerland's secrecy and tax laws made that country one of the world's leading financial centers,[52] and other countries would like to emulate Switzerland's success.

2. *Blocking Laws*

Approximately sixteen nations have enacted blocking statutes,[53] which prohibit the disclosure, inspection, copying and re-

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47. Baker & McKenzie, *supra* note 4, at 2.

48. *Waiver by Conduct, supra* note 5, at 30.

49. *See id.* at 35.

50. The Swiss statute codifies a tradition originating in the 17th century when French Huguenots came to Switzerland to flee religious persecution. *Waiver by Conduct, supra* note 5, at 31. *See* Bankers' Association for Foreign Trade, *supra* note 25, at 4.

51. *Waiver by Conduct, supra* note 5, at 31.

52. *Switzerland's Banking Gnomes, supra* note 18, at 32, col. 1.

53. Release, *supra* note 8, at 11, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1307. These nations include Great Britain, France, the Federal Republic of Germany, Canada, Australia, Denmark, Finland, Belgium, Greece, Italy, the Netherlands, New Zealand, Norway, the Philippines, Sweden, and Switzerland. *Waiver by Conduct, supra* note 5, at 36. Some countries have enacted both blocking and secrecy laws. *See* Memorandum from Subcommittee on Enforcement and Litigation to Committee on Securities Regulation 3 n.1 (Oct. 9, 1984) (preliminary memo prepared by the Bar Association of the City of New York's

moval of documents from a country. Because the purpose of such laws is to protect national interests, private individuals may not waive the applicability of these statutes.[54] Discovery blocking statutes and judgment blocking statutes are the two major types of blocking laws. Discovery blocking statutes prohibit compliance with requests for documents by foreign courts, agencies, or individuals. Some discovery blocking statutes allow compliance with a foreign discovery request if government officials grant permission; others generally permit compliance with discovery requests unless government officials affirmatively invoke the statute and prohibit the granting of the request.[55] Judgment blocking laws, unlike discovery blocking laws, provide that under certain circumstances, the decisions of foreign courts or administrative agencies will not be recognized.[56] Violators of either type of blocking law may be subject to fines, imprisonment, or both.[57]

Many countries adopt blocking laws in response to the United States' efforts to conduct investigations or to regulate conduct within foreign countries,[58] viewing such action as an invasion of sovereignty.[59] A nation may also complain that its compliance with United States discovery requests would infringe upon the integrity of its judicial system because the United States permits broader pretrial discovery than that generally allowed in other countries.[60] Some countries believe that at times the United States applies its laws when the transnational occurrence has no substantial connection to the United States.[61] Furthermore, countries often complain when the United States attempts to apply extraterritorially substantive provisions of domestic laws pertaining to economic conduct, particularly provisions of antitrust law.[62]

Securities Law Committee regarding the SEC's request for Comments on Waiver by Conduct) [hereinafter cited as New York City Bar Association].

54. New York City Bar Association, *supra* note 53, at 3 n.1, 9-10. *See Waiver by Conduct Idea, supra* note 15, at 14, col. 2.

55. *Waiver by Conduct, supra* note 5, at 35.

56. *See id.* at 36-37.

57. *Id.* at 37.

58. *See infra* notes 275-87 and accompanying text.

59. *See Waiver by Conduct, supra* note 5, at 36; Lowenfeld, *supra* note 25, at 5.

60. *Waiver by Conduct, supra* note 5, at 37.

61. *Id.* at 36.

62. Foreign countries are particularly concerned about the extraterritorial application of U.S. antitrust laws because these laws are generally broader in scope than the antitrust laws enacted by other countries. Unlike U.S. antitrust

Such actions may ultimately prompt more foreign nations to enact blocking statutes.

3. *Effect of the Laws on SEC Efforts*

Secrecy and blocking laws may prevent the SEC from obtaining information needed to adequately police foreign participation in United States securities markets.[63] As part of its responsibility to administer and enforce securities laws, the SEC has the power to conduct investigations and to issue subpoenas requiring the testimony of witnesses and the production of relevant documents.[64] Courts have generally given the SEC much discretion to issue subpoenas; probable cause that a violation has occurred or will occur is not a requisite in issuing a subpoena.[65] The geographical scope of the subpoena extends to documents and witnesses located both in and outside of United States territory.[66] If the subpoena is ignored, the SEC may obtain a court order compelling compliance.[67]

When the SEC suspects a violation of the securities laws, and when the misconduct has occurred entirely within the United States, the SEC may issue a subpoena to the broker and customer requesting records, documents, and testimony. If the person or

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laws, most foreign countries rarely permit private suits. Foreign countries are also concerned that treble damage awards available under U.S. antitrust laws may cripple foreign industries. *Id.* at 37. Countries have reacted to the extraterritorial application of U.S. antitrust laws by enacting blocking statutes. *See* Cockwell Letter, *supra* note 45 at 12.

63. Release, *supra* note 8 at 11, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1307.

64. *See* Securities Exchange Act of 1934, 15 U.S.C. § 78u(a)-(b) (1982). Section 78u(b) states:

> (b) For the purpose of any such investigation, . . . any member of the Commission or any officer designated by it is empowered to administer oaths and affirmations, subpoena [sic] witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Commission deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

65. Merrifield, *Investigations by the Securities and Exchange Commission*, 32 BUS. LAW. 1583, 1601 (1977).

66. *Policing Internationalized U.S. Capital Markets*, *supra* note 7, at 94-95 (citing SEC v. Minas de Artenisa, SA, 150 F.2d 215 (9th Cir. 1945)).

67. *See* Securities Exchange Act of 1934, *supra* note 64, at § 78u(c).

entity which the SEC wishes to subpoena is found within the United States, service of the subpoena may be made by delivering a copy of the subpoena to that person pursuant to the SEC's Rules of Practice.[68] Neither the mode of service nor the existence of in personam jurisdiction can be challenged if these Rules are followed.[69] If service has been effective and the subpoena is not obeyed, the SEC may seek a court order compelling compliance.[70]

Although the SEC has the power to request information located overseas, the SEC may have problems obtaining this information if a subpoena must be served overseas, particularly to a foreign citizen.[71] In *Federal Trade Commission v. Compagnie de Saint-Gobain-Pont-a-Mousson*,[72] the court distinguished the service of an investigative subpoena from the service of a summons and complaint. The court held that an investigative subpoena is compulsory and that service of such a subpoena is an exercise of United States sovereignty. The direct service of this type of subpoena to a foreign citizen in a foreign country without the "initial request [through] established channels of international judicial assistance" would constitute a violation of international law.[73]

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68. *See* Securities and Exchange Commission Rules of Practice, 17 C.F.R. § 201.14(b)(3) (1933).

69. *Policing International U.S. Capital Markets, supra* note 7, at 95-96.

70. *See supra* note 67 and accompanying text. For more information about SEC investigatory procedures, see Merrifield, *supra* note 67.

71. International law may permit the extraterritorial application of U.S. securities laws if conduct occurring within the United States has an effect outside U.S. territory or if conduct occurring outside U.S. territory has an impact in the United States. Restatement (Second) of Foreign Relations Law §§ 17, 18 (1965) [hereinafter cited as Restatement]; *see supra* notes 1-3 and accompanying text.

72. 636 F.2d 1300 (D.C. Cir. 1980).

73. *Id.* at 1313. The court further noted that direct service of an investigatory subpoena in a foreign country would not violate international law if that country consented to service of process by signing an international agreement or by specifying a procedural mechanism to be followed. The court gave as an example of such an international agreement the Multilateral Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, *done* 15 Nov. 1965, [1969] 20 U.S.T. 361, T.I.A.S. No. 6638, 658 U.N.T.S. 163 [hereinafter cited as the Hague Convention of 1969]. The Hague Convention does provide for general consent to service of compulsory powers upon its signatory's citizens. Nonetheless, the Convention also permits each signatory to refuse to comply with a request for documents "if it deems that compliance would infringe its sovereignty or security." 636 F.2d at 1313 n.69 (citing Hague Convention of 1969, art. XIII). An example of such a procedural mechanism is the United States-Swiss Memorandum of Understanding. *See infra*

Thus, if the SEC desires to serve an investigative subpoena upon a foreign citizen on foreign soil, it must either request permission from the foreign country, or resort to mechanisms established by an international convention or by the foreign country itself.[74]

Even in circumstances to which the holding of *Compagnie de Saint-Gobain* is inapplicable,[75] the SEC may still be unable to obtain evidence relevant to transnational securities transactions if that information is protected by secrecy or blocking laws. If such laws are applicable,[76] the customer under investigation may not be obligated to comply with the request or the foreign government may not allow compliance. In those situations, the SEC does not know the identity of the customer, and it is forced to request information from the foreign financial institution which effected the transaction. If the foreign entity has effected the transaction through a United States brokerage firm, the domestic firm may only direct the SEC to the foreign financial institution since the foreign financial institution may be the only customer that the firm knows.[77] Often the foreign financial institution will be unable to comply with the request even though it wishes to, because compliance may cause the institution to be held criminally or civilly liable for violating the country's secrecy or blocking laws.[78] Finally, the financial institution may not know the identity of the customer because the holder of the account may be a nominee for an undisclosed principal. Even if the institution does name the nominee, the nominee may not have any legal duty to disclose the identity of its principal.[79]

As a result of secrecy and blocking laws, the SEC has encountered serious difficulties in obtaining information during investi-

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notes 164-88 and accompanying text.

74. A country has the power to require a citizen living abroad to respond to a request for information. *See* Myrick & Love, *Obtaining Evidence Abroad for Use in United States Litigation,* 35 Sw.L.J. 585, 588 (1981).

75. For example, the United States may serve a subpoena on the U.S. subsidiary of a foreign corporation or bank without complying with the holding of *Compagnie de Saint-Gobain. See* FTC v. Compagnie de Saint-Gobain-Pont-a-Mousson, 636 F.2d at 1324. *See also* Marc Rich & Co. v. United States, 707 F.2d 663, 668, *cert. denied,* 103 S.Ct. 3555 (1983).

76. *See infra* note 273 and accompanying text.

77. Bschorr, *Waiver by Conduct: Another View,* 6 J. COMP. BUS. & CAP. MKT. L. 307, 308 (1984).

78. *See* Note, *supra* note 4, at 606.

79. *See* Note, *supra* note 44, at 425 n.33.

gations of cases pertaining to insider trading and manipulation of market prices. It has also experienced considerable problems in investigating misstatements and omissions of disclosure statements, violations of registration requirements, looting of corporate assets, and laundering of funds obtained through illegal conduct.[80] If, however, persons who conduct fraudulent securities transactions executed these transactions entirely within the United States, the SEC would be able to investigate and hold them accountable for violating domestic securities laws.

Persons who participate in securities transactions in United States markets and reap the benefits of the United States market system should be subject to the laws which allow them to reap these benefits. If the SEC continues to have difficulty obtaining information, more investors may attempt to evade United States securities laws by effecting transactions on United States markets through jurisdictions having blocking or secrecy laws. The rapid internationalization of securities markets will contribute to this problem.[81]

III. Current Procedures

If during the course of an investigation, the SEC suspects that a financial institution protected by bank secrecy or blocking laws has been used in connection with a possible violation of United

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80. *See Crime and Secrecy: The Use of Offshore Banks and Companies: Hearings Before the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs,* 98th Cong., 1st Sess. 331 (prepared statement of John Fedders, Director of Enforcement, Securities and Exchange Commission) [hereinafter cited as Statement of John Fedders]. A recent example of this problem is the SEC's investigation into insider trading by Ellis, A.G., called the "largest insider trading investigation ever conducted by the [SEC] both in terms of the number of securities and the amount of possibly illegal profits involved." *SEC Reveals Ellis A.G. Probe Biggest Insider Inquiry Ever* [July-Dec.] 16 Sec. Reg. & L. Rep. (BNA) 1915 (Dec. 7, 1984). The SEC has complained that Swiss secrecy laws have hindered its efforts to obtain information about the Zurich-based firm and the unknown purchasers who were the Ellis, A.G.'s customers. See *id.*; *Swiss Broker Bought Shares in U.S. Firms Prior to News of Takeovers, SEC Charges,* Wall St. J., Dec. 5, 1984 at 7, col. 1; *Swiss Efforts to Aid U.S. in Insider Trading Case is Blocked by Appeals,* Wall St. J., Dec. 18, 1984, at 38, col. 3; *Insider Trading Case Centers on Swiss Firm,* N.Y. Times, Dec. 6, 1984, at D6, col. 5.

81. *See Policing Internationalized U.S. Capital Markets, supra* note 7, at 91. *See also* Release, *supra* note 8, at 11, 53, *reprinted in* [July-Dec.] 16 Sec. Reg. & L. Rep. at 1307, 1317.

States securities laws, the SEC must expend a tremendous amount of time and resources, often unsuccessfully, to obtain information about the transaction. The SEC has employed several different procedures for obtaining this information, but either they do not work or they have many disadvantages. This section discusses some of the methods by which the SEC may obtain requested information and other remedial means enacted by the federal government in response to the problems of secrecy and blocking laws.

A. Voluntary Cooperation

Once the SEC determines that information shielded by nondisclosure laws is needed for investigative and enforcement purposes, the first step is to attempt to obtain the information using diplomatic channels. Generally, these efforts have been unsuccessful.[82] Though on occasion foreign financial institutions and individuals have voluntarily complied with SEC requests, the amount of cooperation in these situations has been "minimal."[83] The customer does not have to consent to waive his rights protected by secrecy laws, and blocking laws may not permit him to release the information. In addition, even if the financial institution knows the identity of the principal customer, it may be held liable for violating the country's secrecy and blocking laws if it discloses the requested information.[84] Thus, although voluntary cooperation should still be attempted whenever information is shielded by secrecy and blocking laws, other approaches are still needed.

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82. *Policing Internationalized U.S. Capital Markets, supra* note 7, at 99. For example, Great Britain, Bermuda, and the Cayman Islands generally deny requests for investigative assistance in the pre-indictment stage of a case. *See* Olsen, *Discovery in Federal Criminal Investigations*, 16 N.Y.U. J. INT'L L. & POL. 999, 1006 (1984). Switzerland has begun to cooperate more with U.S. efforts, although problems still exist. *See infra* notes 164-88 and accompanying text. *But see supra* note 80.

83. *Policing Internationalized U.S. Capital Markets, supra* note 7, at 99.

84. *See id.* at 90, 99; Letter from Robert V. Roosa, Committee Chairman, Advisory Committee on International Capital Markets to the NYSE Board of Directors, N.Y. Stock Exchange, 1-2 (Nov. 7, 1984) (comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct")[hereinafter cited as Roosa Letter]. *See also supra* note 43 and accompanying text.

B. Litigation

Most attempts by the SEC and other federal agencies to obtain information shielded by secrecy and blocking laws have resulted in litigation. If enough information is obtained during the SEC investigation indicating that a violation of the securities laws has occurred or is occurring, the SEC can initiate an action in federal court.[85]

1. *Rule 37*

Once an action has been filed, the SEC may begin discovery procedures in accordance with the Federal Rules of Civil Procedure. If a court subpoena requesting information has been effectively served, and the recipient does not comply, the SEC can request the court to issue an order compelling discovery under Rule 37 of the Federal Rules of Civil Procedure.[86] If the recipient does not comply with this court order, Rule 37 gives the court the power to impose sanctions against the recipient, including contempt proceedings, monetary fines, the striking of pleadings, the prohibition of introducing specified evidence, and other adverse measures.[87]

One of the most publicized cases pertaining to the SEC use of Rule 37 to obtain information shielded by secrecy laws is *SEC v. Banca Della Svizzera Italiana* (the "St. Joe Case").[88] After Banca Della Svizzera Italiana ("BSI") refused to provide the SEC with the identity of the principals and other relevant information regarding BSI's purchase of stock and stock options in St. Joe Minerals Corporation, the SEC requested the court to issue a Rule 37 order compelling discovery. BSI, a Swiss bank with a subsidiary in the United States, did not respond to the SEC's request because disclosure would have violated Swiss secrecy laws.[89] In de-

85. If the SEC does not know the identity of the purchaser, the SEC could file a "John Doe" complaint naming the "unknown purchaser" as primary defendant and the foreign financial institution which effected the transaction as a nominal defendant. *Policing Internationalized U.S. Capital Markets, supra* note 7, at 93-94.

86. *Id.* at 96-97.

87. FED. R. CIV. P. 37. *See Policing Internationalized U.S. Capital Markets, supra* note 7, at 97.

88. 92 F.R.D. 111 (S.D.N.Y. 1981).

89. The SEC alleged that BSI and its principals traded on insider information. Purchases of St. Joe's stock were made immediately prior to an announce-

termining whether to issue a court order compelling discovery, the court balanced the factors in section 40 of the Restatement (Second) of Foreign Relations.[90]

The court first found that the United States had a strong national interest in enforcing its securities laws to ensure the integrity of United States markets and that this interest was being threatened by the use of foreign bank accounts in secrecy jurisdictions. Because the Swiss government did not intervene in these proceedings, and because the secrecy privilege is not required to protect the Swiss government, the court concluded that the United States had the more vital interest at stake.[91] The court then looked at the second factor in section 40 and determined that BSI had effected transactions with the expectation that Swiss law would shield it from the reach of United States laws.[92] The court also found that the other factors in section 40—the place of performance, the nationality of the resisting party, and the extent to which enforcement could be expected to achieve

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ment of a cash tender by a subsidiary of Joseph E. Seagram & Sons, Inc. for all of the common stock of St. Joe at $45 per share, $15 per share above market price. Undue activity in the options market prompted the SEC's investigation. The SEC obtained a temporary restraining order to freeze the bank account holding the proceeds of the transaction. The court also ordered BSI to disclose the identity of its principals "insofar as permitted by law." *Id.* at 113. No disclosure was made. After eight months of efforts to obtain the requested information, the court announced in an informal opinion that it "had determined to enter an order requiring disclosure, to be followed by severe contempt sanctions if it was not complied with." *Id.* BSI obtained a waiver of the Swiss secrecy laws from its customers, but not all information was disclosed. *Id.* at 112-14.

90. *Id.* at 117. Section 40 of the RESTATEMENT (SECOND) OF FOREIGN RELATIONS provides:

> [w]here two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as (a) vital national interests of each of the states, (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person, (c) the extent to which the required conduct is to take place in the territory of the other state, (d) the nationality of the person, and (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

91. 92 F.R.D. at 117-18.

92. *Id.* at 118-19.

compliance—also favored the SEC's position.[93] The court concluded that "it would be a travesty of justice to permit a foreign company to invade American markets, violate American laws if they were indeed violated, withdraw profits and resist accountability for itself and its principals for the illegality by claiming their anonymity under foreign law."[94] The court held that since the factors favored the SEC, BSI could be compelled to disclose the information.[95] BSI ultimately obtained a waiver from its cus-

93. *Id.* at 119.

94. *Id.*

95. *Id.* The *St. Joe's* case is indicative of how U.S. courts have been treating unsuccessful attempts by the United States to obtain information shielded from disclosure by the laws of a foreign country. For the past 25 years much litigation has occurred over the question of the limits of extraterritorial discovery, particularly where the party who has the information is subject to secrecy and blocking laws. The only Supreme Court decision on this issue is Société Internationale Pour Participations Industrielles et Commerciales v. Rogers, 357 U.S. 197, 212 (1958) (Rule 37 does not authorize dismissal of a suit in which petitioner does not comply with a pretrial production order if compliance would violate Swiss law, and if no bad faith or fault on the part of the petitioner was shown).

Several of the early decisions ignored the test articulated in *Rogers,* and instead held that if the production of evidence would violate the laws of a foreign nation, then a court cannot order the production of that information. *See, e.g.,* Application of the Chase Manhattan Bank, 297 F.2d 611 (2d Cir. 1962); First National City Bank of New York v. Internal Revenue Service, 271 F.2d 616, 619 (2d Cir. 1959), *cert. denied,* 361 U.S. 948 (1960). However, the *Chase Manhattan* and the *First National* cases are distinguishable from *Rogers* because the subpoenaed witnesses in these two cases were not parties to the case. Courts later became more flexible, with most adopting a balancing test, using the factors listed in § 40 of the Restatement (Second) of Foreign Relations for guidance. *See, e.g.,* State of Ohio v. Arthur Andersen & Co., 570 F.2d 1370 (10th Cir.), *cert. denied,* 439 U.S. 833 (1978); United States v. Field, 532 F.2d 404 (5th Cir.), *cert. denied,* 429 U.S. 940 (1976); Trade Development Bank v. Continental Insurance Company, 469 F.2d 35 (2d Cir. 1972); United States v. First National City Bank, 396 F.2d 897 (2d Cir. 1968).

Recent decisions indicate that courts continue to be responsive to requests by U.S. law enforcement agencies to force the compliance of subpoenas and court orders seeking the production of documents even though compliance may violate foreign law. Some courts are imposing heavy fines on parties who fail to comply. For example, see United States v. Bank of Nova Scotia, 691 F.2d 1384 (11th cir. 1982), *cert. denied,* 103 S.Ct. 3086 (1983); Marc Rich & Co. v. United States, 707 F.2d 663 (2d Cir.), *cert. denied,* 103 S. Ct. 3555 (1983).

Since 1968, most courts have used the § 40 balancing test to determine whether discovery should be compelled even though production would violate foreign laws. Most of these courts ultimately conclude that the test does favor discovery. Note, *Insider Trading Laws and Swiss Banks: Recent Hope for Rec-*

tomers and produced the requested information before sanctions were imposed.

The threat of a court order and sanctions compelled BSI to give the SEC some of the requested information; such threats of judicial sanctions have been the SEC's most effective weapon in compelling the disclosure of information.[96] By imposing or threatening to impose severe sanctions on noncomplying parties, courts are becoming increasingly responsive to requests made by United States government agencies for judicial aid in compelling the discovery of documents. Based on recent court decisions, this trend likely will continue.[97]

Despite some degree of success in the past, litigation has any disadvantages. First, litigation is an ad hoc approach to resolving discovery problems caused by secrecy and blocking laws.[98] Although an ad hoc approach permits a court to look at each request for information on a case-by-case basis, the seriousness of the problem, the threat of inconsistent results, and the increasing frequency of litigation requires an approach which would ensure more uniform results.[99] Second, to obtain a Rule 37 court order

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onciliation, 22 COL. J. TRANSNAT'L L. 303, 324-25 (1984). Some courts, however, use the § 40 balancing test only to determine whether a U.S. court should impose sanctions. Other courts use the test to determine both whether an order compelling discovery should be issued and whether to impose sanctions. *See* 92 F.R.D. at 117 n.3. Some recent cases have ordered discovery and imposed sanctions without relying on the § 40 balancing test. In *Marc Rich*, for example, the court upheld the district court's order and imposition of sanctions, stating that "the test for the production of documents is control, not location." 707 F.2d 667. The district court had personal jurisdiction over Marc Rich and could therefore enforce obedience to the grand jury subpoena. *Id.*

The § 40 test may be abandoned with the adoption of the Restatement (Third) of Foreign Relations Laws of the United States. Section 420(2) of Tentative Draft No. 2 states that a court may require the party who has been ordered to disclose the information to make "a good faith effort to secure permission from the foreign authorities to make the information available." As long as that party makes this effort, the court "ordinarily" will not impose a sanction of contempt, dismissal, or default. Adoption of this provision may limit the threat of sanctions available under Rule 37. Von Mehren, *Discovery Abroad: The Perspective of the U.S. Private Practitioner*, 16 N.Y.U. J. INT'L L. & POL. 985, 989 (1984).

96. Note, *supra* note 95, at 307.

97. *See supra* note 95.

98. New York City Bar Association, *supra* note 53, at 3.

99. *Id.* at 4-5. According to John Fedders:

[The St. Joe's case] is a significant precedent, but it is of limited utility. A

and sanctions, the case must be pending before a United States District Court, and the SEC must have taken the appropriate steps in order to have reached this stage.[100] Consequently, the SEC must engage in time-consuming and costly litigation, with no assurance of success.[101] This extensive time commitment also impedes other enforcement activities.[102] Finally, litigation creates frictions between nations.[103] Foreign countries view this litigation as an attack on their sovereignty.[104] Thus, tensions created by liti-

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> case-by-case method for analyzing whether production of information will be compelled does not provide the most effective deterrent against securities law violators. It is an extraordinary case. Unless potential violators are deterred by the fear that their transactions will be scrutinized, they will continue to use foreign secrecy and blocking laws to hide fraudulent transactions and their identities.

Statement of John Fedders, *supra* note 80, at 325.

100. Note, *supra* note 5, at 597.

101. For example, in United States v. Newman, 664 F.2d 12 (2d Cir.), *cert. denied*, 104 S.Ct. 193 (1981), an insider trading case in which employees in two major investment banking firms leaked nonpublic market information to persons who subsequently purchased the securities through foreign banks, it took prosecutors more than two years to receive some of the evidence it had requested from one of the countries involved. Another country which had initially refused to disclose the information finally agreed to produce the documents a year and a half after the request was made. None of these documents were produced, however, before the case concluded four years after the first request. Martin, *A Telling Blow at Secrecy Laws*, Wall St. J., Jan. 4, 1985, at 15, col. 1. Litigation and the threat of sanctions may not prove successful when the noncomplying party is located overseas because the party's personal or corporate assets may be immune from attachment or other sanctions. *See Crime and Secrecy: The Use of Offshore Banks and Companies: Hearings Before the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs*, 98th Cong., 1st Sess. 3 (March 15, 1983) (testimony of D. Lowell Jensen, Assistant Attorney General, Criminal Division, Department of Justice) [hereinafter cited as Testimony of D. Lowell Jensen].

102. Statement of John Fedders, *supra* note 80, at 323.

103. *Waiver by Conduct Idea, supra* note 15, at 13, col. 3; *Policing Internationalized U.S. Capital Markets, supra* note 7, at 90.

Canadian and British courts have consistently refused to issue orders compelling a person to comply with U.S. requests for documents, and have often complained about U.S. attempts to obtain evidence in this manner. *See* Letter from R.M. MacIntosh, the Canadian Bankers' Association 4 n.6 (Nov. 28, 1984) (Comment on SEC Release No. 21286, File No. S7-27-84 "Waiver by Conduct"). [hereinafter cited as Canadian Bankers' Association].

104. *See* Memorandum from D. Lowell Jensen, Associate Attorney General, to All United States Attorneys (Regarding Subpoenas to Obtain Records Located in Foreign Countries for Use in Criminal Cases), *reprinted in* Bschorr,

gation ultimately could damage United States foreign relations and adversely affect other cases under investigation.[105]

2. *Letters Rogatory*

The SEC may also request information through the use of letters rogatory in accordance with Rule 28(b) of the Federal Rules of Civil Procedure. Letters rogatory are formal written communications issued by a United States court to a court in a foreign country requesting that the testimony of a witness residing within that foreign court's jurisdiction be formally taken under the foreign court's direction and that the testimony be transmitted to the United States court for pending actions.[106] To obtain the issuance of a letter rogatory, the SEC or other federal agency must apply to a United States District Court. The federal court will issue the letter rogatory on "terms that are just and appropriate," if the person to be examined is subject to the jurisdiction of the foreign court.[107]

Once a United States court issues the letter rogatory, the document is transmitted to the foreign court, officer, or agency, or is channelled to the foreign country through the United States Department of State.[108] Foreign courts have great discretion in determining whether to grant the request.[109] The foreign court may deny the request because compliance would be contrary to the public policy of the requested nation.[110] In some nations, even though a foreign court may honor the request, the designated witness does not have a legal duty to testify and may refuse to testify.[111]

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supra note 77, at 314 [hereinafter cited as Memorandum].

105. In an attempt to reduce these tensions, the Criminal Division of the Justice Department now requires that any federal prosecutor who seeks a subpoena for records believed to be in a foreign country must first obtain the concurrence of the Division's Office of International Affairs. Guidelines were also issued establishing factors to consider when issuing a subpoena. *See* Memorandum, *supra* note 107, *reprinted in* Bschorr at 315.

106. WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE, § 2083 (1970).

107. *Id.* A 1963 Amendment to Rule 28(b) reduced considerably the court's discretion in issuing a letters rogatory. *Id.*

108. *Id.*; Note, *supra* note 44, at 423 n.29.

109. Note, *supra* note 44, at 423 n.29.

110. *Id.*

111. *Id.* For example, unless an agreement specifies otherwise, a Swiss bank may refuse to disclose information to a Swiss court on the ground that Swiss

The SEC and other federal agencies rarely use the letters rogatory procedure.[112] As with Rule 37 court orders, the SEC cannot petition for a letter rogatory until an enforcement action is pending before a United States District Court.[113] Usually, foreign cooperation is needed to complete an investigation before suit may be brought.[114] Also, the letters rogatory procedure is very time-consuming,[115] and a foreign court may not honor the request. A decision not to honor the request is rarely appealable.[116]

C. International Efforts

1. *The Hague Convention*

The Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters was opened for signature on March 18, 1970, and entered into force for the United States on October 7, 1972.[117] The Convention attempted to facilitate the execution of extraterritorial discovery by devising methods which were "tolerable to the authorities of the State where [discovery would be] taken," and by utilizing the forum where the action would be tried.[118] The Convention provides three means for obtaining evidence: letters of request, the use of diplomatic officials and consular agents, and the use of commissioners.

To obtain information using the letters of request procedure, "a judicial authority" of one country must request "the competent authority" of another country "to obtain evidence or to perform

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bank secrecy laws can only be lifted under an international agreement, or under a specific provision in the law. Because Swiss law does not require a Swiss bank to give information during these types of proceedings, a Swiss court cannot force it to do so. If the Swiss bank does comply with the request for information, the bank's officers may be subject to the charge of "economic espionage." Aubert, *The Limits of Swiss Banking Secrecy Under Domestic and International Law*, 2 INT'L TAX & BUS. L. 273, 285 (1984).

112. *Policing Internationalized U.S. Capital Markets*, *supra* note 7, at 99; Olsen, *supra* note 82, at 1025.

113. *Policing Internationalized U.S. Capital Markets*, *supra* note 7, at 99.

114. *Id.*

115. *Id.*; Testimony of D. Lowell Jensen, *supra* note 101, at 216.

116. Olsen, *supra* note 82, at 1025.

117. 23 U.S.T. 2555, T.I.A.S. No. 7444, 847 U.N.T.S. 231 (codified at 28 U.S.C. § 1781 (1982) (Supp. 1983)) [hereinafter cited as Convention].

118. Von Mehren, *supra* note 95, at 991 (citing Report of the U.S. Delegation to the Eleventh Session of the Hague Convention on Private International Law).

some other judicial act."[119] Like Rule 37 orders and letters rogatory, letters of request can only be used once an action is before a United States District Court. The country receiving a letter of request must comply with its terms unless that country determines that compliance would prejudice its sovereignty or security.[120] Even if the country does not object to disclosing the requested information, the Convention provides that "the person concerned may refuse to give evidence insofar as he has a privilege or duty to refuse to give the evidence . . . under the law of the State of execution . . . ."[121] The Convention thus apparently allows secrecy and blocking laws to prevent the disclosure of evidence requested using the letter of request procedures. In addition, most of the nations that signed the Convention reserved the right not to execute letters of request when the evidence is requested for purposes of pretrial discovery.

The Convention also permits diplomatic officers and consular agents located in a foreign nation to take evidence "without compulsion" from nationals of the country which these officials represent.[122] These diplomatic officials may also take evidence without compulsion from foreign nationals if the foreign government has granted permission.[123] Finally, the Convention provides that a person appointed as a commissioner may take evidence without compulsion within the territory of another country as long as the foreign government of that country has given permission.[124] Because diplomatic officers, consular agents and commissioners can take evidence only without compulsion, however, these procedures would not be useful to the SEC in obtaining information shielded by secrecy laws since a witness is not compelled to appear or cooperate.[125]

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119. Convention, *supra* note 117, art. 1.

120. *Id.* art. 12.

121. *Id.* art. 11.

122. Convention, *supra* note 117, art. 15.

123. *Id.* art. 16.

124. *Id.* art. 17.

125. *See id.* art. 21(c). For more information about the Hague Convention, see Myrick & Love, *supra* note 74, at 592-95; Oxman, *The Choice Between Discovery and Other Means of Obtaining Evidence Abroad: The Impact of the Hague Evidence Convention*, 37 U. MIAMI L. REV. 733 (1983); Radvan, *The Hague Convention on Taking of Evidence Abroad in Civil or Commercial Matters: Several Notes Concerning Its Scope, Methods and Compulsion*, 16 N.Y.U. J. INT'L L. & POL. 1031 (1984).

2. *Bilateral Treaties*

The United States has begun a series of bilateral negotiations with nations to adopt more efficient means of obtaining information necessary to the investigation and prosecution of certain criminal violations. The United States has recently entered into force separate mutual assistance treaties with three nations[126] and have held negotiations with other nations.[127] Whether these treaties will resolve enforcement problems caused by secrecy or blocking laws is unclear.[128] Also, the United States has negotiated several agreements which specifically provide a method for obtaining information shielded by secrecy and blocking laws. On September 13, 1984, the United States, the United Kingdom, and the Cayman Islands announced an agreement under which the Cayman Islands would provide United States prosecutors financial data, documents and records for use in United States narcotics investigations. This agreement significantly reduces the protection offered by the Cayman Islands' bank secrecy laws.[129] Recent agreements which provide aid under the Caribbean Basin Initiative to banks that cooperate with United States authorities in drug trafficking and tax violations cases may also reduce the problems as-

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126. *See* Treaty on Judicial Mutual Assistance in Criminal Investigations, June 12, 1981, United States-Netherlands ___U.S.T.___, T.I.A.S. No. 10734; Treaty on Extradition and Mutual Assistance in Criminal Matters, June 7, 1979, United States-Turkey, 32 U.S.T. 311, 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. For more information regarding U.S.-Swiss initiatives, see *infra* notes 132-89 and accompanying text. The United States' mutual assistance treaty on criminal matters with the Netherlands includes the Netherlands Antilles. *See also* Weiland, *The Use of Offshore Institutions to Facilitate Criminal Activity in the United States*, 16 N.Y.U. J. INT'L L. & POL. 1115, 1130 (1984). *Mann*, *supra* note 17, at 12 n.13.

127. The United States Senate has ratified a treaty negotiated with Colombia which will go into effect upon enactment by the Colombian legislature. Treaty negotiations with Italy having been recently concluded, the United States is also presently holding negotiations with Tunisia, Canada, Jamaica, Thailand, Morocco, and the Federal Republic of Germany. The Federal Republic of Germany, the Netherlands, the Netherlands Antilles, Italy and Canada do have some type of secrecy and/or blocking provision. Olsen, *supra* note 82, at 1009-10; *Mann*, *supra* note 17, at 12 n.14. *See supra* notes 45 and 53.

128. *See* Weiland, *supra* note 126, at 1130-31. *See also infra* notes 148-89 and accompanying text (regarding problems associated with the U.S.-Swiss Treaty).

129. Cockwell Letter, *supra* note 45, at 17.

sociated with the investigation of misconduct effected through banks protected by Caribbean secrecy laws.[130] Although these agreements may aid the Justice Department's investigation and prosecution of narcotics and tax fraud cases, they will not help the SEC investigate and prosecute securities laws violations.[131]

3. *United States-Swiss Initiatives*

The most significant agreements made by the United States pertaining to the extraterritorial discovery of information shielded by secrecy and blocking laws are those made with Switzerland. On May 25, 1973, the United States and Switzerland signed a treaty on the mutual assistance of criminal matters ("Treaty").[132] The Treaty, which entered into force on January 23, 1977, was the first international agreement negotiated by the United States which created bilateral assistance in the investigation and enforcement of criminal actions.[133] The Treaty establishes "compulsory assistance measures" which are designed to permit a requesting country to obtain necessary information for investigations of offenses committed within the requesting country's jurisdiction.[134] These measures may be used when the acts being investigated contain elements other than intent or negligence; an offense must either (1) be punishable under the requested country's laws if the act was committed within its jurisdiction and is listed in the schedule of offenses attached to the Treaty,[135] or (2) constitute unlawful bookmaking, lottery, or gambling.[136] Compulsory measures may also be used when the alleged

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130. *Id.* at 17 n.30.

131. Information can also be acquired through the use of informal arrangements. For example, information may often be obtained in Hong Kong, the Cayman Islands, Panama, and the Bahamas by going to the police. Much of this information may only be used for intelligence purposes and is not admissible into court. Informal arrangements may be more available in less developed secrecy jurisdictions, "particularly those with poor reputations for public integrity." Weiland, *supra* note 126, at 1131-32. Although these informal arrangements may prove helpful to the private practitioner, U.S. government officials probably would not use these arrangements.

132. Treaty for Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302. [hereinafter cited as Treaty].

133. *See* Note, *supra* note 44, at 437.

134. Treaty, *supra* note 132, art. 4(1).

135. *Id.* art. 4(2)(a).

136. *Id.* art. 4(2)(b); Schedule: Offenses for Which Compulsory Measures are

violator is a member or affiliate of an organized crime group, or a public official who has knowingly violated his duties by assisting a criminal organization.[137]

If the SEC or other federal agencies wish to obtain information shielded by Swiss secrecy laws, the agency must make a formal request to Swiss authorities. The authorities must determine, based on Swiss law,[138] whether the conditions for compulsory assistance have been met.[139] If the agency wishes to obtain information regarding an offense not listed on the Schedule of Offenses but punishable in the United States, Switzerland has the discretion to determine "whether the importance of the offense justifies the use of compulsory measures."[140] The Treaty does provide, however, that a nation may refuse to give assistance if it decides that honoring the request would "prejudice its sovereignty, security or similar essential interests."[141] But before it can refuse a request, the country must first determine whether assistance could still be given in a manner which would protect its threatened interests.[142]

The problems associated with obtaining information shielded by Switzerland's bank secrecy laws are not specifically discussed in the Treaty. Based on an exchange of letters between Ambassadors of the United States and Ambassadors of Switzerland, however, Swiss secrecy laws would not prevent the Swiss from assisting United States agencies in accordance with the procedures outlined in the Treaty unless the disclosure of information would pertain to persons not connected to the offense under investigation.[143] The letters did state that the Swiss could still refuse to give assistance in "exceptional circumstances" when disclosure would result in prejudice to Swiss "sovereignty, security, or similar essential interests."[144]

Available (appended to treaty), 27 U.S.T. 2064, 2066.

137. *See* Treaty, *supra* note 132, art. 6(2)(a).

138. *See id.* art. 4(4).

139. *Id.* arts. 4(4) and 8(2). *See* Note, *supra* note 44, at 438, 439 n.92.

140. Treaty, *supra* note 132, art. 4(3). *See* Note, *supra* note 44, at 439.

141. Treaty, *supra* note 132, art. 3(1)(a).

142. *Id.* art. 3(2).

143. Note, *supra* note 5, at 586-87 n.129 (citing Treaty Interpreted Letters, from Sheldon Cullen Davis, United States Ambassador to Switzerland, to Dr. Albert Weitnauer, Ambassador of Switzerland to the United States, on May 25, 1973). *See* Treaty, *supra* note 132, art. 10(2).

144. *See* Note, *supra* note 5, at 586-87 n.129. *See also* Treaty, *supra* note

Although information obtained under the Treaty has proven to be instrumental in the investigation and prosecution of criminal misconduct,[145] the Treaty has not been particularly helpful to the SEC in obtaining information relevant to SEC investigations. Under the Treaty, the Swiss are only compelled to give assistance when the conduct being investigated is a criminal offense under both Swiss and United States law. Many actions which would be considered a criminal violation of United States securities laws would not be a criminal violation under Swiss law.[146] Also, the procedures established in the Treaty are time-consuming and may cause substantial delays in the commencement of enforcement actions. These delays may seriously impair the SEC's ability to investigate potential misconduct and to enforce the United States securities laws.[147]

The problems under the Swiss Treaty are evidenced in *SEC v. Certain Unknown Purchasers of the Common Stock and Call Options for the Common Stock of Santa Fe International Corporation (Santa Fe)*.[148] In *Santa Fe*, the SEC attempted to discover the identity of persons whom the SEC believed had traded stock and stock options in Santa Fe Industries while in possession of inside information,[149] but encountered difficulties because most of the transactions were conducted through banks and brokerage firms which were subject to the Swiss secrecy laws.[150] In October 1981 the Justice Department, acting on behalf of the SEC, filed a complaint in United States District Court against the unknown

132, art. 3(1)(a).

145. *See* Testimony of D. Lowell Jensen, *supra* note 101, at 216-17; Olsen, *supra* note 82, at 1009.

146. *See* Note, *supra* note 5, at 587-88; Statement of John Fedders, *supra* note 80, at 326.

147. *See* Statement of John Fedders, *supra* note 80, at 326.

148. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,323 (S.D.N.Y. 1981) [hereinafter cited as *Santa Fe*].

149. The SEC claimed that trading occurred while the purchasers possessed inside information relating to merger discussions between Santa Fe International Corporation and Kuwait Petroleum Corporation. Once the takeover plans were publicly announced, the value of the option contracts and shares rose in aggregate to over $5 million. The shares and most of the options were sold within two weeks following the announcement.

150. These firms included Credit Suisse, Swiss American Securities Inc., Citibank, N.A., Lombard Odier & Cie, Morgan Guaranty Trust Company of New York, Swiss Bank Corporation, Drexel Burnham Lambert, Inc., Chase Manhattan Bank, N.A., and Mosely, Hallgarten, Estabrook and Weeden, Inc. *Id.*

purchasers.[151] The complaint sought a temporary restraining order and injunction which would stop the unknown purchasers from participating in further securities laws violations. The complaint also sought a freeze on $5 million held by the banks and brokerage firms which were named as nominal defendants to the suit, and an order for accounting of all proceeds obtained from the transactions followed by a repayment of the profits.[152] The SEC also requested an order compelling the nominal defendants to identify the purchasers.[153] Although the court granted the order and some of the purchasers were identified,[154] the Swiss banks refused to comply with the court order.[155]

After negotiations with Swiss officials and the Swiss banks' attorneys failed to resolve the conflict, the SEC in March 1982 applied for Swiss assistance under the Treaty.[156] In January 1983 the Swiss Federal Tribunal denied the SEC's request, holding that the SEC had not shown adequately that the alleged act conducted by the unknown purchasers was a criminal offense under Swiss law.[157] Both the United States and Switzerland consider "tipping" a criminal offense; because Swiss law only prohibits tippers from trading on nonpublic information but does not ban company executives and other "insiders" from trading for their own benefit on confidential information, however, the Treaty only covered insider trading cases that included tipping.[158] Thus, in order for the provision of the Treaty to be applicable, the United States had to show that the unknown purchasers were involved in a transaction based on "tipped" information.[159]

The SEC filed a second request which sufficiently showed that

151. *Id.*

152. *Id.*

153. *Id.*

154. *See* Note, *supra* note 4, at 620. The SEC later brought a series of suits against the identified principals, seeking repayment of profits. *Id.*

155. *Id.*

156. The SEC could have attempted to compel discovery through the use of Rule 37, as in the *St. Joe* case; however, it decided to use this case as a test case to determine whether the procedures in the Treaty worked. *Policing Internationalized U.S. Capital Markets, supra* note 7, at 101.

157. A summary of the 1983 opinion in English is in Switzerland: *Swiss Supreme Court Opinion Concerning Judicial Assistance in the Santa Fe Case,* 22 I.L.M. 785 (1983). *See Waiver by Conduct Idea, supra* note 15, at 14, cols. 3-4 n.14.

158. *See* 22 I.L.M. at 796-98.

159. *See id.*

tipping had occurred. The Swiss Federal Tribunal granted this request on May 16, 1984.[160] The unidentified customers[161] twice appealed the decision, once to Justice Minister Elisabeth Kopp and once to the Swiss Federal Council; both appeals were rejected.[162] The Swiss finally shipped the requested documents on February 21, 1985,[163] forty-one months after filing suit.

In August 1982, during the *Santa Fe* litigation, the United States and Switzerland agreed on a Memorandum of Understanding (MOU) which declares the intent of the two nations to improve procedures established by the Treaty for use in the investigation of insider trading cases.[164] The MOU states the belief of both countries that "the conduct of persons who utilize Swiss banks to effect securities transactions in the United States, in order to take advantage of material nonpublic information, is detrimental to the interests of both nations."[165] The agreement also recognizes the difficulties that bank secrecy laws cause the SEC laws when it conducts an investigation of a transaction made on insider information.[166] To resolve these problems, the MOU states Switzerland's plan to introduce legislation in the Swiss Parlia-

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160. *See Swiss High Court Orders Banks to Aid SEC Insider Trading Probe*, [Jan.-June] 16 SEC. REG. & L. REP. (BNA) 861, 862 (May 18, 1984). The court may have been influenced by the Memorandum of Understanding which was executed by the United States and Switzerland and which was negotiated during this time.

161. The SEC was able to determine the identity of six of the unknown purchasers after the Tribunal's ruling in May. *See SEC Seeks Default Against Unknown Santa Fe Purchasers* [July-Dec.] 16 SEC. REG. & L. REP. (BNA) 1210, 1211 (July 20, 1984).

162. The customers claimed in the appeal to Justice Kopp that Swiss assistance in this matter would infringe upon Switzerland's national interests. The Justice Minister denied the appeal after a Swiss government advisory commission ruled that Swiss cooperation would not harm the country's national interests. *Swiss May Cooperate with SEC Inquiry Into Insider Trading*, Wall St. J., Jan. 31, 1985, at 12, col. 3; *International Briefing: Swiss at Last Moving on Loopholes*, AM. BANK. Jan. 11, 1985, at 2.

163. *See Swiss Release Data to SEC in Probe of Insider Trading*, Wall St. J., Feb. 21, 1985, at 5, col. 1.

164. Memorandum of Understanding to Establish Mutually Acceptable Means for Improving International Law Enforcement Cooperation in the Field of Insider Trading, Aug. 31, 1982, United States-Switzerland, *reprinted in* 22 I.L.M. 1 (1982) [hereinafter cited as MOU].

165. *Id.* at 2.

166. *Id.*

ment which would effectively ban insider trading.[167] In addition, the MOU contains exchanged opinions regarding the interpretation, application, and operation of the Treaty.[168] The MOU also states the intent of both nations to exchange diplomatic notes "to facilitate the applications of the 1977 Treaty to . . . offenses . . . relating to trading by persons in possession of material non-public information,"[169] and to consider whether other diplomatic notes should be exchanged to resolve problems with other securities-related offenses.[170]

Most importantly, the MOU includes a private agreement made by members of the Swiss Brokers' Association which establishes a procedure for determining whether to disclose information pertaining to certain insider trading violations not covered by the Treaty.[171] The agreement, also called Convention XVI, would be in effect for three years or until Switzerland enacts insider trading legislation.[172] If legislation banning insider trading is not passed within the three years, the Convention will be renewed annually.[173]

To obtain information about a "possible violation of United States insider trading laws in connection with the Acquisition or Business Combination,"[174] the Convention provides that the SEC[175] must send a written request to the Federal Office for Police Matters which in turn will send the request to a Commission of Inquiry (the Commission) established by the Swiss Bankers' Association. The Commission must first determine whether the transaction under investigation is subject to the procedures outlined in the Convention.[176] Next the Commission must find that the SEC has met the requirements for requesting assistance and

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167. *Id.* at 4.

168. *Id.* at 3.

169. *Id.* at 4.

170. *Id.*

171. Agreement XVI of the Swiss Bankers' Association with regard to the handling of requests for information from the SEC of the United States on the subject of misuse of inside information, *reprinted in* 22 I.L.M. 7 (1982) [hereinafter cited as Convention XVI].

172. *Id.* art. 11.

173. *Id.*

174. *Id.* arts. 1(a), 3(10).

175. The Department of Justice, when arguing a case on behalf of the SEC, could also use the Convention.

176. *See* Convention XVI, *supra* note 171, arts. 1, 3.

implement the procedures outlined in the Convention. If these requirements are not met, then the Commission must review the SEC's request to determine whether the SEC has reasonable grounds for seeking assistance.[177]

Once the Commission determines that the Convention procedures may be applied, the Commission must request a detailed report on the transaction from the banks involved. The banks must freeze the customer's accounts up to the profits earned on the transaction[178] and inform the customer of the Commission's request;[179] the bank must file a report with the Commission within forty-five days.[180] The Commission will send a report to the Swiss Federal Office for Police Matters which in turn will forward it to the SEC unless, based on information provided by the bank, the Commission determines that the customer is not an insider or that the SEC did not meet the requirements for assistance pursuant to the Convention.[181] If the Commission decides not to transmit the requested information to the SEC, it will instead send a report stating the reasons for the Commission's noncompliance with the SEC's request.[182]

The Convention requires banks to inform their clients of the Convention and the Convention's procedures.[183] Thus, if a bank customer continues to order her bank to make securities transactions on United States markets, the order constitutes approval of the Convention's terms and waiver of the right to confidentiality under Swiss secrecy laws.[184] Nonetheless, the Swiss Commission must consent to the customer's waiver, and the waiver only occurs when the procedures of the Convention are applicable to the transaction.[185]

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177. *Id.* art. 3. Note that failure to meet the threshold criteria does not constitute a presumption that the SEC does not have reasonable grounds to request assistance. *See* MOU, *supra* note 164, at 4-5.

178. Convention XVI, *supra* note 171, art. 9.

179. *Id.* art. 4.

180. *Id.* The customer may send evidence to the bank that his transaction was not "in violation of U.S. insider trading laws in connection with the Acquisition or Business Combination or that the requirements set forth in [the Convention] are not met." *Id.* art. 4(2). The bank must include this evidence in its response. *Id.* art. 4(3)(b).

181. *Id.* art. 5.

182. *Id.* art. 7.

183. *Id.* art. 12.

184. Statement of John Fedders, *supra* note 80, at 329.

185. *Id.*

Both the Treaty and the MOU demonstrate that bilateral negotiations may successfully resolve the problems that the SEC confronts when investigating transactions effected through financial institutions located in secrecy jurisdictions. In addition to aiding the SEC's enforcement of United States securities laws, the MOU also preserves Swiss interests by permitting Swiss authorities to control SEC investigations within Swiss territory and to decide when information protected by Swiss secrecy laws should be disclosed.[186]

Although these agreements are helpful to the SEC, they do not resolve the entire problem. First, since the MOU is not a binding agreement, either nation can abrogate it at any time.[187] In addition, the MOU is a "limited solution to a limited problem,"[188] since the procedures outlined in the Convention are only applicable to a few types of transactions. Thus, the SEC must still resort to litigation in many instances. Finally, although Swiss banks are involved in a large percentage of foreign transactions on United States markets,[189] financial institutions in other countries with secrecy and blocking laws also enter into transactions on United States markets. While agreements with Switzerland may alleviate the SEC's problems in conducting its investigations of transactions effected through Swiss financial institutions, the presence of other secrecy jurisdictions reduces the effect of these agreements. Now investors wishing to avoid SEC investigations and prosecutions can easily close their accounts in Switzerland and open new accounts in other secrecy jurisdictions.[190]

D. Legislation

In 1970 Congress enacted the Bank Secrecy Act (the Act)[191] to reduce the number of transactions effected through secrecy jurisdictions by imposing stringent reporting requirements on banks

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186. Note, *supra* note 95, at 311.

187. Note, *supra* note 5, at 565 n.1, 603.

188. *Id.* at 608 (quoting interview with Barbara S. Thomas, former Commissioner of the SEC, Nov. 15, 1982).

189. *See supra* note 43 and accompanying text.

190. Note, *supra* note 5, at 608. For more information about the MOU, see Aubert, *supra* note 111; Note, *supra* note 4; Note, *supra* note 95.

191. Pub. L. No. 91-508, 84 Stat. 1114 (1970) (codified as amended in scattered sections of 12 U.S.C. and 31 U.S.C.).

and individuals who enter into international transactions.[192] The primary objective of the Act is to apply similar controls to both transactions effected through financial institutions in secrecy jurisdictions and those effected through a domestic financial entity.[193] Congress did not intend, however, for the Act to interfere "with the domestic law of any other nation . . . [or] to create obstacles to the free flow of legitimate international trade and commerce."[194]

Although the Act has aided some enforcement activities, it has not been useful to the SEC. The utility of the Act depends upon the voluntary disclosure of information.[195] Secrecy and blocking laws may prevent the SEC and other enforcement agencies from obtaining documents needed to substantiate the disclosure of information and to determine the information withheld. Thus, if a person effects a transaction illegal under United States securities laws through a foreign institution located in a secrecy jurisdiction, and that citizen does not report the transfer of money overseas, the secrecy and blocking laws would prevent the SEC from obtaining records which would prove the existence of an illegal transfer. Consequently, secrecy and blocking laws would shield an individual from liability under the Bank Secrecy Act as well as United States securities laws.[196] Even if this individual complies with the Act and reports the transfer of money, the secrecy and blocking laws would still prevent the SEC from tracing the money to the illegal securities transaction.[197]

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192. The Act imposed three specific reporting requirements. Both domestic financial institutions and the parties involved must file reports regarding transactions with a domestic financial institution "involving the payment, receipt, or transfer of monetary instruments" with the Secretary of the Treasury if such transactions meet certain requirements. *See* H. R. REP. No. 975, 91st Cong., 2d Sess. (1970), *reprinted in* 1970 U.S. CODE CONG. & AD. NEWS 4394, 4407 [hereinafter cited as HOUSE REPORT]. The Act also requires that any person who transports currency into or out of the United States, totalling more than $5000 in one transaction, or $10,000 in one year, must report the transaction. *Id.* Most importantly, the Act requires any resident or citizen of the United States "who engages in any transaction or maintains any relationship with a foreign financial agency" to maintain and file detailed reports regarding the transaction with the Secretary of Treasury. *Id.* at 4408.

193. *Id.* at 4398.

194. *Id.*

195. *See* Note, *supra* note 44, at 435.

196. *See* Note, *supra* note 95, at 307 n.27.

197. *See id.*; Note, *supra* note 44, at 435-37. Thus, a major problem with the

E. Commodity Futures Trading Commission Rules

In its monitoring of the United States commodity futures and options markets, the Commodity Futures Trading Commission (CFTC) has experienced difficulties similar to those confronting the SEC in obtaining information about transactions initiated by foreign brokers and traders. To determine whether futures markets are functioning normally, the CFTC requires the routine filing of reports by contract markets, members of contract markets, futures commission merchants (FCM), traders, and foreign brokers.[198] The CFTC may also issue "special calls" to a FCM, members of contract markets, introducing brokers, or foreign brokers, requesting information about futures and options positions held or introduced on the dates specified in the call.[199] Claims that such information is shielded by foreign secrecy laws hinder efforts to obtain the information.

The CFTC in 1982 enacted Rule 21.03[200] which regulates trading when a foreign broker, trader, or FCM does not respond to the CFTC's special call; the CFTC may issue an order prohibiting further trading on that market or prohibiting execution of contracts traded on behalf of the foreign broker, trader, or FCM named on the call unless the trades would close out the position held by those persons.[201] The CFTC rules require a FCM or introducing broker to inform the customer about Rule 21.03 before opening a futures or options account or effecting a transaction for that customer.[202]

Act is that it "does not adequately reach funds . . . which involve certain multiple foreign transactions or transactions protected by foreign laws or codes which significantly limit access to foreign bank records and information." Note, *supra* note 44, at 436-37. Senator William Roth (R.-Del.) has recently introduced Senate bill S.902 which would amend the Act by increasing civil penalties for violation of the provision requiring the reporting of transborder transactions of $5,000 or more in negotiable instruments or currency. The amendment would also increase the reporting requirement to $10,000, making currency violations predicate offenses under RICO provisions. Weiland, *supra* note 126, at 1133.

198. *See* 17 C.F.R. § 15.01 (1985). *See generally* 17 C.F.R. parts 15-21.

199. *See* 17 C.F.R. § 21.02.

200. *Id.* § 21.03.

201. *Id. See* Letter from Jean A. Webb, Secretary of the Commission, Commodity Futures Trading Commission 2-6 (Dec. 4, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as CFTC].

202. *See* 17 C.F.R. § 21.03(b).

Whether the CFTC Rules[203] reduce the problems of obtaining information shielded by secrecy laws is unknown; no circumstances have yet required implementation of the Rule's procedures.[204] The CFTC has claimed that its rules have not caused a shift of futures trading away from United States markets.[205] Nonetheless, the rules apparently have caused most major Swiss banks to refrain from trading for customers, futures or options transactions on United States markets.[206]

IV. WAIVER-BY-CONDUCT

A. The Concept

The SEC is presently considering whether to endorse a legislative proposal[207] under which the act of trading securities in the

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203. The CFTC also adopted Rule 15.05 which provides that when a foreign broker or trader effects a trade on United States markets through a domestic futures commission merchant, the merchant is "deemed to be the agent of the foreign broker or the foreign trader for purposes of accepting delivery and service of any communication issued by or on behalf of the [CFTC] to the foreign broker or the foreign trader with respect to any futures on option contracts which are or have been maintained in such accounts carried by the futures commission merchants." 17 C.F.R. § 15.05(b). The merchant in turn would transmit the communication to its customer. The merchant is also deemed to be the agent of any of the foreign brokers' customers. *Waiver by Conduct, supra* note 5, at 14. The rule enables the CFTC to promptly notify the person who possesses the requested information without facing the problems inherent in effecting service upon a resident of a foreign country. *Id.* The rule has not often been used. CFTC *supra* note 200, at 6.

204. CFTC, *supra* note 200, at 7.

205. *Id.* at 12.

206. Letter from J.P. Chapuis & A. Hubschmid, Swiss Bankers' Association 5 (Nov. 20, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Swiss Bankers' Association].

207. John Fedders, former Director of the Division of Enforcement at the SEC, has frequently suggested waiver by conduct legislation in speeches, articles, and in testimony before Congress. *See, e.g.*, Statement of John Fedders, *supra* note 80, at 134-47, 318; *Policing Internationalized U.S. Capital Markets, supra* note 7; *Waiver by Conduct, supra* note 5; *Waiver by Conduct Idea, supra* note 15; Fedders, *supra* note 6; Fedders & Mann, *supra* note 20.

On March 30, 1984, Fedders, acting on his own behalf, wrote Senator Alfonse D'Amato, Chairman of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, and Representative John D. Dingell, Chairman of the House Committee on Energy and Commerce, suggesting that Congress enact legislation implementing the waiver by conduct concept. He also sent a draft bill to illustrate how the concept might be imple-

United States waives the applicability of foreign secrecy laws.[208] According to this waiver-by-conduct approach, any purchase or sale of securities in United States markets implies an irrevocable consent to the disclosure of relevant evidence requested in any SEC investigation, court action, or administrative proceeding relating to that transaction.[209] The waiver would only apply to information which is relevant to the transaction, to the purchaser or seller, or to the disposition of the securities involved in the transaction and the proceeds.[210] An order ticket and confirmation made by the American broker-dealer would be proof of consent to the waiver.[211] The proposal provides that foreign law would gov-

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mented. In April 1984, Rep. Dingell asked the SEC whether it endorsed the concept and the draft bill. Release, *supra* note 8, at 7-8, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1306. On May 31, 1984, the SEC unanimously voted to ask Congress to consider the plan, but because of serious policy implications raised by the proposal, decided at that time to remain neutral. *See SEC Issues Release Seeking Comments on 'Waiver by Conduct' Legislation* [July-Dec.] 16 SEC. REG. & L. REP. (BNA) 1285; *SEC Move on Bank Plan,* N.Y. Times, July 27, 1984, at D6, col. 6. The SEC subsequently issued the Release requesting comments on the concept and other suggestions of ways the SEC could handle the problems associated with foreign secrecy and blocking laws. *See supra* notes 8-9 and accompanying text. Most of the comments received by the SEC have criticized the waiver by conduct proposal. The SEC is currently evaluating these comments.

208. Mann contends that the waiver by conduct concept was universally rejected and that the stage is now set for "renewed efforts to explore other alternatives." *Mann, supra* note 17, at 17. "When separated from the proposal of unilateral enactment, the concept behind 'waiver by conduct' has merit, and should be acceptable, both as a principle of comity and as a guideline for incorporation into international agreement." *Id.* Mann concludes by stating a three-point plan:

> (1) all countries should require their securities commissions or other relevant agencies to participate in bilateral and multilateral conferences such "to formulate a scheme for international evidence gathering regarding securities enforcement";
> (2) an international forum must be established for the discussion of transnational securities issues; and
> (3) countries should begin meeting within the next year in order to establish a schedule for resolving the problems associated with international evidence gathering in securities enforcement.

Id. at 21-22.

209. Release, *supra* note 8, at 28-29, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1311.

210. *Id.*

211. *Id.* at 34, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1312. The proposal would create an irrebuttable presumption that this consent was valid.

ern foreign recognition of the consent.[212] Notice of waiver-by-conduct to foreign investors may be made by statute. The SEC's Release for Comments suggests, however, that additional notice may increase the likelihood that foreign courts and governments would accept the waiver-by-conduct approach.[213] One suggested means of supplementing the notice provided by statute is to require United States broker-dealers to include in customer agreements a statement which would give notice of the waiver-by-conduct approach to foreign financial institutions.[214]

If this proposal were enacted, then the SEC could seek desired information about a particular transaction simply by presenting the broker-dealer's order ticket and confirmation to the foreign financial institution that effected the transaction.[215] The foreign bank would then have the option of either accepting the validity

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212. *Id.* at 30, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1311.

213. *See id.* at 31-33, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1312.

214. *Id.* at 30-31, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1311. Also under the proposed legislation, one who effects a securities transaction in United States markets would impliedly consent to the appointment of the United States broker executing the order as his agent for service of process in any action arising out of the transaction. *Id.* at 36-47, *reprinted in*[July-Dec.] 16 SEC. REG. & L. REP. at 1313. Congress could also provide that such a transaction would constitute an implied irrevocable consent to the exercise of in personam jurisdiction over the customer in United States courts to litigation arising out of the transaction. *Id.* at 37-38, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1313. Finally, the legislation may also include the codification of United States courts' judicial authority to impose sanctions to induce the customer of a foreign bank to produce the requested evidence. These sanctions could include:

> impoundment or withholding of any dividends or interest payable to the person by a U.S. issuer; revocation or suspension of voting rights with respect to securities of any U.S. issuer involved in the Commission's investigation; an order to any U.S. issuer or transfer agent to refrain from effecting a registration or transfer with respect to a particular purchase or sale by any person having an interest in the securities involved; an order directing a U.S. issuer to suspend the subject person from serving as an officer or director of the issuer; a decree prohibiting any U.S. broker or dealer known to have effected transactions on behalf of the person to refrain from effecting such transactions in the future; and an order providing such other relief as the court may deem necessary or appropriate under the circumstances.

Id. at 39, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1313-14. The SEC suggested legislation providing similar sanctions in the 1970s. *See infra* notes 298-305 and accompanying text.

215. The SEC can obtain the order ticket and confirmation ticket from the United States broker-dealer under 17 C.F.R. § 204.17a-4(G).

of the consent or seeking assistance from its government or courts. If foreign government officials accepted the validity of the customer's implied consent, the financial institution would then have to disclose the requested information. The financial institution could also petition a court to issue either an order permitting the disclosure of the documents or a declaratory judgment mandating the customer's actions to be a waiver of the secrecy laws. Such disclosure permitted by foreign court or foreign government officials would not only avert litigation but would also avoid subjecting a foreign bank to making a choice between violating a United States court order or violating a foreign secrecy law.[216]

If the foreign government does not accept the validity of the implied consent, the SEC would still be able to request a court order from a United States court compelling the production of evidence. The United States court would be bound to uphold the waiver once the SEC establishes that a purchase or sale of securities had occurred in the United States. The waiver-by-conduct statute would therefore replace the Restatement Section 40 balancing test[217] with a conclusive presumption that United States interests in law enforcement outweigh competing interests.[218] Finally, if the court order is not initially obeyed, then sanctions could be placed on the customer and the bank to induce compliance.[219]

The waiver-by-conduct concept protects the integrity of the United States securities markets by recognizing that "the exercise of jurisdiction over conduct within a nation's territory" is an essential attribute of sovereignty.[220] The SEC's Release for Comments states that the waiver-by-conduct approach would not intrude on the sovereignty of another nation or force any substantive code of conduct upon persons or financial entities located in a nation with secrecy laws.[221] By purchasing or selling

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216. Release, *supra* note 8, at 34-36, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. 1312.

217. *See supra* notes 90, 95 and accompanying text.

218. Release, *supra* note 8, at 35-36, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1313.

219. *See supra* note 213 and accompanying text.

220. Release, *supra* note 8, at 21, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1309. *See Waiver by Conduct, supra* note 5, at 29.

221. *Id.* The Release bases the legal rationale of the waiver by conduct approach on cases defining United States rules for asserting jurisdiction over defendants who are citizens of another state. Release, *supra* note 8, at 24-27, *re-*

securities on the United States market through foreign institutions located in a secrecy law jurisdiction, the customer would voluntarily and purposefully enter the United States markets. Thus, secrecy laws should not be applied extraterritorially.[222] An extension of secrecy law protection in this situation "would be incompatible with U.S. sovereignty."[223]

B. Benefits of the Waiver-by-Conduct Approach

1. *Strengthens the Integrity and Reputation of United States Capital Markets*

As the internationalization of securities markets accelerates,[224] the waiver-by-conduct approach may help effectuate the SEC's goal of maintaining both the integrity of United States capital markets as well as the United States markets' competitive edge among other national securities markets. First, the waiver-by-conduct approach may deter investors from violating United States securities laws since secrecy laws will no longer protect them from SEC enforcement actions. The waiver-by-conduct approach may also enhance the SEC's ability to identify violators as well as to obtain other relevant information necessary to conduct enforcement actions.[225] Since this approach may enable the SEC to obtain information more efficiently, the SEC may also be able to allocate more of its resources to other enforcement actions.[226] The resulting reduction in the number of violations in the United States markets and the enhancement of the SEC's ability to police domestic markets against transborder fraud may promote confidence in the integrity of the United States capital markets,

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printed in [July-Dec.] 16 SEC. REG. & L. REP. at 1310. This reasoning has been criticized. *See, e.g.*, Boyle & Thaw, *The Newest Configuration of the Ugly American: A Response to Mr. Fedders,* 6 J. COMP. BUS. CAP. MKT. L. 323, 325 (1984); Letter from the Monetary Authority of Singapore (MAS) and the staff of the Attorney General of Singapore, 3-5 (Oct. 19, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Singapore]; *cf. Waiver by Conduct, supra* note 5, at 105-06; Letter from Richard W. Jennings, Professor of Law, Emeritus, University of California 2-3 (Oct. 26, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Jennings].

222. *Waiver by Conduct, supra* note 5, at 26.
223. *Id.*
224. *See supra* notes 10-28 and accompanying text.
225. The London Stock Exchange, *supra* note 26, at 2.
226. *Id.*

which will increase trade on United States markets and facilitate capital formation.[227] Whether utilization of the waiver-by-conduct approach, however, would achieve the above results is unclear. Although use of this approach may increase voluntary cooperation with the SEC, many situations could still result in litigation.

2. *Reduce Friction Between Countries*

Many foreign countries view United States efforts to compel foreign nationals and persons residing within foreign territories to produce information as an infringement of sovereignty.[228] A waiver-by-conduct statute could reduce this tension. The statute would provide that the protection accorded by secrecy laws would only be waived with respect to information relevant to the transaction under investigation; any other information regarding the customer's bank accounts would still be protected from disclosure by the secrecy laws.[229] The waiver-by-conduct approach could thus be applied very narrowly with little intrusion into the laws of a foreign secrecy jurisdiction.[230]

Moreover, legislation implementing the waiver-by-conduct approach, unlike an administrative rule, would encourage greater deference from foreign nations.[231] Enactment of such legislation would also indicate to other countries that the United States is attempting to address this problem with sensitivity to the concerns expressed by foreign nations about the preservation of their sovereignty and the extraterritorial application of United States law.[232] Yet even if foreign nations do not view the waiver-by-con-

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227. Release, *supra* note 8, at 40-41, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1314.

228. *See* Release, *supra* note 8, at 42 n.43, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1314 n.43.

229. *Waiver by Conduct Idea, supra* note 15, at 13.

230. Other more intrusive methods could be enacted. One commentator suggests that Congress could prohibit a United States broker from effecting a transaction without first determining whether his customer was acting on behalf of another person, and if so, the identity of that person. Thus, under such a proposal, investors would always be forced to disclose their identity whenever entering into transactions on United States markets; the waiver by conduct proposal would only force the customer to reveal his identity if one of his transactions were under investigation by the SEC. *See* Martin, *supra* note 101, at 15, col. 2. *See also infra* note 325 and accompanying text.

231. *See* CFTC, *supra* note 200, at 11.

232. Release, *supra* note 8, at 42, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1314.

duct approach as a favorable response to the problem, but continue to deny United States requests for evidence, the United States clear statutory position would emphasize the need for negotiations.[233]

Although the waiver-by-conduct approach encourages voluntary cooperation, reduction of litigation depends on whether foreign nations recognize the approach. If countries with secrecy laws do not acknowledge that the purchase of sale of securities on United States markets constitutes a waiver of the applicability of secrecy laws, then the SEC would not be able to obtain information without resorting to litigation and other compulsory measures. Nevertheless, the Release for Comments indicates that the SEC could not initiate litigation in every instance in which it is unable to obtain information through the voluntary cooperation of the parties. Litigation would be employed only if the SEC concluded that the need for the information outweighed the potential conflicts with other nations, the risk of placing foreign intermediaries in the middle of the dispute if the court were to issue a compulsion order or an order imposing sanctions, and the time and resources associated with litigation.[234]

3. *Certainty in Litigation*

If litigation is pursued, the waiver-by-conduct approach may ensure that the United States courts will almost always order disclosure of the information.[235] The approach would eliminate the use of the section 40 balancing test to determine whether a court order should be issued. Instead, courts would hold that the customer who enters the United States securities markets has consented to disclosure relevant to the transactions, and the requested information must therefore be produced.[236] Thus, the result would be a uniform response to the problem.

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233. *See* Release, *supra* note 8, at 43 n.43, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1314 n.43. *See also* Letter from Robert D. Bourgoin, General Counsel, Federal Maritime Commission 3 (Sept. 14, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Federal Maritime Commission].

234. Release, *supra* note 8, at 43 n.44, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. 1314-15 n.44.

235. *Waiver by Conduct Idea, supra* note 15, at 15, col. 5 n.26; Jennings, *supra* note 220, at 5.

236. *See* Release, *supra* note 8, at 43, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1314.

Although the SEC may view predictability in litigation to be advantageous in enforcement efforts, this approach may create unjust results. If in some instances the SEC does not have a legitimate need for the information, foreign financial institutions should not be forced to produce the information. In such a situation, application of the section 40 balancing test would be fairer since the court could then examine the merits of disclosing information on a case-by-case basis. Although courts recently using the Section 40 balancing test[237] have held that the requested information must be disclosed, each decision has been made after analyzing the circumstances of the particular case. Courts applying the waiver-by-conduct approach, however, would not have this discretion to weigh the equities of particular cases.

4. *Cost Effectiveness*

Once Congress enacts waiver-by-conduct legislation, the legislation can easily be implemented, without substantially changing either the manner in which transnational securities transactions are conducted or SEC enforcement procedures.[238] Also, reduction of the need for litigation would enable the SEC to decrease the time, money, and other resources spent on transborder fraud cases and instead permit the SEC to devote more of its resources to other enforcement matters.[239] The amount of these savings, however, would depend upon the effectiveness of promoting voluntary cooperation.

C. Disadvantages

1. *Extraterritoriality*

Many commentators[240] view the waiver-by-conduct concept simply as another attempt by the United States to interfere with the domestic affairs of foreign nations. Foreign countries have specifically complained about the extraterritoriality of the United States securities laws which are indeed the most rigorous securi-

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237. *See supra* note 95.

238. *Waiver by Conduct Idea, supra* note 15, at 15, col. 5 n.24.

239. *See supra* notes 100-02 and accompanying text.

240. *SEC Proposal to Override Foreign Laws on Bank Secrecy Draws Wide Criticism,* Wall St. J., Feb. 11, 1985, at 13, col. 1. Only six out of sixty-seven comments received in response to the Release supported the waiver by conduct proposal. *Id.* at 13, col. 3.

ties regulations in the world.[241] The enactment of a waiver-by-conduct statute may further compound these problems by extending United States jurisdiction into areas protected by foreign secrecy laws. Such a statute would constitute an extraterritorial application of United States securities laws in the following ways. First, the concept fails to recognize that in many countries bank secrecy is an important and fundamental right.[242] The waiver-by-conduct approach eliminates the need for using the Section 40 balancing test[243] to weigh this fundamental interest against the interest of the United States in adequately enforcing its laws. Second, although the Release states otherwise, the waiver-by-conduct approach would "impose . . . substantive regulation of conduct upon persons or institutions located in another nation."[244] For example, under the proposal the courts could obtain in personam jurisdiction over a foreign citizen and make him subject to United States securities laws if he effects a transaction in United States securities markets.

Third, the waiver-by-conduct approach permits the SEC to attempt to acquire information either without obtaining the express consent of those persons who have a right to confidentiality or without following the requirements for obtaining information as mandated by the secrecy laws or international agreements.[245] The United States would therefore force a financial institution, under

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241. The Swiss, for example, consider the United States to be a nation which "enforces detailed regulations of securities transactions along with a willingness to export its notion of securities violations worldwide." Note, *supra* note 5, at 607. *See* Cockwell Letter, *supra* note 45, at 10 (citing Schemmer v. Property Resources Ltd., 3 W.L.R. 406 [1974] 3 All. E.R. 451 (Ch.D.)).

242. *See supra* notes 46-47, 49 and accompanying text.

243. *See supra* notes 85-105 and accompanying text. *See* Bankers' Association for Foreign Trade, *supra* note 25, at 3-4; Dupler, *Unilateral Waiver by Conduct Doomed to Failure*, Legal Times, Nov. 5, 1984, at 15, col. 1.

244. Cockwell Letter, *supra* note 45, at 3. For example, by giving the SEC in personam jurisdiction, the SEC may be able to seek enforcement of sections 10(b) and 13(d) of the '34 Act, and the Insider Trading Sanctions Act of 1984, which would permit the SEC to obtain treble damages from foreign citizens for violations of these acts. The imposition of treble damages has caused great resentment from foreign nations whenever United States antitrust laws have been applied extraterritorilly.

245. *See* Letter from Guenther van Well, the Ambassador of the Federal Republic of Germany 8 (Dec. 10, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as German Ambassador]. *See also infra* notes 245-72 and accompanying text.

threat of sanctions, to disclose the information in violation of its nation's secrecy laws.[246] Furthermore, if a foreign financial institution seeks guidance from a foreign court, the foreign court would have to interpret the customer's purchase or sale of securities on United States markets as a waiver of the right of confidentiality. Thus, the United States would be directing a foreign court in the interpretation of its own laws.[247]

Supporters of the proposal disagree that it constitutes an extraterritorial application of United States laws. Although the waiver-by-conduct approach may intrude upon the application of foreign secrecy laws, the use of those laws to frustrate the SEC's attempts to obtain information has had an extraterritorial effect on the United States and has thereby infringed upon United States sovereignty.[248] Also, when a financial institution located in a secrecy law jurisdiction effects a transaction on United States markets on behalf of a customer, the relationship of that customer with the United States would parallel his relationship with the country where the financial institution is located. Thus, the application of that country's secrecy laws to the transaction could be as much of an extraterritorial extension of law as the imposition by the United States of its securities laws to the transaction.[249]

2. *Scope of Waiver*

The scope of the waiver, the potential for abuse, and the confidentiality of the information acquired during a SEC investigation[250] are sources of great concern to commentators, who fear that the approach might be used to conduct unjustifiable "fishing expeditions" into foreign bank accounts.[251] Three factors fuel

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246. *See supra* note 44 and accompanying text.

247. Letter from Jon-Jo A. Douglas, Investigation Counsel, for John F. Leybourne, Deputy Director, Enforcement, Ontario Securities Commission 4 (Nov. 1, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Ontario Securities Commission]. An alternative argument is that the waiver by conduct approach is an attempt to create advantageous United States rules of evidence which would be used in a foreign jurisdiction. *See id.*

248. *Policing Internationalized U.S. Capital Markets, supra* note 7, at 92; Statement of John Fedders, *supra* note 80, at 321; Fedders, *supra* note 6, at 2, col. 6.

249. Lowenfeld, *supra* note 25, at 7-8.

250. *See* Roosa Letter, *supra* note 84, at 3.

251. *See* Bschorr, *supra* note 77, at 310; Letter from J.B. Atherton, Secre-

these concerns. First, United States securities laws, broader than those in many other nations, may require the disclosure of information which would not be necessary or justified under other countries' securities laws. For example, the waiver-by-conduct concept applies to all securities purchased and sold in the United States;[252] consequently, the proposal may apply to any transaction involving securities as defined in Section 3(a)(10) of the Securities Exchange Act of 1934 ('34 Act), instead of applying only to those securities traded on United States stock markets.[253] Since the definition of a security in the '34 Act is considerably broader than the definitions found in other countries' securities laws, the waiver-by-conduct proposal may be applicable whenever a foreign financial institution effects a securities transaction in the United States, even though other nations would not consider the transaction to be one involving securities.[254]

Second, foreign countries with secrecy laws place great importance on the right to confidentiality. Although other nations have expressed concern over securities fraud, most of these countries value their right to confidentiality more than they desire to help the United States combat fraud on domestic markets.[255] Last, since some nations have developed bank secrecy laws as a means to attract foreign capital, widespread abuse of the waiver-by-conduct approach could severely injure the economy of such countries.[256] Unfortunately, the waiver-by-conduct proposal has very few safeguards to alleviate these fears of potential abuse.[257]

3. *Defection of Foreign Investors*

The SEC has suggested that the waiver-by-conduct approach could promote confidence and integrity in domestic markets and thus enable these markets to maintain a competitive edge over

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tary-General, British Bankers' Association 5 (Nov. 27, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited British Bankers' Association].

252. *See* Release, *supra* note 8, at 28, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1311.

253. *See* 15 U.S.C. § 78c(a)(10) (1982).

254. *See* British Bankers' Association, *supra* note 250, at 5; Cockwell Letter, *supra* note 45, at 23-24.

255. Lowenfeld, *supra* note 25, at 2.

256. *See supra* notes 51-53 and accompanying text.

257. Some have suggested ways to alleviate these fears. *See infra* notes 288-91 and accompanying text.

other securities markets.[258] Adoption of the waiver-by-conduct approach, however, could have the opposite effect by driving foreign investors away from United States markets. Foreign investors who withdraw their investments from domestic markets may still continue to trade United States securities by transferring their investments to other markets which list United States securities. As more foreign investors trade in these markets, more United States issuers probably will place their securities on foreign exchanges.[259] Foreign investors may also trade in United States securities through European Depository Receipts (EDRs), which represent United States securities held on deposit by a foreign institution. EDRs are advantageous to foreign investors since they are issued in bearer form which enables investors to remain anonymous.[260] Thus, if the waiver-by-conduct proposal is adopted, more foreign investors will invest in United States securities, but not on United States markets. Moreover, such securities would not be subject to SEC regulation because they are issued and traded outside the United States.

Adoption of the waiver-by-conduct proposal may also prompt both domestic and foreign investors who would have invested in United States securities on United States markets to invest, instead, in foreign stock listed on foreign exchanges.[261] The extent to which defection could occur is unclear. Some commentators believe that foreign investors will conclude that the advantages of United States markets, such as strength, liquidity, and integrity,

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258. Discussion of the waiver by conduct proposal occurs during a time in which the Reagan Administration is actively encouraging the free flow of investment capital between nations, international economic cooperation, and the lessening of restraints on international financial activities. Letter from Peter J. Wallison, General Counsel, U.S. Department of the Treasury 1 (Nov. 28, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Treasury].

259. *See id.*; Swiss Bankers' Association, *supra* note 205, at 5; Cockwell Letter, *supra* note 45, at 8. *See also supra* notes 16-22 and accompanying text.

260. Letter from William R. Harman, Chairman, Federal Regulation Committee, Securities Industry Association 5 (Nov. 9, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Securities Industry Association].

261. Investments in foreign securities have already become a viable alternative to investment in United States securities; United States investment in foreign securities have tripled between 1971 and 1981. One reason for the draw to foreign markets may be that, between 1970 and 1980, returns on foreign stocks were higher than U.S. stock returns. Cockwell Letter, *supra* note 45, at 9.

outweigh the risks of SEC investigation or disclosure of records normally protected by secrecy laws.[262] Other commentators, however, fear that adoption of the waiver-by-conduct proposal could cause many foreign investors, who tolerate current United States securities laws but find them to be "onerous," to transfer their investments to foreign markets.[263]

Any large defection of foreign investors from United States markets could harm domestic economic interests. First, transfer of foreign capital from United States markets could hinder the ability of United States corporations to raise capital.[264] A disproportionate amount of foreign investment in the few "blue-chip" United States securities presently listed on foreign exchanges could occur. Other United States issuers who do not have stock listed in foreign markets would have serious difficulty attracting foreign investment and raising capital unless they too could issue stock on these foreign exchanges.[265]

A significant decrease in the amount of foreign investment in United States markets could also adversely affect domestic securities industries. A drop in the number of transactions on domestic markets could reduce the market's liquidity.[266] A decrease in the number of transactions would also reduce commissions.[267] Foreign financial institutions which have offices and subsidiaries in the United States could decide to relocate to countries with developing securities markets, resulting in the loss of jobs in the United

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262. *See* Letter from H. Wayne Howell, President, North American Securities Administrators Associations, Inc. 2 (Oct. 10, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as North American Securities Administrators Association]; Jennings, *supra* note 220, at 6. In its comment, the Commodity Futures Trading Commission noted that since it adopted rules which unilaterally forced the waiver of secrecy laws, no large diversion in futures trading away from U.S. futures and options markets has occurred. CFTC, *supra* note 200, at 12.

263. The London Stock Exchange, *supra* note 26, at 3. *See* Cockwell Letter, *supra* note 45, at 5-9; Paine Webber *supra* note 32, at 5.

264. British Bankers' Association, *supra* note 250, at 4.

265. A significant drop in foreign investment could have a particularly adverse effect on the U.S. manufacturing industry. In 1978, U.S. manufacturers issued $31.1 billion of the $47.9 billion equity securities issued by U.S. corporations and owned by foreign investors. Cockwell Letter, *supra* note 45, at 7.

266. Letter from Charles H. Ross, Jr., Chairman, Merrill Lynch International, Inc. 2 (Nov. 29, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Merrill Lynch International].

267. British Bankers' Association, *supra* note 250, at 4.

States.[268]

Finally, the loss of foreign investors in United States markets could promote the popularity of markets which are informal, inefficient, and largely unregulated.[269] Unless regulations are enacted, markets could be subject to undesirable transactions which would affect market integrity. The SEC has proposed the waiver-by-conduct approach to counteract the potentially adverse effects of internationalization upon the integrity of United States markets. Individuals probably will invest in other markets unless the SEC is empowered to obtain information needed for better enforcement of domestic securities laws. Nonetheless, the waiver-by-conduct proposal may actually increase instead of resolve this problem.

4. *Waiver-by-Conduct may not effectuate United States intent*

The waiver-by-conduct concept has some defects which may preclude achievement of its goal: to enable the SEC to obtain information shielded by secrecy laws. First, foreign governments and courts probably will not recognize the validity of the customer's consent to a waiver since most foreign secrecy laws recognize only express consent to disclosure.[270] Those nations acknowledging implied consent in limited circumstances mandate that the customer's actions clearly demonstrate his intent to waive the secrecy laws.[271] Moreover, not all countries will recognize order tickets and confirmations as clearly demonstrating the customer's intent to waive his right to confidentiality. Thus, in order for the waiver-by-conduct approach to be successful, most nations would require that the customer give his express consent before information could be disclosed.[272] Even if foreign governments recognize the validity of the consent under this approach, a customer may be unaware that his order has been effected on United States

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268. Cockwell Letter, *supra* note 45, at 8-9.

269. Merrill Lynch International, *supra* note 265, at 3. *See* Treasury, *supra* note 257, at 1-2.

270. *See infra* note 272 and accompanying text.

271. Hoyt, *Chairman's Column*, 14 Int'l L. News, ABA Section of International Law & Practice, [Winter 1985] at 6, col. 2. [hereinafter cited as *Chairman's Column*].

272. The Canadian Bankers' Association, *supra* note 103, at 2. *See* Baker & McKenzie, *supra* note 4, at 2-3.

securities markets, particularly when the securities traded are also listed outside the United States. In this situation, an implied waiver probably would not be recognized.[273]

Three other flaws in the waiver-by-conduct approach may hinder its effectiveness. First, foreign investors could evade a waiver-by-conduct statute by placing additional financial institutions, serving as agents and nominees, between themselves and the United States broker-dealer who ultimately effectuates the trade, preventing the SEC from discovering the identity of the investor.[274] Second, the waiver-by-conduct approach may fail to alleviate the problems associated with litigation because forcing financial institutions to decide which law to violate may ultimately result in litigation.[275] Finally, the waiver-by-conduct approach will not empower the SEC to obtain information shielded by blocking laws.[276] Since blocking laws protect a national interest, a private party cannot waive these laws.[277] Furthermore, other na-

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273. Letter from Hoany Khalil, Deputy Chairman, Capital Market Authority 1 (Oct. 31, 1984) [hereinafter cited as Capital Market Authority]. The Comments to the Release emphasized this problem. *See, e.g., Chairman's Column, supra* note 270, at 6, col. 2; Letter from Christian Prose, Economic Counselor, Austrian Embassy 1 (Nov. 29, 1984) (Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver by Conduct") [hereinafter cited as Austria]; Letter from Herculano Borges da Fonseca, President, CVM-Comissao De Valores Mobiliarios' Legal Department 1-3 (Sept. 20, 1984) [hereinafter cited as Brazil]; Letter from Peter Hess, Director of the Federal Office for Public Matters, Federal Department of Justice and Police 2 (Dec. 20, 1984) [hereinafter cited as Swiss]; Singapore, *supra* note 220, at 2-3; German Ambassador, *supra* note 244, at 3-4. *But see Policing Internationalized U.S. Capital Markets, supra* note 7, at 106-07 ("Swiss law recognizes the concept of 'acquiescence by conduct' ").

274. *See* Securities Industry Association, *supra* note 259, at 6; Roosa Letter, *supra* note 84, at 2; Treasury, *supra* note 257, at 2. One commentator suggested that to resolve the problem, each financial intermediary should be required to record the name of the person giving the order and the name of the person who initiated the order. However, because no means of ensuring the truth of this information exists, this suggestion may not be practical. Letter from T.G. Barker, Director General, Council for the Securities Industry (London, England) 3 (Nov. 26, 1984) [hereinafter cited as Council for Securities Industry].

275. Bankers' Association for Foreign Trade, *supra* note 25, at 12.

276. Blocking laws limit the effectiveness of the waiver by conduct concept since countries with secrecy laws may either already have blocking laws or may enact blocking laws in response to the enactment of a waiver by conduct statute. Release, *supra* note 8, at 45, 49, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1316.

277. Release, *supra* note 8, at 47-48, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1316.

tions will respond to the offensive application of United States laws by enacting blocking laws.[278]

5. *United States Unilateral Acts Create Tensions*

The greatest problem with the waiver-by-conduct approach is that it will unilaterally affect the efficacy of a foreign country's secrecy laws. Consequently, many countries have responded negatively[279] to the waiver-by-conduct proposal, warning that adoption of the concept would increase bilateral frictions.[280]

The increase of bilateral tension caused by implementation of the waiver-by-conduct approach could seriously undermine the SEC's efforts to enforce domestic securities laws. First, a waiver-by-conduct proposal may not aid SEC efforts to obtain information since bilateral tensions may prevent foreign countries from recognizing that implied consent to disclosure is equivalent to the consent required by foreign secrecy laws; the waiver-by-conduct concept could only be effective with cooperation from foreign countries.[281] Second, foreign countries could impose retaliatory measures, including the enactment of blocking laws which would continue to block disclosure of information despite the waiver-by-conduct procedure.[282] Implementation of the concept could also

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278. *See infra* notes 281-82 and accompanying text.

279. The Swiss Government, for example, has said that "Switzerland cannot tolerate unilateral measures that have the purpose of obtaining proof located within our territory—measures which violate our sovereignty. We have had previous occasions to explain to your Government that such unilateral measures are incompatible with the granting of judicial assistance." Swiss, *supra* note 272, at 4. Note that not all criticism of the United States adopting unilateral measures came from foreign countries. Perhaps the harshest comments came from Securities and Exchange Commissioner Charles L. Marinaccio who stated that:

> Waiver by conduct would bring the Lone Ranger concept to international economic relations. Essentially, it says that the United States will unilaterally establish the standards for crossborder trading and that the rest of the world will have to pass muster. Implicit is the arrogance that the U.S. Market is so inviable that foreigners will be forced to comply with our requirements regardless of their historical sensibilities.

Marinaccio, *Waiver by Conduct Bears Potential for Distortion*, Legal Times, Feb. 18, 1985, at 12, col. 2.

280. *See SEC Proposal to Override Foreign Laws on Bank Secrecy Draws Wide Criticism*, *supra* note 239, at 13, col. 1.

281. Treasury, *supra* note 261, at 1-2; Roosa Letter *supra* note , at 4.

282. Foreign countries have taken this action in the past in retaliation against what was perceived as gross extraterritorial application of United States

prompt countries to enact more restrictive secrecy laws or to enforce existing secrecy laws more vigorously.[283] Foreign countries could also retaliate by limiting the access of United States investors, businesses, and financial institutions to foreign markets.[284]

The increase in tensions which would result from unilateral implementation of the proposal could affect United States relations with foreign governments and, ultimately, United States foreign policy.[285] Friction caused by implementation could also block efforts to improve international economic cooperation;[286] international efforts to curb narcotics trafficking and other criminal activities would also suffer.[287] Moreover, bilateral tensions could also hurt plans by other United States agencies and associations

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law. Merrill Lynch International, *supra* note 265, at 4. Cockwell Letter, *supra* note 45, at 13.

283. Cockwell Letter, *supra* note 45, at 13. A more recent example is the Cayman Islands' response to a U.S. court's holding in *In re Grand Jury Proceedings*, 532 F.2d 404 (5th cir.), *cert. denied*, 429 U.S. 940 (1976): the retaliatory enactment of a new stringent bank secrecy law. *See* Cockwell Letter, *supra* note 45, at 13.

284. For example, access could be conditioned upon the waiver of certain constitutional privileges or statutory protections available in the United States, including the attorney-client privilege, 5th Amendment protections against self-incriminations, and any other right which could be voluntarily relinquished. Cockwell Letter, *supra* note 45, at 13; Bankers' Association for Foreign Trade, *supra* note 25, at 2.

285. Switzerland, for example, has responded to the waiver by conduct release with outrage, suggesting that implementation of the concept would jeopardize the Swiss Treaty and the MOU and prevent the negotiation of other bilateral agreements. *Swiss Bankers Group Rebuffs Proposal by SEC to Curb Certain Secrecy Laws*, Wall St. J., Dec. 6, 1984, at 35, col. 3, Swiss, *supra* note 272, at 3-5. The Swiss Bankers' Association wrote:

> . . . it is a bitter disappointment for the Swiss Bankers' Association to see the United States now attempting to impose unilateral law. Even before you had any practical experience with Agreement XVI, you began considering enactment of legislation which would surely mean the end of Agreement XVI. We wish to add that it is our belief that should 'waiver by conduct' legislation be enacted, Switzerland would hardly be prepared to enter into further bilateral agreements at the request of the United States. Switzerland would have to assume that settlements by international treaty are viewed by the United States only as temporary solutions, to be superseded by subsequent unilateral legislation. The credibility of the United States as a partner in international agreements is at stake.

Swiss Bankers' Association, *supra* note 205, at 6.

286. *Marinaccio Blasts Waiver by Conduct, Urges Limits on Hostile Tender Offers* [Jan.-June] 17 SEC. REG. & L. REP. (BNA) 50, 51 (Jan. 11, 1985).

287. Bankers' Association for Foreign Trade, *supra* note 25, at 10.

to court internationalized markets.[288] Thus, the unilateral implementation of the waiver-by-conduct approach could hinder international cooperation, which would not only impair United States economic interests, but could also seriously jeopardize United States relations with allies and trading parties.

V. Other Proposed Alternatives

A. Amend Waiver-by-Conduct Proposal

One commentator has suggested that the waiver-by-conduct proposal should only be made applicable to United States investors who effect transactions on United States markets through foreign financial institutions located in secrecy jurisdictions. Although foreign countries have expressed overt criticism of the waiver-by-conduct proposal, these countries may find the approach "more palatable" if its application is limited to United States citizens.[289] Another commentator suggests that the waiver-by-conduct approach should only be implemented when the SEC is investigating insider trading and other specified acts.[290] Information obtained under this plan would not be shared with other United States agencies.[291] Last, another amendment suggests implementation of the approach only with the approval of the SEC, and not by its Enforcement Division, and the approach would not be used by private litigants or in conjunction with private litigation.[292]

If enacted, these suggestions could quell much of the criticism surrounding the waiver-by-conduct proposal; if the proposal is narrower and discloses less information, cooperation will be promoted.[293] Though a limited version of the proposal could aid the

288. *See* Cockwell Letter, *supra* note 45, at 6; Letter from Walter T. Cassidy, Assistant General Counsel, Finance Division, U.S. Department of Housing and Urban Development (Oct. 29, 1984) [Comment on SEC Release No. 21186, File No. S7-27-84 "Waiver-by-Conduct").

289. Roosa Letter, *supra* note 84, at 5.

290. Lowenfeld, *supra* note 25, at 6.

291. This may require modification of 17 C.F.R. § 200.30-4 and 17 C.F.R. § 200.30-4(a)(7). *See* Lowenfeld, *supra* note 25, at 5.

292. Lowenfeld, *supra* note 25, at 4.

293. *See* Capital Market Authority, *supra* note 272, at 2. For example, foreign countries may permit the waiver even if a party does not expressly consent, and these countries generally may be more cooperative in forcing financial institutions to disclose requested information.

SEC's efforts to obtain information about certain transactions, the SEC will still have difficulty in obtaining information about other transactions not within the statute's scope unless other alternatives are also enacted.[294] Finally, the waiver-by-conduct proposal, as amended, would still do little to force the disclosure of information shielded by blocking laws.

B. Amend Rule 17a-3(a)(9)

In 1976 and 1977, the SEC solicited comments on a proposal which would amend Rule 17a-3(a)(9)[295] to require that "as a basic condition to participation in United States securities markets . . . those who act on behalf of undisclosed principals . . . [must] establish in advance by written agreement their willingness to disclose[,] to the [Securities and Exchange] Commission upon request, the identity of their principals."[296] Under this proposal, brokers and dealers would be obligated to obtain an agreement from the foreign financial institution or other authorized persons effecting transactions, requiring the institution or person to release the name and address of the beneficial owner upon the request of the SEC. In effect, financial institutions and other intermediaries would be forced to obtain from their customers a waiver of their right to confidentiality under the secrecy laws as a condition to maintaining an account with an American broker-dealer.[297] This proposal, facing many of the same criticisms as the waiver-by-conduct proposal,[298] has neither been adopted nor withdrawn.

In response to the waiver-by-conduct release, one commentator has suggested the adoption of a proposal similar to Proposed Rule 17a-3(a)(9). Under this suggestion, the waiver-by-conduct proposal would require all foreign financial institutions which conduct transactions in United States markets to obtain an express waiver

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294. This is one of the major criticisms of the MOU. *See supra* note 187 and accompanying text.

295. 17 C.F.R. § 240.17a-3(a)(9) (1985).

296. 42 Fed. Reg. 3312, 3315 (1977).

297. *See* Note, *supra* note 44, at 443.

298. Critics of Proposed Rule 17a-3(a)(9) argue that the amendment would divert foreign investment from the United States, that the proposals could easily be evaded, and that they burden broker-dealers. Statement of John Fedders, *supra* note 80, at 331. The waiver by conduct proposal, though similar to the Proposed Rule 17a-3(a)(9), assumes a presumption that the investor agrees to a waiver. Roosa Letter, *supra* note 84, at 5.

of the applicability of the secrecy laws from each client prior to effecting his trade. As a condition to trading in United States securities markets, financial institutions would have to notify their clients in writing that information pertaining to transactions effected on United States markets could not be protected by secrecy laws if requested by the SEC or United States courts.[299]

C. Amend Section 21(c) of the Securities Exchange Act of 1934.

In the mid-1970's the SEC proposed that Congress amend Section 21(a) of the Securities Exchange Act of 1934 to permit service of a subpoena on a foreign financial institution. If the SEC did not obtain the requested information by subpoena, United States courts could then impose sanctions on the beneficial owners of the securities. Because sanctions would not be imposed upon financial institutions, those institutions would not be placed in the middle of the conflict. Also, imposition and enforcement of the sanctions within the United States would create no "jurisdictional conflicts" with other nations.[300]

The proposal was criticized because it lacked procedures for serving a subpoena on the beneficial owner or for enforcing the subpoena in federal court. The court in *Federal Trade Commission v. Compagnie de Saint-Gobain-Point a Mousson*[301] held that service of an investigatory subpoena abroad violates international law unless the foreign country consents.[302] Nonetheless, the Walsh Act[303] may provide a remedy to these deficiencies since it permits a civil action to be filed in federal court to obtain evidence from United States nationals and residents located outside the United States.[304]

Recently, two other proposals have been suggested which would effectively amend Section 21. One proposal would require congressional approval of a judicial proceeding enforcing SEC subpoenas. Not only would this statute authorize a court order requesting information even if no enforcement action had been

299. *See* Brazil, *supra* note 272, at 3-4.

300. *Policing Internationalized U.S. Capital Markets*, *supra* note 7, at 104 n.36; *Waiver by Conduct*, *supra* note 5, at 12-13.

301. 636 F.2d 1300 (D.C. Cir. 1980).

302. *See supra* notes 72-74 and accompanying text.

303. 28 U.S.C. §§ 1783, 1784 (1982).

304. *Waiver by Conduct*, *supra* note 5, at 13-14.

filed, but it would also allow a court order even if the subpoena had not been served on the witness.[305] The second proposal would require congressional authorization of stiffer penalties for refusal to comply with an SEC subpoena.[306]

D. Treaties

1. *Bilateral Treaties*

The successful negotiation of the Memorandum of Understanding and the recent Swiss initiatives illustrate the potential for use of bilateral negotiations to resolve the problem of obtaining information. Bilateral negotiations permit two nations to devise procedures that are compatible with the laws and traditions of both countries. Such procedures eliminate the need for litigation or compelling discovery measures unless otherwise specified in the treaty. Thus, bilateral treaties would enable each nation with secrecy laws to negotiate a procedure with the United States which would allow information to be disclosed as quickly and easily as possible without jeopardizing relations.

Despite these benefits, negotiation of bilateral treaties would only fully resolve the problem if the United States were to negotiate with all secrecy jurisdictions. Such negotiations would require a tremendous amount of time and other resources. Moreover, every country may not agree to a uniform proposal. For example, while some countries may agree to permit a waiver for investigations of market manipulation but not for disclosure violations, other countries may wish to strictly limit the waiver to insider trading cases. Also, the procedures established through negotiation could vary, resulting in "a patchwork of differing and uneven provisions" which would "allow the wrongdoer to select a forum" where secrecy laws would still shield him from SEC investigations.[307] Until bilateral treaties with all major secrecy jurisdic-

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305. *Goelzer Says SEC May Ask Legislation Against Foreign Secrecy Blocking Laws*, [Jan.-June] 16 SEC. REG. & L. REP. (BNA) 469 (Mar. 9, 1984).

306. *Id.* These sanctions may include the withholding of dividends or interests or the suspension or revocation of voting rights. *Id.* Another commentator suggested that persons who refuse to comply with a SEC subpoena should be charged with a felony carrying the maximum fine and an increased jail term. These sanctions would only apply to persons who are subject to the jurisdiction of U.S. courts. Note, *supra* note 44, at 452.

307. *See SEC to Take Up Waiver by Conduct*, *supra* note 19, at 1960. *But see* Dupler, *supra* note 242, at 15, 26. (One commentator argued that these dif-

tions are in force, those already in force may be ineffective since investors seeking to violate United States securities laws can easily conduct their activities through countries which have no treaty with the United States or countries in which the treaty does not cover the activity.[308]

2. *Multilateral Treaty*

A multilateral treaty may resolve some of the problems associated with bilateral treaties. Since many of the signatories would be committed to the same procedure during the same period, a multilateral treaty could provide a comprehensive uniform approach to obtaining evidence shielded by secrecy laws without giving the "wrongdoer" the opportunity to move his operations to another secrecy jurisdiction. A conference composed of representatives from nations with secrecy and blocking laws and nations with securities markets could also permit nations to establish a dialogue regarding their laws, concerns, structure of securities markets and enforcement goals; such a cooperative effort would diminish friction among nations by establishing procedures upon which most nations could agree.[309]

A conference to establish multilateral negotiations may be impractical and unsuccessful due to the number of nations with secrecy and blocking laws and the diversity of views.[310] Several commentators, however, have suggested that a multilateral treaty may be possible if negotiations are established only between nations with major capital markets and/or nations which effect most of the foreign transactions involving the securities of United States corporate issuers.[311]

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ferences "give rise to a reasoned response to pluralism.").

308. *See* Testimony of D. Lowell Jensen, *supra* note 101, at 214.

309. *See Waiver by Conduct Idea, supra* note 15, at 14, cols. 1-2.

310. *Id.*

311. Ontario Securities Commission, *supra* note 246, at 9; The London Stock Exchange, *supra* note 26, at 1; Paine Webber, *supra* note 32, at 4. Other commentators suggest similar approaches. SEC Commissioner Marinaccio proposed that an international structure be established for the world securities markets similar to the General Agreements on Tariffs and Trade (GATT). *Marinaccio Blasts Waiver by Conduct, Urges Limits on Hostile Tender Offers, supra* note 285, at 51. For more information on Marinaccio's proposal, see Marinaccio, *supra* note 278, at 13, cols. 1-3.

VI. Analysis: A Proposed Resolution

The internationalization of securities markets will cause problems for all nations in adapting their securities markets to twenty-four hour global trading. One major problem nations will confront is the rise in incidents of transborder fraud. A fraudulent transaction involving one company's stock may ultimately adversely affect every market where the stock is traded. If such transactions are conducted through financial institutions located in a country with secrecy or blocking laws, then information about the transaction will be protected from disclosure, except when either the United States-Swiss Treaty or MOU is applicable. Since the identity of the purchasers would also be protected from disclosure, these investors would be immune from prosecution. This immunity may encourage more investors to reap profits accrued through fraudulent transactions.

Currently, the United States markets are a major target of fraudulent transactions effected through financial institutions located in jurisdictions with secrecy and blocking laws. As internationalization accelerates other nations with securities markets could also suffer the effects of such fraudulent transfers. To obtain a solution to problems associated with secrecy and blocking laws, nations like the United States must recognize the importance some nations attach to those laws. Many nations view secrecy laws as a means to protect the fundamental right to confidentiality. Also, secrecy laws may promote a nation's economic vitality.

Because of the differing perceptions of secrecy laws, and because of the potential for increasing transborder fraud on an integrated securities market, a conference should be held to negotiate a multinational treaty or agreement that establishes a procedure for countries to use in obtaining information shielded from discovery.[312] Participation in the negotiations should be confined initially to nations with major capital markets and nations considered to be major secrecy jurisdictions to prevent the conference from becoming too unwieldy.[313] By permitting each nation to dis-

312. This convention could be convened solely for the purpose of negotiating a method to obtain information shielded from discovery by secrecy and blocking laws. A preferable alternative may be to produce an agreement which would resolve other problems associated with the internationalization of securities markets.

313. *See supra* note 311 and accompanying text. Some of these na-

cuss the various aspects of the problem, the countries may be able to agree upon a procedure which would permit quick and easy access to information shielded by secrecy laws. This approach may also be the only viable means by which a mechanism could be established to enable countries to receive information protected by blocking laws. Development of securities markets in other nations and use of financial institutions in nations with secrecy and blocking laws to effect transactions on other markets will necessitate that these nations sign the treaty.

Unfortunately, multilateral negotiations are extremely time-consuming. Delays in signing and executing a treaty would affect the United States greatly since, unlike most other countries, it is currently experiencing difficulties in obtaining information shielded by secrecy and blocking laws. Consequently, unless a temporary measure is adopted until a treaty is negotiated, the SEC will be forced to employ litigation to compel the discovery of requested information.

Until a treaty is completed, the SEC should promulgate a rule which would establish a limited form of waiver-by-conduct.[314] First, the waiver proposal would be applicable to investigations of all violations of United States securities laws by domestic investors who invest on United States markets using financial institutions in secrecy jurisdictions.[315] If an investor is not a United States national, then waiver-by-conduct would apply only if the SEC is investigating an insider trading case.[316] If the SEC is unable to determine whether the investor is a United States national, then the investor would be considered a foreign citizen.[317]

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tions—Switzerland, for example—may meet both criteria.

314. John Fedders has suggested that waiver by conduct could be implemented as a short term response. Fedders & Mann, *supra* note 20, at 18. Another commentator suggested that Congress should adopt enabling legislation authorizing the implementation of the waiver by conduct proposal within a certain number of months after adoption. During the period before implementation, negotiations would be held among banking and securities authorities, and among financial institutions. Lowenfeld, *supra* note 25, at 9-10. In effect, pressure would be placed on negotiators to reach a conclusion before the waiver by conduct approach is implemented.

315. *See supra* note 288 and accompanying text.

316. *See supra* note 289 and accompanying text. Analysts are particularly concerned that insider trading violations will increase once an internationalized capital market system is in place if the SEC continues to have difficulties obtaining information shielded by secrecy and blocking laws.

317. Other proposed alternatives distinguish between U.S. and foreign na-

Any bilateral or multilateral treaty or agreement in which the United States is a party would supersede the waiver-by-conduct rule.[318] Furthermore, the waiver-by-conduct approach could not be used without the express consent of the Commissioners of the SEC.[319] To determine whether the rule should be implemented, the Commissioners would consider whether the investor is a United States national, and if he is not whether the transaction constitutes insider trading as established by the proposal. The Commission would also consider the types of records subpoenaed, the applicability of treaties or agreements, the availability of viable alternative methods to obtain records, the "indispensability" of the records to the investigation,[320] the potential chain of foreign intermediaries linking the United States broker-dealer with the beneficial owner, and the potential for conflict with other nations.[321] If the potential for conflict with other nations is great and the Commissioners decide to implement the waiver-by-conduct procedures, then the State Department should be notified. The approach should be implemented only to obtain essential information, not to conduct a "fishing expedition." Moreover, the information waived should pertain only to the transaction under investigation and would be kept confidential.[322]

The purpose of a waiver-by-conduct rule[323] is to provide the SEC with some procedure to implement until a multilateral agreement can be negotiated. As well as enabling the SEC to ob-

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tionals. *See* Note, *supra* note 44, at 449-51; *supra* note 312 and accompanying text.

318. For example, if the procedure outlined in the U.S.-Swiss MOU is applicable, then those procedures, and not the waiver by conduct approach, would be implemented.

319. *See supra* note 291, and accompanying text.

320. *See* Memorandum, *supra* note 104.

321. *See* Release, *supra* note 8, at 43 n.44, *reprinted in* [July-Dec.] 16 SEC. REG. & L. REP. at 1314-15 n.44.

322. No individual or government agency could obtain access to this information. *See supra* note 290 and accompanying text. This may also require amending the Freedom of Information Act. *See supra* note 315; Note, *supra* note 44, at 451.

323. Because the procedure would only be temporary, the SEC should promulgate a rule, rather than request Congress to enact legislation. One commentator suggests that the SEC already has legislative authority to implement the approach. *See* CFTC, *supra* note 200, at 11. A rule would not only be enacted more quickly, but it would also appear less permanent than would legislation—a factor essential to obtaining foreign cooperation.

tain information vital to its enforcement practices, the suggested rule may also give the United States a strong negotiating position at the multilateral convention, since the procedure, as amended, is less intrusive and disruptive than other proposed alternatives.[324] Since the scope of the procedure is limited, it will not guarantee access to all shielded information for investigations of all violations of domestic securities laws.[325] Nevertheless, the proposal should be viewed as an interim measure until a multilateral treaty is negotiated. The SEC should attempt to prevent a large defection of foreign investors from the United States and to reduce foreign hostility, rather than attempting to devise a comprehensive procedure.

The success of this approach depends on two factors. First, foreign investors must be convinced that the scope of the waiver is very narrow and that the proposal rarely will be used. When the undisclosed investor is a foreign national, the only time the SEC will recognize such a waiver will be if the Commissioners find that a possible insider trading violation has occurred, the information requested is absolutely necessary, that no treaty or agreement is applicable, and that the potential harm to United States relations with the foreign nation involved is not great. These limitations should deter any large defection of foreign investors away from United States markets.

The success of the amended waiver-by-conduct approach depends upon the cooperation of foreign governments. The SEC and the State Department must explain to all foreign nations with secrecy laws that this rule is a temporary resolution, which will expire upon the conclusion of multilateral negotiations and

324. *See supra* note 229, and accompanying text. The waiver by conduct approach is preferable to amending Rule 17a-3(a)(9) because the latter prevents foreign entities from trading on the United States securities markets unless their customers agree to permit disclosure of their identities at the SEC's request. If the customer refuses to agree, the transaction cannot take place. The waiver by conduct approach permits the transaction on United States markets to occur. If the SEC ultimately does decide to seek the disclosure of information the customer could attempt to fight it by requesting the foreign government's intervention. The transaction, however, would still have taken place. More foreign investors probably would be deterred from participating in U.S. markets under the Rule 17a-3(a)(9) proposal than under waiver by conduct. Any amendment to Section 21(c) which stiffens sanctions would only further heighten tensions between nations.

325. *See supra* note 293 and accompanying text.

the execution of an agreement or treaty. Most importantly, the SEC must expressly recognize the importance that other nations attach to secrecy laws. As some of the comments to the Release indicate, many perceive the SEC as attempting to force its rules upon the rest of the world.[326] Since any foreign hostility to this proposal may jeopardize multilateral negotiations, the SEC must change this perception to obtain foreign cooperation. If this limited form of waiver-by-conduct is still met with great foreign hostility, then this rule may be further amended or withdrawn because multilateral negotiations should take precedence over any unilateral action implemented in the interim.

VII. Conclusion

Due to the acceleration of the internationalization of the securities markets, a resolution to the problems confronting the SEC in obtaining information shielded by secrecy and blocking laws is desperately needed. The best approach toward resolving these problems is to commence a convention which would ultimately draft a multinational treaty. The SEC should also promulgate a rule adopting a limited version of the waiver-by-conduct approach which would remain in effect until either the multilateral agreement is enacted, or bilateral treaties preempt it. Yet the rule, and more importantly, the multilateral negotiations, will achieve their objectives only if all nations cooperate with each other. All nations must recognize the laws and concerns of every other. Only with this spirit of cooperation can progress be made on a solution to the problem.

Rochelle G. Kauffman

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326. *See supra* notes 240-48 and accompanying text. *See also* Editorial, *supra* note 43, at 32, col. 2.