

CONFLICT OF LAWS—DISCOVERY—SWISS BANKS CAN BE COMPELLED TO DISCLOSE IDENTITIES OF CLIENTS SUSPECTED OF INSIDER TRADING—*Securities And Exchange Commission v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981).

Efforts to police international transactions on the American securities market have been frustrated for decades by the Swiss banking privilege.<sup>1</sup> This difficulty arises because Swiss banks trading on the American securities market<sup>2</sup> are prevented by Swiss banking law from disclosing the identities of their clients.<sup>3</sup> Thus, American enforcement agencies are prevented from ascertaining the identities of those individuals who might fraudulently trade on the American market.<sup>4</sup> American officials believe such undiscoverable fraudulent activity threatens the integrity of the securities market,<sup>5</sup> thereby diminishing the investing public's confidence in the market.

Against this background, the United States District Court for the Southern District of New York in *Securities And Exchange Commission v. Banca Della Svizzera Italiana*<sup>6</sup> (*SEC v. BSI*) ordered a Swiss bank to reveal to the Securities and Exchange Commission the identities of customers suspected of insider trading, even though disclosure would violate Swiss law and might result in possible criminal sanctions against bank officers.<sup>7</sup> This exercise of American jurisdiction and extraterritorial application of American securities law to foreign defendants,<sup>8</sup> may lead to international complications.<sup>9</sup>

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<sup>1</sup> See Kelly, *United States Foreign Policy: Efforts To Penetrate Bank Secrecy in Switzerland from 1940 to 1975*, 6 CAL. W. INT'L L. J. 211 (1976); see also H.R. REP. NO. 975, 91st Cong., 2d Sess. 12, reprinted in 1970 U.S. CODE CONG. & AD. NEWS 4394, 4397 [hereinafter cited as HOUSE REPORT].

<sup>2</sup> *Trade Dev. Bank v. Continental Ins. Co.*, 469 F.2d 35, 37 (2d Cir. 1972) (Swiss banks may act as stockbrokers).

<sup>3</sup> See *infra* note 183.

<sup>4</sup> See HOUSE REPORT, *supra* note 1, at 13-14, reprinted in 1970 U.S. CODE CONG. & AD. NEWS at 4397-98; 116 CONG. REC. 32,627-28 (1970).

<sup>5</sup> See 116 CONG. REC. 32,627 (1970).

<sup>6</sup> 92 F.R.D. 111 (S.D.N.Y. 1981).

<sup>7</sup> *Id.* at 119.

<sup>8</sup> See generally Hacker & Rotunda, *The Extraterritorial Regulation of Foreign Business Under the U.S. Securities Laws*, 59 N.C.L. REV. 643 (1981); Loss, *Extraterritoriality in the Federal Securities Code*, 20 HARV. INT'L L. J. 305 (1979).

<sup>9</sup> See Onkelinx, *Conflict of International Jurisdiction: Ordering the Production of Documents in Violation of the Law of the Situs*, 64 NW. U. L. REV. 487, 507-09 (1969); Note, *Power to Reverse Foreign Judgments: The British Clawback Statute Under International Law*, 81 COLUM. L. REV. 1097, 1100, 1102 (1981) (discussing foreign retaliatory legislation or action in response to American discovery efforts abroad) [hereinafter cited as Note, *British Clawback*]; Note, *Ordering Production of Documents from Abroad in Violation of Foreign Law*, 31 U. CHI. L. REV. 791, 797-98 (1964) [hereinafter cited as Note, *Ordering Production of Documents*]; Note, *Discovery of Documents Located Abroad in U.S. Antitrust Litigation: Recent Develop-*

Additionally, different legal viewpoints have evolved from this conflict between American discovery laws and Swiss nondisclosure laws. American courts maintain that their law should control procedure,<sup>10</sup> while others relying on international law maintain that deference be granted to foreign law thus resulting in greater restraint by the American courts.<sup>11</sup> This Note will examine the depth of the competing American and Swiss interests and review the propriety of judicial action in this internationally sensitive area.

On March 10, 1981, Banca Della Svizzera Italiana (BSI), a Swiss bank, purchased 1055 call options and 3000 shares of St. Joe Minerals Corporation (St. Joe) common stock<sup>12</sup> for certain undisclosed purchasers.<sup>13</sup> The call options and stock were traded through two broker-dealers on the Philadelphia and the New York Stock Exchanges respectively.<sup>14</sup> At the time of the purchase the price of the stock was

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*ments in the Law Concerning the Foreign Illegality Excuse for Non-Production*, 14 VA. J. INT'L L. 747 n.1 (1974) [hereinafter cited as Note, *Recent Developments*]; see also *infra* note 171 and accompanying text.

<sup>10</sup> *Lex fori* is the term used for the concept that the law of the forum controls procedure. See *Societe Internationale v. McGranery*, 111 F. Supp. 435, 444 (D.D.C. 1953), *modified and aff'd sub nom. Societe Internationale v. Brownell*, 225 F.2d 533 (D.C. Cir. 1955), *cert. denied*, 350 U.S. 937 (1956); Note, *Recent Developments*, *supra* note 9, at 748 n.4. See generally 3 J. BEALE, *CONFLICT OF LAWS* 1600 (1935), *cited in* Note, *Foreign Nondisclosure Laws and Domestic Discovery Orders in Antitrust Litigation*, 88 YALE L. J. 612, 614 (1979).

<sup>11</sup> *In re Chase Manhattan Bank*, 297 F.2d 611, 613 (2d Cir. 1962); *Federal Maritime Comm'n v. DeSmedt*, 268 F. Supp. 972, 974-75 (S.D.N.Y. 1967). International comity is the recognition of the judicial, legislative, or executive acts of a foreign country. *Hilton v. Guyot*, 159 U.S. 113, 163-64 (1894); *Ings v. Ferguson*, 282 F.2d 149, 152-53 (2d Cir. 1960); see also *Onkelinx*, *supra* note 9, at 530 (international comity should be considered as one factor in defining jurisdiction); Note, *Recent Developments*, *supra* note 9, at 748 n.5 (international comity evidences recognition of foreign sovereignty). *But cf.* Note, *Ordering Production of Documents*, *supra* note 9, at 794-96 (since comity is used in many senses, it is not binding principle).

<sup>12</sup> 92 F.R.D. at 113. A call option permits its holder to call for securities at a fixed price in a stated quantity within a stated period. BLACK'S LAW DICTIONARY 185 (rev. 5th ed. 1979). St. Joe, a diversified producer of natural resources, is a New York corporation registered pursuant to the Securities Exchange Act of 1934 and its corporate securities are listed and traded on the New York Stock Exchange. In this transaction, however, its options were traded only on the Philadelphia Stock Exchange. Amended Complaint of Plaintiff at 4, *Securities And Exchange Commission v. Banca Della Svizzera Italiana*, 92 F.R.D. 111 (S.D.N.Y. 1981) [hereinafter cited as Amended Complaint of Plaintiff].

<sup>13</sup> Subsequent discovery revealed that three Panamanian companies: Transatlantic Financial Co., S.A. (TFCO), Nayarit Investment, S.A. (NICO), and Finvest Underwriters and Dealers (Finvest Panama) had securities trading accounts with BSI. On behalf of these companies, Giuseppe Tome, a registered representative with Baird-Patrick & Co., instructed BSI to effect the transactions in question. Amended Complaint of Plaintiff, *supra* note 12, at 2-5; see also *infra* notes 34-35 and accompanying text.

<sup>14</sup> 92 F.R.D. at 112. The call options were traded by Becker, a registered broker-dealer and a member of the Philadelphia Stock Exchange with retail offices in Geneva, Switzerland and New York, New York. The stock was traded by Baird-Patrick, a registered broker-dealer and a member of the New York Stock Exchange with principal offices in New York, New York and a branch office in Geneva, Switzerland. Their Switzerland office was run by Tome, a registered representative of the firm. Amended Complaint of Plaintiff, *supra* note 12, at 4.

approximately thirty dollars per share.<sup>15</sup> The next day a public announcement revealed that Joseph E. Seagram & Sons, Inc. was making a cash tender offer of forty-five dollars per share for all of St. Joe's common stock.<sup>16</sup> St. Joe's stock price increased dramatically that day,<sup>17</sup> whereupon BSI informed its American brokers to liquidate the option positions and sell the stock.<sup>18</sup> A profit of nearly two million dollars was realized by BSI's clients "virtually overnight" and was placed in BSI's bank account with the Irving Trust Company in New York.<sup>19</sup>

These developments aroused the suspicion of the Securities and Exchange Commission (SEC) which promptly filed an action against BSI and certain undisclosed purchasers in the United States District Court for the Southern District of New York.<sup>20</sup> On March 27, 1981, the SEC sought a temporary restraining order to prevent further trading violations, additional orders to freeze the assets derived from the sales of St. Joe securities, and information to gain the identities of the unknown purchasers.<sup>21</sup> The SEC alleged that BSI and the undisclosed purchasers had violated the provisions of American securities law pertaining to insider trading by acting on confidential information relating to the acquisition of St. Joe.<sup>22</sup>

On that same day, the SEC obtained a temporary restraining order from Judge Pollack, freezing the proceeds of the stock transaction in BSI's account at Irving Trust.<sup>23</sup> Additionally, the order directed discovery proceedings requiring BSI to disclose the identity of its clients "insofar as permitted by law."<sup>24</sup> For an eight month period, BSI refused to appropriately answer the SEC's discovery requests<sup>25</sup> and declined to disclose the requested information regarding the identity of its customers,<sup>26</sup> maintaining that such disclosure would

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<sup>15</sup> 92 F.R.D. at 112.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 113.

<sup>18</sup> *Id.* BSI was instructed to perform these transactions by Tome. Amended Complaint of Plaintiff, *supra* note 12, at 9.

<sup>19</sup> 92 F.R.D. at 113.

<sup>20</sup> Memorandum In Support of Plaintiff's Application For An Order Compelling Answers And Imposing Sanctions at 1, Securities And Exchange Commission v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981) [hereinafter cited as Plaintiff's Memorandum].

<sup>21</sup> *Id.* at 2.

<sup>22</sup> *Id.* at 1-2.

<sup>23</sup> See Plaintiff's Memorandum, *supra* note 20, at 1-2.

<sup>24</sup> 92 F.R.D. at 113.

<sup>25</sup> *Id.* The SEC propounded interrogatories and attended court conferences in an attempt to learn the identity of the undisclosed principals. *Id.* These attempts, however, failed. The SEC merely received "[e]xplanatory but uninformative letters" from BSI concerning the identity of the principals. *Id.*

<sup>26</sup> *Id.*

violate Swiss law and thus place BSI in jeopardy of criminal sanctions.<sup>27</sup>

In November, 1981, the court announced in an informal opinion that it would enter an order requiring disclosure and permit the SEC one week within which to submit the order.<sup>28</sup> The court made it clear that a failure to comply with the disclosure order would result in the imposition of severe contempt sanctions.<sup>29</sup> Subsequently, the bank secured client waivers, furnished some of the answers to the interrogatories, and requested additional time to answer the remaining interrogatories or show why it could not comply.<sup>30</sup>

Although some compliance had occurred, the court could not predict whether the bank would fully comply with the discovery order or whether further discovery would give rise to additional defenses by the bank.<sup>31</sup> Accordingly, the court decided "to analyze the legal situation posited."<sup>32</sup> Because BSI had not fully complied, the court ordered the bank to complete its answers, but decided to withhold its final order to allow BSI time to comply with the discovery order or explain the reason for its failure to do so.<sup>33</sup> BSI eventually disclosed the identity of its clients pursuant to the waivers it had received, thus eliminating the necessity of the court order.<sup>34</sup> The SEC then filed an amended complaint naming the newly identified clients as defendants.<sup>35</sup>

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<sup>27</sup> Memorandum Of Defendant Banca Della Svizzera Italiana In Opposition To Plaintiff's Application For An Order Compelling Answers And Imposing Sanctions at 9, Securities And Exchange Commission v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981) [hereinafter cited as Defendant's Memorandum].

<sup>28</sup> 92 F.R.D. at 113.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 114.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 119.

<sup>34</sup> See Nat'l L.J., Nov. 30, 1981, at 3, col. 1.

<sup>35</sup> Amended Complaint of Plaintiff, *supra* note 12, at 1, 6. Subsequent discovery revealed that Edgar M. Bronfman, Seagram's Chairman of the Board of Directors and Chief Executive Officer enjoyed a close personal and business relationship with Tome, the representative for Baird-Patrick. *Id.* at 6. Before March 10, 1981, Tome was given material nonpublic information in confidence from Seagram that a tender offer for St. Joe was forthcoming. Tome moved rapidly to acquire St. Joe stock and options before the public announcement of the offer. Accordingly, Tome directed BSI to buy St. Joe call options for NICO, TFCO, and Finvest Panama (the Tome group). The order was executed by BSI through its account at Becker. Tome also placed an order to buy St. Joe stock for BSI through Baird-Patrick. These orders were executed and delivered to BSI's account at the Irving Trust Company. *Id.* at 7-8.

Claudio Nesa, Assistant Manager of BSI, confirmed the execution of these orders, but he clearly stated that there was "no discussion of the investment motivation." Affidavit of Claudio Nesa at 6, Securities And Exchange Commission v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981) (In response to Interrogatory 7).

The leading case on the conflict between discovery orders and foreign nondisclosure laws is *Societe Internationale v. Rogers*.<sup>36</sup> The action was filed as *Societe Internationale v. McGranery*<sup>37</sup> but the leading case, although arising from the same facts, concerned a different procedural issue.<sup>38</sup> The case arose when the assets of a German firm were seized by the American Government during World War II.<sup>39</sup> The seizure was carried out pursuant to section 5(b) of the Trading with the Enemy Act<sup>40</sup> which enabled the United States, through an Alien Property Custodian, to seize the property of a “foreign country or national” during a time of war.<sup>41</sup> These assets, specifically cash in American banks and ninety percent of the stock of a Delaware corporation, were valued at more than one hundred million dollars and were under the control of a German firm, I. G. Fabenindustraie.<sup>42</sup>

In 1948, a Swiss holding company known as Interhandel or I. G. Chemie, brought suit in the United States District Court for the District of Columbia to recover the assets under section 9 of the Trading with the Enemy Act.<sup>43</sup> The suit was brought against the Treasurer of the United States and the Attorney General, successor to the Alien Property Custodian.<sup>44</sup> The company claimed that it owned the stock and cash and should be permitted to recover the assets under section 9(a) as a national of Switzerland, a neutral country.<sup>45</sup> The United States challenged the ownership claim and alleged that the company had conspired with the German firm, a Swiss banking firm, and others to “conceal” ownership of the assets and thus prevent

<sup>36</sup> 357 U.S. 197 (1958).

<sup>37</sup> 111 F. Supp. 435 (D.D.C. 1953), *modified and aff'd sub nom.* *Societe Internationale v. Brownell*, 225 F.2d 533 (D.C. Cir. 1955), *cert. denied*, 350 U.S. 937 (1956).

<sup>38</sup> The first action involved the original dismissal of the complaint for failure to produce documents pursuant to a court order. *See id.*

<sup>39</sup> *Id.* at 437.

<sup>40</sup> ch. 106, § 5(b), 40 Stat. 411, 415 (1917) (current version at 50 U.S.C. app. §§ 1-44 (1976 & Supp. III 1979)).

<sup>41</sup> 357 U.S. at 198 (quoting *id.*). The United States assumed control of the assets during World War II at which time the alien property custodian was vested with title to the assets. *See id.* at 198-99.

<sup>42</sup> *Id.* at 199. The Delaware corporation was General Aniline-Film Corporation. *Id.*

<sup>43</sup> 111 F. Supp. at 437; *see* ch. 285, § 9(a), 42 Stat. 1511, 1511 (1923) (amending Trading with the Enemy Act, ch. 106, § 9, 40 Stat. 411, 419-20 (1917)) (current version at 50 U.S.C. app. §§ 1-44 (1976 & Supp. III 1979)).

<sup>44</sup> 357 U.S. at 199. Throughout the long history of this case, culminating with a settlement in 1963 by Attorney General Robert Kennedy, several United States Attorneys General have been successors to the Alien Property Custodian. *See* Kelly, *supra* note 1, at 236; Note, *Limitations on the Federal Judicial Power To Compel Acts Violating Foreign Law*, 63 COLUM. L. REV. 1441, 1458 n.159 (1963).

<sup>45</sup> 357 U.S. at 199.

seizure by the United States.<sup>46</sup> Thus, the United States moved to order production of documents by the Swiss bank under rule 34 of the Federal Rules of Civil Procedure.<sup>47</sup>

The district court granted the Government's motion for an order compelling production of the records of the Swiss holding company's bank.<sup>48</sup> The company contended that production of these bank records could lead to criminal sanctions under the penal laws of Switzerland.<sup>49</sup> This contention was confirmed when the Swiss Federal Attorney "confiscated" the records upon a determination that disclosure would violate article 273 of the Swiss Penal Code dealing with economic espionage and article 47 of the Swiss Bank Law dealing with the secrecy of bank records.<sup>50</sup>

The district court referred the case to a special master to make findings of fact and determine the nature of Swiss law.<sup>51</sup> The master found that: Switzerland's actions were in accordance with accepted Swiss doctrine; no collusion was present between the Swiss Government and the company; and good faith was exercised by the company in attempting "to comply with the production order" under the good faith test of attempting "all which a reasonable man would have undertaken in the circumstances."<sup>52</sup> The district court accepted these findings, but ruled favorably on a motion by the American Government to dismiss the company's complaint, concluding that compliance with Swiss law was an insufficient pretext for failure to produce the records.<sup>53</sup> The court, however, did suspend the effective date of its order to afford the company an opportunity to obtain waivers thereby facilitating compliance with the production order.<sup>54</sup> The company, seeking "to achieve maximum compliance with the production order" without violating Swiss law<sup>55</sup> offered a plan whereby a "neutral expert" would be appointed to inspect the files and identify relevant documents for production.<sup>56</sup> The company could then secure the documents by obtaining additional waivers, initiating Swiss arbitration proceedings, or seeking letters rogatory.<sup>57</sup> The district court refused to

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<sup>46</sup> 111 F. Supp. at 437.

<sup>47</sup> *See id.* at 438.

<sup>48</sup> *Id.*; *see also* Note, *supra* note 44, at 1458 n.159.

<sup>49</sup> 111 F. Supp. at 438.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 439.

<sup>52</sup> 357 U.S. at 201.

<sup>53</sup> *See id.* at 201-02.

<sup>54</sup> *Id.* at 202. Over 190,000 documents were released, however, the most relevant documents were not produced. *See id.* at 202-03.

<sup>55</sup> *See id.* at 203.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

accept this plan and ordered final dismissal of the case.<sup>58</sup> The Court of Appeals for the District of Columbia affirmed.<sup>59</sup>

The Supreme Court reversed and remanded to the district court, holding that the dismissal was not justified where the "failure to comply has been due to inability, and not . . . bad faith."<sup>60</sup> The Court maintained that an American court may require that a party ordered to comply with production requests make all possible efforts to identify owners of seized assets,<sup>61</sup> but emphasized that disclosure of the banking records would violate Swiss law, and that "fear of criminal prosecution constitutes a weighty excuse for nonproduction," which is "not weakened because the laws preventing compliance are those of a foreign sovereign."<sup>62</sup> The Court considered this concern and the holding company's production of thousands of nonbank related documents a "good faith" effort and sufficient grounds for permitting the company to argue the merits of the case.<sup>63</sup> The Court qualified the good faith defense by noting that this was not a case of a petitioner who deliberately courted legal impediments, as the American government had suggested.<sup>64</sup> The Court indicated that had collusion between a foreign party and its government been established, the good faith defense would be of no avail.<sup>65</sup> On that basis, courts have subsequently held that discovery orders may be issued by American courts notwithstanding restrictions by a foreign country's law.<sup>66</sup>

Thus, two contrasting principles are derived from *Societe*.<sup>67</sup> The first provides that production may be ordered despite foreign nondisclosure laws.<sup>68</sup> This principle had previously been utilized by American courts and was substantially opposed by foreign countries.<sup>69</sup> The second provides that a good faith effort is a viable defense to sanctions for nonproduction.<sup>70</sup>

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<sup>58</sup> *Id.*

<sup>59</sup> *Id.*; see *Societe Internationale v. Brownell*, 243 F.2d 254 (D.C. Cir. 1957), *rev'd sub nom. Societe Internationale v. Rogers*, 357 U.S. 197 (1958).

<sup>60</sup> 357 U.S. at 212-13.

<sup>61</sup> See *id.* at 205.

<sup>62</sup> *Id.* at 211.

<sup>63</sup> See *id.* at 209-12.

<sup>64</sup> *Id.* at 208-09.

<sup>65</sup> *Id.*; see Note, *Recent Developments, supra* note 9, at 751 (dismissal could result from "evidence of collusion with the foreign government").

<sup>66</sup> See, e.g., *In re Grand Jury Proceedings*, 532 F.2d 404 (5th Cir.), *cert. denied sub nom. Field v. United States*, 429 U.S. 940 (1976); *United States v. First Nat'l City Bank*, 396 F.2d 897, 900-01 (2d Cir. 1968).

<sup>67</sup> See Note, *Recent Developments, supra* note 9, at 750.

<sup>68</sup> See *supra* note 66.

<sup>69</sup> See *supra* note 9.

<sup>70</sup> See, e.g., *In re Chase Manhattan Bank*, 297 F.2d 611, 613 (2d Cir. 1962).

The Court of Appeals for the Second Circuit narrowly interpreted *Societe*,<sup>71</sup> exhibiting substantial deference to international comity.<sup>72</sup> In *First National City Bank v. IRS*,<sup>73</sup> the Second Circuit court reinstated a subpoena requiring compliance with an IRS summons for production since it was not shown that production of the records would violate Panamanian law or result in criminal sanctions.<sup>74</sup> Significantly, the court indicated that production would be excused if that action forced a violation of Panamanian law.<sup>75</sup> Several years later, in *In re Chase Manhattan Bank*,<sup>76</sup> the Second Circuit court again considered whether a court could compel production of documents held in a Panamanian branch of an American bank. By this time, however, Panamanian law had made production of certain documents a crime.<sup>77</sup> The court modified a subpoena requiring production, noting that a sufficient showing had been made that production would violate Panamanian law.<sup>78</sup>

In *Ings v. Ferguson*,<sup>79</sup> foreign banks attempted to quash subpoenas served upon their New York branches which required production of documents located in Canada.<sup>80</sup> The court restricted the scope of the subpoenas and limited production to documents located in New York, holding that letters rogatory were a proper means for obtaining information located in foreign countries.<sup>81</sup> Furthermore, the court stated that American courts should refrain from taking action that circumvents a friendly neighbor's laws and procedures.<sup>82</sup> The Court of Appeals for the Second Circuit did not pursue the *Societe* Court's intimation that production could be ordered despite foreign nondisclosure laws. Rather, the Second Circuit court treated foreign nondisclosure laws as an absolute bar to the production of documents.<sup>83</sup>

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<sup>71</sup> See *infra* notes 73-83 and accompanying text; see also Onkelinx, *supra* note 9, at 517. Because the New York and American Stock Exchanges are located within the Second Circuit, the majority of securities cases are decided in that circuit.

<sup>72</sup> See *supra* note 11.

<sup>73</sup> 271 F.2d 616 (2d Cir. 1959), *cert. denied*, 361 U.S. 948 (1960).

<sup>74</sup> *Id.* at 618-20.

<sup>75</sup> *Id.* at 619.

<sup>76</sup> 297 F.2d 611 (2d Cir. 1962).

<sup>77</sup> *Id.* at 612. Article 89 and article 93 of Law No. 17 provided for "a fine not greater than one hundred balboas (B/100.00)," similar to a misdemeanor under American law. 297 F.2d at 612 (quoting *id.*).

<sup>78</sup> 297 F.2d at 613.

<sup>79</sup> 282 F.2d 149 (2d Cir. 1960).

<sup>80</sup> *Id.* at 150.

<sup>81</sup> *Id.* at 151-53.

<sup>82</sup> *Id.* at 152.

<sup>83</sup> See Note, *Recent Developments*, *supra* note 9, at 752. The International Law Association maintained that this viewpoint adopted in the Second Circuit was preferable to the previously adopted approach in which American courts issued controversial court orders requiring the



This treatment was greatly affected by the issuance of the *Restatement (Second) of Foreign Relations Law of the United States*. Section 39 of the *Restatement* provides that a country is not prevented from exercising its jurisdiction "solely" because a person would be subject to liability under a foreign country's law.<sup>84</sup> In effect, the *Restatement* provides that the exercise of jurisdiction should not be exclusively decided on the basis of a prohibition by foreign law.<sup>85</sup> Additionally, section 40 of the *Restatement* provides several factors which courts should balance when determining whether to moderate its jurisdictional reach.<sup>86</sup> Of particular importance are the competing "vital national interests" of the respective nations and the degree of hardship imposed upon the individual by the forum country's action.<sup>87</sup> In employing a balancing of interests test, courts should consider the concerns of both countries and the subsequent impact of the decision upon the individual. Thus, a more informed and equitable decision might result.<sup>88</sup>

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"production of documents from abroad." See *infra* note 171. An Association report noted that eight countries had filed formal protests concerning these earlier American practices and further noted that retaliatory legislation had been enacted by several nations. The report concluded that it was difficult to find support under international law upholding American orders compelling production. INTERNATIONAL LAW ASS'N, REPORT OF THE FIFTY-FIRST CONFERENCE 403-07 (Tokyo 1964) [hereinafter cited as TOKYO REPORT].

<sup>84</sup> RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 39 (1965). Section 39(1) provides: "A state having jurisdiction to prescribe or to enforce a rule of law is not precluded from exercising its jurisdiction solely because such exercise [is] conduct subjecting him to liability under the law of another state having jurisdiction with respect to that conduct."

<sup>85</sup> See *id.* § 39 comment b.

<sup>86</sup> *Id.* § 40. Section 40 provides:

Where 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.

*Id.* But see Metzger, *The Restatement of Foreign Relations Law of the United States: Bases and Conflict of Jurisdiction*, 41 N.Y.U. L. REV. 7, 19 (1966) (international law does not require use of § 40).

<sup>87</sup> See *SEC v. BSI*, 92 F.R.D. at 117-19. Judge Pollack concentrated upon factors 40 (a) and 40 (b) and relegated the remaining factors to less significant roles. See *id.*

<sup>88</sup> See generally RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 comment a (1965); Meal, *Governmental Compulsion as a Defense Under United States and European Community Antitrust Law*, 20 COLUM. J. TRANSNAT'L L. 51, 98-101 (1981); Note, *supra* note 10, at 619-20.

Following publication of the *Restatement*, the Second Circuit court retreated from its absolute position concerning production and adopted the *Restatement's* balancing test.<sup>89</sup> In *United States v. First National City Bank*,<sup>90</sup> the court affirmed the district court's decision holding the defendant bank in civil contempt for refusing to compel its foreign branch to answer a subpoena requesting the documents necessary for the investigation of alleged antitrust violations by the bank's clients.<sup>91</sup> The court announced that antitrust laws are the "cornerstones" of American economic policy and found this interest to override possible civil liability for disclosure in Germany.<sup>92</sup> In *City Bank* the court noted that no German statute required bank secrecy and that bankers were absent from the list of persons who may be subject to criminal sanctions for unauthorized disclosure of secrets.<sup>93</sup>

In *Trade Development Bank v. Continental Insurance Co.*,<sup>94</sup> the defendant bank refused to disclose the identity of its customers relying on a Swiss statute that imposed criminal sanctions for such disclosure.<sup>95</sup> The court recognized that disclosure would violate Swiss law<sup>96</sup> and noted that the *Restatement's* balancing test permitted a court "to defer to Swiss law."<sup>97</sup> The court concluded that because the identity of the customers was not an essential element in resolving the case,<sup>98</sup> the bank did not have to obtain waivers from its customers.<sup>99</sup> The court observed that it was necessary to expand the balancing test to include whether the requested information was needed to resolve the case.<sup>100</sup>

Other federal courts have considered whether to apply American law when faced with conflicting foreign nondisclosure laws.<sup>101</sup> In *In re Grand Jury Proceedings*,<sup>102</sup> the Court of Appeals for the Fifth Circuit ruled that a foreign individual subpoenaed while in the United States had to testify before a grand jury, notwithstanding the fact that

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<sup>89</sup> See *infra* notes 90-100 and accompanying text.

<sup>90</sup> 396 F.2d 897 (2d Cir. 1968).

<sup>91</sup> *Id.* at 905.

<sup>92</sup> See *id.* at 903. See generally *United States v. Topco Assocs.*, 405 U.S. 596 (1972); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

<sup>93</sup> 396 F.2d at 903.

<sup>94</sup> 469 F.2d 35 (2d Cir. 1972).

<sup>95</sup> See *id.* at 39; see also *infra* note 183.

<sup>96</sup> 469 F.2d at 40.

<sup>97</sup> *Id.* at 41.

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* The court also doubted that customer waivers would have yielded useful evidence. *Id.*

<sup>100</sup> *Id.* The court commented that in balancing the interests, "the relative unimportance of the information as to the clients' identity . . . was entitled to be considered." *Id.*

<sup>101</sup> See *infra* notes 102-34 and accompanying text.

<sup>102</sup> 532 F.2d 404 (5th Cir.), *cert. denied sub nom.* *United States v. Field*, 429 U.S. 940 (1976).

his native country could impose criminal sanctions for such an act.<sup>103</sup> Although the court recognized the delicate position in which the individual had been placed,<sup>104</sup> after weighing the competing interests, it concluded that the "significant [national] interest" in enforcing the tax laws through the use of the grand jury outweighed the foreign interest.<sup>105</sup>

In *United States v. Vetco*,<sup>106</sup> the Court of Appeals for the Ninth Circuit affirmed the district court's order and enforcement of contempt sanctions against Vetco Inc., its accountants, and its lawyers for noncompliance with summonses requesting certain documents.<sup>107</sup> In affirming the district court, the Ninth Circuit court observed that there is no "absolute bar" to disclosure or contempt sanctions for failure to disclose "whenever compliance is prohibited by foreign law."<sup>108</sup> Moreover, the court maintained that the district court had not found that disclosure would violate Swiss law.<sup>109</sup> The court considered it important that disclosure was sought pursuant to an IRS criminal summons since "[s]uch summonses are . . . more widely recognized in the international community" than disclosure orders issued pursuant to civil discovery.<sup>110</sup> The court next balanced the competing Swiss and American interests<sup>111</sup> and determined that the American interest in enforcement of the summonses outweighed the competing Swiss interest.<sup>112</sup>

In *In re Uranium Antitrust Litigation*,<sup>113</sup> the United States District Court for the Northern District of Illinois considered a motion seeking to compel production of documents held by some fifteen defendants under various laws of four foreign nations.<sup>114</sup> The court

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<sup>103</sup> *Id.* at 405.

<sup>104</sup> *See id.* at 410.

<sup>105</sup> *See id.* at 407-10.

<sup>106</sup> 644 F.2d 1324 (9th Cir.), *cert. denied*, 102 S. Ct. 671 (1981).

<sup>107</sup> *Id.* at 1326.

<sup>108</sup> *Id.* at 1329.

<sup>109</sup> *Id.* at 1330. The court noted that the district court determined that the records ordered to be produced were not the type of records designed to be protected by the Swiss statute. *Id.* at 1330 n.7.

<sup>110</sup> *Id.*; *cf.* Convention on Double Taxation of Income, May 24, 1951, United States-Switzerland, art. XVI, para. 1, 2 U.S.T. 1751, T.I.A.S. No. 2316 (disclosure of tax materials permitted only for assessment and collection of taxes). The Swiss have recently recognized the importance of disclosure of tax materials for domestic and foreign purposes and have accordingly facilitated the release of these materials pursuant to Swiss law. *See Kelly, supra* note 1, at 257; Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 NEW ENG. L. REV. 18, 60-63 (1978).

<sup>111</sup> *See* 644 F.2d at 1330-33. The Ninth Circuit court held that the factors listed in § 40 of the Restatement were the proper factors to be balanced. *Id.* at 1331.

<sup>112</sup> *Id.* at 1333.

<sup>113</sup> 480 F. Supp. 1138 (N.D. Ill. 1979).

<sup>114</sup> *Id.* at 1143-44.

refused to use the *Restatement* balancing test in its analysis, instead calling it unworkable in this instance, and suggested that it was not within the function of the judiciary to evaluate a foreign country's social and economic policies.<sup>115</sup> However, the court balanced three factors similar to the *Restatement* factors in arriving at its decision to issue production orders:<sup>116</sup> the strength of the American interest;<sup>117</sup> the crucial nature of the documents in deciding the case;<sup>118</sup> and, the flexibility of the foreign nation in applying its nondisclosure law.<sup>119</sup> The court, emphasizing the importance of effective enforcement of the antitrust laws,<sup>120</sup> held that this interest coupled with the importance of the documents in deciding the case outweighed the foreign nations' interest in applying its nondisclosure law,<sup>121</sup> and thus ordered production of the documents.<sup>122</sup>

In *Ohio v. Arthur Andersen & Co.*,<sup>123</sup> the state alleged that Andersen failed to indicate in financial statements that it had prepared, the relationship between a foreign company and a company to which Ohio had loaned money.<sup>124</sup> The Court of Appeals for the Tenth Circuit examined the validity of the district court's imposition of sanctions upon Andersen for its failure to produce documents which the state requested during discovery proceedings.<sup>125</sup> Andersen did not produce the documents, maintaining that production would violate Swiss law,<sup>126</sup> however, the company waited more than a year following the court order for production before attempting to justify the Swiss defense.<sup>127</sup> Eventually, the company determined that Swiss law was not applicable to the documents it possessed and withdrew its reliance on the Swiss defense.<sup>128</sup> These events led the court to hold that

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<sup>115</sup> *Id.* at 1148; see Note, *Ordering Production of Documents*, *supra* note 9, at 804-05; see also *id.* at 804 n.52 (construing *Chicago & S. Air Lines v. Waterman Corp.*, 333 U.S. 103 (1948)).

<sup>116</sup> See 480 F. Supp. at 1154-56.

<sup>117</sup> *Id.* at 1154.

<sup>118</sup> *Id.* at 1154-55.

<sup>119</sup> *Id.* at 1155.

<sup>120</sup> See *id.* at 1154-55; see also *First Nat'l City Bank*, 396 F.2d at 903; *supra* note 92.

<sup>121</sup> See 480 F. Supp. at 1154-56.

<sup>122</sup> *Id.* at 1156.

<sup>123</sup> 570 F.2d 1370 (10th Cir.), *cert. denied*, 439 U.S. 833 (1978).

<sup>124</sup> *Id.* at 1372.

<sup>125</sup> See *id.* at 1372-76.

<sup>126</sup> *Id.* at 1372-73.

<sup>127</sup> *Id.* at 1374. The court observed that Andersen did not specify the Swiss law upon which it relied in invoking this "foreign law" defense. *Id.*

<sup>128</sup> See *id.*

the sanctions were an appropriate response to Andersen's "flagrant bad faith and callous disregard."<sup>129</sup>

In *In re Westinghouse*,<sup>130</sup> the Court of Appeals for the Tenth Circuit determined that an order imposing sanctions on an American company for noncompliance with a discovery order requesting production of documents was not proper because disclosure would violate the Canadian Uranium Information Security Regulations.<sup>131</sup> The court recognized that the defendant had made a diligent effort to obtain a waiver from the Canadian government and noted the strong Canadian interest in controlling the development and application of atomic energy.<sup>132</sup> Furthermore, the court emphasized that the American interest in disclosure was weak since the case did not involve a grand jury investigation or enforcement of the antitrust laws.<sup>133</sup> The court concluded that the Canadian interest outweighed the American interest and accordingly rejected the district court's reasoning that the "law of the forum would prevail, regardless of the particular facts of the case."<sup>134</sup>

The confrontation between American discovery orders and foreign nondisclosure laws is resolved through a balancing test with good faith considerations.<sup>135</sup> Although it is difficult to reach a consensus as to when American courts should refrain from applying federal law to foreign defendants, two maxims emerge from application of the balancing test. First, American courts are inclined to rule in favor of disclosure pursuant to discovery orders despite the presence of other interests.<sup>136</sup> This occurs even though such action has historically brought protests from foreign governments and consequent nondisclosure or retaliatory legislation.<sup>137</sup> Second, American courts are reluctant to issue an order forcing one to violate a foreign country's criminal laws.<sup>138</sup>

In *BSI v. SEC*, the district court confronted a situation in which both maxims were examined. Specifically, the court had to analyze

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<sup>129</sup> *Id.* at 1376. The *Andersen* court did not balance the competing Swiss and American interests and, in fact, did not even consider the possible application of Swiss law. *See id.*

<sup>130</sup> 563 F.2d 992 (10th Cir. 1977).

<sup>131</sup> *Id.* at 994.

<sup>132</sup> *Id.* at 995-96.

<sup>133</sup> *Id.* at 999.

<sup>134</sup> *Id.* The Tenth Circuit court observed that the district court erred in failing to balance the appropriate competing interests. *Id.*

<sup>135</sup> *See generally* Meal, *supra* note 88; Note, *supra* note 10, at 616, 619-20.

<sup>136</sup> *See* Note, *supra* note 10, at 621 (international comity frequently subordinated to American interests).

<sup>137</sup> *See supra* note 9; *infra* note 171. *See generally supra* note 83.

<sup>138</sup> *See Onkelinx, supra* note 9, at 527. *But see In re Grand Jury Proceedings*, 532 F.2d at 410 (disclosure order forced party to violate legal commands of Cayman Islands).

the American interest, i.e. maintaining the integrity of the securities market, with the Swiss interest, i.e. nondisclosure and the consequential imposition of criminal liability for unauthorized disclosure.<sup>139</sup> In pursuing this analysis, Judge Pollack adopted the *Restatement* balancing test thereby considering the vital national interests of both countries, the hardship that Swiss law would impose upon the bank employees for disclosure, and the presence of good faith considerations.<sup>140</sup>

The court stated that there was a strong American governmental interest in ensuring the "integrity of its financial markets" through the enforcement of its securities law, and acknowledged that this interest was frustrated by "the use of foreign bank accounts."<sup>141</sup> The court observed that there was no corresponding Swiss governmental interest of similar magnitude<sup>142</sup> and indicated the fact that neither government had opposed discovery was probative of this since a foreign government would object if a vital national interest were threatened.<sup>143</sup> The court maintained that the secrecy privilege belonged to the bank customer and was not required to protect a public interest or a Swiss governmental interest.<sup>144</sup> Furthermore, the court stated that there was some flexibility in the application of the Swiss law.<sup>145</sup> It was admitted that Swiss law might subject the bank to fines and its officers to imprisonment, yet the court noted that there were two alternatives which the bank could embrace to prevent this.<sup>146</sup> First, by obtaining waivers from its customers, the bank could insulate itself from criminal liability.<sup>147</sup> Second, article 34 of the Swiss Penal Code<sup>148</sup> relieves a party from criminal liability for acts done to protect one's own good

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<sup>139</sup> See 92 F.R.D. at 112.

<sup>140</sup> *Id.* at 117-19. The court did consider the other factors delineated in the *Restatement* balancing test, but observed that these additional factors were less significant than the aforementioned factors. See *id.* at 119. See *infra* note 154.

<sup>141</sup> 92 F.R.D. at 117.

<sup>142</sup> See *id.*

<sup>143</sup> See *id.* at 117-18; cf. Defendant's Memorandum, *supra* note 27, at 27 (quoting statement of Dr. Rudolph Gerber, Swiss Federal Attorney General, reprinted in Affidavit of Chester J. Straub, exhibit P, Securities And Exchange Commission v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981)) (Swiss government will prosecute one who discloses records without permission, but magnitude of governmental interest does not mandate governmental confiscation of records).

<sup>144</sup> 92 F.R.D. at 118; accord *Trade Dev. Bank v. Continental Ins. Co.*, 469 F.2d 35, 41 n.3 (2d Cir. 1972) ("Swiss bank secrecy law was enacted primarily to protect the right of privacy of clients, the client is the 'master of the secret'"); see also Mueller, *The Swiss Banking Secret from a Legal View*, 18 INT'L. & COMP. L.Q. 360 (1969).

<sup>145</sup> 92 F.R.D. at 118.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> See STGB, C.P., COD. PÉN., art. 34.

where the party is not responsible for the present conflict and cannot be expected to abandon his own best interest.<sup>149</sup> Judge Pollack opined that the second alternative might not be available if the Swiss government concluded, as the court had, that BSI was responsible for the conflict.<sup>150</sup> The court next considered the good faith efforts of BSI. It indicated that as an agent or principal, the bank certainly profited in some manner from invading the American securities market, and then deliberately attempted to escape liability for insider trading by using the Swiss nondisclosure law to "shield" its activities from American laws.<sup>151</sup> The court observed that BSI deliberately courted legal impediments and thus acted in bad faith.<sup>152</sup> The court maintained that a contrary result would be a "travesty of justice," therefore, it refused to countenance BSI's behavior.<sup>153</sup> Accordingly, the court held that the American interest outweighed the competing Swiss interest.<sup>154</sup>

Although the problem of extraterritoriality is not a new one, *SEC v. BSI* extends the *Restatement's* section 40 balancing test into the uncharted territory which exists when American securities law and the Swiss bank nondisclosure law conflict.<sup>155</sup> This case highlights the potential unworkability of the section 40 balancing test in attempting to measure the depth of the competing American and Swiss interests and the difficulty courts face in balancing the relevant factors. Yet, without a treaty outlining the resolution of conflicts, the judiciary must resolve these controversies. *BSI v. SEC* illustrates the potential problems that may result from requiring the judiciary to decide questions that affect the relations between two countries.<sup>156</sup>

An analysis of the strength of the United States' interest in the integrity of its securities market as measured against the competing Swiss interest involves a consideration of both positive and negative factors resulting from enforcement of the securities laws. It is recognized that complete disclosure of all relevant information is necessary

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<sup>149</sup> 92 F.R.D. at 118. The article 34 defense has not been invoked often. In fact, no cases factually similar to *SEC v. BSI* have been decided based upon this defense. See Lowenfeld, *Bank Secrecy and Insider Trading: The Banca Della Svizzera Italiana Case*, 15 THE REV. OF SEC. REG. 942 (1982).

<sup>150</sup> 92 F.R.D. at 118. The court emphasized BSI's "active part in the insider trading transactions" in deciding that BSI was responsible for the conflict. *Id.*; see *supra* notes 12-19 and accompanying text.

<sup>151</sup> 92 F.R.D. at 117.

<sup>152</sup> *Id.* at 118-19; see also *Societe*, 357 U.S. at 208-09.

<sup>153</sup> 92 F.R.D. at 119.

<sup>154</sup> See *id.* The Court also considered the remaining *Restatement* factors and concluded that they offered further support for advancing the American interest. See *id.*

<sup>155</sup> Lowenfeld, *supra* note 149, at 945.

<sup>156</sup> See *infra* notes 198-219 and accompanying text.

to promote the effective operation of the American securities market.<sup>157</sup> Federal legislation reflects the American interest in the effective operation of the American securities market.<sup>158</sup> Underlying this inter-

<sup>157</sup> *E.g.*, 15 U.S.C. §§ 78e, 78j(b) (1976); *cf.* 8 J. WIGMORE, EVIDENCE § 2193 (J. McNaughton rev. ed. 1961) ("duty to attend and disclose all that is needed for the ascertainment of truth applies" to all evidentiary material including documents). Underlying this "complete disclosure" theory is the premise that a profiteering party benefitting from deceitful, fraudulent, or covert transactions shall be identified and held accountable for all profits obtained via these transactions. *Stock Exchange Regulation: Hearings on H.R. 7852 & H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934); *see, e.g.*, 15 U.S.C. § 78p(b) (1976); *see also infra* note 158.

<sup>158</sup> *See, e.g.*, Securities Exchange Act of 1934, ch. 404, 48 Stat. 885 (codified as amended at 15 U.S.C. §§ 78a-78kk (1976 & Supp. III 1979)). Particularly important to the present discussion are sections 10(b) and 14(e).

Section 10(b) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1976).

Section 14(e) provides:

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

15 U.S.C. § 78n(e) (1976).

To facilitate the operation of these provisions, the Securities and Exchange Commission, created by 15 U.S.C. § 78d (1976), promulgated rules 10b-5 and 14e-3 pursuant to its authority under 15 U.S.C. § 78c(b) (1976). *See* 17 C.F.R. §§ 240.10b-5, .14e-3 (1981). Courts have traditionally applied these provisions and the rules promulgated thereunder to domestic parties guilty of fraudulent activity. Furthermore, some courts have maintained that the American interest in the market's integrity extends beyond the boundaries of the United States, and accordingly have extraterritorially applied these provisions and rules. *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206, *modified on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969) (Congress intended "to protect the domestic securities market from the effects of improper foreign transactions in American securities" through extraterritorial application of Securities Exchange Act); *accord* *IIT v. Cornfeld*, 619 F.2d 909, 918-21 (2d Cir. 1980); *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977); *see* RESTATEMENT (REVISED) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 416(1) (Tent. Draft No. 2, 1981; Tent. Draft No. 3, 1982) (courts of United States maintain jurisdiction for any transaction carried out on American securities market). *See generally* Becker, *Extraterritorial Dimensions of the Securities Exchange Act*, 2 N.Y.U. J. INT'L L. & POL. 233 (1969); Hacker & Rotunda, *supra* note 8, at 648.



est is the principle of fairness<sup>159</sup> which requires that investors should have equal access to information that can influence their trading.<sup>160</sup> Similarly, traders lacking inside knowledge of the conditions of the market should be protected from those traders receiving such information.<sup>161</sup> Only then can the American interest in a creditable securities market be maintained. Balanced against this positive factor are negative considerations which may dilute the strength of the American interest. In *Santa Fe Industries v. Green*,<sup>162</sup> the Supreme Court continued its trend of denying federal relief for alleged claims of fraudulent securities transactions.<sup>163</sup> In *Santa Fe*, the Court considered minority shareholders' requests either to set aside a merger or to recover the true value of their shares.<sup>164</sup> Both remedies were sought pursuant to the shareholders' claims that rule 10b-5 prohibiting fraudulent conduct in transactions involving securities had been violated.<sup>165</sup> The Supreme Court held that the majority shareholders' conduct was neither deceptive nor manipulative under the statute and therefore could not be considered fraudulent.<sup>166</sup> Thus, the Court concluded that it would be "appropriate in this instance to relegate respondent and others in his situation to whatever remedy is created by state law."<sup>167</sup> The Court noted an appraisal remedy was available in the Delaware Court of Chancery,<sup>168</sup> and indicated that it would not extend federal securities law "[a]bsent a clear indication of congressional intent" since such an extension would interfere with traditional state corporate law.<sup>169</sup>

*Santa Fe* illustrates the United States Supreme Court's diminishing concern in broadening federal securities regulation.<sup>170</sup> By relegat-

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<sup>159</sup> Barry, *The Economics of Outside Information and Rule 10b-5*, 129 U. PA. L. REV. 1307, 1355 (1981).

<sup>160</sup> SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969); see Barry, *supra* note 159, at 1355 n.171.

<sup>161</sup> Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943), cert. denied, 321 U.S. 786 (1944).

<sup>162</sup> 430 U.S. 462 (1977).

<sup>163</sup> See *infra* note 170.

<sup>164</sup> 430 U.S. at 467.

<sup>165</sup> *Id.* See *supra* note 158.

<sup>166</sup> 430 U.S. at 474.

<sup>167</sup> *Id.* at 478 (quoting Piper v. Chris-Craft Indus., 430 U.S. 1, 41 (1977)). See generally Cort v. Ash, 422 U.S. 66 (1975).

<sup>168</sup> 430 U.S. at 466-67.

<sup>169</sup> *Id.* at 479.

<sup>170</sup> See Piper v. Chris-Craft Indus., 430 U.S. 1 (1977) (no implied cause of action for defeated tender offeror under § 14(e)); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (scienter or intention to defraud essential for 10b-5 violations); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (10b-5 claimants limited to securities purchasers and sellers); Note, *Supreme Court and the Counter Revolution in Securities Regulation*, 30 ALA. L. REV. 335 (1979); Note, *Judicial Retrenchment Under Rule 10b-5: An End To The Rule As Law?*, 1976 DUKE L. J. 789.

ing the plaintiff to a state remedy, the Court refused to construe expansively federal law, and thereby denied the shareholders the protections afforded by the uniformity of federal law. The Court, in denying shareholders the protection of uniform federal securities law and instead forcing aggrieved shareholders to rely on disparate state law, has failed to treat the American interest in the integrity of the securities market as highly significant. Therefore, there is at least some doubt as to whether this interest is strong enough to unequivocally predominate a foreign interest, particularly a foreign statute imposing criminal sanctions for disclosure.

There are additional factors to be considered in determining the strength of the American interest. In measuring the propriety of extraterritorial application of American securities law, the imminence of retaliatory legislation and action on the part of foreign countries must be considered. The possibility of coerced disclosure may prompt foreign countries to raise additional restrictions on disclosure or more stringently enforce existing laws.<sup>171</sup> In response to these possible disclosure orders, foreigners and their financial agents may withdraw a large proportion of the funds currently held in the United States securities market and thus trade solely on foreign exchanges.<sup>172</sup> A reduced volume of transactions on the American market of this magnitude would have a cataclysmic effect on the American balance of payments, international trade, and commissions and income for financial personnel, as well as the general liquidity of the economy and securities market.<sup>173</sup> Thus, in analyzing a national interest, one cannot examine it isolated from other equally important domestic factors.

In addition to considering the diverse factors which determine the strength of the American interest, courts are faced with the bur-

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<sup>171</sup> Foreign countries have expressed vociferous opposition to extraterritorial application of American law. See TOKYO REPORT, *supra* note 83, at 403-06; Onkelinx, *supra* note 9, at 518-21. International displeasure with such American imperialism has been pointedly expressed in legislation aimed at halting American discovery efforts and restricting jurisdictional expansion. See Onkelinx, *supra* note 9, at 520 (listing retaliatory legislation of Belgium, Denmark, Finland, Italy, Japan, Norway, Philippines, and Sweden); Note, *Recent Developments*, *supra* note 9, at 847 n.1 (listing retaliatory legislation of Canada and United Kingdom). See generally Note, *Subpoena of Documents Located in Foreign Jurisdiction Where Law of Situs Prohibits Removal*, 37 N.Y.U. L. REV. 295, 296-97 (1962); *supra* note 9.

<sup>172</sup> See Statement of Carl W. Desch, senior vice president of the First National City Bank of New York, *reprinted in* 116 CONG. REC. 32,631 (1970); Telegram from Henry C. Froy, chairman of the Foreign Committee of the National Association of Securities Dealers, Inc., *reprinted in* 116 CONG. REC. 32,631 (1970).

<sup>173</sup> See generally 116 CONG. REC. 32,629-32 (1970). *But cf. id.* at 32,627-29 (stricter disclosure promotes greater integrity in securities market and will counterbalance adverse effects).

den of discovering the underlying interests of foreign laws, thereby increasing the complexity of this judicial duty. This complex task is particularly manifest when courts balance forum interests with the Swiss interest in bank secrecy.

Swiss secrecy laws are deeply rooted in Switzerland's history,<sup>174</sup> thus illustrating the firm Swiss belief in an individual's right to privacy.<sup>175</sup> Privacy, or "sphere of secrecy," has been viewed as part of the individual's "personality rights,"<sup>176</sup> an essential factor in the personal liberty of Swiss citizens.<sup>177</sup> An important element of this personal liberty is the privacy of financial affairs, in particular the confidentiality between banker and client.<sup>178</sup> Traditionally, the importance of this principle of secrecy has been sustained through Swiss custom and usage.<sup>179</sup> In 1934, the international banking crisis<sup>180</sup> coupled with attempts by Hitler's forces to uncover assets in Switzerland<sup>181</sup> prompted statutory protection of the bank secrecy principle. Enacting the Banking Law of 1934, the Swiss Parliament placed approval on the long established tenet of Swiss society that individual arrangements in banking are personal matters.<sup>182</sup> Article 47 of the Swiss Banking Law provides:

Whoever divulges a secret entrusted to him in his capacity as officer, employee, mandatory, liquidator or commissioner of a bank . . . or who has become aware of such a secret in this capacity, and whoever tries to induce others to violate professional secrecy, shall be punished by a prison term not to exceed six months or by a fine not exceeding 50,000 francs.<sup>183</sup>

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<sup>174</sup> See *Swiss Banks and Secrecy Laws: Hearings on H.R. 15073 Before the House Comm. on Banking and Currency*, 91st Cong., 1st & 2d Sess. (1969-1970); Dagon, *Securities Regulation in Switzerland*, 6 VAND. J. TRANSNAT'L L. 511 (1973); Friedrich, *The Anonymous Bank Account in Switzerland*, 79 BANKING L. J. 961, 964 (1962); Kelly, *supra* note 1, at 212; Meyer, *supra* note 110, at 24; Meyer, *The Banking Secret and Economic Espionage in Switzerland*, 23 GEO. WASH. L. REV. 284, 288 (1955); Mueller, *The Swiss Banking Secret*, 18 INT'L & COMP. L. Q. 360, 361 (1969); Note, *Swiss Banking Secrecy*, 5 COLUM. J. TRANSNAT'L L. 128 (1966); Note, *Swiss Banks and the Avoidance of American Tax and Securities Laws: An Assessment Based on Proposed Legislation*, 3 N.Y.U. J. INT'L L. & POL. 94 (1970).

<sup>175</sup> See ZGB, C.C., COD. CIV. art. 28. See generally, Meyer, *supra* note 110, at 20.

<sup>176</sup> Meyer, *supra* note 110, at 20; Meyer, *supra* note 174, at 287.

<sup>177</sup> Friedrich, *supra* note 174, at 964.

<sup>178</sup> See Meyer, *supra* note 110 at 22; Mueller, *supra* note 174, at 361.

<sup>179</sup> See Meyer, *supra* note 174, at 288.

<sup>180</sup> See *id.*; Meyer, *supra* note 110, at 25.

<sup>181</sup> Meyer, *supra* note 110, at 26.

<sup>182</sup> *Id.* at 22.

<sup>183</sup> STGB, C.P. COD. PÉN. art. 47, reprinted in UNION BANK OF SWITZERLAND, FEDERAL LAW RELATING TO BANKS AND SAVINGS BANKS 4 (1972). See generally Meyer, *supra* note 110, at 24-27.

Thus, article 47 provides criminal liability in the form of imprisonment for the disclosure of bank secrets. Article 47 evidences the Swiss national interest in maintaining secrecy in banking transactions.<sup>184</sup> Economic factors further evidence this interest.<sup>185</sup> The banking business helps the Swiss maintain a favorable balance of payments and generally affects the entire Swiss economy.<sup>186</sup> A foreign nation's attempt to limit bank secrecy would be detrimental to Swiss national interests since bank secrecy is the salient feature which has enabled the Swiss banking business to obtain its lofty status.<sup>187</sup>

Nevertheless, bank secrecy is not an absolute privilege in Switzerland.<sup>188</sup> On the federal level, both the Swiss Federal Laws of Civil Procedure and Criminal Procedure require a public duty of testimony.<sup>189</sup> Neither Code absolutely exempts bankers from this requirement.<sup>190</sup> Article 42 (2) of the Federal Law of Civil Procedure, however, permits a judge to exempt witnesses from revealing professional secrets "on a case-by-case basis."<sup>191</sup> On the more frequently used cantonal level,<sup>192</sup> the Cantonal Codes of Criminal Procedure fail to exempt a banker from a public duty to testify in criminal proceedings.<sup>193</sup> The Cantonal Codes of Civil Procedure are divided in their approach to the exemption-disclosure issue. The Codes require testimony in all circumstances or allow the judge to exercise discretion in deciding to order testimony or permit one to refuse to give testimony.<sup>194</sup> Thus, according to Swiss law bank employees will be required to disclose information in certain instances.<sup>195</sup> Nevertheless, the inroads made into the secrecy privilege have been limited by Swiss

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<sup>184</sup> Meyer, *supra* note 110, at 26. Furthermore, article 162 of the Swiss Penal Code, STGB, C.P. COD. PÉN. art. 162, illustrates the breadth of the secrecy principal by establishing criminal liability for the disclosure of manufacturing or business secrets which one has a contractual duty to guard. *Id.*; see also STGB, C.P. COD. PÉN. art. 273 (crime to disclose business secret to foreign source); Jenckel & Rider, *The Swiss Approach to Insider Dealing*, 128 NEW L. J. 683, 684 (1978); Meyer, *supra* note 110, at 26.

<sup>185</sup> See Meyer, *supra* note 110, at 53.

<sup>186</sup> *Id.* at 53 & n.209.

<sup>187</sup> See *id.* at 53.

<sup>188</sup> *Id.* at 29. *But cf.* FEDERAL LAW OF ADMINISTRATIVE PROCEDURE (exemption provided for bankers in most instances).

<sup>189</sup> Meyer, *supra* note 110, at 31.

<sup>190</sup> *Id.*

<sup>191</sup> *Id.* at 31 n.79.

<sup>192</sup> Most cases are considered on the cantonal level as the federal rules apply only to cases before the Federal Supreme Court and federal administrative authorities. Thus, cantonal courts hear "the bulk of criminal, civil, and administrative cases." *Id.* at 31 n.82.

<sup>193</sup> *Id.* at 31.

<sup>194</sup> *Id.* at 31-32.

<sup>195</sup> *Id.*

courts to their own proceedings<sup>196</sup> excepting specific treaties providing for disclosure.<sup>197</sup>

In the absence of a treaty, the Swiss will respond positively to foreign requests for legal assistance only if the activity condemned by the foreign courts is also indictable under Swiss law.<sup>198</sup> Since insider trading is not a crime in Switzerland, the Swiss would not provide legal assistance to a foreign court seeking to pursue insider trading violations.<sup>199</sup> However, a proposal which would make insider trading a criminal offense was placed before the Swiss Government more than four years ago, but no action has yet been taken.<sup>200</sup> One reason may be the Swiss Government's perception that the Swiss citizenry would not approve a change which would further impair the operation of its secrecy law.

The strong Swiss interest in maintaining secrecy in banking transactions, although restricted in certain domestic instances, is as important as the strong American interest in maintaining the integrity of its financial markets. In view of this, it is difficult to conclude that the American interests should unequivocally predominate the Swiss interests.

The *Restatement's* balancing test provides little guidance for resolving the ostensibly irreconcilable interests of two nations. Consequently, the judiciary is placed in the untenable position of evaluating distinctive and competing interests which occupy corresponding positions in each nation's national policy.<sup>201</sup> Because this aspect of the balancing test does not provide a workable solution to this problem, the *Restatement's* hardship consideration inquiry becomes increasingly important. This inquiry requires a consideration of "the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person."<sup>202</sup> In considering "the extent and the nature of the hardship," courts should recognize that some "degree of protection" may be afforded the individual at the "expense" of the state's interest.<sup>203</sup> Particularly, courts should contemplate the penalty

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<sup>196</sup> See *Trade Dev. Bank*, 469 F.2d at 39-41 (article 204 of Ticino Canton exempting professionals from testifying inapplicable to proceeding in United States Court).

<sup>197</sup> E.g., Treaty on Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302 (providing mutual disclosure in criminal matters); Convention on Double Taxation of Income, May 24, 1951, United States-Switzerland, 2 U.S.T. 1751, T.I.A.S. No. 2316 (providing mutual disclosure in tax matters).

<sup>198</sup> See Meyer, *supra* note 110, at 54-55 ("This principle was expressly provided for in the European Convention on Mutual Assistance in Criminal Matters as well as in all subsequent treaties").

<sup>199</sup> Jenckel & Rider, *supra* note 184, at 683; see N.Y. Times, March 4, 1982, at 13, col. 1.

<sup>200</sup> Jenckel & Rider, *supra* note 184, at 684.

<sup>201</sup> See *In re Uranium Antitrust Litig.*, 480 F. Supp. at 1148.

<sup>202</sup> RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (b) (1965).

<sup>203</sup> *Id.* § 40 comment c.

which may be imposed by the other state in deciding whether to exercise jurisdiction.<sup>204</sup>

In *SEC v. BSI*, the court acknowledged that imprisonment may result because of the disclosure order imposed upon the bank.<sup>205</sup> Imprisonment is undoubtedly an extreme hardship and in situations in which it is a distinct possibility, courts employing the balancing test should assign it a weight commensurate with its importance to the innocently threatened parties.<sup>206</sup> Thus, the hardship to which bank employees may be subjected should induce a court to recognize the foreign interest above the American interest. Since the Swiss have imposed imprisonment in discovery situations,<sup>207</sup> and the Swiss Federal Attorney has indicated that his office would investigate and prosecute a violation,<sup>208</sup> there is sufficient probative evidence of ensuing hardship thereby mandating that courts refrain from requiring disclosure in bank secrecy-securities cases.

If a court orders disclosure and a defendant fails to comply, it should refrain from imposing sanctions where the defendant has acted in good faith. The "good faith" doctrine requires a defendant to make a reasonable effort to gain a sovereign's consent to produce records which are barred from production by that sovereign's law.<sup>209</sup> However, a good faith standard is difficult to measure.<sup>210</sup> In *SEC v. BSI*, the court found that the bank acted in bad faith because it engaged in illegal transactions expecting to rely on foreign law to place it beyond the purview of American securities laws.<sup>211</sup> The court rejected the bank's claim of good faith, summarily stating: "BSI acted in bad faith. It made deliberate use of Swiss nondisclosure law to evade in a commercial transaction for profit to it, the strictures of American securities law against insider trading."<sup>212</sup> The court provided no guidance in explaining how it arrived at its conclusion.<sup>213</sup> Nevertheless, the *Societe* Court outlined the parameters of the good faith analysis. For good

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<sup>204</sup> See *id.*

<sup>205</sup> 92 F.R.D. at 118.

<sup>206</sup> In most investigated transactions, it is likely that threatened bank employees trading securities have no knowledge of the principal's motives. See Meyer, *supra* note 110, at 51-52.

<sup>207</sup> See Jenckel & Rider, *supra* note 184, at 689 n.9 (conviction for revealing business secrets); cf. 185 N.Y.L.J. 3 (1971) (French officials jailed for investigating secret assets in Switzerland). See generally Meyer, *supra* note 174.

<sup>208</sup> See Lowenfeld, *supra* note 149, at 943. But see Note, *Recent Developments*, *supra* note 9, at 757 (likelihood of actual prosecution and imprisonment doubtful).

<sup>209</sup> *In re* Investigation of World Arrangements, 13 F.R.D. 280, 286 (D.D.C. 1952); see Onkelinx, *supra* note 9, at 511.

<sup>210</sup> See Note, *supra* note 10, at 619 & n.40.

<sup>211</sup> 92 F.R.D. at 117-19.

<sup>212</sup> *Id.* at 117.

<sup>213</sup> See *id.*

faith to exist, a party must maximize his efforts to disclose the ordered information.<sup>214</sup> The Court also indicated that if collusion existed between the party from whom disclosure is ordered and the foreign government, a good faith claim would rarely be justified.<sup>215</sup> An examination of BSI's efforts reveals that it did in fact make a good faith effort to comply with the court's disclosure order. The bank, recognizing that absolute compliance with the court's discovery order could subject it to Swiss criminal penalties, attempted to obtain waivers from its clients and presented alternative discovery means so that the information could be released without violating Swiss law and still satisfy the court's demand for disclosure.<sup>216</sup> Furthermore, the court's assertion that BSI " 'deliberate[ly] court[ed]'" ' legal impediments to make use of the Swiss secrecy laws is unsupported by evidence.<sup>217</sup>

The conflict between American discovery orders seeking disclosure of information for alleged fraudulent securities transactions and the Swiss nondisclosure laws imposing criminal liability poses a special dilemma. The two major considerations in resolving the dilemma are the respective nations' vital national interests and potential hardship upon the person ordered to disclose information. Under a vital national interests test, the American interest in the integrity of its financial market and the Swiss interest in bank secrecy cannot be satisfactorily balanced. Thus, courts should closely examine the hardship considerations and good faith claims to reach an equitable decision. The possibility of criminal imprisonment of an employee, particularly a party innocent of wrongdoing, is a concern which sufficiently subordinates the American interest. Finally, a good faith analysis will provide the deciding factor to ensure that an equitable result is reached. If a party refuses to comply with a discovery order requiring disclosure after a court engages in this analysis, the noncomplying party should be subject to sanctions.

The court's cursory evaluation and analysis of the hardship consideration and good faith claim illustrate the court's obstinate refusal to truly recognize the competing concerns and international repercussions inherent in its shortsighted decision. Although the immediate effect of *SEC v. BSI* is tempered since waivers were eventually ob-

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<sup>214</sup> 357 U.S. at 205; *see also supra* notes 61-63 and accompanying text.

<sup>215</sup> 357 U.S. at 208-09; *see also supra* notes 64-66 and accompanying text.

<sup>216</sup> *See* 92 F.R.D. at 113; Defendant's Memorandum, *supra* note 27, at 5-6, 8, 38.

<sup>217</sup> The only evidence which the court presented to support its conclusion that BSI acted collusively was "that BSI . . . deposited the proceeds of [the challenged] transactions in an American bank account in its name and . . . certainly profited in some measure from the challenged activity." 92 F.R.D. at 118-19.

tained by BSI, the effect of future decisions based upon the analysis adopted in *SEC v. BSI* could be alarming. Therefore, it is doubtful whether it is wise to continue to permit the judiciary to resolve matters as internationally sensitive as these. If the American interest in the integrity of its financial markets is truly a vital national interest, a treaty with the Swiss should be negotiated to avoid any individual hardships or international tensions resulting from shortsighted judicial action.<sup>218</sup> The treaty should permit bank employees to disclose information without the threat of imprisonment. Disclosure would only be proper in specific instances, e.g., an American court order or diplomatic request pertaining to precise securities violations. Thus the Swiss bank secrecy privilege would effectively remain viable. Admittedly, negotiating these changes with a foreign country may be a difficult task,<sup>219</sup> but considering the delicate nature of this dilemma, negotiation is undoubtedly more attractive than expansion of American law abroad.

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<sup>218</sup> Other methods include: (1) encouraging the SEC to make formal requests to the Justice Department seeking legal assistance from the Swiss Government in obtaining the identities of those suspected of insider trading violations; (2) making insider trading a crime in Switzerland thus permitting the application of the Swiss-American Mutual Assistance Treaty in American court proceedings; and, (3) utilizing letters rogatory more efficiently. See *N.Y. Times*, Sept. 1, 1982, at A1, col. 3; *Wall St. J.*, Aug. 3, 1982, at 36, col. 1; *N.Y. Times*, March 4, 1982, at D13, col. 1.

<sup>219</sup> Currently, talks are proceeding between the United States and Switzerland aimed at resolving this conflict. See *N.Y. Times*, March 4, 1982, at D13, col. 1.