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Blocking Laws and Secrecy Provisions: Do International Negotiations Concerning Insider Trading Provide a Solution to Conflicts in Discovery Rules

DORA L. MCNEW*

INTRODUCTION

When is a crime not a crime? When the investigations and/or prosecution are stymied by jurisdictional conflicts which bar the production of evidence or the prosecution of the crime itself. Conflicts of this type are becoming more and more common. The growth in international securities trading¹ exemplifies the opportunities for conflict between the United States and foreign jurisdictions. The conflict is especially apparent in the application of Rule 10b-5, the "antifraud rule."²

The courts have defined trading on inside information (private information intended to be available only for corporate purposes) as a fraud upon the other purchasers of the same stock who buy and sell without this valuable information. To protect those who trade on its securities markets, the United States has enacted stiff penalties for insider trading. The millions of dollars of profits to

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1. *Crime and Secrecy: The Use of Offshore Banks and Companies, Hearings Before the Permanent Subcomm. on Investigations of the Senate Comm. on Governmental Affairs*, 98th Cong., 1st Sess. 319 (1983) (increase from \$25.6 billion in 1971 to \$99.2 billion in 1982, cited from a Treasury Bulletin, Winter Issue 1984 at 106-09, in prepared statement of J. Fedders) [hereinafter *Crime and Secrecy Hearings*]; Fedders, Wade, Mann & Beizer, *Waiver by Conduct—A Possible Response to the Internationalization of the Securities Market*, J. COMP. BUS. & CAP. MKT. 1, 2 (1984).

2. The Securities and Exchange Commission [hereinafter SEC] promulgated Rule X-10b-5, later designated Rule 10b-5, in 1942. Rule 10b-5 follows the language of section 17 of the Securities Act of 1933 and is under section 10(b) of the 1934 Act. Rule 10b-5 provides that:

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

- (1) to employ any device, scheme, or artifice to defraud,
- (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
- (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

15 U.S.C. § 78j(b) (1976).

be made from insider trading continue to tempt insiders.³ Insiders still search for ways to avoid the discovery and prosecution of their "insider" securities transactions.

One method of avoidance involves routing the transaction through a foreign financial institution in a jurisdiction that does not consider insider trading a crime.⁴ Foreign jurisdictions not only do not define the use of inside information as fraud; some may even consider the use of inside information in trading as a prerequisite of being privy to such information. Besides having differing definitions of criminality, many foreign jurisdictions have other public policies concerning the protection of confidential information which are reflected in their substantive and procedural laws. Typically, the foreign institutions involved in insider trading are offshore banks,⁵ but that is not always the case. The discrepancies between the regulations in the United States and foreign jurisdictions tend to create a type of "safe harbor" for insider-traders.

For example, a foreign jurisdiction may provide secrecy provisions which prevent a bank from disclosing the beneficial owner of any account, including trading accounts.⁶ Secrecy provisions impose a duty of confidentiality on the banker-client relationship.⁷

3. One of the biggest insider scandals concerned Ivan Boesky, who was recently forced to disgorge fifty million dollars in profits made from insider trading. *See The Secret World of Ivan Boesky*, NEWSWEEK, Dec. 1, 1986, 50, at 51 [hereinafter *Ivan Boesky*].

4. For the United Kingdom view on regulating insider trading see Loss, *Multinational Approaches: Corporate Insiders*, ch. 12 (Loss ed. 1976) [hereinafter Loss]; for France, see *id.* ch. 13; for Germany, see *id.* ch. 14.

5. The term offshore bank or offshore financial haven refers to a company practicing international banking which is kept separate, in most jurisdictions, from local banking and business. The separation from the local banking and business of the haven country is necessary because the regulations governing the offshore haven differ from those which govern the local institutions. This separate regulation, or rather lack of regulation, allows the offshore bank to provide its clientele with a veil of secrecy. The havens' laws authorize numbered bank accounts and nominal corporations. The beneficial owners are shielded by the secrecy provisions which provide criminal sanctions and civil liabilities which are exercised against those bankers and institutions which reveal any information about the owners. The offshore banks may be split into two groups; the legitimate banks, generally a branch office of a major commercial bank, and shell banks or corporations which may only exist on paper or consist of an office with a mailing address, a telephone, and a "bank officer" to answer it. R. BLUM, *OFFSHORE HAVEN BANKS, TRUSTS, AND COMPANIES: THE BUSINESS OF CRIME IN THE EUROMARKET* (1984) [hereinafter R. BLUM].

6. For a listing of nations with secrecy provisions (generally "tax havens") see Staff of Senate Committee of Government Affairs, 98th Cong., 1st Sess., *Crime and Secrecy: The Use of Offshore Banks and Companies*, 10 (Comm. Print 1983) [hereinafter *Staff Study*]. See also M. Langer, *Practical International Tax Planning*, 309-21 (1979); E. Chambost, *Bank Accounts: A World Guide to Confidentiality*, 3 (Walton & Thompson, trans. 1983).

7. Switzerland's secrecy laws are probably the best known example of the legislation concerning the relationship between the banker and the customer. Any communication with the customer is within the confidentiality, and only the customer can waive the secrecy laws.

Banker-client confidentiality is protected by criminal and civil sanctions which may be imposed on bankers who disclose information about a client or an account.⁸ Insider traders trade through accounts in banks whose personnel is subject to secrecy provisions.

In addition to differing standards of criminality and secrecy provisions, some foreign jurisdictions provide a third layer of protection in disclosure blocking laws. These laws block or limit the release of information in the absence of secrecy provisions, or in the unlikely event that the secrecy provisions were overcome.⁹ Blocking laws may be divided into two major categories: (1) laws that prohibit the disclosure of any information that relates to specific subject matters and (2) laws that condition disclosure on compliance with the terms of a multi-national treaty,¹⁰ a specific international agreement,¹¹ or the discovery procedure as mandated by the courts or legislatures of the foreign jurisdiction.¹²

This second category of legislation and/or common law prevents the disclosure of confidential information under two separate public policy considerations. One policy consideration involves the

8. See Swiss Federal Law, art. 47(1), reprinted in *Staff Study*, at 230 (maximum fine of 50,000 Swiss francs or a prison term not exceeding 6 month for intentional disclosure); *id.* art. 47(2) (30,000 Swiss francs for negligent disclosure).

9. CANADA: Foreign Extraterritorial Measures Act, Statutes of Canada 1984-85, C.49 allows the Attorney General of Canada to seize records and otherwise prohibit disclosure when:

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

Foreign Extraterritorial Measures Act § 5(1).

UNITED KINGDOM: Protection of Trading Interests Act of 1980, 1980, Ch. 11 prevents courts from complying with foreign orders:

- (a) if it infringes the jurisdiction of the United Kingdom or is otherwise prejudicial to the sovereignty of the United Kingdom: or
- (b) If compliance with the requirement would be prejudicial to the security of the United Kingdom or to the relations of the government of the United Kingdom with the government of any other country.

FRANCE: Law No. 80-538 of July 16, 1980 has similar language.

10. For example, the (Hague) Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, 1970, 23 U.S.T. 2555, T.I.A.S. no. 7444 (1972) appears in 7 MARTINDALE-HUBBELL LAW DIRECTORY 4509 (1980) with a listing of signatory nations and their reservations, and is discussed *infra* note 42 and accompanying text.

11. Treaty on Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T.R. 2019, T.I.A.S. No. 8302 (January 23, 1977) [hereinafter Treaty on Mutual Assistance]; Treaty on Mutual Legal Assistance with the Republic of the Netherlands and the United States, June 12, 1981, T.I.A.S. 10734; Treaty with the Republic of Turkey on Extradition and Mutual Assistance in Criminal Matters, June 7, 1979, T.I.A.S. 9891; similar treaties in criminal matters with Columbia, Italy, Morocco, and Canada.

12. See *supra* note 9.

concept of sovereign immunity¹³—the right of a state to rule itself—which includes the regulation of its securities markets, its substantive law concerning confidential relationships, and its procedural rulings concerning discovery. Another public policy concern involves the foreign state's underlying rationales for its decision regarding the parameters of disclosures allowed within the foreign court systems.

The problems in investigating and prosecuting cases that cross jurisdictional lines involve both the claiming of jurisdiction and the possible challenge caused by secrecy provisions and disclosure blocking laws. A current trend in cases brought under Rule 10b-5 shows a decrease in the amount of contact with the United States considered necessary to claim jurisdiction. Current attempts by United States courts to claim jurisdiction over predominantly foreign cases may be exacerbating, rather than easing, the problems inherent in getting information and evidence from a foreign jurisdiction. In addition, foreign states have already shown a tendency to enact even more protective blocking legislation in response to demands for the disclosure of information.

Even though negotiation with foreign jurisdictions is a proven method of gaining needed cooperation, especially in the area of securities, United States courts are currently developing a policy of aggressively demanding compliance with discovery requests. In response, foreign states protect their interests by enacting laws which force the United States courts to submit their demands for disclosure through the foreign courts, thus subjecting these requests to the substantive laws and the procedural rules of the foreign nation.

I. FOREIGN STATES' INTEREST IN PROTECTING JURISDICTION

Foreign states pursue differing national objectives through diverse national methods.¹⁴ Every nation is a sovereign power and exercises its morals and self-interest through its own institutions. No absolute standard, or even an agreed-upon standard, for judging criminality exists in international law.¹⁵ Nations have differing standards of criminality.¹⁶ When one nation's standards are measured against those of another, discrepancies become apparent. These discrepancies may create a zone of political immunity, a

13. See *supra* note 9.

14. Symposia, *Transnational Litigation, Part II, Perspectives from the Untied States and Abroad*, 18 INT'L LAW. 773 (1984) [hereinafter *Transnational Perspectives*].

15. See generally A TREATY ON INTERNATIONAL CRIMINAL LAW, (M. Bassiouni & V. Nanda eds. 1973) [hereinafter *INTERNATIONAL CRIMINAL LAW*].

16. See generally note 15.

criminal sanctuary, or a financial haven.¹⁷ No nation may assume its legal system will be viewed sympathetically by any other. A nation's intent to exploit a competitive advantage over another may not necessarily be judged immoral even by a rigorous standard.¹⁸ A nation has the right to regulate the banks and corporations within its jurisdiction as much or as little as it sees fit.¹⁹

A nation may choose to purposefully legislate a legal climate that will allow businesses to: (1) avoid restrictive legislation, (2) to profit from higher interest rates when lending, (3) to avoid taxation, (3) to take advantage of lower interest rates when borrowing, (4) to protect confidential activities which, if known to others, would jeopardize the chances of success or lessen the profit margin, and (5) to take advantage of opportunities to hedge business risks through off-shore diversity liquidity and forward speculation.²⁰

A guarantee of banking secrecy²¹ reinforces a protective business climate. Other legitimate reasons for the secrecy provisions exist. Individuals may justify the use of bank secrecy laws for five reasons: 1) capital flight from political, religious and racial persecution;²² 2) freedom from oppressive government confiscatory taxes, and the risks of war;²³ 3) freedom from unwanted popularity and threats to one's reputation;²⁴ 4) protection from legal judgments;²⁵ and 5) protection from the increasing domestic threat of robbery, fraud or swindles.²⁶

In order to keep this legislated protection firmly in place, foreign jurisdictions are enacting and reinforcing blocking provisions which channel discovery orders through the foreign judicial system.

17. See R. BLUM, *supra* note 5, ch. 2.

18. Switzerland's secrecy laws developed to protect fleeing Jewish capital from the Nazi government, the legitimate government at the time.

19. Foreign nations perceive the aggressive claims of jurisdiction and demands for disclosure from the United States as attempts to impose the United States' policy decisions and legal standards on the world through extraterritorial application of United States laws. See Widmer, *The United States Securities Laws: Banking Law of the World? (A Reply to Messrs. Lomiss & Grant)*, 1 J. COMP. CORP. & SEC. REG. 39 (1978).

20. *Staff Study*, *supra* note 6, at 44.

21. The guarantee of secrecy is enforceable in common law. The recent trend in many jurisdictions with common law secrecy provisions is to codify them. *Crime and Secrecy Hearings*, *supra* note 1, at 181. Other jurisdictions allow a civil suit for damages under tort law for violation of secrecy provision. *Id.* at 177-245.

22. SKOUSEN, *COMPLETE GUIDE TO FINANCIAL PRIVACY* 3-4 (4th ed. 1983).

23. *Id.* at 4-10.

24. *Id.* at 11-13.

25. *Id.*

26. *Id.* at 13-14.

A. Example: The Cayman Islands

The Cayman Islands secrecy provisions subject bankers to both civil and criminal penalties for breach of confidentiality. In *In re Grand Jury Proceedings, United States v. Field*,²⁷ Field was a Canadian citizen and resident of the Cayman Islands, where he was a banker. A subpoena was served on him at a Miami airport. He refused to answer questions concerning his clients which he felt violated the secrecy provisions of the Cayman Islands.²⁸

The ultimate result of the decision to claim jurisdiction in the *Field* case was the enactment by the Cayman Islands of further blocking legislation which provided even broader protection for clients and stiffer penalties for bankers.²⁹ As an added protection, this legislation provided for disclosure of confidential information through the Cayman Islands judicial system. The judge may direct that the information be given, withheld, or be given subject to conditions which safeguard confidentiality.³⁰

II. SPECIAL PROBLEMS IN THE AREA OF INSIDER TRADING

The area of securities regulation poses even more specific problems. For example, the substantive law in European nations regulating securities markets³¹ differs greatly in substance from that of the United States. These differences are especially apparent in regulations concerning insider trading, because of the different national attitudes toward insider trading.

In *Cady, Roberts & Co. v. SEC*,³² the Securities and Exchange Commission imposed sanctions for trading on "information intended to be available only for a corporate purpose and not for the personal benefit of anyone."³³ The SEC held that the integrity of the United States securities markets was in jeopardy from "the inherent unfairness involved where a party takes advantage of such [inside] information knowing it is unavailable to those with

27. 532 F.2d 404 (5th Cir. 1976), *cert. denied*, 429 U.S. 924 (1976). For an in-depth analysis of the legal issues presented by *Field*, see Note, *Federal Judicial Compulsion of an Alien's Testimony Contrary to the Mandate of the Laws of His Native Land*, 16 COLUM. J. TRANSNAT'L L. (1977).

28. *Staff Study*, *supra* note 6, at 230.

29. Confidential Relationships (Preservation) Law (Law 16 of 1976), *published in* Cayman Islands Gazette No. 20 (1976).

30. See *In re Grand Jury Proceedings, Bank of Nova Scotia*, 740 F.2d 817 (11th Cir. 1984) *cert. denied*, 469 U.S. 1106, 105 S. Ct. 778 (1985) for a case in which the government eventually waived the secrecy laws and provided the information requested.

31. See generally Loss, *supra* note 4.

32. *Matter of Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). See also Dann & Phillips, *The Implication of Cady, Roberts*, 17 BUS. LAW. 939 (1962).

33. 40 S.E.C. at 912.

whom he is dealing."³⁴ The average investor would probably perceive this unfairness as a powerful incentive *not* to invest in a market under the control of insiders.³⁵

Of the European nations, only France and the United Kingdom have legislation concerning the use of insider information.³⁶ And, even in these two exceptions to the general no-legislation policy, commentators have expressed opinions that the laws go unenforced to the point where tipping³⁷ is "virtually legal"³⁸ in the United Kingdom³⁹ and "even a social duty" in France.⁴⁰

In claiming jurisdiction over cases under 10b-5, the United States takes the rather simplistic approach that its statutes regulating insider trading are based on preventing fraudulent activities. All legal systems contain anti-fraud provisions. Therefore, no regulatory conflict exists in the imposition of the United States' regulations and definitions of fraud on the foreign regulatory systems.⁴¹ In reality, each sovereign nation defines fraudulent activity in accord with its own moral and ethical precepts. Conduct defined as fraudulent (such as insider trading) in the United States, may be encouraged in another country, such as France, which views tipping as a social duty.

IV. FOREIGN JURISDICTIONS' INTEREST IN CONTROLLING DISCLOSURE

This insensitivity to the goals of foreign regulatory systems, while claiming jurisdiction, is partially responsible for a policy

34. *Id.*

35. Market analysts fear that the exposure of insider traders may cause the average investor to perceive the markets as under the control of a conspiracy of insiders. This perception would lead to a "crisis of confidence", in which investors would refuse to invest in such a controlled market. *See Ivan Boesky, supra* note 3, at 51.

36. *See Cruikshank, Insider Trading in the EEC*, 10 INT'L BUS. LAW. 345, 346 (1986).

37. Tipping is the knowing disclosure of material, nonpublic information which the tippee then trades on, knowing that the information was given to him in breach of an insider's fiduciary duty to his corporation.

38. *See Loss, supra* note 4, at 236.

39. This attitude may be changing in the wake of the Boesky scandal, which crossed the Atlantic to reveal massive insider trading in the Guinness brewery takeover.

40. *See Tunc, A French Lawyer Looks at American Corporate Law and Securities Regulation*, 130 U. PA. L. REV. 757, 762 (1982).

41. *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir. 1977) (extraterritorial enforcement of anti-fraud provisions will cause favorable reciprocal responses by other nations), *cert. denied sub nom.*, *Churchill Forest Indus. v. SEC*, 421 U.S. 938 (1977); *Bersch v. Drexel, Firestone, Inc.*, 519 F.2d 974, 989 (2d Cir. 1977) (same) *cert. denied sub nom.*, *Bersch v. Arthur Andersen & Co.*, 423 U.S. 1918 (1975); *see also Grunenthal GmbH v. Hotz*, 511 F. Supp. 582, 587 n.7 (C.D. Cal. 1981) (rejecting need for evaluation of interests of other nations on grounds that every "civilized nation doubtless has [this rule against fraud] as part of its legal system") *rev'd on other grounds*, 712 F.2d 42 (9th Cir. 1982); Comment, *The Transnational Reach of 10b-5*, 121 U. PA. L. REV. 1363, 1399 (1973).

among foreign nations of refusing to disclose documents and information.⁴² Foreign nations perceive the United States' aggressive claims of jurisdiction as undermining their own sovereign authority, and, in response, have enacted or are proposing legislation that would automatically serve as a barrier to any discovery attempted within the foreign state. The overly broad disclosure⁴³ granted in United States courts and the subsequent disclosure of private, confidential business records may damage a corporation whose competitors are not in a position where the forced disclosure of similar records is required. Blocking legislation usually conditions the production of information in compliance with the judicial process of the foreign state. As the foreign state may and usually does have stricter discovery requirements and will not violate secrecy provisions, the discovery allowed is far less than that to which a United States litigant would have access under United States discovery procedures.

A. Example⁴⁴

Using the French legislation as an example, a request for pre-trial discovery would proceed in the following fashion. First, jurisdiction must be clear or have been claimed by a United States court. The French blocking statute makes disclosure not made in accord with the "Convention on the Taking of Evidence Abroad in Civil or Commercial Matters"⁴⁵ a criminal offense. However, when France became a signatory to the Hague Convention in 1974, it took an Article 23⁴⁶ reservation (which allows a nation to refuse to execute pretrial discovery). As almost all discovery in

42. See generally Note, *Subject Matter Jurisdiction Over Transnational Securities Fraud: A Suggested Roadmap to the New Standard of Reasonableness*, 71 CORNELL L. REV. 919 (1986) [hereinafter *Suggested Roadmap*].

43. See *Rio Tinto Zinc Corp. v. Westinghouse Elec. Corp.*, (1978) 1 All E. R. 434 (English court refused to give effect to language in a discovery order requesting any memorandum, correspondence, or other document relevant to the described document, and labelled the request a fishing trip); *Asbestos Insurance Coverage Cases*, [1985] 1 W.C.R. 33 (House of Lords) (established two requirements for discovery orders; 1. the document must be described with particularity, 2. the party seeking the document must establish its existence and that the party from which the document is being sought has possession).

44. See Batista, *Confronting Foreign "Blocking Legislation" A Guide to Securing Disclosure from Non-resident Parties to American Litigation*, 17 INT'L LAW. 61 (1983) [hereinafter Batista].

45. The test of the (Hague) Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, 1970, 23 U.S.T. 2555, T.I.A.S. no. 7444 (1972) appears in 7 MARTINDALE-HUBBELL LAW DIRECTORY 4509 (1980), with a listing of signatory nations and their reservations.

46. "A Contracting State may at the time of signature, ratification or accession, declare that it will not execute Letters of Request issued for the purpose of obtaining pretrial discovery of documents as known in Common Law Countries." *Id.* at art. 23.

United States litigation is pretrial,⁴⁷ the unlucky litigant is “blocked” from obtaining all the documents that he may consider necessary for the furthering of his case.⁴⁸ An examination of the history of the French legislation clearly reveals that the primary purpose of the legislation was “the protection of French companies against abusive investigation by foreign authorities.”⁴⁹

The above examples of secrecy provisions and disclosure blocking legislation clarify the consequences of aggressive claims of jurisdiction. The validity of the United States claim to jurisdiction is clearly doubted by foreign jurisdictions. To protect its businesses and ensure compliance with its substantive and procedural laws, foreign nations are requiring that discovery requests be filtered through the foreign judicial system. The foreign states perceive an overly aggressive “grasping” of jurisdiction by United States courts and have responded in such a way as to make it impossible for the United States to ignore the national interests of the foreign nation.

This perception is confirmed by an examination of the recent expansion in claiming subject matter jurisdiction over securities fraud cases. The United States courts have claimed jurisdiction over cases in which the transactions have had no effects in the United States or on the United States markets. Jurisdiction is based, in some cases, on an act as insignificant as a phone call.

V. UNITED STATES CLAIMING JURISDICTION OVER 10B-5 CASES

As a first step in cases with foreign aspects,⁵⁰ a court must claim jurisdiction over a case. Originally, courts focused on two tests for jurisdiction: 1) fraudulent conduct⁵¹ which takes place within the United States⁵² and 2) adverse effects⁵³ within the

47. Fed. R. Civ. P. 37. For further discussion of Rule 37, *see generally* 8 WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE § 2284.

48. *See* Graco v. Kremlin, 101 F.R.D. 503 (N.D. Ill. 1984); Club Mediterranee, S.A. v. Dorin, 465 U.S. 1019 (1984).

49. Cited in Batista, *supra* note 37, at 66.

50. For the purposes of establishing subject matter jurisdiction over securities fraud actions that include a foreign transaction, a foreign transaction is one that involves one or more of the following: foreign investors, foreign sellers and defendants, foreign securities, and negotiations and sales occurring outside the United States.

51. For a definition of conduct for the purposes of foreign relations law *see* RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 (1965) [hereinafter RESTATEMENT].

52. *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968) *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom*, *Manley v. Schoenbaum*, 395 U.S. 906 (1969); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334-36 (2d Cir. 1972). Subsequent analyses point to the holding in *Schoenbaum* which was based on the analysis of the Restatement. *See Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975) *cert. denied sub nom*, *Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018

United States.⁵⁴ The first cases looked at both conduct and effects. In *Schoenbaum v. Firstbrook*,⁵⁵ the court commented that "we think it tips the scales in favor of applicability when substantial misrepresentations were made in the United States."⁵⁶ A later court interpreted this language as requiring both conduct and effects.⁵⁷ The conduct test evolved requirements which distinguish the conduct by the nature of the act.⁵⁸ However, some jurisdictions have expanded their claims to jurisdiction by holding that fraudulent conduct within the United States is sufficient grounds, in and of itself, to grant jurisdiction.⁵⁹ The importance of requiring only fraudulent conduct became clearer when further developments set the threshold level of required activity⁶⁰ necessary for

(1975); *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975); *IIT, Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 917 (2d Cir. 1980).

53. For a definition of effects for the purposes of foreign relation law, see RESTATEMENT, *supra* note 51, at § 18.

54. *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968) *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom.*, *Manley v. Schoenbaum*, 395 U.S. 906 (1969); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334-36 (2d Cir. 1972); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.) *cert. denied sub nom.*, *Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975); *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975); *IIT, Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 917 (2d Cir. 1980).

55. 405 F.2d 200 (2d Cir. 1968) *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom.*, *Manley v. Schoenbaum*, 395 U.S. 906 (1969).

56. *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1336, 1339 (2d Cir. 1972).

57. *Grunenthal GmbH v. Hotz*, 511 F. Supp. 582 (C.D. Cal. 1981).

58. *Leasco v. Data Processing Corp. v. Maxwell*, 468 F.2d 1326, 1334-36 (2d Cir. 1972); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 987 (2d Cir. 1975) (jurisdiction will not be found in "cases where the United States activities are merely preparatory or take the form of culpable nonfeasance and are relatively small in comparison to those abroad") *cert. denied sub nom.*, *Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975); *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975) (distinguished the facts from those in *Bersch* and found jurisdiction over fraudulent acts that were more than merely preparatory).

59. *IIT, Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 917-18 (2d Cir. 1980) (rejected the need to fulfill the effects test from *Schoenbaum*, but suggested that jurisdiction might be found upon further finding of conduct based on *Bersch* and *Vencap* and remanded to make further findings); *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977) (quotes *Vencap* in rejecting the effects test and holds that jurisdiction may be found on conduct alone) *cert. denied*, 431 U.S. 938 (1977); *United States v. Cook*, 573 F.2d 281, 283 n.4 (1978) (jurisdiction was established through an analysis of conduct without going further to analyze whether adverse effects were present or necessary); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 417 (8th Cir. 1979) ("jurisdiction may be established [by fulfilling the] requirements of either not both, the conduct or effects test"); *Grunenthal GmbH v. Hotz*, 511 F. Supp. 582 (C.D. Cal. 1981).

For an analysis of the conduct test that favors the expanded jurisdiction provided by holding that fraudulent conduct alone is sufficient ground for jurisdiction see generally Comment, *Subject Matter Jurisdiction in Transnational Securities Fraud Cases: The Expanding Application of the Conduct Test*, 59 N.D.L.R. 471 (1984).

60. In claiming jurisdiction the court should pay close and particular attention to the concrete facts of each case. *Venture Fund (International) N.V. v. Willkie Farr & Gallagher*, 418 F. Supp. (S.D.N.Y. 1975); *Continental Grain*, 592 F.2d at 414.

jurisdiction at a mere phone call.⁶¹

In 1977, a third circuit court based jurisdiction on the use of the United States mail system, the operation in part from a corporate office in the United States, and the signing of the final contract in the United States.⁶² In 1979, a court in the eighth circuit found jurisdiction where an attorney in the United States was involved in the closing of the sale of a corporation and the related travel to the attorney's office led to an inference of use of United States telephones and mails.⁶³ In 1980, the second circuit based jurisdiction on the American nationality of the issuer and the execution of the transaction in the United States.⁶⁴ However, in 1981, the ninth circuit rejected the more liberal eighth circuit approach and declined to find jurisdiction over a case involving the execution of a contract for the sale of stocks in the office of an American attorney, where the misrepresentations that had led to the sale were repeated but not confirmed,⁶⁵ and related travel to the attorney's office was imputed by the representative's presence in the United States.⁶⁶ Although the court did not claim jurisdiction, it indicated that its analysis⁶⁷ and holding⁶⁸ were in accord with the second circuit line of cases.

Even though the ninth circuit retreated from the more liberal approach of the eighth circuit, a chronological analysis of the controlling cases illustrates a change to sole reliance on the conduct test and a clear decrease in the amount of fraudulent activity necessary to meet the test and claim jurisdiction in the United States.

VI. BEYOND JURISDICTIONAL PROBLEMS

Once jurisdiction⁶⁹ has been established, the court may require information regarding documents held in a foreign jurisdiction. In

61. Section 10b-5 prohibits the use of instrumentalities of interstate commerce for fraudulent purposes. The courts have expanded upon this until a telephone call originating in or coming into the United States is sufficient for jurisdictional purposes. The courts have also ruled that a person's presence inside the United States is also sufficient to prove that an instrument of interstate commerce has been used in order for the person to be traveling in the United States.

62. *Kasser*, 548 F.2d at 111.

63. *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 412-13 (8th Cir. 1979) ("a substantially foreign transaction, little if any domestic impact, and domestic conduct which consisted for the most part of use of the mail and telephones." *Id.* at 421).

64. *IIT, Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 918 (2d Cir. 1980).

65. *Grunenthal GmbH v. Hotz*, 511 F. Supp. 582 (C.D. Cal. 1981).

66. *Id.* at 588 n.6.

67. *Id.* at 587 ("Second Circuit reiterated its case by case approach . . . emphasizing that neither the conduct nor the effects test was necessarily dispositive").

68. *Id.* at 588.

69. The courts claimed in personam jurisdiction in the cases examined in this section

SEC v. Banca della Svizzera Italiana,⁷⁰ the bank, BSI, refused to reveal the identities of its account holders. These account holders had ordered the purchase of stocks and stock options in the St. Joe Minerals Corp. The following day, a cash tender offer caused the price of the stock to go from \$30 to \$45. The subsequent transactions netted an overnight profit of over \$2 million. Judge Pollack of the second circuit granted the SEC's motion to compel discovery under Rule 37 of the Federal Rules of Civil Procedure.

The court's opinion rested on an analysis of *Société Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers*,⁷¹ and current law in the second circuit. According to the BSI court, "*Société* holds that the good faith of the party resisting discovery is a key factor in the decision whether to impose sanctions when foreign law prohibits the requested disclosure."

Early second circuit cases judged foreign law prohibitions as an absolute bar to ordering inspection or production of documents.⁷² Judge Pollack distinguished these cases as concerning nonparty witnesses.⁷³ Yet he failed to explain why parties to suit should have to violate the foreign law, while nonparty witnesses could claim an exemption from the production of documents.

Then Judge Pollack analyzed two recent second circuit cases⁷⁴ in which he had found jurisdiction. His opinions had been affirmed by the Court of Appeals, which had used an analysis of Sections 39⁷⁵ and 40⁷⁶ of the Restatement of Foreign Relations.

Section 39(1) specifically states that foreign laws prohibiting disclosure do not present an absolute bar to ordering disclosure. Section 40 presents several factors which are used to decide which nation has the controlling interest in (and therefore, jurisdiction over) the matter. Judge Pollack examined the other circuits and

of the paper.

70. 92 F.R.D. 111, 112 (S.D.N.Y. 1981) (In this case, the bank (BSI) itself operated in New York through a subsidiary corporation) (hereinafter *BSI*).

71. 357 U.S. 197 (1958) (a Swiss holding company was suing for the return of property seized by the Alien Property Custodian Act during World War II).

72. *Id.*

73. *Id.*

74. *In re First Nat'l City Bank*, 285 F. Supp. 845 (S.D.N.Y. 1968), *aff'd*, *United States v. First National City Bank*, 396 F.2d 897 (2d Cir. 1968) (held Citibank in contempt and imposed sanctions for refusal to comply with a subpoena duces tecum in a grand jury investigation into anti-trust violation occurring in the United States. The court held that foreign law did not prohibit disclosure and that Citibank had not shown good faith in its attempts to comply); *Trade Development Bank v. Continental Insurance Company, Co.*, 71 Civ. 85 (S.D.N.Y. 1972) *aff'd*, 469 F.2d 35 (2d Cir. 1972) (Court of Appeals alluded to the factors of Restatement § 40).

75. *City Bank* 396 F.2d at 901-02; *Trade Bank* does not specifically mention Restatement § 39; however, § 39 must apply before the balancing tests found in § 40 are used.

76. *City Bank*, 396 F.2d at 902-905; *Trade Bank*, 469 F.2d at 41.

district courts that had used the balancing approach and held that the second circuit would use the factors found in section 40 to balance competing national interests.

Courts since *BSI* have purported to apply the balancing test⁷⁷ to order enforcement of summons through the application of sanctions in several tax evasion cases.⁷⁸

VII. UNITED STATES INTERESTS IN CLAIMING JURISDICTION

The *Continental Grain* court commented that "taking jurisdiction [was] largely a policy decision."⁷⁹ The policy interests of the United States in claiming jurisdiction over cases involving the extraterritorial application of the provisions of Rule 10b-5, have been enumerated in several cases.⁸⁰ The *Leasco* court examined the legislative intent behind 10b-5 to decide if Congress meant 10b-5 to have an extraterritorial application.⁸¹ In the absence of any expression of legislative intent, the *Leasco* court found that it simply could not "perceive any reason why [Congress] should have wished to limit the protection [of 10b-5]"⁸² to securities of American issuers⁸³ or to securities traded on American exchanges.⁸⁴ The *Kasser* court followed and expanded upon the *Leasco* court's rationale when it held that "to deny such jurisdiction may embolden those who wish to defraud. . . . We are reluctant to conclude that Congress intended to allow the United States to become a 'Barbary Coast' as it were, harboring international securities 'pirates.'"⁸⁵

Imputing a legislative intent through an absence of either dis-

77. *BSI*, 92 F.R.D. 111, 116 (S.D.N.Y. 1981).

78. *United States v. Vetco Inc.*, 644 F.2d 1324, *cert. denied*, 454 U.S. 1098 (1981); *In re Grand Jury Proceedings, Bank of Nova Scotia*, 740 F.2d 817 (11th Cir. 1984) *cert. denied*, 469 U.S. 1106, 105 S. Ct. 778 (1985); *United States v. First Nat'l Bank of Chicago*, 699 F.2d 341 (7th Cir. 1983); *United States v. Toyota Motor Corp.*, 52 A. F.T.R. 2d 83-5752 (D.C. Cal. 1983); *In re Grand Jury Subpoena directed to Marc Rich & Co., A.G.*, 707 F.2d 663 (2d Cir. 1983) *cert. denied*, 463 U.S. 1215 (1983).

79. 592 F.2d at 421.

80. *Leasco v. Data Processing Corp. v. Maxwell*, 468 F.2d 1326, 1334-36 (2d Cir. 1972). *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.) *cert. denied sub nom.*, *Bersch v. Arthur Anderson & Co.*, 423 U.S. 1018 (1975); *IIT v. Vencap, Ltd.*, 519 F. 2d 1001, 1017 (2d Cir. 1975); *IIT, Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 917 (2d Cir. 1980); *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977) *cert. denied*, 431 U.S. 938 (1977); *United States v. Cook*, 573 F.2d 281 (1978); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979); *Grumenthal GmbH v. Hotz*, 511 F. Supp. 582 (C.D. Cal. 1981).

81. *Leasco*, 468 F.2d at 1334.

82. *Id.* at 1336.

83. *Id.*

84. *Id.*

85. *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir. 1977), *cert. denied*, 431 U.S. 938 (1977).

cussion of other information or congressional intent is not a sound principle of construction. Legislative intent must either be fairly implied from or explicitly found within the statute or in the statute's history. The court in both *Leasco* and *Kasser* recognized that Congress made no mention of whether 10b-5 was meant to be applied on an extraterritorial basis. The intent of the *Leasco* and *Kasser* courts to extend the protection of 10b-5 by claiming jurisdiction over predominantly foreign cases may be laudable. However, strong policy reasons exist that argue for limiting the jurisdiction accorded by Rule 10b-5.

Rule 10b-5 was promulgated under section 10(b) of the Securities Exchange Act of 1934. The purpose of the Act is "to ensure the maintenance of fair and honest markets."⁸⁶ Clearly, the markets to be protected were the United States markets. Furthermore, the United States Supreme Court traditionally has been reluctant to impose its jurisdiction over cases in which the foreign elements predominate, under the doctrine of separation of powers. Foreign relations is a function of the executive branch of the government. Neither the court nor the Congress may grant jurisdiction over a foreign matter.

The finding of jurisdiction may be construed by a foreign state as an invasion of its sovereign right to rule its own capital markets. Therefore, the courts should be especially careful to prevent unwarranted intrusion into the jurisdiction of another legislative and judicial system. This argument is strengthened by a parallel development in antitrust law in which the courts have limited their jurisdiction to cases in which an effect on a United States market has been established.

The *Kasser* court also explained that prosecuting those who attempted to bypass prosecution by mixing jurisdictions would 'encourage other nations to take appropriate steps against parties who seek to perpetrate fraud. . . .'⁸⁷ This policy argument has an uncomfortable ring of 'Big Brother-ism' to it; an implication that foreign nations are quick to pick up on. Some foreign states feel strongly that the United States is attempting to impose its judgments and definitions of criminality in the area of securities on foreign securities markets.⁸⁸

86. Securities and Exchange Act of 1934 § 2, U.S.C. § 78b (1976).

87. *Kasser*, 548 F.2d at 116.

88. See *supra* note 9.

VIII. ANALYSIS OF INTERNATIONAL VIEWS ON EXCHANGE OF INFORMATION

Treaties concerning the exchange of information or documents require the crime being investigated or prosecuted to be a crime under the laws of both states.⁸⁹ As most European nations have no legislation or common law that makes the use of inside information illegal, disclosure would not be required by treaty, even though the exchange of information in other criminal matters may be well established.⁹⁰ In a situation where no laws ban disclosure and treaties require it, the disclosure of information becomes an act of comity between nations, which in turn is based on a recognition of jurisdiction over the parties and transactions involved. Such an act of comity is based on respect for the interests, policies, and laws of both nations in evaluating what has become a jurisdictional conflict.

IX. UNITED STATES INTERESTS IN ORDERING DISCLOSURE⁹¹

Policy interests similar to those discussed in *Kasser* and *Leasco* have been articulated as justifying disclosure orders and the application of sanctions⁹² to entities that do not comply with the disclosure orders. The *BSI* court intended to "ensure the integrity of the [United States] financial markets." Other courts have held that a grand jury investigation concerning the enforcement of the United States tax laws will outweigh a foreign state's interest in

89. A treaty that concerns the release of information follows the requirements of an extradition treaty. The state is literally extraditing the information. The requirement of double criminality (the crime must be a crime in both nations) evolved in international law and may be imputed as a requirement of an extradition treaty even though not specifically stated in the treaty. See generally 2 INTERNATIONAL CRIMINAL LAW, *supra* note 15, at ch. 8-9.

90. For a discussion of how a treaty may be utilized based on the Treaty on Mutual Assistance, *supra* note 11, see Tigar & Doyle, *International Exchange of Information in Criminal Cases*, MICH. Y.B. INT'L. LEGAL STUDIES 61, 63-71 (1983). For a general discussion of the provisions usually found in such treaties see Ellis & Pisani, *United States Treaties on Mutual Assistance in Criminal Matters: A Comparative Analysis*, 19 INT'L. LAW. 189 (1985).

91. The following cases are not all in areas covered by 10b-5 or securities exchange regulation. They all do involve the extraterritorial application of United States disclosure procedure.

92. Blocking statutes are only relevant in decisions to invoke sanction on non-complying parties. Compare *In re Westinghouse Elec. Corp. Uranium Contract Litig.*, 563 F.2d 992 (10th Cir. 1977) and *Federal Maritime Comm'n v. DeSmedt*, 268 F. Supp. 972 (S.D.N.Y. 1967) (non-production of documents excused) with *Ohio v. Arthur Andersen & Co.*, 570 F.2d 1370 (10th Cir. 1978) (sanctions imposed for failure to produce documents) *cert. denied*, 439 U.S. 833 (1975). Both a direct conflict with the blocking or secrecy laws and a good faith effort to obtain a waiver to the blocking or secrecy laws must be present to excuse failure to comply and to avoid sanctions. See also *BSI*, 92 F.R.D. 111, 117 n.3 (S.D.N.Y. 1981).

enforcing its secrecy laws.

The courts steadfastly refuse to realize that their cavalier dismissal of the secrecy provisions and blocking laws of foreign countries as being of less importance than the enforcement of a United States interest, no matter how attenuated, is not really in the best interests of cooperation and comity between judicial systems. When a court has in personam jurisdiction over a branch of a bank or corporation, it may impose sanctions to compel discovery. However, when the court claims subject matter jurisdiction, it is powerless to enforce either sanctions or its judgment without the help of the foreign judicial system. In response, the foreign state may choose to enact or reinforce legal impediments to what it perceives as an invasion of its sovereign immunity. An alternative exists.

A. Example

In *SEC v. Certain Unknown Purchasers of Santa Fe Stock*,⁹³ the court urged the Securities and Exchange Commission to utilize the Treaty of Mutual Assistance in Criminal Matters⁹⁴ as an alternative to imposing sanctions, in order to compel compliance with a discovery order.⁹⁵ Even though the exchange of information in criminal matters was well-established,⁹⁶ the Swiss bankers could not release the necessary information of documents without violating the secrecy laws, because insider trading was not prohibited by Swiss law.⁹⁷

Negotiations between the SEC and the Swiss government and bankers resolved the matter by arriving at a special agreement specifically concerning insider trading.⁹⁸ The agreement stipulated

93. *SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of Santa Fe Int'l Corp.*, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) 98,323 (S.D.N.Y. 1983) [hereinafter *Santa Fe*].

94. Treaty on Mutual Assistance, *supra* note 11.

95. *Santa Fe*, *supra* note 93.

96. *Santa Fe*, *supra* note 93.

97. The court tried to fit insider trading under some of the other criminal statutes concerning the use and misuse of information, but had no success. *Santa Fe*, *supra* note 93. For a discussion of insider trading as a use or misuse of confidential information, see generally Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 19 SUP. CT. REV. 309 (suggests a new category for problems concerning the use of, the misuse of, and the formation of property rights in confidential information).

98. Memorandum of Understanding, Switzerland-United States. The Swiss-United States negotiations and the MOU are discussed in Green, *U.S., Switzerland Agree to Prosecute Inside Traders*, LEGAL TIMES, Oct. 4, 1982, at 12. The MOU is reprinted *id* at 17-19. See also Navickas, *Swiss Banks and Insider Trading in the United States*, 2 INT'L TAX BUS. LAW. 159 (1984); Note, *The Effect of the U.S.-Swiss Agreement on Swiss Banking Secrecy and Insider Trading*, 15 LAW AND POLICY IN INT'L BUS. 565 (1983).

that the SEC would have access to the Swiss judicial system, would use Swiss disclosure procedures, and would be limited by Swiss judicial discretion. This case proves that the two systems can work together to reach a common goal, while recognizing that the secrecy and blocking laws are not in place to protect criminals.

B. *Suggestions Toward a Solution*

One approach would be to legislate jurisdiction under the guise of foreign policy.⁹⁹ The Draft Restatement of Foreign Relations Law is an example. The Draft Restatement re-defines the jurisdiction of United States courts along the lines of "minimum contacts" which the United States developed in previous 10b-5 cases. Formalizing this expanded jurisdiction could further aggravate foreign states and possibly provoke an international round of "jurisdiction grabbing."

A suggestion that Congress clarify the jurisdiction of 10b-5 by promulgating a clear set of statutory rules would be perilously close to allowing Congress to make what is, in essence, foreign policy. One possible way of getting around this problem would be to place the focus of the statutory scheme on limiting trading on American securities markets to those entities that agree that the act of trading will serve as a waiver of the protection offered by the foreign jurisdiction.¹⁰⁰ This waiver by conduct approach was originally a provision of the Bank Secrecy Act.¹⁰¹ It was removed because of fear of limiting foreign involvement and investment, and the subsequent loss of profits.¹⁰² SEC proposal of an amendment to Rule 17a-3(a)(9) was also cancelled because of similar negative responses.¹⁰³ Yet even if the waiver by conduct is legitimized by amendment or case law, it would still only affect the problems created by the secrecy provisions.

C. *Suggestions for Negotiations*

The best approach to regulating insider trading would be to set a world standard that would apply to all capital markets involved

99. Compare Robinson, *Compelling Discovery and Evidence in International Litigation*, 18 INT'L LAW. 533 (1984) (a discussion that favors the current Restatement's balancing of interests found in § 40) with Note, *Suggested Roadmap*, *supra* note 42, (a discussion that favors the Draft Restatement, which follows the expanded jurisdiction).

100. See generally Note, *The SEC's Waiver by Conduct Proposal: A Critical Appraisal*, 71 VA. L. REV. 1411 (1985); Fedders, *Policing Internationalized Capital Markets: Methods to Obtain Evidence Abroad*, 18 INT'L LAW. (1984) [hereinafter Fedders].

101. S. 3678, § 401, 91st Cong., 2d. Sess., 116 Cong. Rec. 32626-27 (1970).

102. 116 Cong. Rec. 32630-33 (1970) (statement of Senator Bennet).

103. See Note, *Foreign Bank Secrecy and the Evasion of United States Securities Laws*, 9 N.Y.U.J. INT'L. L. & POL. 417, 446-49 (1977).

in securities trading.¹⁰⁴ The varying standards in the differing markets make a common standard difficult to envision. One approach would be to establish a world standard based on the standards common to all the regulatory systems: a minimal approach that would allow free investigatory and prosecutorial access to information when one of the common standards had been violated. The process of working out a common standard would also set up common, basic definitions¹⁰⁵ that would be helpful in subsequent negotiations. The necessary articulation of purposes, policies, definitions, and individual standards of differing jurisdictions would help to indicate other areas of agreement between individual states that might lead to further accords in specified areas beyond the minimal standards. Nation-by-nation agreements based on the Swiss-U.S. Memorandum of Understanding would be limited in their application to the nations which agree to them.

As a first step¹⁰⁶ towards this type of international regulatory

104. See Securities Exchange Act Releases No. 65168, 50 Fed. Reg. 9,261 (Feb. 28, 1985); No. 21958, 50 Fed. Reg. 16,302 (April 18, 1985); 22190, 50 Fed. Reg. 16,302 (June 28, 1985).

105. This would be particularly appropriate in the area of insider trading, as the United States has no statutory definition and the judicially created doctrine is not clear. See generally Committee on Federal Regulation of Securities, *Report of the Task Force on Regulation of Insider Trading: Part I Regulation under the Antifraud Provision of the Securities and Exchange Act of 1934*, 41 BUS. LAW. 223 (1985) (concludes that Congress should address specifically the use of information rather than to allow the rules to develop on a case-by-case basis.)

106. The SEC has taken a first step in recognizing the validity of each nation's concerns in regulating its own markets in the area of registered securities. In Exchange Act Release No. 33-4708 (July 9, 1964) 29 FR 9828, the SEC took the position that the registration requirements under Section 5 should not be imposed on offerings with only incidental jurisdictional contacts. Under Release 4708 and the subsequent no-action letters issued by the SEC, United States corporations would be allowed to forego the registration requirements if all the securities came to rest abroad or in the hands of foreign nationals.

The Securities and Exchange Commission has taken a step in this direction in three recent releases which propose a territorial approach to the registration requirements for offshore offerings. See "Regulation S," Securities Act Release No. 6779, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) Par. 84,242 (June 10, 1988); (The proposal of a 'safe harbor' for offshore offerings); "Proposed Rule 144A", Securities Act Release No. 6806, [Current] Fed. Sec. L. Rep.(CCH) Par. 84,335 (Oct. 25, 1988) (The rule would permit securities distributed abroad to be resold to institutions in the United States under specified circumstances); the third release would concern mutual recognition of prospectuses and certain aspects of takeover regulation with certain Canadian securities authorities. See generally Coogan, *SEC Proposes Safe Harbor for Offshore Offers*, 9 THE BUSINESS LAWYER UPDATE 1 (January/February 1989).

REGULATION S

Proposed Regulation S consists of six proposed Rules. Rule 901(a) is a general statement of the intent to exempt offers and sales that occur outside the United States. See Release 6779, at 89, 130.

Rule 901(b) provides the factors to analyze whether the transaction is outside the United States. *Id.* The first factor requires that each element of the transaction must take place or be performed entirely outside of the United States. See Release 6779, at 89,131. If offers or even advertisements are made within the United States by telephone, the mail, in per-

scheme, the current "minimum contacts" standard for claiming subject matter jurisdiction currently evolving in some district courts needs to be re-evaluated. When jurisdictions are in conflict, especially on an international level, a more demanding set of criteria should be used.

A detrimental effect on American securities markets would be adequate for jurisdictional purposes, as would in personam jurisdiction. These criteria would adequately serve the American interest in protecting its markets and to protect United States invest-

son, or in any other manner, the exemption would not apply. *Id.* The location of the buyer when the buy order originates and the place of execution, payment and delivery will also be considered. *Id.*

The "directed selling efforts" discussed in 901(b)(2) would be directed to activities undertaken by the issuer or any sellers (which term would include the distributor and its affiliates or agents) to induce buyers to buy. *Id.* Even advertisements which specifically stated that this was an offshore offer would be included.

Rule 901(b)(3) provides the factors to determine whether the securities would come to rest outside of the United States. *Id.* at 89,123.

Rule 901(b)(4) concerns the justified expectations of the parties concerning the applicability of the United States registration requirements. *Id.*

SAFE HARBORS UNDER REGULATION S

Fulfilling the general requirements would protect an offshore offering from the registration requirements even if the offering does not fit specifically within one of the three safe harbors. Proposed Rules 903-906 describe two non-exclusive safe harbors for extraterritorial sales and resales of securities. *Id.* at 89,133.

The first category provides a safe harbor for non-reporting foreign issuers with no substantial United States market interest. The major problem associated with this exemption would be for those issuers that could not establish the volume of off-exchange United States trading in their securities.

The second category concerns reporting United States and foreign issuers. These issuers gain several advantages over the requirements developed under Release 4708. The 90-day lock-up begins with the closing of the offering. [Under Release 4708, the 90 day period began at the completion of the distribution which could be difficult to accurately calculate.] The 90 day requirement would be the same for both debt and equity securities [the prior requirement for equity securities was 1 year]. However, recommendations to change the 90 day period to 40 days to correspond with Section 4(3) are being considered. Release 4708 used the terms "American investors," "American nationals," and "foreign nationals" but did not define the terms. The more common phrase "U.S. person" devolved from later no-action letters concerning the applicability of Release 4708 on specific offers. The term "U.S. person" includes citizens and residents of the United States as well as organizations formed under the laws of the United States or any political subdivision thereof. See *Goldman, Sachs & Co.*, (Oct. 3, 1985); *Executive Management Inc.* (Oct 28, 1983). Businesses regulated locally, such as foreign branches of United States banks and insurance companies, were not considered U.S. persons. See *Foreign Agencies and Branches of United States Banks and Insurance Companies*, (Feb. 25, 1988); *Dresser Industries Canada, Ltd.* (Oct. 31, 1977); *Vizcaya International N.V.* (Apr. 4, 1973); *First Interstate Bancorp* (Mar. 15, 1985).

Regulation S uses the term "U.S. person." Under Regulation S, United States citizens residing abroad, agencies or branches of United States corporations subject to substantive regulation in the foreign jurisdiction, or agencies or branches that were not established to invest unregistered securities would not be included under the buyer prohibition. Regulation S indicates that these would be covered, but the staff indicates that they may be exempt under the final version.

The safe harbor may still be available to other issuers if they satisfy the conditions set out in Rule 901 and the stringent requirements developed under Release 4708.

tors. However, conduct sufficient to justify jurisdiction should go past the minimal contacts which the eighth circuit has determined are adequate.

In cases requiring disclosures, the disclosure orders should be tailored to reveal only the information necessary to the investigation or prosecution. Foreign jurisdictions object to the overly broad disclosure requirements under the United States system. A voluntarily tailored request shows a good faith effort to respect foreign procedure and may encourage a foreign judicial system to recognize that the intrusion into the foreign jurisdiction has been deliberately minimized.

A comparison between the steps set out in the Swiss-United States Memorandum of Understanding and the French example shows a similar pattern of utilizing the foreign judicial system. This avenue of cooperative effort should not be ignored under the assumption that foreign courts will automatically ignore or reject the request.