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INTERNATIONAL LEGAL ASSISTANCE IN SECURITIES LAW ENFORCEMENT

**REMARKS TO SEMINAR ON SWISS CAPITAL MARKET LAW --
STATUS AND PERSPECTIVES**

**MICHAEL D. MANN, CHIEF
OFFICE OF INTERNATIONAL LEGAL ASSISTANCE
DIVISION OF ENFORCEMENT
U.S. SECURITIES AND EXCHANGE COMMISSION**

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I. Introduction

Securities trading is entering a revolutionary period as national markets become increasingly internationalized. Bankers, brokers and investors, all in search of markets which trade the broadest variety of securities and which are always open for business, are playing a key role in promoting this transition. The U.S. securities markets, the largest in the world, are increasingly affected by these changes.

As internationalized markets develop, we must not allow the desire for development to distract from consideration of the need for protecting those markets from fraud. Conflicts of law which currently frustrate enforcement efforts must be resolved. New means must be developed to investigate and prosecute those who transact business from abroad in violation of national securities laws. Cooperation holds the key to any solution.

This paper will:

- describe the enforcement challenges posed to the SEC by internationalization;
- discuss the conflicts which exist between SEC enforcement efforts and foreign evidence gathering laws;
- comment on the adequacy of available approaches for obtaining evidence abroad;
- propose new approaches for resolving the current situation.

II. Developments in International Securities Trading

Foreign participation in the U.S. securities markets has been on the increase for the past decade. During 1984, the dollar volume of trading in U.S. equity securities by foreign investors was \$123.7 billion, compared to \$75.4 billion in 1981. 1/ In

1984, Swiss participation in the U.S. market accounted for almost one-sixth of foreign trading, over \$20 billion. 2/

Because of the rapid development of computer capabilities and recent advances in telecommunications, the securities markets are more accessible than ever to the world's citizens. The capacity of brokers and the markets to handle daily trading volumes of over 100 million shares is now taken for granted. Orders can be placed and paid for in seconds in markets which are thousands of miles away from the ultimate customer's or his broker's location.

However, this revolution will go far beyond the already established system of communications where investors electronically enter a foreign market. Formal electronic linkage of the markets is the next step. The SEC has already approved such linkages between the Montreal Stock Exchange and the Boston Stock Exchange and between the Toronto Stock Exchange and the American Stock Exchange. Speculation now is focused upon the possible establishment of a link between London and the New York Stock Exchange. Such links will further increase international participation in "world exchanges."

Market forces are driving the development of international securities markets. As momentum for internationalization builds, pressure will mount for the development of reciprocal listing and registration requirements, and consolidated reporting for securities with multiple listings. Combined, these changes will provide opportunities for legitimate investors and, unfortunately, for criminals as well. However, today, the development of international enforcement capabilities to respond to the

new market structure is lagging. Such new mechanisms must not be ignored.

III. Information Requirements and Restrictions

While the vast majority of transnational transactions are legitimate, the multi-jurisdictional nature of such transactions can be abused by securities law violators who attempt to conceal evidence of their activities from enforcement authorities. As a result, the SEC increasingly must seek access to information outside its borders. In many instances, the SEC confronts a highly restrictive system where access to foreign-based evidence is foreclosed because it is maintained within a sovereign's territorial boundaries. In this regard, secrecy and blocking laws, which have important and legitimate underpinnings, can inhibit disclosure of evidence critical to SEC investigations. 3/ This may occur without regard to the fact that the information sought is evidence of a securities fraud.

Evidence gathering rules vary from jurisdiction to jurisdiction. U.S. rules allow the broadest latitude for compelling the production of evidence for litigation or administrative inquiry. 4/ U.S. rules do not allow for uncontrolled "fishing expeditions." The objective of these rules is to narrow and clarify issues for trial and encourage settlements. Conflicts between U.S. and foreign rules occur because the documents or evidence which the SEC seeks pursuant to U.S. rules may be outside the scope of allowable discovery within the foreign nation. In such instances, SEC efforts can be totally frustrated.

No method exists for resolving this conflict of laws. There is no logical manner in which the conflict can be untangled, once it occurs. Only through compromise will a solution be found. But both sides must compromise.

To understand how a reasonable and acceptable compromise might be reached, one must examine the conflicting interests which have stimulated the development of laws restricting discovery, on the one hand, and securities law enforcement on the other. Although conflicts between these laws often occur, the interests which have motivated their development are not inconsistent. As a result, this analysis may provide a logical framework for improving international legal assistance.

IV. Comparing Interests: Securities Laws v. Discovery Restraining Statutes

A. U.S. Securities Laws

The U.S. securities laws prohibit market participants from engaging in deceptive, manipulative or fraudulent practices in connection with purchases and sales of securities. Disclosure to investors of information material to their investment decisions is the cornerstone of the U.S. securities laws.

The SEC was established to enforce the U.S. securities laws. It is authorized to investigate possible violations of those laws and, where appropriate, to bring lawsuits to enforce them.

Most SEC lawsuits are preceded by an investigation conducted by the Commission staff for the purpose of determining the full facts and circumstances regarding a questionable securities transaction. No person or entity is accused of wrongdoing at this initial stage.

Based upon the investigative record developed, the Commission makes a decision whether a violation of the law has occurred and should be prosecuted in U.S. Court.

The scope of formal SEC investigations is defined and limited by Orders issued by the SEC. The Orders grant designated SEC staff members the authority to issue administrative subpoenas compelling the production of relevant documents and testimony. The U.S. securities laws provide that through an administrative subpoena the SEC may require the production of documentary and testimonial evidence "from any place in the United States or any State." 5/ U.S. courts have held that this provision allows production of evidence from abroad where the necessary nexus with the U.S. can be established. 6/

The U.S. securities laws and regulations govern transactions executed on U.S. securities markets, whether or not the person originating the transaction is physically located in the U.S. Similarly, the U.S. securities laws and regulations govern reports and financial statements filed with the SEC by multinational corporations, including the financial statements of foreign subsidiaries which are consolidated into the financial statements of the multinational parent.

The integrity of the U.S. securities markets is threatened when investors, wherever they are physically located, fraudulently trade in the U.S. securities markets, or when companies provide materially misleading financial information to investors in those markets. Other traders are damaged by the unlawful conduct, and the confidence of all participants in the markets is weakened when the rules governing the markets are not obeyed.

The U.S., and all other countries which host securities markets, have an overwhelming national interest in applying their laws to all participants in those markets. In an age in which investment funds flow quickly and easily among the capital markets of our respective nations, law enforcement with respect to those markets should not be stymied by territorial borders.

B. Discovery Restraining Laws

Blocking laws, which inhibit evidence gathering for use in foreign tribunals, often reflect a national commitment to limit foreign "fishing expeditions." Secrecy laws reflect a commitment to the preservation of fiduciary relationships. Further, while foreign discovery rules do not explicitly limit the types of evidence which may be sought, they delineate prerequisites for seeking evidence which are tailored to their nations' national legal systems. As a result they reflect national policy regarding the manner in which litigation should be conducted.

While these laws may restrict the SEC in its evidence gathering efforts, they do not restrict the efforts of a local prosecutor investigating similar conduct. For example, France has a blocking law which would prevent the SEC from obtaining evidence in France in support of an insider trading case involving a French transaction on the New York Stock Exchange. However, if the conduct had taken place on the Paris Bourse, a French prosecutor could investigate the case and obtain all evidence it needed in France. Similarly,

in Switzerland the SEC cannot obtain evidence directly from a bank in Switzerland for an investigation involving false disclosures by a U.S. corporation which concerns a Swiss based transaction. However, a Swiss investigating magistrate would be able to obtain the needed documents for his own investigation, despite the fact that they were protected by secrecy laws. Finally, in countries with restrictive discovery rules the SEC has been unable to obtain access to documents unless it could identify those documents with "particularity", an impossible task when first initiating a fraud investigation, where the evidence of the crime is in the possession of the wrongdoer. However, in England, for example, the British Secretary of State for Trade and Industry has the ability to open a special inquiry and appoint an inspector who has power to obtain access to documents, free from these "relevance" restrictions. 7/

C. Need for New Approaches to Evidence Gathering

I do not suggest that because a national authority has the power to obtain evidence pursuant to its local law, a foreign authority should be given similar latitude. Yet the present system of rigid restrictions is equally unacceptable.

All nations share an interest in the maintenance of fair, secure and accessible securities markets. Most nations with securities markets apply common principles for ensuring that their markets are fair. While the degree of regulation may vary from country to country, no nation condones fraud.

We should build on the mutuality of interest and common regulatory scheme by exploring the degree to which foreign nations can

assist each other in obtaining evidence with respect to securities law enforcement. Further, we must begin to explore the development of methods which could enhance the assistance which is available today. The prospect of efficient worldwide securities markets demands no less.

The problems encountered by the United States in evidence gathering may be novel today. However, as the internationalized market expands, they will become more frequent and will be felt by a broader spectrum of countries.

The only agreements presently in place for gathering evidence abroad are multinational agreements such as the Hague Convention, bilateral agreements specifically governing assistance in criminal matters, and letters rogatory. However, while these agreements have proven useful in several situations, they do not provide the type of comprehensive scheme for evidence gathering which increasingly will become necessary for policing the internationalized securities markets. New arrangements for obtaining assistance need to be developed to ensure that all nations can obtain the information necessary to enforce their securities laws and to maintain the integrity of their securities markets.

V. Present Mechanisms for Obtaining Evidence

A. The Hague Convention and Letters Rogatory

Both the Hague Convention on Evidence Gathering and letters rogatory provide useful mechanisms for obtaining evidence from neutral witnesses. They are generally available to the SEC, however, only after a civil lawsuit has been filed in a U.S. District Court. Most often, the SEC needs foreign cooperation to obtain

evidence and complete an investigation before commencing such a lawsuit.

The limitations placed upon foreign discovery often are so extensive that efforts to obtain evidence by litigants such as the SEC are frustrated. Many nations agreed to the Hague Convention on the condition that no "pretrial" discovery may take place pursuant to Convention procedures. Thus, unless a document or testimony can be shown to be relevant for trial, production cannot be compelled. Further, the British House of Lords in the Westinghouse and Asbestos cases has taken a highly restrictive view of what documents may be produced for U.S. litigation. 8/ This is a burden which is often impossible to meet in the early stages of litigation where the evidence sought is in fact the direct evidence which proves the violative conduct. Similarly, the SEC has found that it is difficult to obtain evidence pursuant to letters rogatory with either speed or certainty.

The Santa Fe case illustrates the types of evidence which the SEC seeks in its cases as well as the usefulness and limitations of the Hague Convention. 9/ In the Santa Fe case the SEC alleged that certain persons had illegally taken advantage of knowledge of the merger plans by purchasing Santa Fe securities. The SEC sought documents and testimony pursuant to the Hague Convention from third party witnesses residing in London. These witnesses included a hotel, a credit card company and two individuals who had acted as stockbrokers for purchases of Santa Fe International Corporation ("Santa Fe") securities just prior to the announcement that Santa Fe had agreed to merge with Kuwait Petroleum Corporation.

The documents sought from the hotel related to a purported visit and the use of telephones at the hotel by officers of Santa Fe as well as one of the defendants in the case. Such records might have shown whether the officers had been staying at the hotel at the same time as the defendant. Further, the telephone records might have identified the source of any leaks regarding merger negotiations. Similarly, the credit card records would have reflected the activities of one of the defendants during the time he was purchasing Santa Fe securities. Using the defendant's credit card and charge slips, it was believed that circumstantial evidence linking that defendant with other defendants and events could be established.

Finally, the SEC sought documents and testimony from the two individuals to learn the details concerning the Santa Fe purchases which they had made and to determine the identities of their customers. Further, these two individuals were formerly employed by several of the defendants in the action and the SEC wished to question them about their knowledge of those defendants' purchases of Santa Fe securities.

When asked to voluntarily provide the evidence sought, the hotel, credit card company and two individuals all refused on the grounds that without a court order or subpoena they owed a duty of confidentiality to their customers. Because none of the witnesses had contact with the U.S., a U.S. court subpoena would have been difficult to serve, much less enforce. However, the

matter was already in litigation. As a result the SEC had an alternative: the Hague Convention on Taking Evidence Abroad.

On July 25, 1983, the Commission sought and received an Order in U.S. Court seeking assistance from England pursuant to the Hague Convention. Upon presentation of its request, an English Master granted the SEC's request and ordered the evidence be given. Accordingly, the credit card company and hotel produced the documents sought. However, the two individuals refused, arguing that the SEC's requests were improper under the terms of the Hague Convention and that their testimony would violate Luxemburg bank secrecy law because at the time the purchases were made, they were employees of a London-based Luxemburg bank.

Seven months later, on February 23, 1984, after extensive briefing and four days of oral argument before the Honorable Mr. Justice Drake, the High Court of the Justice, Queens Bench Division, ordered the two individuals to testify. 10/ The Court rejected both of the witnesses' arguments, holding that the SEC sought relevant testimony for trial and that under the circumstances a foreign secrecy law should not preclude such testimony in England. 11/ Two months later the testimony was taken and critical evidence was obtained to support the SEC's case.

The use of The Hague Convention was a success in the Santa Fe case. Yet, it cost the SEC thousands of dollars in attorneys fees and staff time and took nine months to complete the process. Such expenses cannot be borne regularly by any agency of government. Further, the delays attendant to the process result in great prejudice to the SEC; documents may be lost or destroyed and memories

of critical events fade. 12/ Finally, unlike most SEC cases, the Santa Fe case was in litigation when the request for assistance was made. Had the matter merely been under investigation, the Hague proceeding would not have been available.

B. Bilateral Treaties

The U.S. has three treaties for Mutual Assistance in Criminal Matters 13/ and is making substantial efforts to negotiate with many other countries. 14/ The U.S. securities laws provide criminal penalties in addition to civil and administrative sanctions. However, while from a technical standpoint these treaties are available for SEC cases, their value has been limited because the SEC generally seeks information for use in a civil rather than criminal court. In this regard, the Santa Fe case again provides a useful case in point.

In Santa Fe, unknown purchasers had bought over 3000 deep-out-of-the-money Santa Fe call options just prior to the merger announcement. These purchases had been conducted through several Swiss banks which, based upon claims of Swiss bank secrecy, refused to identify their clients.

On March 22, 1982, after extensive consultations with the Swiss banks and government alike, the SEC made its first request for assistance to the government of Switzerland pursuant to the 1977 Treaty of Mutual Assistance in Criminal Matters. Thereafter the unknown purchasers, pursuant to Swiss law, were informed of the request and filed oppositions to its execution with the federal authorities and courts. The SEC had no right to learn the content

of or respond to the unknown purchaser's arguments. Rather, the arguments were made in secret before the Swiss authorities and ultimately before the Swiss Federal Tribunal.

On January 26, 1983, the SEC's request was denied by the Federal Tribunal on the grounds that it failed to set out sufficient facts for the court to determine whether the unknown purchasers had violated Swiss law. Since the Treaty requires that the conduct in question must violate the criminal laws of both countries before assistance can be granted, the Court said it was unable to consider the request.

Although the request was denied in late January, it took five months until the opinion of the Court was made publicly available in late May 1983. The opinion 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 26, 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 granted the SEC's request and the SEC 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 SEC. During

the following three months documents responsive to the SEC's request were produced.

The total process took a little more than three years. The SEC was again successful in the Santa Fe case. But, as in England, the costs in terms of time and money were enormous. Further, the burdens of showing "dual criminality," a standard which is not uncommon to criminal mutual assistance agreements, nearly prevented the SEC's success. It is unclear whether, in another case, this burden can be met in the next insider trading case or for that matter any case involving violations of the U.S. securities laws.

C. Limits of Present Agreements

The Hague Convention and the bilateral agreements which are available for extraterritorial evidence gathering prove that broad based agreements can be reached for accommodating foreign discovery efforts. However, the present mechanisms were not designed to provide assistance in SEC civil investigations.

As discussed above the SEC has demonstrated its commitment to utilizing established agreements to obtain evidence. Further, the SEC will work to develop understandings which will meet its investigative needs on a case-by-case basis when no formal agreement exists. However, when these efforts fail, the SEC cannot ignore its mandate and terminate efforts to obtain critical evidence regarding a potential violation of U.S. law. In such instances, the SEC has utilized the U.S. courts to compel production of evidence. 15/ This type of action is an act of last resort. No one relishes the confrontation and bad feelings which such litigation fosters.

When such a confrontation occurs, resolution is hinged upon a balancing of the interests involved. 16/ However, at that point in a confrontation, no result could possibly satisfy all interests concerned. The Court is left to choose which law is to be enforced. The only way to avoid this situation is to develop international agreements and understandings which build upon the agreements already in place by setting comprehensive standards governing the extraterritorial gathering of evidence.

VI. ALTERNATIVE SOLUTIONS

A. The "Waiver by Conduct" Concept

Two years ago, John M. Fedders, the former director of the SEC's Division of Enforcement proposed to this seminar consideration of a concept called "waiver by conduct." The concept was designed to facilitate law enforcement against those who prey on U.S. securities markets from abroad and take advantage of the international law enforcement problems noted above. Under that concept, the purchase or sale of securities on a U.S. market would constitute a waiver of the protection that would otherwise be afforded by foreign secrecy laws.

Last year the SEC issued a release describing the concept as one approach that could preserve the SEC's ability to investigate violations of U.S. securities laws. 17/ The SEC requested ideas for solutions to the problems created by transactions originating in one nation that affect the securities markets of other nations. The SEC also invited public consideration of the broader factual, legal and policy issues implicated by the increasingly international securities markets.

The release received world-wide attention. 18/ Sixty-five commentators submitted over 500 pages of comments on the "waiver by conduct" concept release. Comments were received from nine foreign governments, 19/ eleven departments and commissions of the United States government, 20/ thirteen representatives of the securities industry and regulatory organizations, 21/ thirteen banking and business associations, 22/ four foreign banks, 23/ one nationally-chartered bank and one bank holding company, 24/ five bar associations and legal societies, 25/ six attorneys and law firms 26/ and two law professors. 27/

Most of the comments were negative. They made three general points in support of the argument that the concept should not be adopted. Summarized, their points were that a "waiver by conduct" concept:

- a. represented an extraterritorial extension of American law to nationals who conduct transactions through foreign banks and brokers;
- b. would be unenforceable under most foreign laws and therefore would not resolve the conflict which presently exists; and
- c. would drive business away from the U.S. markets in favor of markets with less regulation.

The adverse reaction which the concept received obscured the dilemma which the Commission or any enforcement authority faces today when attempting to police an internationalized marketplace without the ability to follow the wrongdoer across borders. No comprehensive alternative was proposed to "waiver by conduct" other than the negotiation of bilateral and multilateral arrangements which expressly provide the necessary assistance.

It is an understatement to say that the "waiver by conduct" concept was poorly received. Its almost universal rejection has now set the stage for renewed efforts to explore other alternatives. But the goal must be resolution of the problem "waiver by conduct" was designed to confront and not preservation of the status quo.

B. "Waiver by Conduct" - A Statement of Principle

When separated from the proposal of unilateral enactment, the concept behind "waiver by conduct" has merit and should be acceptable, both as a principle of comity and as a guideline for incorporation into international agreements.

As an initial step toward a comprehensive solution to the SEC's evidence gathering problems, nations should acknowledge the principle of "waiver by conduct" as a matter of comity. This proposal responds to the commentators' concern that the unilateral imposition of a waiver would be an extraterritorial act. Further, it builds upon the fact that most law enforcement officials have the domestic authority to force disclosure of otherwise protected data where a legitimate public interest in such disclosure exists.

An additional basis for such a "plea for comity" is obvious -- all nations benefit from the existence of the U.S. securities markets. Indeed, foreign participation in the U.S. market has continuously increased steadily over the past decade. Thus, countries should agree to assist the U.S. as a matter of comity in its efforts to enforce U.S. securities laws. 28/ Reciprocal assistance should also be made available.

A "waiver by conduct" principle would invite all other nations concerned about the misuse of their jurisdiction to evade others' sovereigns' laws to adopt a consistent approach which recognizes the paramount interest in the regulation and protection of the world's securities markets. It would recognize that, to the extent possible, a foreign nation's jurisdiction should not be asserted to frustrate another nation's enforcement efforts when that nation's securities laws have been violated. None of the comments received on the "waiver by conduct" concept rejected the possibility of such mutual recognition. As a result, this concept warrants further exploration.

C. New Agreements

No doubt comity and informal assistance could combine to provide useful assistance in SEC investigations and litigation. However, they are no substitute for formal agreements to provide assistance in specific cases, pursuant to agreed-upon standards, applied in a predictable fashion. In this regard, formal agreement in the area of mutual assistance in securities matters may be possible and should be attempted. This suggestion should not be considered to encompass the negotiation of new and comprehensive evidence gathering agreements. Whereas it may be possible to agree upon offenses for which assistance could be granted in the securities area, there are other topics such as antitrust, tax and export control where agreement may not be possible. Thus, for the time being the goal for agreement should be limited.

The first goal of any arrangement for assistance in evidence gathering must be to allow participating nations to obtain all the

information necessary to protect their securities markets against foreign-based fraud. At the same time, such an arrangement must not jeopardize the sovereign interests of participating nations with respect to activities occurring within their borders.

If countries can agree that securities enforcement is an area where mutual assistance should be available, compromises regarding the parameters of allowable discovery will be possible. For example, a foreign law enforcement agency's request for evidence located abroad might be required to meet a new relevancy standard to be applied by a court in the country where the evidence or witness is located. This new relevancy standard would guard against unwarranted "fishing expeditions." The arrangement might also apply only to governmental investigations and litigation, thereby excluding private lawsuits. Such a limitation would reduce potential fears that the process might be abused. Finally, the arrangement might limit assistance to matters arising under specified statutes, which would ensure that a participating nation would not be forced to assist in the enforcement of a foreign law contrary to its policies.

D. Model Agreement

The 1982 Memorandum of Understanding ("MOU") between the U.S. and Switzerland and Convention XVI of the Swiss Bankers' Association proves that agreements can be designed to deal with conflicting policy concerns (See Appendix A). Convention XVI was achieved at a time of great tension. The St. Joe and Marc Rich cases had demonstrated the will of U.S. judges to order production

of evidence subject to secrecy protection. Further, in those cases it appeared that such secrecy protection was being asserted by individuals who were attempting to evade U.S. law enforcement. A solution to defuse this confrontation was necessary; Convention XVI was the needed response.

Convention XVI is unique. 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. In this regard, the Convention delineates both the type of investigation or litigation for which assistance is available and the standards which will be applied for determining whether assistance should be granted. Further, the Convention creates an examining Commission which is composed of professionals familiar with the standards to be applied. This Commission evaluates the request and determines, within an agreed period of time, whether assistance should be granted. Where assistance is granted, the Convention specifies the evidence which may be produced.

While today the Convention is limited to certain types of insider trading and provides only narrow assistance, it works both as a concept and in practice. Because it has express standards, it can be applied fairly and quickly. Because it is applied by a Commission which is sensitive to the needs of the SEC and the privacy concerns of a bank customer alike, it can take a balanced view of the evidence. This reduces the ability of either party to abuse the process. The approach applied in the Convention thus provides a useful model for future agreements which should be explored.

VII. Issues for Future Consideration

I have spoken about evidence gathering problems and solutions from a U.S. point of view. As countries begin to explore the role of and need for enforcement in the internationalized securities markets, the questions which will dominate the debate will be:

- 1) The need for international agreements to clarify jurisdiction to protect their securities markets;
- 2) The need for national rules, as alternatives to international agreements, to clarify such jurisdictional disputes;
- 3) The role which cooperation can play for enhancing internationalized enforcement efforts;
- 4) The degree to which uniform regulation and liability standards are necessary for providing protection for predictable enforcement policies; and
- 5) The necessity for the development of an international securities authority and the role of national securities commissions in regulation of internationalized securities markets.

These questions cannot be avoided. Until they are resolved conflicts will continue.

Hopefully it will not require a market crash or serious fraud to convince all nations that these questions must be addressed and resolved. This process can and must begin now. The necessary groundwork can be laid in the coming months. This would involve three basic steps:

First, all countries should mandate their securities commissions or other relevant authorities to participate in international discussions, both bilateral and multilateral, to formulate a scheme for international evidence gathering regarding securities enforcement;

Second, a forum must be designated as the international forum for airing transnational securities fraud regulation issues. In this regard, the Organization for Economic Cooperation and Development, the International Organization of Securities Commissions and the Cook Commission all present possible fora for such discussions; and

Third, within the next year, the first meeting of interested nations should occur at which a work program for resolving the problems of international evidence gathering in securities enforcement can be undertaken.

The above three points represent modest proposals; but they are a beginning. If undertaken seriously, the chances for resolving conflicts while enhancing the integrity of internationalized securities markets, will be increased greatly.

IX. Conclusion

As the securities markets become more international, law enforcement problems will become more severe and more complex. As foreign markets begin to link with one another, the nationality of an exchange, a transaction, or a security will rapidly fade. Old concepts of jurisdiction and law enforcement must evolve if they are to keep up with these trends. If they cannot keep up, all nations with securities markets will face the dilemma of deciding whether to act unilaterally to protect their markets from foreign-based fraud, or to live with markets where some participants can defraud others with impunity. Neither alternative is acceptable.

FOOTNOTES

- 1/ New York Stock Exchange 1985 Fact Book, 64.
- 2/ Securities Industry Association, "Foreign Activity in U.S. Securities," Volume VIII. No. 2, April 10, 1984, p. 4.
- 3/ Secrecy laws, like the attorney-client relationship, generally protect from disclosure information given to a fiduciary, such as a banker or personal advisor. The protection extends to the relationship of trust and confidence and may be waived by the individual who controls the protected information. Blocking laws prevent all cooperation by nationals or residents with foreign authorities. They reflect national policies that prohibit efforts to obtain evidence for use in a foreign tribunal. Where the SEC is confronted with either of these types of laws, exceptions must be found before evidence can be produced.
- 4/ The evidence which can be obtained by the SEC when it investigates alleged wrongdoing can be placed in three categories:
 - a) evidence in the hands of principals to a transaction. This would include evidence held by or within the knowledge of a purchaser or seller of securities in a market investigation involving, for example, allegations of market manipulation or insider trading. Alternatively, it would involve evidence in the possession of an issuer of securities or within the knowledge of the issuers' employees which related to alleged illicit conduct by the issuer such as accounting or other disclosure fraud.
 - b) evidence in the hands of third parties retained by the principal to a transaction. This would include evidence in the hands of a stockbroker or banker who assisted in a market transaction or an accountant or other specialist retained by an issuer or securities.
 - c) evidence in the hands of witnesses with particular knowledge relevant to an investigation. This would include such persons and entities as: telephone or credit card companies which would have documents which evidence the activities of the principal to the transaction during relevant times, former and present employers or other witnesses who could supply relevant background information; customers, business associates or related corporations who possess relevant information concerning an issuer's activities or which is relevant background concerning certain activities.

5/ 15 U.S.C. 78u(b) provides:

For the purpose of any such investigation, or any other proceeding under this title, any member of the Commission or any officer designated by it is empowered to administer oaths and affirmations, 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.

6/ See, e.g., F.T.C. v. Compagnie de Saint-Gobain-Pont-a-Mousson, 636 F.2d 1300 (D.C. Cir. 1980); SEC v. Zanganeh, 470 F. Supp. 1307 (D.D.C., 1978); SEC v. Minas De Artemisa, S.A., 150 F.2d 215 (9th Cir. 1945).

7/ Section 172, Companies Act of 1948, as amended.

8/ Rio Tinto Zinc Corporation and Others v. Westinghouse Electric Corporation (1978) AC 547, Sedgwick Group PLC and Others v. Johns-Manville Fiberboard Corporation, In Re Asbestos Insurance Coverage Case, House of Lords, February 11, 1985.

9/ SEC v. Certain Unknown Purchases of Call Options for the Common Stock of and the Common Stock of Santa Fe International Corporation, 81 Civ. 6553 (WCC)(S.D.N.Y.)

10/ In the Matter of Evidence Proceedings Act 1975, Order of Mr. Justice Drake, February 23, 1984 reprinted in 34 Int'l Legal Materials 511.

11/ Id. at 515. The Court went on to state:

"There is, in my view, a public interest in maintaining the confidential relationship between banker and client, so that wherever a banker seeks to be excused from answering a question which would involve the breach of that confidentiality, it is improper, in my view, for the Court to consider such a request and to judge it in the context of the circumstances in which it is made. There is, in my view, also clearly a public interest, and a very strong one, in not permitting the confidential relationship between banker and client to be used as a cloak to conceal improper or fraudulent activities evidence of which would otherwise be available to be used in legal proceedings, whether here or abroad.

12/ In this regard it should be noted that in the Santa Fe case, only after four days of hearing before the English

Judge did the SEC learn that the documents it had been seeking no longer existed.

- 13/ Treaty between the U.S. and the Swiss Confederation on Mutual Assistance in Criminal Matters, 27 UST 2019, done on May 25, 1973.

Treaty on Mutual Legal Assistance with the Republic of the Netherlands and the United States, done on June 12, 1981, TIAS 10734.

Treaty with the Republic of Turkey on Extradition and Mutual Assistance in Criminal Matters, done on June 7, 1979, TIAS 9891.

- 14/ The United States has recently concluded negotiations of mutual assistance treaties in criminal matters with Columbia, Italy, Morocco, and Canada; however, they have not yet entered into force.

- 15/ In SEC v. Banca Della Svizzera Italiana, 92 F.R.D.111 (S.D.N.Y. 1981), the SEC sought to compel production of Swiss bank records after it had determined that letters rogatory would not yield the needed information. Further, the SEC believed that the Swiss Mutual Assistance Treaty in Criminal Matters would probably not apply to the Commission's case. This was confirmed in a SEC staff affidavit filed in the U.S. Court.

- 16/ Restatement (Second) of Foreign Relations Law §40 1965: "Limitations on Exercise of Enforcement Jurisdiction
Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as:

- (a) vital national interests of each of the states,
- (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,
- (c) the extent to which the required conduct is to take place in the territory of the other state,
- (d) the nationality of the persons, 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."

The text of the Restatement is proposed by an advisory body of scholars. In the past, courts have applied its provisions to resolve conflicts of jurisdiction in the U.S. There are currently discussions to modify the above section of the Restatement, among others, to broaden the application of the balancing test. However, the proposed changes have not yet been adopted. Further, it is unclear, given the current state of U.S. court decisions, whether the new more narrow provisions of the Restatement would be accepted and applied.

17/ "Request for comment regarding a concept to improve the Commission's ability to investigate and prosecute persons who purchase or sell securities in the U.S. Markets from other countries." (Release No. 34-211186)

The Commission issued the concept release as part of its commitment to creating an environment in which an internationalized marketplace is encouraged and allowed to thrive within the United States. In this regard the Commission has issued two concept releases discussing: Methods for harmonizing disclosure and distribution practices for multi-national offerings by nongovernmental issuers in the U.S., the United Kingdom and Canada; and raising issues with respect to international market regulation. See, Release Nos. 33-6568 issued February 28, 1985 and 34-21958, April 28, 1985.

18/ S. Brown, "Removing Foreign Secrecy Laws that Thwart SEC," The Market Chronicle, (July 19, 1984), p. 1; "SEC Seeking Foreign Support in War Against Secrecy Laws," The Globe and Mail (August 1, 1984), p. 20; "The SEC Steps Up Its Attack on Swiss Secrecy," Business Week, (August 20, 1984), p. 3; Fedders, "Waiver by Conduct" Idea Deserves Closer Look", (September 3, 1984), Legal Times, p. 10; "Balkanization of the Markets", Wall St. J., (December 21, 1984), p. 18, M.S. Dupler, "Unilateral Waiver by Conduct Doomed to Failure" Legal Times, (November 5, 1984), p. 15; Ingersol, "SEC Proposal to Override Foreign Law On Bank Secrecy Draws Wide Criticism," Wall St. J., (Feb. 11, 1985), p. 13; Marinaccio, "Waiver by Conduct Bears Potential for Distortion," Legal Times, (Feb. 18, 1984), p. 12; "Waiver by Conduct Proposal Meets Waive of Foreign, U.S. Opposition", 17 BNA Sec. Reg. & L. Rep. 291 (Feb. 15, 1985) p. 16; "The Fedders Proposal Won't Go Away," Euromoney, (April, 1985), p. 45. 17 SEC. Reg. L. Rep. 291, "SEC's Waiver by Conduct Proposal Meets Strong Wave of Foreign, U.S. Opposition"; 6 Journal of Comparative Business and Capital Market Law No. 4, December 1984, pp. 307-354, (Six responses to "Waiver by Conduct"); International Financial Law Review, September 1984, Fedders, Interdependence and Cooperation: The SEC's "Waiver by

Conduct" concept release, p. 10; Id., November 1984, Verdict on "The SEC's Waiver by Conduct concept," (analyses of seven foreign lawyers) p. 4; Id., December 1984, Fedders and Mann "Waiver by Conduct Concept - a reply" p. 10.

19/ Austria, Bahrain, Brazil, Canada, France, Germany, Pakistan, Singapore, and Switzerland.

20/ Department of Agriculture; Department of Energy; Department of Housing and Urban Development; Department of the Interior; Department of Labor; Department of the Treasury; Commodity Futures Trading Commission; The Commissioner of Customs; Federal Energy Regulatory Commission, Federal Maritime Commission, and the Office of the General Counsel of the Interstate Commerce Commission.

21/ Capital Market Authority (Cairo, Egypt); Commission des Operations de Bourse ("Operating Committee of the Stock Exchange" (Paris, France); Compagnie Des Agents De Change (Paris, France); Council for the Securities Industry (London, England); Office of the Securities Commission (Wellington, New Zealand); Ontario Securities Commission (Toronto, Canada); The London Stock Exchange (London, England); Merrill Lynch Capital Markets; New York Stock Exchange; North American Securities Administrators Association, Inc.; Oppenheimer & Co., Inc.; PaineWebber Group, Inc.; and Securities Industry Association.

22/ Association Francaise Des Banques (Paris, France); Bankers' Association for Foreign Trade; British Bankers' Association (London, England); Bundesverband deutscher Banken ("Association of German Banks") (Cologne, West Germany); The Canadian Bankers' Association (Toronto, Canada); Confederation of British Industry (London, England); Deutscher Sparkassen- und Giroverband Bonn ("German Savings Banks and Giro Association") (Basel, Switzerland); Schweizerische Bankiervereinigung Association Suisse Des Banquiers Associazione Svizzera Dei Banchieri (the "Swiss Bankers' Association") (Basel, Switzerland); Federation Bancaire de la Communaute Europeenne ("The Banking Federation of the European Community") (Brussels, Belgium); Federation of Bankers Association, Inc.; Institute of Foreign Bankers, Inc.; and Swiss-American Chamber of Commerce.

23/ Credit Suisse (Zurich, Switzerland); The Chartered Bank, Hong Kong; HongKongBank; and Swiss Bank Corporation.

24/ The Chase Manhattan Bank, N.A.; and Citicorp.

25/ American Bar Association, Section of International Law and Practice; American Bar Association, Section of Corporation, Banking and Business Law; American Corporate Counsel

Association; The City of London Solicitors' Company; and New York Bar Association, Banking Corporation and Business Law Section.

- 26/ Pierre de Charmant of Borel, Barbey, de Charmant, Perret et Dunant (Geneva, Switzerland); Donald Cronson; Baker & McKenzie; John S. Martin, Jr. of Schulte Roth & Zabel; Sullivan & Cromwell; and Paul J. Bschorr of White & Case.
- 27/ Richard W. Jennings, Professor of Law Emeritus, University of California at Berkeley; and Andreas F. Lowenfeld, Charles D. Denison Professor of Law, New York University.
- 28/ While today the principle of comity is often a limitation upon the application of sovereign power over extraterritorial events and persons, it was "originally developed to explain how a sovereign state, absolutely powerful within its own territory, could give recognition or effect in its courts to another nation's laws without diminishing or denying its own sovereignty." Maier, "Extraterritorial Jurisdiction at a Crossroads: An Intersection Between Public and Private Law," 76 Am. J. Int'l L 280, 281 (1982). The Dutch scholar, Ulrich Huber, acknowledged in his three axioms that where the laws of one state "do not prejudice the powers or rights of another state, or its subjects," they should be given extraterritorial effect. Davies, "The Influence of Huber's de Conflictu Legum on English Private International Law," 18 Brit. Y.B. Int'l 49, 56-57.

APPENDIX A

Operation of the Agreement

The Memorandum of Understanding between the U.S. and Switzerland signed on August 31, 1982 ("MOU") and Convention XVI of the Swiss Bankers' Association provide a unique mechanism for dealing with problems of secrecy. They illustrate one possible approach for addressing different conflicts of law.

While Convention XVI has been concluded under the aegis of the Swiss Bankers' Association, it provides that the signatory banks, under certain circumstances and working through the Swiss Federal Office for Police Matters, may disclose the identity of a customer and furnish information to the Commission without violating Swiss secrecy law. Thus, both the government and the banks are participants in the operation of the private agreement.

Convention XVI requires a three member Commission of Inquiry be appointed by the Swiss Bankers' Association to examine the request to determine first whether certain subject matter thresholds are met. The Convention provides a test as a threshold for determining when its procedures will be available. 1/ The Convention also requires the Securities and Exchange Commission to establish to the reasonable satisfaction of the Swiss commission the circumstances of the trading and the application of the Convention. 2/

However, the MOU provides that even if on their face certain circumstances do not appear to require application of the convention, where there are reasonable grounds to suspect wrongdoing,

it will be applied. 3/ Thus, under extreme circumstances, the thresholds can be set aside to allow for the requested discovery by the SEC.

Execution of the Request for Assistance

Upon a finding that the transaction in question is one which properly may be resolved under the private agreement, the Commission of Inquiry will request the subject bank to submit for its review a detailed report regarding the transaction in question. Upon receipt of the request from the Commission of Inquiry the bank will freeze its customers' accounts up to the amount of the profit realized in the transaction, inform the customer, and give him an opportunity to respond to the allegations contained in the request. Within 45 days, the bank will then forward the requested report to the Commission of Inquiry.

Upon receipt, the Commission of Inquiry will examine the bank's report and forward it to the Federal Office for Police Matters for transmission to the SEC. However, in the event that the customer independently establishes, or the bank's report establishes, to the reasonable satisfaction of the Commission of Inquiry that the customer did not order the purchases or sales that are the subject of the SEC's request, or the Swiss commission determines that the customer is not an insider under the definition provided in the private agreement, the Federal Office for Police Matters will not transmit the report to the SEC.

Following is the definition of an insider as provided in the private agreement:

- a) 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 insider information.

In the event that the Commission of Inquiry finds that the conditions for the transmitting of information to the SEC are not satisfied, it will submit, through the Swiss Federal Office for Police Matters, a report containing its conclusions to the SEC. However, if there is doubt as to the validity of the bank's conclusions, the Commission of Inquiry itself, or the SEC, can ask the Swiss Federal Banking Commission to examine whether the bank complied with its obligations under the proposed agreement. A second report will then be submitted to the SEC after such reexamination has taken place.

FOOTNOTES

- 1/ "if within 25 trading days prior to a public announcement of (a) a proposed merger, consolidation, sale of substantially all of an issuer's assets or other similar business combination ("Business Combination") or (b) the proposed acquisition of at least 10% of the securities of an issuer by open market purchase, tender offer or otherwise ("Acquisition"), a customer gives to a bank an order to be executed in the U.S. securities markets for the purpose 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."
- 2/ "(i) material price or volume movements have occurred with respect to trading in the securities which are the subject of the Acquisition or Business Combination during the 25 day period prior to its announcement or (ii) it has other material indications that the transactions referred to above were made in violation of U.S. insider trading laws. The Commission shall be satisfied in all cases in which the daily trading volume of such securities increased 50% or more at any time during the 25 trading days prior to such announcement above the average daily trading volume of such securities during the period from the 90th trading day to the 30th trading day prior to such announcement or the price of such securities varied at least 50% or more during the 25 trading days prior to such announcement. In all other cases, the Commission shall review the information submitted by the SEC to decide whether it is reasonably satisfied that the SEC has reasonable grounds to make the Inquiry."
- 3/ "The parties understand that these thresholds are set at high levels because they are intended to define the circumstances under which the Commission 'shall' be satisfied that the SEC has reasonable grounds to make the request. In all other cases in which the criteria are not met, the parties understand that the Commission of Enquiry will be required to review the information submitted by the SEC to decide whether it is reasonably satisfied that the SEC has reasonable grounds to make a request. Accordingly, the parties understand that a failure by the SEC to meet the threshold criteria specified in the private Agreement shall not result in any presumption that the SEC does not have reasonable grounds to make the request for assistance under the terms of the private Agreement and this Memorandum of Understanding."