CHAPTER VII

Enforcement of the Securities Laws in an International Securities Market

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CHAPTER VII

ENFORCEMENT OF THE U.S. SECURITIES LAWS IN A GLOBAL SECURITIES MARKET

The accelerating internationalization of the securities markets has presented new opportunities for investors and securities professionals to utilize capital legitimately in innovative ways. But the ability to effect transactions in and between the markets of many nations also has afforded the unscrupulous new opportunities exploit others and to violate the federal securities laws. In particular, those who seek to engage in illegal trading while in possession of nonpublic information have attempted to conceal their activities by conducting their trading through foreign entities.

This trend toward the internationalization of fraud is illustrated in SEC v. Tome, 638 F. Supp. 596 (S.D.N.Y., June 3, 1986), appeal pending, No. 86-6192(L) (2d Cir.). In that case, the court found that Tome, an Italian securities professional with substantial business in the U.S., had exploited a confidential relationship with Edgar Bronfman, the chairman and chief executive officer of Seagrams, to obtain and misuse material, nonpublic information concerning Seagram's planned takeover bid for St. Joe Minerals Corporation. Tome and his tippees bought large quantities of St. Joe call options and common stock the day before the announced takeover bid.

Tome, an Italian national currently residing in Switzerland, purchased the St. Joe securities through brokerage accounts maintained at a Swiss bank, Banca Della Svizzera Italiana ("BSI")

in the names of three Panamanian entities in which he had a beneficial interest. Tome also tipped certain individuals and entities in Europe. 1/

The court found that Tome violated Section 10(b) of the Securities Exchange Act and Rule 10b-5, by misappropriating valuable corporate information, entrusted to him by Bronfman for the purpose of advising Bronfman and Seagrams, for his own benefit. The three Panamanian entities were found to be equally liable for Tome's violations. Although the identified tippee purchasers, Leati and Lombardfin, did not appear at trial, the court ruled that the Commission had effected personal service on all defendants pursuant to Rule 4 of the Federal Rules of Civil Procedure by publication in newspapers of general circulation in Europe. Both Leati and Lombardfin were found liable for violations of Section 10(b) and Rule 10b-5.

Significantly, the court also ordered the New York branch of BSI to request that the frozen proceeds from the illegal trading in St. Joe securities be transferred to it from BSI in Lugano, Switzerland for subsequent deposit with the

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1/ Initially, the Commission was unable to determine the identity of the tippee purchasers. The Commission was subsequently able to identify as purchasers of St. Joe call options Paolo Leati, a resident of Italy and a friend of Tome, and Lombardfin S.p.A., a foreign holding company formed by Leati for subsidiaries and affiliates engaged in securities brokerage. At trial, on October 23, 1985, the court granted the Commission's motion to amend the complaint to include both Leati and Lombardfin.

court. BSI agreed to pay the required sums. After the commencement of the SEC investigation, Tome fled the United States, and has not returned.

The increasing frequency with which foreign corporations are incorporating entities in the United States, which thereafter register and sell securities, also has presented problems in enforcing the securities laws. In such cases the operations of the parent may be wholly located abroad and the capital raised as a result of the offering immediately exported for use in the parent's operation. Accordingly, if there are irregularities in the initial disclosure made in the company's registration statement, or if the company has engaged in fraud, the money may have left the United States before any action can be taken. Where this occurs, problems associated with gathering evidence to prove the fraud, as well as recovering the money from a foreign jurisdiction, arise. Thus, the Commission's best, and most practical, opportunity to protect investors may occur prior to the time the registration statement goes effective.

In SEC v. Balsa Donde USA and Arye Donde a/k/a Arik Donde, Civil Action No. 86-3373 (U.S.D.C., December 9, 1986), the Commission sued Balsa Donde USA, Inc. ("Balsa Donde") and Arye Donde ("Donde") seeking Final Judgments of Permanent Injunction from violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. Balsa Donde was a Delaware corporation with manufacturing facilities located in Israel, which manufactured airframe components for remote piloted vehicles ("RPV's"). Donde was chief

operating officer, and a vice president and director of Balsa Donde. The Commission's complaint alleged that Balsa Donde filed with the Commission a registration statement on Form S-1 on May 23, 1986, and an amended registration statement on September 5, 1986, which contained false and misleading statements of material facts. The defendants consented to the court's entry of a judgment of final injunction without admitting or denying the Commission's allegations.

In a related action, the Commission issued an Order Instituting Proceedings Pursuant to Section 8(d) of the Securities Act, and Findings and Stop Order suspending the effectiveness of the registration statement filed by Balsa Donde and ordered Balsa Donde to return investors' money. In the Order, the Commission found that Balsa Donde's registration statement contained untrue statements of material facts and omitted to state material facts required to be stated or necessary to make the statements not misleading. Balsa Donde consented to the issuance of the Order without admitting or denying the Commission's findings.

The Commission has been vigorous in enforcing the U.S. securities laws to protect U.S. investors and the integrity of U.S. markets. In this effort, the ability of the Commission's staff to obtain evidence located overseas has been crucial. This Chapter examines the means that the Commission has employed to obtain this evidence including multilateral and bilateral agreements. First, however, the Chapter examines the extent of U.S. jurisdiction under the federal securities laws and the tests

employed by U.S. courts in determining whether that jurisdiction exists and may appropriately be exercised.

I. APPLICATION OF U.S. JURISDICTION IN SECURITIES CASES

A. Introduction

The federal securities statutes contain broad statements of jurisdiction, premised generally on securities transactions and related activities conducted through interstate or foreign commerce involving any point in the United States, or through the mails. 2/ Thus, in addition to covering wholly domestic transactions, the federal securities laws have been construed to cover transactions initiated in the United States and consummated abroad, as well as those initiated abroad and concluded in the

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2/ Section 2(7) of the Securities Act, 15 U.S.C. 77b(7), defines "interstate commerce" to include "trade or commerce in securities or any transportation or communication relating thereto * * * between any foreign country and any State, Territory, or the District of Columbia * * *." The Securities Exchange Act 3(a)(17), 15 U.S.C. 78c(a)(17), contains a similar definition. See also Section 2(a)(18) of the Investment Company Act, 15 U.S.C. 80a-2(a)(18), and Section 202(a)(10) of the Investment Advisers Act, 15 U.S.C. 80b-2(a)(10). The preambles to both the Securities Act and the Securities Exchange Act state that they are intended to apply to "interstate and foreign commerce."

Two provisions of the federal securities statutes expressly refer to foreign participation in the securities markets. Securities Exchange Act Section 30 prohibits the use of foreign stock exchanges in contravention of Commission rules for the protection of investors and to prevent evasion of the Act (15 U.S.C. 78dd), and Section 7(d) of the Investment Company Act authorizes the Commission to issue an order permitting a foreign investment company to be registered in the United States and to make a public offering of its securities if the Commission finds that such an order is consistent with the public interest and the protection of investors, and that it can effectively enforce the provisions of that Act against such company. 15 U.S.C. 80a-7(d).

United States. 3/

In general, the courts will exercise subject matter jurisdiction under the securities laws based on the existence of significant conduct or effect in the United States. Courts have tended to be more receptive to the exercise of United States jurisdiction in fraud cases than in those involving regulatory matters. Jurisdiction under the federal securities laws is also limited by the willingness of other states to tolerate or respect the exercise of United States jurisdiction in the particular circumstances. These restrictions are the subject of two recent scholarly projects of the American Law Institute. 4/

B. Jurisdiction of the Federal Securities Laws: Case Law 5/

United States courts will exercise jurisdiction to apply the federal securities laws to a matter that entails relatively

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3/ The Commission has defined the jurisdiction it will exercise through the adoption of rules, disclosure requirements, and special service provisions for certain non-residents engaged in the securities business in the United States, and through the issuance of "no-action" letters with respect to securities business initiated in the United States and conducted abroad. See generally Chapters III, V and VI.

4/ American Law Institute, Restatement of the Foreign Relations Law of the United Stated (Revised) (July 15, 1985 Tentative Final Draft) as amended by Tentative Draft No. 7 (April 10, 1986); and American Law Institute, Federal Securities Code. See discussion in Part C, infra.

5/ Issues concerning a court's exercise of personal jurisdiction over the parties and its choice of American law or foreign law are beyond the scope of this Report. In general, the personal jurisdiction of a United States court over a foreign party is a question of due process. See World-Wide Volkswagon Corp. v. Woodson, 444 U.S. 286 (1980); Asahi Metal Industry Co., Ltd. v. Superior Court of California, Solano County, 107 S. Ct. 1026 (1987). Additionally, a U.S. court may have jurisdiction over the parties, but, under choice of law principles, may choose to apply foreign law.

significant conduct within the United States, or that produces or is likely to produce relatively significant effects in the United States. 6/

These concepts are framed in two sections of the American Law Institute's Restatement (Second) of Foreign Relations Law of the United States. Section 17 states that a government may regulate (and thus a court may apply its national law to) conduct occurring and matters located in its territory. 7/ Section 18 states that a government may regulate conduct outside its territory that causes effects within the country where that conduct is generally recognized as illegal; or where the effects were foreseeable and substantial, and regulation by that government would be consonant with the law of other states. 8/ These

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6/ See generally Laker Airways Ltd. v. Sabena Belgian World Airways, 731 F.2d 909, 921-26 (D.C. Cir. 1984).

7/ The section reads as follows:

> § 17. Jurisdiction to Prescribe with Respect to Conduct, Thing, Status, or Other Interest Within Territory
>
> A state has jurisdiction to prescribe a rule of law
>
> (a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and
>
> (b) relating to a thing located, or a status or other interest localized, in its territory.

8/ That section reads:

> § 18. Jurisdiction to Prescribe with Respect to Effect within Territory

(footnote continued)

formulations of the "conduct" and "effects" tests of jurisdiction have strongly influenced judicial analysis of jurisdiction under the federal securities laws.

In applying these tests, particularly in the antifraud area, the courts have sought to discern Congressional intent, express or implied, with respect to the extraterritorial application of the securities laws. As a general proposition, the courts have construed the broad statutory language of the antifraud provisions of the securities laws, in light of the guidance provided by the conduct and effects tests, as indicating that Congress intended to provide comprehensive protection against fraud in the offer, purchase, or sale of securities. See Leasco Data Processing v. Maxwell, 468 F.2d 1326, 1334-37 (2d Cir. 1972).

8/ (footnote continued)

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

1. The conduct test

It is well established that U.S. courts may assert jurisdiction over cases where a fraudulent offer was made, or a securities transaction fraudulently induced, within the United States, even if the transaction was ultimately consummated outside of the United States. However, a court may decline to exercise jurisdiction if it deems such exercise to be inappropriate in light of Congressional intent.

Leasco Data Processing

1972), is an example of a case in which the court did assert its jurisdiction even where the transactions were culminated abroad. There, the plaintiffs alleged that they had been induced to purchase securities on the London Stock Exchange by significant misrepresentations made to them in the United States. The court in that case noted that

> [c]onduct within the territory alone would seem sufficient from the standpoint of [United States] jurisdiction to prescribe the rule.

Id. at 1334 (emphasis in original). In support of its exercise of jurisdiction, the court also referred to Congressional intent to prohibit substantial misrepresentations in the United States.

In contrast, courts have declined to exercise jurisdiction where the conduct in the United States has been deemed relatively unimportant to the alleged misconduct. In Bersch v. Drexel Firestone, 519 F.2d 974 (2d Cir.), cert. denied, 423 U.S. 1018 (1975), for example, repeated and important meetings among American lawyers, underwriters, accountants, and the SEC, as well as some

drafting of the prospectus and the opening of bank accounts in the United States, were deemed sufficient to warrant the application of United States law. 519 F.2d 985, citing Section 17 of the Restatement (Second). Nevertheless, because the court determined that the United States activities were "merely preparatory," consisted merely of "culpable nonfeasance," and were small in comparison with the activities abroad, it declined to exercise that jurisdiction. 519 F.2d 987. 9/ The prospectus had been issued from London, Brussels, Toronto, the Bahamas, and Geneva, and was delivered only to purchasers outside the United States. Thus, the court found that the transactions were "predominantly foreign." Id.

In other cases, limited conduct in the United States has been viewed as significant to the scheme as a whole and thus courts have determined to exercise their jurisdiction. In Grunenthal GmbH v.

9/ With respect to some American residents who bought into the offering, the court did consider it proper to exercise jurisdiction based on the combination of conduct and effects in the United States.

Another court of appeals has stated that conduct in the United States is not "merely preparatory" when it is "'significant with respect to the alleged violations,'" and "'furthered the fraudulent scheme.'" Grunenthal GmbH v. Hotz, 712 F.2d 421, 425 (9th Cir. 1983), quoting Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, 592 F.2d 409, 420 (8th Cir. 1979). But see F.O.F. Proprietary Funds v. Arthur Young & Co., 400 F. Supp. 1219, 1222-23 (S.D.N.Y. 1975) (in which the court concluded that, despite preparatory work performed in the United States, contact with the United States was insufficient because the materially misleading information was only circulated abroad).

Hotz, 712 F.2d 421 (9th Cir. 1983), an agreement negotiated between foreign parties outside the United States was executed in Los Angeles. The court concluded that jurisdiction could be based on two material misrepresentations arising from the execution. These misrepresentations related to the authority of one of the signators and to the intentions of certain other signators to perform in accordance with the agreement.

In cases where the offer is directed outside the United States, the exercise of United States jurisdiction may depend on whether there was a preponderance of United States activity. In IIT v. Vencap Ltd, 519 F.2d 1001 (2d Cir. 1975), a London fund with predominantly foreign (but some American) investors sued a Bahamian corporation over transactions negotiated in New York. 10/ The court found it proper to exercise jurisdiction over the action because, on the facts of the case, the fraud was "concocted" in the United States. The Second Circuit stated that

> [w]e do not think Congress intended to allow the United States to be used as a base for

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10/ While 28 U.S.C. 1350 provides jurisdiction over "any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States," the court was reluctant to exercise jurisdiction under that section (even though one of the defendants was owned and controlled by a United States citizen):

> Although the United States has power to prescribe the conduct of its nationals everywhere in the world, * * *, Congress does not often do so and Courts are forced to interpret the statute at issue in the particular case.

519 F.2d at 1016 (citation omitted).

> manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.

519 F.2d at 1017. This statement reflects the broad language of Section 10(b) of the Securities Exchange Act and the strong United States policy interest in prohibiting fraud. 11/

Likewise, in United States v. Cook, 573 F.2d 281 (5th Cir. 1978), cert. denied, 439 U.S. 836 (1978), the court upheld jurisdiction where a group of Americans in Texas placed false and misleading advertisements in European publications, soliciting investors in American oil ventures. The Americans signed contracts in Europe with European investors and recorded those contracts in the United States. On appeal, one of the American defendants contended that the district court could not exercise jurisdiction because the victims of the fraud were foreign. The court of appeals concluded that the facts of the case -- including activities in Dallas, the American securities, and the repatriation of funds -- were "so far within the jurisdiction as to give us little pause." 573 F.2d at 283. According to the opinion:

> That Congress would allow America to be a haven for swindlers and confidence men when the victims are European while expecting the highest level of business practice when the investors are American is "simply unimaginable."

573 F.2d at 284, citing Vencap's discussion of the export of fraud. 12/

11/ See also Bersch, 519 F.2d at 987.

12/ In IIT v. Cornfeld, 619 F.2d 909, 920 (2d Cir. 1980), jurisdiction was based on two factors: the existence of American

(footnote continued)

In employing the conduct test of jurisdiction, courts have also struggled with the problem of ascribing a location to alleged fraud consisting solely of a failure to disclose. In one such case, Continental Grain (Australia) Pty. Ltd. Pacific Oilseeds, 592 F.2d 409 (8th Cir. 1979), American defendants seeking to sell the stock of an Australian company allegedly failed to disclose

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12/ (footnote continued)

securities and conduct in the United States. In that case, a Luxembourg corporation entered into three separate transactions with an American corporation, its American affiliate, and its Netherland Antilles subsidiary. With regard to a purchase of the American parent's stock in the United States over-the-counter market, as well as a purchase of the American affiliate's note, the court had "no difficulty" in determining to exercise jurisdiction, because "these were securities of American corporations, [and] the transactions were fully consummated within the United States." Id. at 918. Although the court considered neither factor alone sufficient to exercise jurisdiction, it observed that their combination "points strongly toward applying the antifraud provisions of our securities laws." Id.

With respect to losses resulting from the Netherland Antilles subsidiary's Eurobond offering, consummated almost entirely in Europe, the court concluded that the Eurobond offering was "closely coordinated" with an offering in the United States, that the subsidiary had no operating assets, and that the American parent corporation guaranteed the Eurobond notes, which were convertible into the parent's stock. Thus, the court labelled the securities "in substance * * * American." Id. at 919-20. In addition, the court noted that the sole underwriter of the Eurobond offering was American and, "[p]erhaps most important of all," the prospectus was "wholly drafted in the United States," even to its printing, and the accounting work was performed in the United States. Id. at 920. Under these circumstances, the court stated (id.) that

> while many of the acts in the United States in this case were similar to those in Bersch, the relativity is entirely different because of the lack here of the foreign activity so dominant in Bersch * * *.

material information in communicating from the United States to the Australian buyer. The court based its exercise of jurisdiction on its conclusion that the fraud had been "devised in and completed in the United States * * * and then it was 'exported' to Australia." 592 F.2d at 420. 13/

The conduct upon which jurisdiction is premised may include not only fraudulent representations or omissions, but also acts designed to further the fraud. In SEC v. Kasser, 548 F.2d 109 (3d Cir.), cert. denied, 431 U.S. 938 (1977), the defendants allegedly defrauded a Canadian corporation, furthering the scheme through the use of the United States telephone system and mails, maintainence in the United States of records crucial to the consummation of the scheme, the use of a New York bank as a conduit for the proceeds and the execution of a key investment contract in the United States. The court considered that the totality of this conduct was not only "essential to the plan to defraud," but constituted the export of fraud warranting the exercise of United States jurisdiction. 14/ 548 F.2d 114-115.

13/ The court cited in this connection Section 17 of the Restatement (Second). Id.

14/ In a recent commodities fraud case, the plaintiff contended that he had been falsely advised, by oral communications in Athens and by written communications from New York, that his transactions on the American commodities markets would be handled by qualified managers. The alleged fraud consisted of both the initial misrepresentations and subsequent mismanagement of the account, and the commodity trades in the United States that "directly caused" the loss. The court concluded that the preparation and issuance

(footnote continued)

2. The effects test

An alternative basis for the exercise of subject matter jurisdiction is the impact or effect that acts have in the United States. Under this test, a court will entertain a cause of action where conduct outside the United States is deemed to significantly injure the American securities markets. That principle was first recognized in Schoenbaum v. Firstbrook, 405 F.2d 200, rev'd on other grounds, 405 F.2d 215 (2d Cir. en banc 1968), cert. denied, 395 U.S. 906 (1969). There the common stock

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14/ (footnote continued)

in New York of the broker-dealer's written description of its services, and the ultimate completion of commodity futures contracts on American exchanges, consituted a "substantial enough" contact in the United States to give the court jurisdiction over this dispute between a Greek citizen and resident and the American employer of his account executives in Athens and Paris. Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1046-48 (2d Cir. 1983). See also Tamari v. Bache & Co., (Lebanon), S.A.L., 547 F. Supp. 309 (N.D. Ill. 1982), aff'd. 730 F.2d 1103, cert. denied, 469 U.S. 871 (1984). See also Arthur Lipper Corp. v. SEC, 547 F.2d 171 (2d Cir. 1976), cert. denied, 434 U.S. 1009 (deciding an antifraud action allegedly involving fraudulent and illegal kickbacks on commissions for securities transactions executed on the New York Stock Exchange and the United States over-the-counter-market, even though the only relevant misrepresentation consisted of an omission in Mexico). Cf. Fidenas AG v. Compagnie Internationale pour l'Informatique CII Honeywell Bull, S.A., 606 F.2d 5 (2d Cir. 1979)(affirming the dismissal of an action by foreign plaintiffs against foreign defendants in which the alleged fraud and the central transactions occurred in Europe, and the only United States contacts were that some of a group of promissory notes were placed in the United States, and some of the proceeds were intended to be, but never were, used in the United States); Mormels v. Girofinance, S.A., 544 F. Supp. 815 (S.D.N.Y. 1982) (dismissing a suit by an American residing in Costa Rica against a Costa Rican commodities broker because the alleged misconduct, i.e., the misrepresentation, delivery, and conversion of funds, all occurred in Costa Rica).

of a Canadian corporation was registered for trading on the American Stock Exchange. The Canadian corporation's controlling shareholder, a wholly-owned subsidiary of a French company, bought 500,000 shares of the Canadian company's common stock on the Toronto Stock Exchange. Subsequently the Canadian company sold 270,000 of its shares to ten professional European investors. 15/ The complaint alleged that the French company bought the 500,000 shares on the Toronto Stock Exchange while in possession of material undisclosed information about the Canadian company's assets, and further, that affiliates of the French company bought the 270,000 shares placed in Europe.

The Second Circuit stated that because the transactions took place outside the United States, its exercise of jurisdiction was premised on specific allegations which

> involve stock registered and listed on a national securities exchange, and [transactions which] are detrimental to the interests of American investors.

Id. at 208 (citations omitted). 16/ The court found in that case that the alleged fraud on the Canadian company could "be reflected in lower prices bid for its shares on the [U.S.] market." 405 F.2d at 208. The assertion of jurisdiction was warranted because the conduct in Canada,

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15/ 405 F.2d at 205.

16/ The court construed Section 30(b), 15 U.S.C. 78dd, providing an exemption from the Securities Exchange Act for "business in securities without the jurisdiction of the United States," to be limited to foreign transactions by persons "in the securities business" such as broker-dealers. 405 F.2d at 207-08.

> allegedly in violation of the [Securities Exchange] Act, has * * * a sufficiently serious effect upon United States commerce * * *.

Id. at 209 (citations omitted).

The magnitude of effect in the United States may be determinative of the exercise of jurisdiction. Compare Des Brisay v. Goldfield Corporation, 549 F.2d 133, 136 (9th Cir. 1977) (upholding jurisdiction where the takeover of a Canadian corporation effected in Canada by an American corporation whose stock was listed on the American Stock Exchange violated the Securities Act and proximately caused the collapse of the American market in the American company's shares) with Bersch v. Drexel Firestone, supra, 519 F.2d at 988 (where "generalized effects" on the American market were held insufficient to confer subject matter jurisdiction over a damage suit by a foreigner when the fraudulent conduct was alleged to have occurred abroad and there was no intention that the securities would be offered to anyone in the United States).

Moreover, jurisdiction may be based on the combination of some United States conduct and specific detrimental effects on American residents or citizens. Indeed, the court in Bersch reasoned that a sufficient injury to such persons minimized the amount of United States conduct necessary for the assertion of jurisdiction:

> While merely preparatory activities in the United States are not enough to trigger application of the securities laws for injury to foreigners located abroad, they are sufficient when the injury is to Americans so resident.

519 at 992. 17/ Thus, in that case, where almost 400 Americans purchased securities at the offering price of $10 and the securities were "virtually unsaleable" within a few weeks (519 F.2d at 981), the court exercised jurisdiction based upon the combination of the conduct in the United States and the injury to American citizens abroad. 519 F.2d at 992. The court relied in this connection on Section 18 of the Restatement (Second). 18/

As the discussion in many of these decisions demonstrates, the U.S. courts may have a basis on which to exercise jurisdiction over a controversy, but nonetheless may determine not to do so.

17/ Although the authority to regulate and protect a country's nationals, even outside of the state, is a long-recognized basis of jurisdiction (see, e.g., Restatement (Second) of the Foreign Relations Law of the United States, Section 30 (1965); Restatement of Foreign Relations Law of the United States (Revised), Section 402(2) (July 15, 1985 Tentative Final Draft)), the nationality-based distinction drawn in Bersch between non-resident victims has been criticized as constitutionally suspect for denying equal protection to aliens (see Continental Grain v. Pacific Oilseeds, Inc., 592 F.2d 409, 418 n.14 (8th Cir. 1979)).

18/ The court in Bersch separately recognized that jurisdiction could have been premised on effects in the United States if there had also been some United States conduct, such as false prospectuses mailed into the United States, or alternatively, if the value of the shares in the United States market was depressed by fraud committed abroad. 519 F.2d at 988-89. Other cases that have weighed the magnitude of United States effects as a test for jurisdiction include Vencap, 519 F.2d at 1016 (rejecting the argument that fraudulent activities abroad had significant effect in the United States simply because the victims of the fraud included some United States citizens or residents whose exposure amounted only to "some .5% of the total [investment]") and Continental Grain, 592 F.2d at 417 (rejecting as "too remote" an effects-based jurisdictional approach premised on the loss produced on the books of the plaintiff's American parent).

The courts have frequently referred to considerations beyond mere weighing of the facts in order to decide the significance of the United States interest. 19/ One major policy factor has been the courts' distaste for the "export of fraud." IIT v. Cornfeld, 619 F.2d at 920. A countervailing one has been a reluctance to construe Congressional intent so broadly as to reach all securities transactions that have some American component or relationship, however trivial. Thus, the Second Circuit has cautioned

> the language of § 10(b) * * * is much too inconclusive to lead us to believe that Congress meant to impose rules governing conduct throughout the world in every instance where an American company bought or sold a security.

Leasco, 468 F.2d at 1334 (emphasis supplied).

Sections 17 and 18 of the Restatement (Second) have been utilized by the courts in identifying policy considerations that bear on the determination to exercise jursidiction in federal securities cases. Their suitability to the federal securities laws is demonstrated by recent scholarly commentary in matters of international securities jurisdiction, which generally defers to the jurisdictional analyses the courts have developed under the Restatement (Second) in cases arising under the federal securities laws.

19/ The court in Continental Grain, "frankly admit[ted] that * * * [its jurisdictional determination] is largely a policy decision." Nonetheless, it observed that, under Section 10(b), "[t]he range of significant conduct should * * * be fairly inclusive," citing "the general purpose of the securities laws to mandate the highest standards of conduct * * *." Id. 592 F.2d at 421. Accord, Leasco, 468 F.2d at 1336.

C. Recent Work On Federal Securities Jurisdiction

The American Law Institute has recently issued two documents that address the international limits of jurisdiction under the federal securities laws. The discussion in the Federal Securities Code is based upon the authorities cited in Part B, supra, and focuses upon subject matter jurisdiction as the concept has developed in the area of federal securities regulation. The Restatement of the Foreign Relations Law of the United States (Revised) (July 15, 1985 Tentative Final Draft), as amended by Tentative Draft No. 7 (April 10, 1986) 20/, is designed, according to its Reporters, to suggest the direction in which all domestic and international law should develop. The Restatement (Revised) also discusses jurisdiction of securities laws cases in the context of the considerable body of law that United States courts have developed in this area. However, because of the different approaches, the conclusions of the two documents are somewhat different.

1. The Federal Securities Code

Fundamentally, the Federal Securities Code provides broader international jurisdiction over fraud than jurisdiction for other activities addressed by the federal securities laws. Section 1905 (a)(1)(A) provides that the Code is applicable to purchases, sales or offers to buy or sell securities, proxy solicitations, tender

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20/ The Revised Restatement was adopted by the ALI at its May, 1986 annual meeting. As of the date of this Report, no final version of the Revised Restatement has been published.

offers, and activity as an investment adviser occurring "within the United States although * * * initiated outside the United States." Section 1905(a)(2), which adopts essentially the "export of fraud" theory, would apply the Code's antifraud provisions to offers, purchases and sales, proxies, tender offers, and activity as an investment adviser initiated in this country but occurring elsewhere. Under Section 1905(a)(1)(B), the Code would apply to such nonresidents who have an identifiable status to which the Code attaches legal significance, without regard to the existence of conduct in the United States. This status includes registrants, officers, directors, and shareholders subject to Sections 13, 14(a), and 16 of the Securities Exchange Act, and banks and participants in registered clearing agencies.

2. The Revised Restatement.

The Revised Restatement is premised upon a balancing test, labelled "reasonableness." This test would require an American court, before exercising jurisdiction, to consider eight factors, including conduct and effect. 21/ These factors were derived

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21/ These factors are set forth in Section 403(2):

(a) the extent to which the activity (i) takes place within the regulating state, or (ii) has substantial, direct, and forseeable effect upon or in the regulating state;

(footnote continued)

almost exclusively from case law in the antitrust area, see note 2 to Section 403, and are, in many instances, irrelevant or unhelpful in cases alleging violations of the federal securities laws. Earlier drafts of the revision applied these factors uncritically to cases involving the federal securities laws.

In October 1984, the Commission's General Counsel submitted extensive comments to the ALI with respect to the Revised

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21/ (footnote continued)

(b) the connections such as nationality, residence, or economic activity, between the regulating state and the persons principally responsible for the activity to be regulated, or between that state and those whom the law or regulation is designed to protect;

(c) the character of the activity to be regulated, the importance of regulations to the regulating state, the extent to which other states regulate such activities and the degree to which the desirability of such regulation is generally accepted;

(d) the existence of justified expectations that might be protected or hurt by the regulation in question;

(e) the importance of the regulation in question to the international political, legal or economic system;

(f) the extent to which such regulation is consistent with the traditions of the international system;

(g) the extent to which another state may have an interest in regulating the activity; and

(h) the likelihood of conflict with regulation by other states.

Restatement, strongly criticizing the reasonableness test as vague and uncertain. By contrast, he pointed to Section 1905 of the Federal Securities Code as a straightforward restatement of current law and practice. Both the Attorney General and the Legal Adviser to the Department of State also submitted comments to the ALI on the Revised Restatement. Although the focus of their comments varied from those of the Commission's General Counsel, each also observed that the reasonableness test neither represented current law nor necessarily improved upon the fundamental premise of current law, which is comity i.e., "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience and to the rights of its own citizens or of other persons who are under the protection of its laws * * *." Hilton v. Guyot, 159 U.S. 113 (1895).

After receiving the General Counsel's comments, the Reporters of the Revised Restatement met several times with the Commission's staff to discuss ways to improve the Restatement's approach to the securities laws. Some of the changes subsequently made in Revised Restatement Section 416 reflect these discussions. While the Commission's General Counsel would have approached the matter differently, the new Section 416(1) attempts to state general principles derived from existing case law, and to set forth in Section 416(2) particular principles relevant to the securities laws to guide the application of the Section 403 factors.

Section 416 in its present form has two principal parts. 22/ The section recognizes United States jurisdiction with respect to

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22/ Section 416 reads as follows:

> Jurisdiction to Regulate Activities related to Securities: Law of the United States.
>
> (1) The United States generally has jurisdiction to prescribe with respect to
>
> (a) (i) any transaction in securities in the United States to which a national or resident of the United States is a party, and
>
> (ii) any offer to enter into a securities transaction, made in the United States by or to a national or resident of the United States;
>
> (b) any transaction in securities
>
> (i) carried out, or intended to be carried out, on an organized securities market in the United States, or
>
> (ii) carried out, or intended to be carried out, predominantly in the United States, although not on an organized securities market;
>
> (c) conduct, regardless of where it occurs, significantly related to a transaction described in Subsection 1(b), if the conduct has, or is intended to have, a substantial effect in the United States;
>
> (d) conduct occurring predominantly in the United States that is related to a transaction in securities, even if the transaction occurs outside the United States; and

(footnote continued)

offers or transactions in securities made or carried out predominantly in the United States, or by or to an American national or resident, as well as with respect to situations involving substantial effect in the United States or conduct occurring predominantly in the United States. The general descriptions contained in Section 416(1), which recognizes United States jurisdiction without reference to further factors, are derived from the case law under the conduct test, including Leasco,

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22/ (footnote continued)

(e) investment advice or solicitation of proxies or of consents with respect to securities, carried out predominantly in the United States.

(2) The jurisdiction of the United States to apply its securities laws to transactions or conduct other than those addressed in Subsection (1) depends on whether it is reasonable to do so in the light of § 403, giving particular weight to

(a) whether the transaction or conduct has, or can reasonably be expected to have, a substantial effect on a securities market in the United States for securities of the same issuer or on holdings in such securities by United States nationals or residents;

(b) whether representations are made or negotiations are conducted in the United States; and

(c) whether the party sought to be subjected to the jurisdiction of the United States is a United States national or resident, or the persons sought to be protected are United States nationals or residents.

Bersch, Continental Grain, Vencap, Cook, Cornfeld, Kasser, Psimenos, and Lipper. Section 416(1) also reflects the holdings under the effects test in Des Brisay and Bersch. For all other matters, the section would require reference to the eight factors in Section 403, with "particular weight" given to substantial effects on United States securities or holdings, representations or negotiations conducted in the United States, and the interest of the parties in obtaining protection under United States law. The section makes no attempt to replicate the distinctions drawn in the Code between antifraud jurisdiction on the one hand and status jurisdiction on the other.

Section 416(2)(a) of the Revised Restatement deals with the "effects" line of cases under Schoenbaum. That section provides that in determining the existence of jurisdiction for such cases weight should be given to various enumerated factors, including substantial effect or potential effect in the United States market.

Section 416 of the Revised Restatement as approved by the ALI now recognizes and builds upon the major decisions on subject matter jurisdiction in the federal securities area. By emphasizing in Section 416(2) the considerations most important to a securities case, the new section now also avoids the pitfall of applying law that is, as termed in AVC Nederland, B.V. v. Atrium Investment Partnership, 740 F.2d 148, 154-55 (2d Cir. 1984), "inapplicable, dubious or neutral" to jurisdiction under the securities law.

II. INVESTIGATING POSSIBLE VIOLATIONS OF THE U.S. SECURITIES LAWS

A. Introduction

Where activities involving securities come within the jurisdictional ambit of the U.S., either because conduct has taken place in this country or because the activities have had an effect on U.S. markets, the staff of the Commission may find it necessary to investigate possible violations of the securities laws. The Commission has broad statutory authority to conduct investigations to determine whether a violation of the federal securities laws has occurred or is about to occur. Most enforcement actions are preceded by a private investigation. The sources and types of information sought in international investigations are much the same as those in domestic investigations, and, as discussed infra, the Commission employs many of the same mechanisms to obtain information. However, because of limitations in the Commission's jurisdiction and the interposition of blocking and secrecy laws by other nations, the Commission has found it necessary to develop other means to obtain evidence located abroad, including bilateral agreements for cooperation in enforcement efforts.

B. Methods for Obtaining Information

1. Voluntary Cooperation

During the preliminary stages of an investigation, the Commission's staff may request information from persons or entities on a voluntary basis. For example, routine trading information from broker-dealers and general corporate information from public

and private companies is often obtained in this manner. In international investigations, even where the desire to provide information voluntarily exists, foreign blocking and secrecy laws may prevent such cooperation.

2. Administrative subpoenas

Where voluntary compliance is not forthcoming, or does not yield needed information, the Commission has the power, under the securities laws, to issue subpoenas compelling the production of documents and testimony relevant to the areas of Commission inquiry. Those same laws give a federal district court the power to order compliance with a Commission investigatory subpoena in the case of a refusal to obey the subpoena without good cause. The Commission is authorized to subpoena witnesses "from any place in the United States." 23/ This statutory language, commonly employed in the laws governing most American regulatory agencies, has been construed by U.S. courts to be a broad and flexible authorization to compel the production of evidence

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23/ Securities Exchange Act Section 21, 15 U.S.C. 78u(b), gives the Commission the authority to

> subpoena 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.

See also Section 19(b), Securities Act of 1933, 15 U.S.C. 77s(b); Section 42(b) of the Investment Company Act of 1940, 15 U.S.C. 80a-41; and Section 209(b) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-9.

from anywhere in the world, so long as service has been properly effected in the U.S.

In the first challenge to the Commission's use of administrative subpoenas to obtain records from outside of the United States, SEC v. Minas de Artemisa, S.A., 150 F.2d 215 (9th Cir. 1945), the court ordered a Mexican company to produce books and records pursuant to a Commission administrative subpoena served on the company's president, an American citizen, at his residence in Arizona. The subpoena was directed to the Mexican company and sought documents maintained in Mexico and required by Mexican law to be kept there. When the president refused to comply, the Commission sought enforcement in district court. The district court dismissed the Commission's application.

The court of appeals reversed. The Ninth Circuit concluded that the district court in Arizona had personal jurisdiction over the Mexican company, and that the statutory language governing the issuance of administrative subpoenas gave the Commission authority

> to require the attendance of witnesses or the production of documentary evidence at any designated place of hearing, provided only that service of the subpoena is made within the territorial limits of the United States.

150 F.2d at 218. 24/

24/ In the face of evidence that Mexican law prohibited the removal of certain corporate records from the country, but

(footnote continued)

Except as provided by statute, United States administrative agencies do not have the power to compel persons outside the U.S., who have no contact with the U.S. (and who therefore are not under a federal court's jurisdiction), to produce evidence for an investigation. 25/ Foreign brokers who trade on American exchanges and are registered with the Commission are subject to Commission subpoenas concerning securities trading because they are required by Commission rule to appoint the Secretary of the Commission as their agent for service.

3. Discovery During Civil Litigation

If a Commission investigation results in a case which is inappropriate for resolution administratively, and U.S. courts

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24/ (footnote continued)

did not prohibit production of books and records in Mexico itself, the court ordered the company to apply to Mexican authorities for authorization to remove the books. In the event that authorization was not permitted, the court ordered that the company allow the Commission to inspect the books in Mexico and provide authenticated copies of any records requested pursuant to that inspection. Id. at 218-19.

25/ The Federal Trade Commission and the Internal Revenue Service have been expressly authorized to serve investigative demands in foreign states in a manner parallel to the service of process provisions of Rule 4 of the Federal Rules of Civil Procedure. See, 15 U.S.C. 57b-1 (F.T.C.) and 26 U.S.C. 982 (I.R.S.). On October 17, 1986, in a bill extending funding authority for the Commodity Futures Trading Commission, Congress provided the CFTC with authority to serve subpoenas on persons resident outside the United States in connection with fraud or market manipulation cases.

have personal jurisdiction over the defendant, the Commission may file a lawsuit in federal district court for violation of the federal securities laws. In such civil actions, the Commission may obtain information through pre-trial discovery such as depositions, interrogatories and document requests. If parties to an action fail to respond to requests for discovery, the Commission may move for a motion to compel discovery pursuant to Rule 37 of the Federal Rules of Civil Procedure.

In many cases, these procedures have proven efficacious in international investigations. In others, however, the Commission's ability to obtain information located abroad has been limited. Foreign blocking and secrecy laws have presented particularly difficult obstacles in some cases.

4. Blocking Statutes

Blocking statutes enable foreign governments to prohibit or control the distribution of information outside the territorial boundaries of the state. 26/ Blocking laws reflect a legislative decision to protect certain types of information -- most often related to international commerce or trade, national security and economic matters. They often prohibit even voluntary disclosure of information to foreign states and provide civil and criminal penalties for violations.

Blocking statutes vary, depending on the interest which states perceive in information located within their borders.

26/ Countries with blocking statutes include France, the United Kingdom, Canada (Ontario), and Switzerland.

As examples, three statutes are described below.

The Canadian Foreign Extraterritorial Measures Act (Statutes of Canada 1984-1985, C.49) authorizes the Attorney General of Canada to prohibit disclosure of information from Canada, to seize records, to require a person in Canada to give him notice of foreign court compulsion, and to prohibit that person from complying with orders of foreign courts. In order to invoke these powers, the Attorney General must determine that a foreign state or a foreign tribunal has taken or is proposing to take measures affecting international trade or commerce that will adversely affect significant Canadian interests in relation to international trade or commerce involving business carried on in whole or in part in Canada, or that would otherwise infringe Canadian sovereignty. The Act provides for criminal sanctions for failure to comply.

The United Kingdom's Protection of Trading Interests Act ("PTI") of 1980 authorizes its Secretary of State to require a person doing business in the United Kingdom to give notice of any foreign compulsion and to direct that person's response to such compulsion. Like the Canadian statute, it prohibits domestic courts from complying with proscribed foreign orders, and provides criminal sanctions against persons who violate the Act. It differs from the Canadian law in its greater specificity of the actions against which it is directed, but has a similar standard for objectionable foreign conduct.

The effect of the PTI was extended by Parliament in the Financial Services Act of 1986, which provides that the Secretary of State may block the production of documents even where such documents are being provided on a voluntary basis. This provision appears to be a direct response to the approach developed by the Commission whereby stock exchanges agreed, as a matter of contract, to provide each other with access to their files with the understanding that this information could be passed on to regulatory authorities.

The French Law, No. 80-538 of July 16, 1980, forbids French nationals, and certain others with ties to France, from communicating economic, commercial, industrial, financial or technical matters to foreign authorities except as provided by treaty or international agreement. It also prohibits requests for economic, commercial, industrial, financial, or technical information or documents to be used directly or indirectly for proof in court or administrative tribunals, except as provided by treaty or international agreement. Unlike the British and Canadian statutes, the French statute is automatic, and virtually universal in scope.

One decision which evaluated the effect that U.S. courts will give the French statute is Graco, Inc. v. Kremlin, Inc., 101 F.R.D. 503 (N.D. 111. 1984). In Graco, the court observed that:

> compliance with U.S. discovery, even if ultimately effected in the United States, necessarily would involve some activity in France,

> such as gathering documents or information. * * * [Thus], it would not be possible * * * to avoid * * * [the French blocking statute] completely by effecting * * * compliance outside France.

101 F.R.D. at 510. The court also concluded that treaties and international agreements were unavailing to avoid the confict. 27/

5. Secrecy Laws

Secrecy laws establish rights by which individuals may require others to keep secret specific information. 28/ Like blocking statutes, secrecy laws take a variety of forms. They range from statutes that create fiduciary relationships, subject to waiver only by the principal, to statutes investing private confidentiality with a state interest. Two examples of secrecy laws are described below.

Switzerland has both civil and criminal provisions governing secrecy. Banking secrecy is an aspect of the fiduciary relationship between the bank and its customer under Swiss civil law. It extends to any communication with the customer, even where the information concerns third parties. The customer may waive secrecy; the bank will then provide the customer any evidence in its possession for the customer to produce in foreign courts.

27/ The French statute also was at issue in Societe Nationale Industrielle Aerospatiale v. U.S. District Court for the Southern District of Iowa, 96 L.Ed. 2d 461.

28/ Countries with secrecy laws include Switzerland, the Cayman Islands, the Bahama Islands, Lichtenstein and Panama.

In addition, the Swiss Penal Code provides sanctions for persons associated with banks who breach client confidentiality. Similarly, criminal sanctions are available against individuals who disclose manufacturing or business secrets. Most of the criminal provisions characterize the interest in secrecy as being personal to the parties; however, one provision of the Swiss Penal Code describes the release of Swiss banking, manufacturing, or business secrets to a foreign authority as an offense against the state. This provision is inapplicable if the principal is not Swiss. In the event of a refusal by a Swiss principal, secrecy may be waived by a Swiss court.

Two cases illustrate the application of Swiss secrecy law in a U.S. investigation into possibly illegal trading on non-public information. In SEC v. Banca Della Svizzera Italiana, et al., 92 F.R.D. 111 (S.D.N.Y. 1981) (the "St. Joe case"), the Commission was attempting to learn identities of a Swiss bank's customers who had purchased common stock and options in St. Joe Minerals Corp. securities the day before the announcement by Joseph E. Seagrams & Sons, Inc. of a proposed tender offer for all the outstanding shares of that company at a $14 per share premium.

The Commission obtained a temporary restraining order from the federal district court freezing profits derived from the transactions at the U.S. office of Banca Della Svizzera Italiana ("BSI"), the Swiss bank through which the original order had

been placed, based upon: (a) the circumstances of the transactions; (b) the Commission's inability to learn the identity of the purchaser(s); and (c) the need to prevent the profits gained as a result of the allegedly violative transactions from leaving the jurisdiction of a U.S. court. The bank refused to respond to interrogatories or to reveal its customers' identities.

The Commission moved for an order to compel discovery under Rule 37 of the Federal Rules of Civil Procedure. BSI countered that such disclosure would violate Swiss secrecy laws and subject it to civil and ciminal liability in Switzerland. After a hearing on the matter, on November 6, 1981, the court granted the Commission's motion and ordered BSI to disclose its its customer's identities. SEC v. Banca Della Svizzera Italiana, 92 F.R.D. 111, 113, (S.D.N.Y. 1981). Before the court order was signed, BSI obtained a waiver of Swiss secrecy laws from its customers and responded to the Commission's interrogatories. 29/

In SEC v. Musella, et al., 83 Civ. 342 (S.D.N.Y. 1983), the Commission obtained a court order compelling a witness to waive Swiss bank secrecy. Shortly after the insider trading suit against Musella was filed, the Commission wrote to counsel

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29/ The information obtained as a result of the court's decision on the discovery request against BSI ultimately contributed to the Commission's successful action against the foreign purchasers of St. Joe securities in SEC v. Tome, discussed supra.

for Musella requesting that he waive all bank secrecy protections extended by any foreign jurisdiction, including Switzerland. The Commission never received a response to this request. Accordingly, at a deposition the Commission presented Musella with a waiver of all Swiss bank secrecy protections and asked him to sign it. He refused. Thereafter, the Commission sought disclosure of the account information from Musella's Swiss bank, which claimed that Swiss bank secrecy laws prevented its cooperation. The court granted a motion by the Commission to direct Musella to sign the waiver, rejecting his claim that he was protected against such an order by the Fifth Amendment to the U.S. Constitution, which prohibits the compulsion of self-incriminating statements. Musella still refused to sign the secrecy waiver, and, on October 6, 1983, the court held Musella in civil contempt and granted the Commission's motion to draw on adverse factual inference "to the effect that the defendant has an account at Credit Suisse [the Swiss bank]." The court ordered that this inference may be "cured" should Musella agree to permit "appropriate inquiries to be made in Switzerland by the Commission."

When Musella refused to permit such inquiries, the Commission sought the assistance of the Swiss government under the Treaty Regarding Mutual Legal Assistance in Criminal Matters (discussed infra). In June of 1984, Musella was killed in a car accident, without having signed the waiver. The Swiss

Supreme Court ultimately decided that Swiss secrecy laws would not protect the financial privacy of a dead person.

The Bahamas Banks and Trust Companies Regulation (Amendment) Act, 1980 provides for bank secrecy. Persons associated with banks licensed to conduct business in the Bahamas shall not, without the express or implied consent of the customer concerned, disclose to any other person "information relating to the identity, assets, liabilities, transactions [or] accounts of a customer" except under certain enumerated circumstances, e.g., when a bank is lawfully required to make disclosure by any court of competent jurisdiction within the Bahamas or under the provisions of any law of the Bahamas. Disclosure of information without customer authorization or other approval as specified in the Act may result in criminal penalties.

6. The Restatement (Second)

The Restatement (Second) of Foreign Relations Law of the United States, in Section 40, 30/ addresses the appropriateness

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30/ Section 40 reads as follows:

> 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,

(footnote continued)

of a state's exercise of jurisdiction where such an exercise might require conduct inconsistent with the law of a foreign state. The section permits the United States, and its courts, to require a party subject to the jurisdiction of another state to commit an act that may violate the law of the other state if, upon consideration of five separate factors, it is appropriate to do so. This section has been particularly useful in resolving discovery disputes where the foreign state is alleged to restrict production of requested evidence.

For example, in In re Westinghouse Electric Corporation Uranium Contract Litigation, 563 F.2d 992 (10th Cir. 1977), a Canadian company had complied in part with a civil subpoena, but had refused to produce certain evidence on the ground that production would violate Canadian criminal law. The district court held the company in contempt. The Ontario Supreme Court had previously declined to enforce letters rogatory seeking

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30/ (footnote continued)

(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.

some of the same records because, inter alia, enforcement would violate a Canadian public policy statement. Id. at 995. The Canadian company subsequently attempted formally to obtain the permission of Canadian authorities to release the requested evidence, but was unsuccessful. Id. at 998. The Tenth Circuit, citing Section 40 of the Restatement (Second), concluded that "Canada has a legitimate interest in the disclosure of these documents * * *." Id. at 999. Accordingly, that court reversed the order of contempt and vacated the sanctions.

In contrast, in United States v. First National City Bank, 396 F.2d 897 (2d Cir. 1968), the Second Circuit held that West German interests were not entitled to control when the West German government had taken no interest in the discovery, would not allow bank secrecy to block its own criminal investigations, and had not even been approached for protection in the case. There, an American bank contended that it could not produce documents maintained by its foreign branch in West Germany to a grand jury because such production would expose the branch bank to civil liability under German law. However, its good faith was questionable. 31/ After carefully reviewing the factors

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31/ The bank had failed to produce documents subject to the subpoena that would not expose it to civil liability under German law. Moreover, one of the companies subject to the grand jury investigation was also incorporated in New York. Compare United States v. First National Bank of Chicago,

(footnote continued)

set forth in Section 40, and determining that many appeared equally weighted for and against enforcement of the grand jury subpoena, the court concluded that

> [i]f indeed City Bank might suffer civil liability under German law in such circumstances, it must confront the choice -- * * * the need to "surrender to one sovereign or the other the privileges received therefrom" or, alternatively a willingness to accept the consequences.

Id. at 905 (citation omitted).

The application of these principles in the context of the securities law is illustrated by SEC v. Banca della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981), discussed supra. The court's decision in that case turned on the bank's apparent lack of good faith, as well as the Section 40 balancing test, with particular emphasis on the relative significance of the legal interests of the United States and Switzerland. The court

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31/ (footnote continued)

699 F.2d 341 (7th Cir. 1983), in which the court held that an American bank, which provided general descriptive information in response to a tax summons regarding an account maintained in Greece, but which declined to provide exact account information on the ground that criminal penalties could be levied against its Greek employees, may have acted in good faith. That matter was remanded to the district court for consideration of whether it should issue an order requiring the bank to make a good faith effort to receive permission from the Greek authorities to comply with the summons.

observed that, while the use of secret foreign bank accounts and secret foreign financial institutions had "eviscerate[d] the United States interest in enforcing its securities laws * * *", the Swiss government had expressed no opposition to the requested disclosure in the circumstances of that particular case. Id. at 117-18. On this basis the court concluded

> [i]t 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.

Id. at 119.

7. The Restatement (Revised)

The Restatement (Revised) of Foreign Relations Law also addresses discovery practices in Section 437. Although the proposed Section 437, like Section 416, attracted considerable criticism from government commentators, the Reporters made only one clarification in response to governmental criticism that the Section suggests unilateral revisions to the Federal Rules of Civil Procedure: to allow governmental agencies so empowered by Congress to continue to unilaterally exercise their investigatory subpoena power. Originally, the Reporter proposed to override Congressional intent by requiring all agencies to seek court approval for subpoenas for information located abroad.

The principal change that the Section proposes to state and federal rules of procedure is to require all litigation

discovery requests for information located abroad to be issued by the court, rather than by the parties. In addition, the agency or court issuing the discovery or request order would be required before issuance to undertake a special analysis. 32/ The analysis is described as patterned on the provision in

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32/ The Section reads as follows:

Section 437[420]. Discovery and Foreign Government Compulsion: Law of the United States

(1) (a) Subject to Subsection (1)(c), a court or agency in the United States, when authorized by statute or rule of court, may order a person subject to its jurisdiction to product documents, objects, or other information relevant to an action or investigation, even if the information or the person in possession of the information is outside the United States.

(b) Failure to comply with an order to produce information may subject the person to whom the order is directed to sanctions, including finding of contempt, dismissal of a claim or defense, or default judgment, or may lead to a determination that the facts to which the order was addressed are as asserted by the opposing party.

(c) In issuing an order directing production of information located abroad, a court or agency in the United States should take into account the importance to the investigation or litigation of the documents or other information requested; the degree of specificity of the request; whether the information originated in the United States; the availability of alternative means of

(footnote continued)

Rule 26(b)(1) of the Federal Rules of Civil Procedure that allows a court to restrict discovery which is unreasonably burdensome. 33/

32/ (footnote continued)

securing the information; and the extent to which non-compliance with the request would undermine important interests of the United States, or compliance with the request would undermine important interests of the state where the information is located.

(2) If disclosure of information located outside the United States is prohibited by a law, regulation, or order of a court or other authority of the state in which the information or prospective witness is located, or of the state of which the prospective witness is a national,

(a) the person to whom the order is directed may be required by the court or agency to make a good faith effort to secure permission from the foreign authorities to make the information available;

(b) sanctions of contempt, dismissal, or default should not ordinarily be imposed on the party that has failed to comply with the order for production, except in cases of deliberate concealment or removal of information or of failure to make a good faith effort in accordance with paragraph (a);

(c) the court or agency may, in appropriate cases, make findings of fact adverse to a party that has failed to comply with the order for production, even if that party has made a good faith effort to secure permission from the foreign authorities to make the information available and that effort has been unsuccessful.

33/ See Comment a to Section 437.

These provisions are a significant departure from current law, as embodied in Section 40 of the Restatement (Second). Section 40 of the Restatement (Second) is only applicable in the event of a conflict with foreign law. By contrast, Section 437 of the Restatement (Revised) requires no conflict and presumes that all United States discovery of information outside the country from a person subject to the jurisdiction of a U.S. court, even a party litigant, is burdensome and requires limitations. Section 40 of the Restatement (Second) sets forth factors designed to determine the significance in the particular litigation of objections based upon conflicts with foreign law; it places the burden of showing the conflicts and their importance on the objecting party. Section 437 of the Restatement (Revised), instead, implies a shift in the law by placing a significant burden upon the requesting party to make an extraordinary showing in support of its request.

The Reporters suggest that this comprehensive approach restricting all discovery is appropriate because United States document discovery "has given rise to so much friction * * *," stemming both from foreign "dislike of substantive aspects of enforcement of American law * * *," and from "a difference in civil and criminal procedure between the United States and many foreign states." 34/ Section 437, thus, abandons at the

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34/ Reporters' Note 1 to Section 437.

outset the mechanisms for civil discovery contained in the Federal Rules of Civil Procedure, and their state analogues, and requires the court to determine how it would be most politic to apply United States discovery.

In his comment on the Restatement (Revised), the Attorney General of the United States observed that the Revision would usurp the power of the Congress and the Executive to the extent that it would require the courts to make political decisions that substantive or procedural American law should be restricted or not be followed, even if completely applicable. 35/

C. Agreements for the Production of Evidence

During the last several years, the Commission has successfully used existing private agreements, treaties and understandings with foreign countries to complete several of the most significant insider trading cases in the Commission's history. In addition, the Commission has been actively involved in negotiating new agreements with foreign countries to obtain their cooperation in the Commission's enforcement efforts and has participated in programs encouraging greater multinational cooperation in securities law enforcement.

35/ In a letter to the ALI dated November 26, 1985, the Attorney General stated that such choices to waive appropriate United States law "would require U.S. courts to make political decisions, which the U.S. courts are prohibited from doing under the Constitution and which * * * courts are particularly unqualified to make."

1. Private Agreements for the Production of Evidence Intermarket Linkages 36/

As discussed in Chapter V, supra, a number of intermarket linkages and agreements facilitating transnational trading have been established recently. In this regard there has been concern to ensure that these agreements provide protections for U.S. investors and the integrity of U.S. markets. In reviewing rule changes of national securities exchanges developing electronic linkages, for example, the Commission has ensured that adequate arrangements have been made for market surveillance and information sharing for law enforcement purposes.

The experience with Canada demonstrates this process. The Commission's staff has worked closely with the Canadian Provincial securities authorities to develop private contractual agreements between the exchanges providing for cooperation and active sharing of information, and with the Provincial regulatory authorities to provide further assurance of cooperation in enforcement investigations. For example, the Boston Stock Exchange and Montreal Stock Exchange have agreed to cooperate in the investigation of any questioned trades, and to transfer investigatory information to each other or to either governing regulatory authority. The American Stock Exchange and the Toronto Stock Exchange have also agreed to exchange trade and

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36/ Market linkages and attendant surveillance and information sharing agreements are discussed more fully in Chapter V.

market data, and to cooperate in the investigation of any questions arising out of transactions through the linkage.

In addition, the Toronto Stock Exchange and the Ontario Securities Commission have formally assured the Commission's staff that the recently-enacted Canadian blocking statute would not hinder the sharing of information. The Director of the Ontario Securities Commission ("OSC") stated in a letter dated September 24, 1985, to the Directors of the Commission's Divisions of Enforcement and Market Regulation:

> It is extremely unlikely that an order will be issued to prohibit the exchange of information between the OSC and SEC. As insider trading and market manipulation are offences under the Securities Act (Ontario) or the Criminal Code (Canada), it is extremely unlikely that the Canadian Government would have any interest in protecting those who have engaged in such trading. It is important to note that the [Canadian] Federal Government, in enacting the legislation, described it as a "mechanism of last resort" and "clearly designed to protect national sovereignty in exceptional cases." It is difficult to conceive of an insider trading, market manipulation, or other case of improper trading that would fall into that category * * *.

Consents to Jurisdiction

The Commission recently has imposed compliance with the securities laws on foreign entities as a condition of transacting business in U.S. securities markets. The Commission recently granted an exemption from the broker-dealer registration requirements of Section 15(a)(1) of the Securities Exchange Act to certain foreign securities subsidiaries of Citicorp, a U.S. bank holding company. 37/ This exemption, issued on August 14, 1986, was

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37/ See discussion in Chapter V, supra.

specifically conditioned on representations that information with respect to the trading activities of any foreign securities subsidiary will be provided to the Commission upon request. Further, in the event that the Commission requests information regarding trading activity by a customer of a foreign securities subsidiary, Citicorp has undertaken to use its best efforts to obtain, or cause the foreign subsidiary to obtain, the consent of the customer authorizing provision of the requested information to the Commission. The exemption was also conditioned on the representation that Citicorp will cause a U.S. subsidiary to be designated as an agent for service of process.

2. Treaties

The U.S. has four treaties for mutual assistance in criminal matters. The Treaty between the U.S. and the Swiss Confederation on Mutual Assistance in Criminal Matters, 27 UST 2019, done on May 25, 1973 (effective 1977), the Treaty on Mutual Legal Assistance with the Kingdom of the Netherlands, done on June 12, 1981, TIAS 10734, the Treaty with the Republic of Turkey on Extradition and Mutual Assistance in Criminal Matters, done on June 7, 1979, TIAS 9891, and the Treaty Between the U.S. and the Italian Republic on Mutual Assistance in Criminal Matters, Sen. Ex. 98-25, 98th Cong. 2d Sess. The United States has concluded negotiations of mutual assistance treaties in criminal matters with Colombia, Morocco, Canada and the Cayman Islands; however, they have not yet entered into force.

The Swiss Treaty

The 1977 Treaty on Mutual Assistance in Criminal Matters Between the Swiss Confederation and the United States was the first mutual assistance treaty of its kind to which the U.S. was a party. It provides for broad assistance in criminal matters, including assistance in locating witnesses, obtaining statements and testimony of witnesses, production and authentication of business records, and service of judicial and administrative documents.

The Treaty is available only to the governments of the U.S. and Switzerland and is supplemented by six exchanges of letters interpreting certain language used in the provisions in the Treaty. It may be employed during an investigation or after a proceeding has already been initiated. Except for cases of organized crime, the offenses investigated must have dual criminality, that is, be criminal in nature in both the requesting and the executing states.

At consultations between the U.S. and Switzerland in Bern and Washington, D.C. in 1982, the parties agreed in principle to an exchange of diplomatic notes to facilitate the application of the Treaty to offenses which concern trading by persons in possession of material nonpublic information. 38/ Three specific

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38/ The fact that the Commission, which is an administrative agency, is investigating a potential insider trading violation would not preclude application of the Treaty, so long as its investigation is related to conduct which might be dealt with in a criminal proceeding. See Section 32(a) of the Securities Exchange Act, 15 U.S.C. 78ff(a).

antifraud provisions exist in the Swiss criminal law which arguably provide protection similar to the antifraud provisions of the Securities Exchange Act. While these provisions appear to be more restrictive than the U.S law concerning insider trading, they may apply under certain circumstances when a person trades while in possession of material nonpublic information.

The Treaty provides that the state granting assistance may refuse assistance to the extent that the request is likely to "prejudice its sovereignty, security or similar essential interests". Although bank secrecy may be considered an essential Swiss interest, generally, unless the person about whom the information is requested is unconnected with the offense, or the secret itself is of special importance to the Swiss economy, assistance will be granted under the Treaty. Assistance may also be refused if the request has been made for the purpose of prosecuting a person if that person already been acquitted on similar charges in the requested state.

Article 5 of the Treaty provides that information received pursuant to the Treaty, unless otherwise agreed by diplomatic note, must be used as evidence in a criminal proceeding before it can be introduced in a civil proceeding. This provision is the product of the tension which existed between the U.S. position that information furnished under the Treaty should be available for all uses, and the Swiss view that information gained under the Treaty should be used solely for the purpose

for which it was furnished. The Article accepts the Swiss view with respect to limitations on use, with certain exceptions. These exceptions allow for further use of the information, after the requested state is advised of such intended use, where the same subjects are involved. The article also provides for the use of the requested information by the governmental authorities in proceedings concerning "civil damages" or in any continuing criminal investigation covered by the Treaty, provided that such information is not introduced into evidence.

In the exchange of interpretive letters which accompanied the Treaty, the parties agreed that Article 5 is not "intended to restrict the use of information which has become public any more than the use of information which has become public would be restricted in the requested State." In addition, the parties agreed that the limitations of the Article constituted solely an agreement between governments, and could not be used on the part of any person to suppress or exclude any evidence gained under the Treaty. 39/

39/ Nevertheless, some criminal defendants have challenged production of such evidence as a violation of the Treaty. These challenges have been rejected by the courts. See, U.S. v. Johnpoll, 739 F.2d 702, 74 (2d Cir.), cert. denied, 469 U.S. 1075 (1984); U.S. v. Davis, 767 F.2d 1025, 1029 (2d Cir. 1985). The courts also have found the use of such evidence consistent with fairness and due process, since defendants retain the right to challenge the relevance of the evidence, U.S. v. Davis, 767 F.2d at 1030-33.

request did not parallel the three Swiss criminal statutes that might relate to insider trading: harm to a person owed a contractual or legal obligation; fraud to procure personal gain by causing others to harm themselves; or abuse of a business secret by a party obligated to honor it.

The court noted that a person who uses to his advantage information that he is obligated to keep secret, without revealing it to a third party, may not be guilty of abuse of a business secret, since the secret had not been revealed and no profit was realized from the revelation. The Tribunal concluded that, while the trading in the Santa Fe case could violate Swiss law, because the Commission had been unable to allege whether the traders were insiders or tippees, the Tribunal could not make the requisite determination of dual criminality.

The court left open an avenue for a second request, based upon its analysis that while an "insider" could trade while in possession of the nonpublic information, a "tippee" who purchased stock would violate Swiss law. Accordingly, on July 27, 1983, the SEC alleged additional facts in support of its request for assistance under the Treaty.

On May 16, 1984, after all appeals were exhausted by the defendants, the Federal Tribunal, in an unpublished opinion, ruled that the new request adequately demonstrated that the traders were tippees, and not insiders. Accordingly, it granted

the Commission's request and the Commission learned the identities of the purchasers. However, just after these names were revealed, the purchasers appealed the ruling to prevent further disclosures of documents or testimony. This appeal to the Swiss Consultative Commission, the Swiss Justice Minister, and ultimately to the Swiss Federal Council, took nine additional months before it was finally resolved in favor of the Commission. The Commission ultimately received documents responsive to its request three years after its original request.

On February 26, 1986, all remaining defendants agreed to settle the Commission's action and disgorge $7.8 million in profits. Six of the eight defendants consented to the entry of Final Judgements of Permanent Injunction restricting each from future violations of the Securities Exchange Act. The remaining two defendants agreed to disgorge their profits from the transactions at issue.

Another recent example of the SEC's use of the Treaty for purposes of discovery in a suit involving insider trading arose out of SEC v. Banca Della Svizzera Italiana, et al., (see discussion of the St. Joe case, supra). In November 1986, the Swiss Federal Court considered an appeal by the subjects of a Commission request for information relating to trading by Guiseppe Tome and Lombardfin in the securities of St. Joe Minerals just prior to the announcement of a tender offer by Seagrams. The Court summarily dismissed the appeals to deny

Under the Treaty, a request is handled between "Central Authorities," defined as the U.S. Justice Department and the Swiss Department of Justice and Policy. If a request is made to the U.S. and the U.S. Justice Department determines that the Treaty applies, the request will be immediately executed. This is not the case in Switzerland. Concurrently with the ratification of the Treaty, the Swiss passed additional implementing legislation which created specific rights of appeal for those who wish to oppose execution of U.S. Treaty requests. While this additional legislation does not bar the ultimate execution of the request, it has introduced significant time delays in the Treaty request process.

The SEC experience in using the Treaty has been limited, due to the general lack of dual criminality between the U.S. securities laws and the Swiss Penal Code. However, a recent exchange of opinions between the U.S. and Switzerland, and the Swiss Federal Tribunal's opinion in the Santa Fe (discussed below) and other cases, establish that the Commission may request and receive assistance in the area of insider trading from the Swiss.

Two insider trading cases, involving trading through Swiss bank accounts, were completed recently by the Commission using the Swiss Treaty. In SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of Santa

Fe International Corporation, et al., 81 Civ. 6553 (WCC) (S.D. N.Y., November 13, 1981) (the "Santa Fe" case), the Commission sought to learn the identities of certain accountholders who had directed purchases of Santa Fe stock and options through Swiss banks just prior to the announcement of a merger. The banks refused to answer on the ground that to do so would violate Swiss bank secrecy laws. On March 22, 1982, the Commission formally submitted a request for assistance under the 1977 Treaty to the government of Switzerland.

The Unknown Purchasers, utilizing Swiss procedures, opposed cooperation, and on January 26, 1983, the Swiss Federal Tribunal denied the Commission's request. The court accepted the facts as stated in the Commission's request and focused upon whether the allegations constituted a prima facie case of an offense for which assistance could be granted under the Treaty. 40/

The court concluded that the Commission had failed to establish the requisite violations of Swiss law. In particular, the court held that the facts as demonstrated in the Commission

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40/ The Federal Tribunal held that requests by the Commission could properly be processed under the Treaty, despite the fact that the Commission did not have the authority to prosecute them criminally. Because the securities laws may carry criminal penalties and because the Commission has the authority to refer a case for criminal prosecution, the Court held that the Commission's requests were in furtherance of an "investigation" in advance of a possible criminal referral, and thus could be processed under Article 1 of the Treaty.

assistance, confirming the fact that the Treaty applies to requests by the Commission where the dual criminality standard is met. No written opinion has been issued to date.

The Netherlands Treaty

The United States and the Kingdom of the Netherlands entered into a treaty providing for mutual assistance in criminal matters in August 1983. Unlike the 1977 Treaty on Mutual Assistance in Criminal Matters Between the Swiss Confederation and the United States, this Treaty does not have a list of applicable offenses and does not generally require dual criminality. The "assistance" to be provided under the Treaty includes locating persons, serving judicial documents, providing records, taking testimony, producing documents, and executing requests for search and seizure. Assistance may be refused under the Treaty for political offenses or where execution of the request "would prejudice the security or other essential public interests" of the requesting state. Evidence and information obtained under the Treaty may not be used "for purposes other than those stated in the request," but this use restriction may be waived with the prior consent of the executing state.

The Turkish Treaty

The United States and Turkey entered into a treaty providing for mutual assistance in criminal matters in June 1979. That Treaty applies to all offenses which fall within the jurisdiction of judicial authorities of the requesting state. The

"assistance" provided for by the Treaty includes locating persons, serving judicial documents, and effecting the taking of testimony, the production of documents, and the service of process compelling the appearance of witnesses before a court of the requesting state. Assistance may be refused for political or military offenses or where the executing state considers execution of the request "likely to prejudice its sovereignty, security, or other similar essential interests." Use of materials obtained under the Treaty is limited to the purposes of investigations, criminal proceedings, and damage claims concerning the offense which is the subject of the proceeding or investigation in the requesting state.

The Italian Treaty

The Treaty Between the United States and the Italian Republic on Mutual Assistance in Criminal Matters provides mutual assistance in criminal investigations and proceedings concerning a broad range of offenses. A particularly significant aspect of this Treaty is that persons in the requested state may be required by the requested state to appear for testimony in the requesting state where the requesting state certifies that the testimony is relevant and material.

The Canadian Treaty

On March 17, 1985, Canada and the United States entered into a Treaty on Mutual Legal Assistance in Criminal Matters.

It provides for mutual legal assistance in all matters relating to the investigation, prosecution and suppression of criminal offenses. The Canadian Treaty does not require dual criminality and specifically provides for assistance with regard to securities offenses under Canadian Provincial law or the law of the United States. The "assistance" to be provided includes locating persons or objects, serving documents, taking testimony, providing documents and records, and executing requests for searches and seizures. A significant aspect of this Treaty is that there are virtually no limitations on the use of evidence obtained through its processes.

The Cayman Islands Treaty

On July 3, 1986, the United States entered into a Treaty with the Government of the United Kingdom of Great Britian and Northern Ireland and the Cayman Islands providing for mutual cooperation between the U.S. and the Cayman Islands in criminal investigations and prosecutions that involve offenses punishable by more than one year's imprisonment under the laws of either country. The Cayman Islands are a British Crown colony; therefore, this Treaty will not be effective until ratification by both the British Parliament and the U.S. Senate. The Treaty authorizes cooperation with respect to specific crimes, including but not limited to, insider trading, fraudulent securities practices, racketeering and failure to report international

currency transfers or financial transactions in connection with any criminal offense covered by the Treaty as required by law. Mutual assistance to be provided under the Treaty includes the taking of testimony, provision of documents, records, and articles of evidence, serving documents, locating persons and immobilizing criminally obtained assets.

The Treaty contains several limitations on assistance. For example, assistance will not extend to conduct not punishable by imprisonment of more than one year. Assistance also may be denied where the request does not establish that there are reasonable grounds for believing that the specified criminal offense has been committed, or where execution of the request is contrary to the public interest of the requested party.

3. Memoranda Of Understanding

The Swiss Memorandum

On August 31, 1982, the governments of Switzerland and the U.S. announced the signing of a Memorandum of Understanding (MOU) with respect to problems of insider trading. The MOU recognizes the availability of the 1977 Mutual Assistance Treaty for insider trading litigation and investigations. For those cases in which necessary information cannot be obtained under the Treaty, however, the MOU refers to a private agreement among members of the Swiss Bankers' Association who trade on U.S. securities markets concluded under the aegis of the Swiss Bankers' Association.

Under the MOU the signatory banks, under certain circumstances, may disclose the identity of a customer and furnish information to the Commission, working through the Swiss Federal Office for Police Matters, without violating Swiss law. The private agreement, known as Convention XVI of the Swiss Bankers' Association, will remain in effect until the Swiss government revises its penal and civil laws to include insider trading. Such efforts are presently under way, and legislation has been presented to the Swiss Parliament.

The private agreement provides that its procedures will be available if, within 25 trading days prior to a public announcement of a proposed merger, similar business combination, tender offer or other acquisition, a customer gives to a bank an order to be executed in the U.S. securities markets for the purchase or sale of securities or call options or put options for securities of any company that is a party to a business combination or the subject of an acquisition. Under such circumstances the Commission may transmit a request for assistance to a three-member commission of inquiry appointed by the Swiss Bankers' Association. The Swiss commission will examine the request and determine whether certain basic thresholds are met and whether sufficiently suspect circumstances are presented.

Upon receipt of the request from the Swiss commission, the bank will freeze the relevant customers' accounts up to the amount of the profit realized in the transaction, inform the

customer, and give the customer an opportunity to respond to the allegations contained in the request. Within 45 days, the bank will then forward the requested report to the Swiss commission. The Swiss commission then forwards the report to the Federal Office for Police Matters for transmission to the SEC. In the event that the bank's report establishes, or the customer independently establishes, to the reasonable satisfaction of the Swiss commission, that the customer did not make the purchases or sales that are the subject of the SEC's request, or if the commission determines that the customer is not an insider under a definition provided in the private agreement, 41/ the Federal Office for Police Matters will not transmit the report to the SEC.

The MOU provides that information gained pursuant to the private agreement can be used only by the SEC and the Department of Justice and will not be disclosed "to any other administrative body in the United States or to the public, except to the extent necessary for administrative or judicial purposes of the specific case."

41/ The private agreement defines an insider as a member of the board, an officer, an auditor or a mandated person of the company or an assistant of any of them; or (b) a member of a public authority or a public officer who in the execution of his public duty received information about the company; or c) a person who on the basis of information about an Acquisition or a Business Combination received from a person described in (a) or (b) above, has been able to act for the latter or to benefit himself from inside information.

The Commission recently used the MOU, for the first time, in a civil action. Securities and Exchange Commission v. Harvey Katz, Marcel Katz, Elie Mordo, and Fred Aizen, Civil Action No. 86 Civ. 6088 (S.D.N.Y., 1986), involved allegations of insider trading in the securities of RCA Corporation. The Commission's complaint alleged that Marcel Katz obtained material, nonpublic information relating to a merger between RCA and the General Electric Company in the course of his employment as an analyst at Lazard Freres & Co. Marcel Katz, it was alleged, subsequently disclosed this information to his father, Harvey Katz. The complaint further alleged that Harvey Katz disclosed this information to Elie Mordo, who resides abroad, and Fred Aizen, Katz's stockbroker. Mordo allegedly purchased 100,000 shares of RCA stock through a Swiss bank, Union Bank of Switzerland.

The Commission used the 1982 Memorandum of Understanding between the United States and Switzerland and Convention XVI of the Swiss Bankers' Association to identify defendant Mordo as the purchaser of RCA common stock through the Geneva office of the Union Bank of Switzerland. The Commission's request was reviewed by the Bankers' Association, the Swiss Federal Tribunal (Swiss Supreme Court) and the Swiss Federal Council, all of which affirmed the Commission's right to obtain the evidence sought. During these deliberations, the profits which Mordo later disgorged in the U.S. civil action were frozen pending a final resolution of the case in Switzerland.

In consenting to injunctions, Harvey Katz agreed to disgorge $1,035,425 and to pay a civil penalty of $2,111,168 pursuant to the Insider Trading Sanctions Act of 1984. Marcel Katz agreed to pay a civil penalty of $173,891 under the ITSA. Mordo consented to disgorgement of $1,087,532 and Aizen consented to pay $60,000 and to pay a civil ITSA penalty of $20,000.

The assistance available through the Convention, and the mechanism for obtaining that information, is specifically tailored to the securities enforcement issue it was negotiated to address: insider trading. While the Convention is limited to certain types of insider trading and provides only specified assistance, it has been effective, as evidenced by the speed with which assistance was furnished in the Katz case (approximately seven months). Because it is applied by a Swiss commission which is sensitive to both the needs of the SEC and the privacy concerns of a bank customer, it can produce a disinterested view of the evidence, reducing the ability of a party to abuse the process.

Case-by-case Agreements

Where the Commission must seek evidence from countries with which no formal understanding has been negotiated, it may approach the government of that country through the U.S. State Department, requesting assistance for a particular case. While this case-by-case approach is not optimal, it provided the Commission with evidence in one of its most important cases.

In In the Matter of Guaranty Trust Co. Ltd., Supreme Court of the Bahamas No. 423 (May 22, 1985), the Commission sought a court order requiring the production of evidence relating to the identity of customers of a Bahamian bank who had purchased securities just prior to a merger announcement. The Commission argued that a securities transaction was not a banking transaction pursuant to Bahamian law and that therefore the Bahamian secrecy law should not be applied to shield the customers' identity. The case was dismissed on the ground that the Commission's action sought an advisory opinion. On July 4, 1986, the Commonwealth of The Bahamas Court of Appeal affirmed the dismissal of the SEC's case for lack of standing.

While this attempt to obtain a court order for release of the information in the Guaranty Trust case was unsuccessful, it laid the groundwork for success in one of the Commission's largest insider trading cases to date, SEC v. Dennis Levine, et al., 86 Civ. 3726 (RO) (S.D.N.Y. 1986). In that case, the Commission's enforcement staff worked with the Bahamas Attorney General to obtain documents from Bank Leu International ("BLI"), a financial institution located in the Bahamas, that arguably were shielded from disclosure under the Bahamian bank secrecy laws. BLI turned over the requested information to the Commission after the bank received written assurances from the Bahamas Attorney General that criminal penalties would not result from a release of documents pertaining to Levine's securities transactions. The information from BLI greatly assisted the Commission

in its civil case against Levine, who settled the action by consenting to a permanent injunction against future violations of the federal securities laws, and by agreeing to disgorge $11.6 million and to cooperate with the Commission in related investigations.

The U.K. Memorandum

On September 23, 1986, the Commission and the Commodity Futures Trading Commission entered into a Memorandum of Understanding with the U.K. Department of Trade and Industry which, on a reciprocal basis, will provide assistance in obtaining records that are in the hands of the other, or that can be obtained through the best efforts of the parties to the MOU.

The U.K. MOU is intended to enhance international enforcement of both countries' securities laws by providing assistance for investigations of violative conduct within each authority's jurisdiction as well as for regular market oversight. Specifically, the MOU makes assistance available in matters involving insider trading, market manipulation and misrepresentations relating to market transactions. The MOU also provides for exchange of information in matters relating to the oversight of the operational and financial qualifications of investment businesses and brokerage firms.

The U.K. MOU is the first accord negotiated by the Commission that provides assistance for a broad range of matters relating

to market conduct and regulation of investment businesses. Use of the information received under the agreement is generally limited to prosecuting securities offenses or to a general charge (i.e., mail and wire fraud) related to an underlying securities law violation.

The U.K. MOU provides special safeguards to ensure that assistance is properly invoked. Requests must be made with particularity. When questions arise as to the MOU's operation, consultations between the parties are mandated by the agreement. Finally, at the conclusion of the matter in question and to the extent permitted by law, all documents not previously made public will be returned to the other authority.

The U.K. MOU establishes the first working arrangement between securities regulators in the U.S. and the U.K. It is an interim arrangement which both parties describe as a first step in their efforts to establish a comprehensive understanding to provide bilateral cooperation relating to securities regulation. The MOU expressly provides for the initiation of negotiations by September 22, 1987.

The Japanese Memorandum

On May 23, 1986, the Commission and the Securities Bureau of the Japanese Ministry of Finance executed a memorandum in which the agencies "agreed to facilitate each agency's respective requests for surveillance and investigatory information

on a case-by-case basis." The memorandum appointed a specific contact person in each agency to ensure timely processing of requests.

The Hague Convention

In addition to arrangements with individual countries, the Commission has used the Hague Convention on the Taking of Evidence Abroad. Although the Treaty encompasses three of the most common devices for foreign discovery: letters rogatory, evidence-taking by a counsular official, and private commissioners, these methods have been of limited utility to the Commission. The Hague Convention can only be used in connection with litigation, and not investigations. Moreover, most of the signatory nations have exercised their prerogative, under Article 23 of the Hague Convention, to refuse to execute letters rogatory for the purpose of pre-trial discovery of documents. 42/

42/ On February 10, 1987, however, France modified its declaration regarding Article 23 as follows:

> The declaration made by the French Republic in accordance with Article 23 relating to Letters of Request issued for the purpose of obtaining pre-trial discovery of documents does not apply when the requested documents are enumerated limitatively in the Letter of Request and have a direct and precise link with the object of the procedure. (Translation)

Even where the Hague Convention is available for pretrial discovery of testimony, the requester must establish that the requested evidence is "relevant" to trial. This is a burden which is often difficult to meet at the early stages of U.S. litigation, where the evidence sought is not necessarily direct evidence which proves violative conduct, but rather, evidence which may lead to such proof.

In the Santa Fe case, discussed supra, the Commission sought documents and testimony pursuant to the Hague Convention from third parties resident in London. These third parties included a hotel, a credit card company and two individuals who had acted as stockbrokers for purchasers of Santa Fe securities just prior to the announcement that Santa Fe had agreed to merge with Kuwait Petroleum Corporation. The hotel, credit card company and individuals had all refused to provide the evidence voluntarily on the grounds that without a court order or subpoena they owed a duty of confidentiality to their customers.

The Commission sought and received letters rogatory in a U.S. court seeking assistance from England pursuant to the Hague Convention. Upon presentation of this request, an English Master granted the Commission's request and ordered the evidence to be given. Accordingly, the credit card company and hotel produced the documents sought. However, the two individuals refused, arguing that the request was improper under the terms of the Hague Convention and that should they give testimony,

they would violate the Luxembourg bank secrecy law because, at the time the purchases were made, they were employees of a London-based Luxembourg bank.

Seven months later, after extensive briefing and four days of oral argument, the High Court of Justice, Queens Bench Division, ordered the two individuals to testify. Reprinted in: 34 Int'l Legal Materials 511 (1984). The court held that the information was relevant, based upon affidavits submitted by the Commission, and that it was sought for a civil prosecution, as provided for in the Foreign Evidence Act. The court refused to give effect to the Luxembourg privilege which had no parallel in British law. Finally, the court held that British bank secrecy laws would not apply because, based on the facts of the case, such an application would not be in the public interest.

Athough the Commission was ultimately successful in obtaining the requested evidence, the British Santa Fe application for letters rogatory cost the SEC thousands of dollars in staff time and fees paid to foreign counsel and took nine months to complete.

The Commission also used the Hague Convention to gather evidence for trial of the Sante Fe case from a central witness residing in France who, the Commission had learned, had been with a defendant at or near the time that the defendant had traded Santa Fe securities. In the Matter of the testimony

of Costandin Nasser, Tribunal admin. de Paris, 6'eme section - 2'eme chamber, No. 51546/6, December 17, 1985.

The Commission initiated the process on June 2, 1983, by motion to a U.S. district court for issuance of letters of request under the Hague Convention for assistance from the courts of France. The Commission's motion was granted and the subsequent request was granted by the French Ministry of Justice on August 26, 1983. Upon granting the request, the Ministry of Justice transmitted it to a civil investigating judge who was authorized to gather the requested evidence.

On January 18, 1984, the civil judge who had received the Commission's letter of request convened a hearing on the execution of the request. However, as the witness did not appear, the Commission sought imposition of a fine. The judge reserved ruling on this question, stating that he would have the witness served again for a further hearing. The witness then filed a brief ("recours gracieux") with the French Ministry of Justice protesting the procedure by which his evidence was being sought and requesting an administrative review of the Ministry of Justice's decision to transmit the request. Thereafter, on September 26, 1984, the Ministry of Justice confirmed its initial decision and instructed that the proceedings go forward.

On January 25, 1985, a second proceeding was held at which time the witness appeared though counsel. In the meantime,

however, the witness had filed a "recours contentieux" (request for review by an administrative court) against the initial decision by the Ministry of Justice to transmit the letters of request, as well as its confirmation on September 26, 1984. Since such a request did not stay the action, the Commission again sought imposition of a fine against the witness for his failure to appear. The civil judge again deferred this decision for consideration at a time after the administrative court ruled.

On December 17, 1985, the Administrative Court confirmed the Commission's right to obtain the evidence sought under the Hague Convention. However, by that time the Commission was engaged in settlement negotiations and it was determined that the request should not be pursued. The underlying enforcement action was resolved by entry of a consent injunction on February 26, 1986.

In SEC v. Banca Della Svizzera Italiana, 81 Civ. 1836 (MP)(S.D.N.Y.), the SEC sought documents and testimony pursuant to the Hague Convention in Italy and Guernsey. The U.S. district court issued letters rogatory to the Ministry of Foreign Affairs of Italy requesting the production of documents by an SEC registered broker-dealer located in Milan, Italy, and certain individuals affiliated with that broker-dealer. By decree of the court of appeals of Milan, dated September 10, 1985, the letters rogatory were authorized and directed to be carried out on October 2, 1985.

At the proceedings in the Praetor's Court of Milan, lawyers for the witnesses objected to the letters rogatory, arguing that the pending action in the U.S. was an administrative proceeding, not a civil action, and, therefore, that the letters rogatory did not comply with the Hague Convention. The Praetor concluded that the U.S. proceeding was a civil action, as required by the Hague Convention, and ordered the implementation of the letters rogatory. The witnesses then responded to questions put by the Praetor. The Praetor, however, refused to compel the witnesses to produce the requested documents because under the Italian law implementing the Convention such compulsion is unavailable. Nonetheless, he "invited" the witnesses to produce the requested documents.

The U.S. district court also issued letters rogatory to the Bailiwick of Guernsey, Channel Islands, requesting the production of documents and the testimony of an individual employed by a Guernsey banking institution. By order of the Guernsey Court, the witness was to appear and produce documents. On October 7, 1985, the witness filed a motion to set aside the order, arguing that the U.S. proceeding was administrative and not civil and that request was for pre-trial discovery and thus not allowed in accordance with Guernsey's reservations to the Hague Convention. On March 11, 1986, the Deputy Bailiff of Guernsey denied the Commission's request for assistance on the grounds that because the Commission sought testimony relating

to identities of persons involved in securities transactions, the inquiry was a "fishing expedition." On April 10, 1986, the Commission appealed this order. On July 15, 1986, upon motion by the Commission, this matter was dismissed as moot in view of the fact that the Commission had prevailed in the underlying U.S. litigation.

Thus, while the Hague Convention has proven useful, its procedures are costly and time consuming. As a result, the Commission's enforcement staff prefers to use specific bilateral and multilateral mutual assistance agreements or memoranda of understanding. Thus, the Supreme Court's decision this term in Societe Nationale Industrielle Aerospatiale and Societe de Construction d'Avions de Tourism v. United States District Court for the Southern District of Iowa, 94 L.Ed 2d 461 (1987), is significant for the Commission. In this case, the Supreme Court held that the Hague Convention does not provide the exclusive mechanism for obtaining evidence located abroad. Moreover, even where it is asserted that American discovery methods would violate a foreign nation's law or policies, principles of comity do not require that the Hague Convention be the mechanism of first resort to obtain evidence abroad. Rather, comity requires the courts to consider the availability of the Hague Convention as an alternative means of obtaining discovery and to attempt to accommodate the foreign interests giving due regard to the likelihood that the Convention will produce efficient and effective discovery under

the circumstances of the particular case. 43/ The Court's opinion is consistent with the position taken by the Commission and the United States as amici curiae.

4. Other Initiatives

Outside of particular agreements, the Commission participates in several groups concerned with the internationalization of the securities markets and attendant enforcement problems. The Commission is a member of the International Organization of Securities Commissions ("IOSC"). The IOSC was established over eleven years ago as the Inter-American Association of Securities Commissions and Similar Organizations. In an effort to facilitate discussion among a broader base of securities regulators, the Organization has expanded its membership to include regulators from all over the world. At the suggestion of former SEC Chairman Shad, the IOSC at its 11th annual meeting in July

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43/ Many countries are not signatories to the Hague Convention so that the Commission must use letters rogatory, a more formal request for assistance, to obtain evidence. Such a procedure is used when seeking evidence from Canada. For example, in SEC v. Cayman Islands Reinsurance Corp., 82 Civ. 1166 (WCC), S.D.N.Y. and R.E. 2792/82 (S. Ct. Ont. (Oct. 25, 1982), see also, 551 F. Supp. 1056 (S.D.N.Y. 1982), the Supreme Court of Ontario executed letters rogatory issued by the federal district court in New York, requiring a witness to appear before a Canadian Examiner to be deposed by U.S. counsel and to produce subpoenaed documents. However, the Ontario court order stated that while the examination would be conducted in accordance with U.S. rules of evidence, the witness remained entitled to invoke objections under the Ontario and Canada Evidence Acts.

set up five working groups in the following areas:

1. Exchange of information concerning the enforcement of the securities laws;

2. Acceleration of clearing and settlement systems;

3. Access of foreign issuers, brokers-dealers, and investors to national markets;

4. Growth of developing nations' securities markets; and

5. Modernization of prospectuses.

The Commission chairs the working group relating to the exchange of enforcement information.

In November of 1986, the Executive Committee of the IOSC adopted a Commission proposal relating to cooperation among securities commissions. That resolution provides:

> Considering the increasing international acvitity in the securities markets;
>
> Recognizing the need to enhance investor protection through both oversight of the internationalized markets and securities-related businesses as well as through enforcement of national securities laws with respect to international transactions;
>
> Desiring to develop new mechanisms for mutual cooperation and assistance among securities authorities;
>
> NOW THEREFORE BE IT RESOLVED THAT the Executive Committee of the International Organization of Securities Commissions ("IOSC") hereby calls upon all securities authorities:
>
> a) to the extent permitted by law, to provide assistance on a reciprocal basis for obtaining information related to a market oversight and prosecution of each nation's markets against fraudulent securities transactions;

b) to designate a contact person(s) who will insure the timely processing of all requests for assistance.

The resolution has now been submitted to the membership for consideration.

The Commission has also been a participant in matters at the Organization for Economic Cooperation and Development ("OECD"), including discussions relating to international evidence gathering and an examination of obstacles faced by foreign organizations seeking to participate in the financial services industry. Last fall the Commission proposed that the OECD Working Group on International Investment Policies of the Committee on International Investmesnt and Multinational Enterprises initiate a survey of all member countries concerning mutual assistance and cooperation in securities enforcement matters. The first phase of this program, the circulation of a questionnaire, is currently under way. The information gathered through this process should prove useful in continuing efforts to develop new mechanisms in the area of mutual legal assistance.