

Swiss Banks and Insider Trading in the United States

by
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One of the most important applications of Securities and Exchange Commission (SEC) Rule 10b-5¹ is its use as a sanction against “insider trading.”² However, insider traders have often frustrated attempts to enforce the prohibitions of Rule 10b-5 by using foreign financial institutions as trading intermediaries. Large foreign banks typically use numbered trading accounts to buy and sell securities on behalf of their clients,³ al-

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1. 17 C.F.R. § 240.10b-5 (1983). Rule 10b-5 was promulgated by the Securities and Exchange Commission (SEC) in 1942 under the authority of § 10(b) of the Securities Exchange Act of 1934. 15 U.S.C. § 78j(b) (1982) [hereinafter cited as the Exchange Act]. It is one of the most significant antifraud provisions enacted under the federal securities laws and reads as follows:

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,

(a) To employ any device, scheme, or artifice to defraud,

(b) 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 the light of the circumstances under which they were made, not misleading, or

(c) 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.

Other significant antifraud provisions include § 17(a) of the Securities Act of 1933, 17 C.F.R. § 230 (1982) [hereinafter cited as the Securities Act], §§ 14(e) and 15(c)(1) of the Exchange Act, 17 C.F.R. §§ 240.14e and 240.15c (1983), and § 206 of the Investment Advisors Act, 17 C.F.R. § 275.206 (1983) [hereinafter the Advisors Act].

2. Rule 10b-5 does not specifically define or even mention “insiders”, nor does it specifically require that a person having information not known by another disclose this information in a securities transaction. Nevertheless, a jurisprudence of insider trading has developed over the years, drawing distinctions among the types of information on which insiders trade and the positions that insiders hold within or without the corporation whose securities are the object of the insiders’ trading. Recently, there has been talk of drafting a legislative definition of insider trading. This trend is in response to securities industry critics of newly proposed amendments to the Exchange Act which would increase sanctions against insider traders. BARRONS, Apr. 18, 1983, at 43, col. 1.

3. Many large foreign banks, modeled after the German system, offer a much wider range of services than those traditionally offered by commercial banks in the United States. Thus, in addition to such services as checking and savings accounts, consumer credit, hire-purchase loans, real estate mortgages, and safety deposit facilities, foreign universal service banks may hold seats on national stock exchanges and buy or sell securities on their own account or for the accounts of their customers. Foreign banks may also engage in stock and

lowing insider traders to shield their identity from those responsible for recording the tainted transactions in the United States. Unlike United States dealers, foreign financial institutions are under no direct obligation to divulge the names of those on whose account they trade.⁴ To the contrary, the laws in many foreign countries prohibit financial institutions from divulging the names of their customers to outsiders, including government authorities, except under certain circumstances.⁵

When direct appeals to foreign nationals or governments through treaty or other mechanisms are not available, the process of obtaining financial information from foreign sources is time-consuming and often futile. In cases involving federal securities law violations, these difficulties may allow certain violators to escape prosecution and may frustrate SEC efforts to enjoin future violations. In addition, any significant delay in the transmission of necessary information may compromise its effectiveness, as potential defendants may remove illicit profits from the United States before they can be frozen there for execution of judgments. Indeed, difficulties in obtaining information may allow such assets to be so well-hidden abroad that enforcement of any judgment against them would be impossible, irrespective of the separate problems inherent in enforcing United States judgments abroad. As long as no one has the power to force the bank which traded on the account to disclose the accountholder's identity, the insider trader can avoid detection and punishment. Thus, foreign non-disclosure laws create a double standard of justice that becomes more pronounced as the security markets in the United States are increasingly influenced by foreign traders.

Until recently, Swiss banks have been very effective intermediaries for insider trading transactions. The banking industry is one of Switzerland's most important businesses, and over the years it has taken on a decidedly international character. Numerous banking institutions have established themselves in Switzerland, and several Swiss banks have created footholds of various types abroad.⁶ The success of Swiss banking may partially be

bond underwritings, handle transactions in gold coin and bullion, buy and sell foreign exchange, and, through subsidiaries, conduct open-end investment company operations. For an excellent critique of the German model, see Immenga, *Participatory Investments by Banks: A Structural Problem of the Universal Banking System In Germany*, 2 J. COMP. L. & SEC. REG. 29 (1979).

4. See the discussion on foreign "blocking" and "secrecy" laws, Section I.B, *infra*.

5. *Id.*

6. As of 1981, there were a total of ninety-one foreign owned banks in Switzerland with assets totalling SF 52,486,085. *Das Schweizerische Bankwesen im Jahre 1981, Nr. 66*, SCHWEIZERISCHE NATIONALBANK ORELL FÜSSLI VERLAG ZÜRICH, at 306-09 (1982). There were a total of sixteen foreign bank subsidiaries with assets totalling SF 10,817,140. *Id.* at 315. In addition, sixteen Swiss banks had a total of seventy affiliates in foreign countries, including the United States. Approximately twenty-eight percent of the total assets of these institutions are attributable to their foreign affiliates. In particular, the "Grand Banks" had a total of thirty affiliates in foreign countries, and three of these had at least one branch office in the United States. "Other" banks with a majority of Swiss shareholders had a total of two affiliates in

attributed to a number of Swiss laws which serve to protect the financial privacy of banking customers.⁷ Nevertheless, it is the relative strength of the Swiss economy and accompanying political stability that have enabled Swiss banking to advance beyond the banking industries of other countries with similar secrecy laws.⁸

It is only natural, then, that Switzerland has become the target of efforts by the United States to eliminate the use of foreign banks as agents of, and caches for, those engaged in illegal activities.⁹ The most recent example of these efforts is the August 1982 signing of a Memorandum of Understanding Between the Federation of Switzerland and the United States (hereinafter MOU)¹⁰ and an accompanying Private Agreement Among Members of the Swiss Bankers' Association (hereinafter Bankers' Agreement).¹¹ Both the MOU and the Bankers' Agreement relate to insider trading violations of United States securities laws. While neither document can prevent insider trading from occurring, each attempts to facilitate production of evidence against alleged insider traders already subject to investigation and prosecution in the United States.

This Article will examine both the MOU and the Bankers' Agreement, in the context of past, present, and future prosecutions of insider traders in the United States. Part I presents a general historical overview of the problems in obtaining information about securities laws violators from foreign sources, with an emphasis on the problems of obtaining information from Switzerland. Part II examines the approach taken by U.S. courts in the absence of any executive solution for gaining access to information secreted in foreign countries, the Swiss reaction to this approach, and the circumstances which led to the signing of the MOU and the Bankers'

foreign countries, while banks with a majority of foreign shareholders had thirty-eight affiliates in foreign countries. *Id.*, at 44-45.

7. For an extended discussion of Swiss banking secrecy laws, see Section I.C, *infra*.

8. See Note, *Banking Secrecy and Insider Trading: The U.S.-Swiss Memorandum of Understanding on Insider Trading*, 23 VA. J. INT'L L. 606 (1983).

9. Various congressional hearings are replete with details of how Swiss bank accounts are used for the purpose of tax evasion, securities law violations, and the concealment of criminal activities, including those of organized crime. One particularly good source of such information is the hearings preceding enactment of the Mutual Assistance Treaty for Criminal Matters between the United States and Switzerland in the early 1970s. See generally *Legal and Economic Impact of Foreign Banking Procedures on the United States: Hearings Before the House Committee on Banking and Currency*, 90th Cong., 2d Sess. (1968); *Foreign Bank Secrecy and Bank Records: Hearings on H.R. 15073 Before the House Committee on Banking and Currency*, 91st Cong., 1st and 2d Sess. (1969-1970). See also STAFF OF PERMANENT SUBCOMM. ON INVESTIGATIONS OF SENATE COMM. ON GOVERNMENTAL AFFAIRS, 98TH CONG., 1ST SESS., CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES 7 (Comm. Print 1983).

10. Memorandum of Understanding To Establish Mutually Acceptable Means For Improving International Law Enforcement Cooperation in the Field of Insider Trading, August 31, 1982, United States-Switzerland, 22 I.L.M. 1 (January 1983) [hereinafter cited as MOU].

11. Agreement of the Swiss Bankers' Association with Regard to the Handling of Requests for Information from the Securities and Exchange Commission of the United States on the Subject of Misuse of Inside Information, August 31, 1982, 22 I.L.M. 7 (January 1983) [hereinafter cited as Bankers' Agreement].

Agreement. Part III contains a detailed outline of the major provisions of the MOU and the Bankers' Agreement, and Part IV offers an analysis of the advantages and disadvantages of these agreements and their usefulness in light of recent events.

I

OBTAINING TRADING INFORMATION FROM FOREIGN SOURCES

A. Extraterritorial Enforcement of U.S. Territorial Laws

The regulation of United States capital markets by means of its various securities laws is unique in at least two respects. First, the United States government plays a much larger role in the regulation of the securities industry than is the case in other countries. Second, the system depends on a disclosure of arguably private information, unparalleled in most other market economies.¹² These two characteristics are manifested in the broad investigatory powers granted the SEC. Under section 21(a) of the Exchange Act, the SEC may commence and conduct any investigation, both informal and formal, necessary "to determine whether any person has violated, is violating, or is about to violate" any provision of the federal securities laws.¹³ Moreover, section 21(b) authorizes the SEC to subpoena any documents or witnesses useful to its investigations,¹⁴ and section 21(c) permits it

12. While many foreign countries do regulate their securities industries to an extent, their regulations are often limited to those of recordkeeping and exchange control. These countries leave the principal regulatory functions to the established national exchanges. For examples of the wide variety of securities regulation around the world, see Eizirik, *The Role of the State in the Regulation of the Securities Markets: The Brazilian Experience*, 1 J. COMP. CORP. L. & SEC. REG. 211 (1978); Guyon, *Les Missions De La Commission Des Operations De Bourse*, 2 J. COMP. CORP. L. & SEC. REG. 141 (1979); Rosen, *The Myth of Self-Regulation or The Dangers of Securities Regulation Without Administration: The Indian Experience*, 2 J. COMP. CORP. L. & SEC. REG. 261 (1979); Tatsuta, *Enforcement of Japanese Securities Legislation*, 1 J. COMP. CORP. L. & SEC. REG. 95 (1978); Rider, *Self-Regulation: The British Approach to Policing Conduct in the Securities Business, With Particular Reference to the Role of the City Panel on Take-Overs and Mergers and the Regulation of Insider Trading*, 1 J. COMP. CORP. L. & SEC. REG. 319 (1978); Schwark, *Regulation of the German Capital Markets—Present Situation, Problems and Outlook*, 1 J. COMP. CORP. L. & SEC. REG. 299 (1978).

13. Section 21(a) of the Exchange Act provides, in pertinent part:

The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this chapter, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member The Commission is authorized in its discretion to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of such provisions, in the prescribing of rules and regulations under this chapter, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this chapter relates.

15 U.S.C. § 78u(a) (1982).

14. Section 21(b) of the Exchange Act reads:

For the purpose of any such investigation, or any other proceeding under this chapter, any member of the Commission or any officer designated by it is

to invoke, if necessary, the aid of a United States district court to enforce its subpoena should the SEC be faced with contumacy on the part of the subpoenaed.¹⁵

The language of the last sentence of section 21(b), however, raises the question of whether the SEC's subpoena power is limited to documents and witnesses located within the United States or its territories. The pertinent language reads: "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."¹⁶ Legislative history and subsequent case law suggest that the SEC's subpoena power is valid so long as the subpoenaed party is a resident of the United States, even if compliance requires the production of documents located abroad.¹⁷ Other authority goes so far as to suggest that testimony and evidence production by United

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.

15 U.S.C. § 78u(b) (1982).

15. Section 21(c) of the Exchange Act reads, in pertinent part:

In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Commission or member or officer designated . . . by the Commission, there to produce records, . . . or to give testimony . . . ; and any failure to obey such order of the court may be punished . . . as a contempt thereof. . . . Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Commission, shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than \$1,000 or to imprisonment for a term of not more than one year, or both.

15 U.S.C. § 78u(c) (1982).

16. See also Securities Act § 19(b), 15 U.S.C. § 78s(b) (1982).

17. Judge Friendly's opinion in *FMC v. DeSmedt*, 366 F.2d 464, 469 (2d Cir. 1966), cert. denied, 385 U.S. 974 (1966), analyzes the legislative history of the Interstate Commerce Act, from which most of the other acts governing sister regulatory agencies were derived, and which contains substantially similar language to § 21(b) of the Exchange Act. Judge Friendly's opinion reads in part as follows:

[H]istory fully enlightens us as to the legislative purpose. The [Interstate Commerce] Commission's Annual Reports for 1889 and 1890 show that Congress was simply responding to requests by the agency to clarify that its subpoena power was not limited to requiring attendance within the district of a witness' residence [The legislative] history makes it as plain as anything can be that the purpose of the new provision, which has had so large a progeny, was to enhance or confirm the powers of the ICC, not to thwart it by allowing parties to Commission proceedings to refuse to produce documents from foreign countries, a problem which was in no one's mind.

Id. at 470-71.

States citizens located outside the United States and by nonresidents is the valid subject of an SEC subpoena where such persons have engaged in activities that significantly affect United States securities markets. These authorities reason that a foreign party lies within U.S. jurisdiction if sufficient contacts exist with the United States to justify the assertion of jurisdictional authority as fair.¹⁸ Such logic has led courts to construe section 27 of the Exchange Act, which expressly permits service of process in civil suits commenced against securities law violators "wherever the defendant may be found,"¹⁹ as authorizing international service of process in such cases.²⁰ This construction has even been extended to statutes which do not specifi-

18. Technically, the jurisdictional issue may be broken down into at least two different components: (1) the assertion of "personal" jurisdiction over one who was never, or is no longer, within the jurisdictional confines of the United States; and (2) the assumption of "subject matter" jurisdiction over those activities conducted outside the United States which have an adverse impact on U.S. securities markets. An example of a case in which a court refused, at least in the case of certain defendants, to assert personal jurisdiction over a foreigner is *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972). *See also* *SEC v. Zanganeh*, 470 F. Supp. 1307 (1978).

The issue of subject matter jurisdiction arises because securities transactions fall into one of three categories: (1) United States transactions in foreign securities; (2) foreign transactions in United States securities; and (3) foreign transactions in foreign securities which have some impact on American investors or markets. U.S. courts have long wrestled with the question of whether Congress in fact intended for various securities laws to apply to acts done outside the United States. The earlier cases focused on the existence of minimum contacts to bring a given transaction within the definition of interstate commerce. *See, e.g.,* *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), *cert. denied sub nom.*; *Manley v. Schoenbaum*, 395 U.S. 906 (1969). Later, courts began to ask whether the minimum contacts were sufficiently "significant" to lead to the conclusion that Congress intended that United States law be applied. *See* *Leasco v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972); *Travis v. Anthes Imperial Limited*, 473 F.2d 515 (8th Cir. 1973). *See also* *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977), *cert. denied sub nom.*; *Churchill Forest Industries (Manitoba) v. SEC*, 431 U.S. 938 (1977); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979).

Any possible limitations to such interpretations imposed under international law were supposedly satisfied by an analysis of "significant contacts" under RESTATEMENT (SECOND) FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 [hereinafter the RESTATEMENT]. Some more recent cases, however, more explicitly invoke the concerns and techniques of the conflict of laws in interpreting and carrying out the intent of Congress. *See, e.g.,* *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 (1975); *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980).

The result of all this jurisprudence can perhaps best be seen in tentative drafts of the RESTATEMENT (REVISED) FOREIGN RELATIONS LAW OF THE UNITED STATES § 416 (Tent. Draft No. 2, 1981), which includes an individual section devoted to the subject of jurisdiction over securities transactions. Section 416 is to be read in light of §§ 402 and 403 of the draft, which establish a jurisdictional test of reasonableness. Thus, the more direct and substantial the effect of a given transaction on the U.S. market, the more reasonable is a U.S. effort to apply its laws to that transaction.

19. Section 27 of the Exchange Act, 15 U.S.C. § 78aa (1982), provides in pertinent part:

The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. . . . Any suit or action to enforce any liability or duty created by this chapter or rules and regulations . . . may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and

cally mention service outside the United States.²¹ Naturally, this expansive construction of U.S. jurisdiction has not met with universal approval.²²

B. Foreign Secrecy and Blocking Laws

Assuming the SEC can serve administrative subpoenas abroad, either under its own authority or with the assistance of a federal court, certain impediments to obtaining compliance or imposing sanctions nonetheless remain. Difficulties exist even if the SEC has concluded an investigation and has filed suit pursuant to its authority under section 21(d) of the Exchange Act.²³ In particular, foreign laws which impose civil liability or criminal penalties for cooperation with foreign authorities, including disclosure of certain information, greatly hamper SEC prosecution of alleged securities laws violators.

Foreign non-disclosure laws are of two types: "secrecy" and "blocking." Secrecy laws usually reflect a nation's careful balancing of the public's need for information and the individual's right to privacy. They prohibit the disclosure of business records and related information where it is believed that the interest in economic privacy inherent in the individual's personality rights outweighs the public interest in enforcing public and private law. Noncompliance can result in civil liability and/or criminal penalties.²⁴ Blocking laws, on the other hand, are an assertion of sovereign

process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.

20. See, e.g., *International Controls Corp. v. Vesco*, 593 F.2d 166, 175 (2d Cir. 1979), cert. denied, 442 U.S. 941 (1979); *Leasco*, 468 F.2d 1326 (2d Cir. 1972).

21. See, e.g., *SEC v. Myers*, 285 F. Supp. 743, 748 (D. Md. 1968) (§ 214 of Advisors Act); *SEC v. VTR, Inc.*, 39 F.R.D. 19, 20-210 (S.D.N.Y. 1966) (§ 22(a) of Securities Act); *SEC v. Briggs*, 234 F. Supp. 618, 622 (N.D. Ohio 1964) (§ 22(a) of Securities Act and § 27(a) of Exchange Act).

22. As to the assertion of jurisdiction over extraterritorial activity by United States courts, critics abound, both in the United States and elsewhere. For an interesting discussion of where the United States position now stands, see Maier, *Extraterritorial Jurisdiction at a Crossroads: An Intersection Between Public and Private International Law*, 76 AMER. J. INT'L L. 280 (1982).

23. If an SEC investigation uncovers evidence of a violation of the securities laws, the SEC may order an administrative hearing to determine responsibility and to impose sanctions. Administrative proceedings, however, can only be brought against persons or firms registered with the SEC, or with respect to securities registered with the SEC. See § 15(b) of the Exchange Act, *supra* note 1. Nevertheless, the SEC has specific statutory authority to bring an action in a federal district court to enjoin violation of the securities laws by any person. See, e.g., § 21(d) of the Exchange Act, *supra* note 1. In addition, the SEC may seek a rescission order (see *SEC v. Bangor Punta Corp.*, 331 F. Supp. 1154 (S.D.N.Y. 1971), *aff'd with modifications*, 480 F.2d 341, 390-91 (2d Cir. 1973)), or disgorgement of any profits made by a securities law violator (see *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir. 1971)). Willful violations of the securities laws are often followed by criminal prosecutions conducted by the Justice Department, with violators subject to fines and imprisonment. See § 21 of the Exchange Act, *supra* note 1.

24. Bank accounts may be kept secret from investigators in over twenty-five countries. Some prominent examples of such countries include: the Bahama Islands, the Cayman Islands, Liechtenstein, Luxembourg, Panama, Switzerland, and Federal Republic of Germany.

authority. Often enacted in response to the extraterritorial application of United States antitrust laws, blocking laws restrict testimony or prohibit the disclosure, copying, inspection, or removal of documents in the territory of the enacting state in compliance with either requests or orders of foreign authorities. The potency of these laws is increased by the use of penal sanctions for noncompliance, either by the party requesting information or the party producing it.²⁵

Secrecy and blocking laws are not always absolute. International letters rogatory, formal requests for assistance from one national court to an appropriate foreign court, are the most universal means of obtaining requested financial information.²⁶ Another method is court-ordered discovery, pursuant to Rule 37 of the Federal Rules of Civil Procedure.²⁷ Bilateral or multilateral treaties may provide another means of obtaining information, such as application to diplomatic or consular intermediaries.²⁸ In addition, depending on the type of law prohibiting disclosure and the

Remarks of John M. Fedders, SEC Director of Enforcement, Tenth Annual Securities Regulation Institute, at the University of California, San Diego (January 1983) (on file with the International Tax & Business Lawyer) [hereinafter cited as Fedders Remarks].

25. Some important examples of countries with prohibitive blocking laws include: Australia, Canada, Federal Republic of Germany, France (perhaps the most prohibitive of the various blocking statutes), Norway, South Africa, Switzerland, and the United Kingdom. *Id.*

26. Using the letters rogatory procedure, the SEC or other governmental agency would apply to a United States district court for issuance of a letter rogatory. FED. R. CIV. P. 28(b); FED. R. CRIM. P. 15(d)(e). Although under Rule 28(b) issuance of letters rogatory appears to be mandatory, courts have refused to do so where the taking of depositions abroad could prove extremely prejudicial to the opposing party. *See, e.g., Oscar Gruss & Son v. Lumbermens Mutual Casualty Co.*, 422 F.2d 1278, 1282 (2d Cir. 1970). Upon issuance of a letter rogatory, the district court may transmit the letter directly to a foreign court, officer, or agency (28 U.S.C. § 1781(b)(2) (1970)), or do so through the Department of State (28 U.S.C. § 1781(a)(2) (1970)). The foreign courts have wide discretion to grant the request contained therein, but such requests are usually granted on the basis of international comity.

27. FED. R. CIV. P. 37 provides, in pertinent part:

(a) **MOTION FOR ORDER COMPELLING DISCOVERY.** A party, upon reasonable notice to other parties and all persons affected thereby, may apply for an order compelling discovery as follows:

(1) *Appropriate Court.* An application for an order to a party may be made to the court in which the action is pending, or, on matters relating to a deposition, to the court in the district where the deposition is being taken. . . .

(2) *Motion.* If a deponent fails to answer a question propounded or submitted under Rule 30 or 31, or a corporation or other entity fails to make a designation under Rule 30(b)(6) or 31(a), or a party fails to answer an interrogatory submitted under Rule 33, . . . the discovering party may move for an order compelling an answer, or a designation

(3) *Evasive or Incomplete Answer.* For purposes of this subdivision, an evasive or incomplete answer is to be treated as a failure to answer.

28. *See, e.g.,* The Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, November 15, 1965, 20 U.S.T. 361, T.I.A.S. No. 6638, 658 U.N.T.S. 163; The Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, March 15, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444, 847 U.N.T.S. 231. The United States is also a party to a number of executive agreements with other nations which are used to facilitate mutual law enforcement cooperation. More than fifty of these agreements have been concluded with twenty-seven countries concerning cases involving questionable or illegal corporate payments. Fedders Remarks, *supra* note 24.

nature of the request, the individual whose privacy is threatened, or the applicable foreign government, may waive the restraints on disclosure.²⁹

C. *Swiss Secrecy and Assistance Laws*

The Swiss have a well-developed system of privacy law which is deeply rooted in the concept of personality rights. These rights include protection of physical and intellectual integrity, as well as protection of other highly personal rights.³⁰ Remedies for infringement of personality rights can be found in the Swiss Constitution and Civil Code, the latter of which enables an individual whose privacy is endangered or has been violated to sue for relief, damages, or both.³¹ Included among the privacy rights so protected is the right to financial privacy, as embodied in the banker-client relationship. Financial privacy is considered such an integral part of liberty and personal independence that the banker-client relationship is viewed as more than an ordinary business relationship. "Possessing a deeper insight into the financial affairs of his customer than the government or the client's family, the banker is considered a person of confidence and trust, much in the same way as a clergyman, physician or lawyer."³²

The legal relationship which exists between Swiss banks and their clients itself serves as a source of protection for banking secrets in Switzerland. Under the Swiss laws of contract and agency, a contract for deposit of securities or money creates contractual secrecy obligations on the part of the contracting bank.³³ Furthermore, article 162 of the Swiss Penal Code makes disclosure of such business secrets, in violation of legal or contractual obligations, a criminal offense.

Various other provisions of the Swiss Penal Code have also been interpreted as protecting banking secrecy. For instance, if disclosure of confidential facts causes the resources of the client to be impaired, the bank may be charged with unfaithful management under article 159 of the Penal Code. Further, article 273 of the Penal Code makes it a crime to disclose to a foreign authority or private person information of an economic nature, if it is in Switzerland's national interest to keep this information secret, or if

29. An individual, for example, can often waive his privacy rights, provided there is no law prohibiting him from divulging the particular information sought by foreign authorities. *See, e.g., infra* discussion of article 273 of the Swiss Penal Code accompanying note 34.

30. Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 *NEW ENG. L. REV.* 18, 20 (1978).

31. *See, e.g.,* SCHWEIZERISCHES ZIVILGESETZBUCH, CODE CIVIL SUISSE, CODICE CIVILE SVIZZERO, art. 28 [hereinafter cited as ZGB]; SCHWEIZERISCHES OBLIGATIONRECHT, CODE DES OBLIGATIONS, CODICE DELLE OBLIGAZIONI, arts. 41, 49 [hereinafter cited as OR].

32. Meyer, *supra* note 30, at 22-23. The banker-client relationship is not "privileged", however, in the same sense that the attorney-client relationship is privileged. Privileged relationships are given their own form of protection under the Swiss Penal Code. *See* SCHWEIZERISCHES STRAFGESETZBUCH, CODE PENAL SUISSE, CODICE PENALE SVIZZERO, art. 321 [hereinafter cited as STGB].

33. OR, *supra* note 31, art. 398.

third persons having an interest worthy of protection have not consented in advance to the disclosure.³⁴ Article 271 of the Swiss Penal Code also makes it a violation of Swiss sovereignty for any foreign government to request a Swiss resident to perform certain acts within Swiss borders without the permission of the Swiss government.³⁵ This provision has been construed to include official contacts with United States government employees or agents, through the mail, over the telephone, or in meetings in Switzerland.³⁶ In each case, noncompliance may be punishable by imprisonment.³⁷

Underlying all these provisions is the statutory protection provided by the Federal Banking Law of 1934.³⁸ Article 47 is the foundation for all the various Swiss secrecy protections.³⁹

1. Whoever divulges a secret entrusted to him in his capacity as an officer, employee, mandatory, liquidator or commissioner of a bank, as a representative of the Banking Commission, officer or employee of a recognized auditing company, or who has become aware of such a secret in this capacity, and whoever tries to induce others to violate professional secrecy, shall be punished by a prison term not to exceed 6 months or by a fine not exceeding 50,000 francs.

2. If the act has been committed by negligence, the penalty shall be a fine not exceeding 30,000 francs.

34. This provision of Swiss criminal law covers a much wider area than banking. However, because article 273 has occasionally been invoked in connection with banking transactions, it has often been misinterpreted as a banking secrecy provision. *BAR, THE BANKING SYSTEM OF SWITZERLAND* 59 (1973).

35. Indeed, unless the Federal Department of Justice and Police and the competent authority of the Canton concerned have given explicit permission, no party to a foreign proceeding may take evidence on Swiss territory, and no court, agency or party may effect service upon Swiss residents by directly mailing from abroad the documents that have to be served in Switzerland. Although the Swiss attitude may not necessarily be binding for the U.S. courts when U.S. procedural laws have been respected, both parties and courts should be aware of the fact that improper service or unlawful taking of evidence may make any judgment [sic] by an American court unenforceable in the Swiss courts.

Frei, The Service of Process and the Taking of Evidence on Behalf of U.S. Proceedings—The Problem of Granting Assistance, Remarks before the Seminar on the European Business World and the Extraterritorial Application of United States Economic Regulation, Zurich, Switzerland (Sept. 24, 1982), at 1-2 [hereinafter cited as Zurich Seminar]. The effect of improper service has recently been realized by certain U.S. courts. See *Kadota v. Hosagi*, 608 P.2d 68 (Arizona App. 1980). Cf. *F.T.C. v. Compagnie de Saint-Gobain-Pont-A-Mousson*, 636 F.2d 1300 (1st Cir. 1980).

36. Fedders Remarks, *supra* note 24, at 9.

37. STGB, *supra* note 32, art. 271.

38. Federal Law Relating to Banks and Savings Banks, *RECUEIL SYSTEMATIQUE DU DROIT FEDERAL (SDR)* 952.0 [hereinafter cited as Banking Law of 1934].

39. The Banking Law of 1934 did not establish banking secrecy as one of its main objectives. Basically, it was intended to meet the problems raised in the banking crisis of the early thirties. At the same time that economic reasons produced the need for federal supervision of the banking business, however, Hitler's attempts to ferret out suspected accounts of Jews and other politically oppressed people in Switzerland also threatened serious invasions of privacy and banking secrecy. Meyer, *supra* note 30, at 25-26.

3. The violation of professional secrecy remains punishable even after termination of the official or employment relationship or the exercise of the profession.

4. Federal and cantonal regulations concerning the obligation to testify and to furnish information to a government authority shall remain reserved.⁴⁰

Article 47 applies to all banks, whether foreign dominated Swiss companies, foreign branches or agencies, or accredited representatives in Switzerland, and to all bank personnel, including employees, managers, auditors, and members of the board.⁴¹ While not specifically stated in the law, a client may expressly release the banker from his obligations under the law.⁴²

The Swiss Banking Law does not define banking secrecy per se. When it was originally enacted in 1934, the law did not create any new professional discretion, but only reaffirmed and reinforced the long established protection provided by private law.⁴³ In any given case, a judge must utilize private law concepts to determine whether the banker has breached his commitments under Article 47.⁴⁴ This private law character of banking secrecy means, however, that secrecy must yield whenever the public law stipulates a duty irreconcilable with private law banking secrecy notions. For example, where a duty of disclosing information is stipulated by public law, a banker can be compelled to disclose banking secrets.⁴⁵ Under Swiss law, however, this compelled disclosure may only be effected by formal exami-

40. The Draft Banking Law of the Study Committee in Charge of the Revision of the Banking Law, intended to replace the Banking Law of 1934, includes a new version of the law on banking secrecy in its article 53:

1. Anyone who in the service of a Bank intentionally discloses secret information of which he has gained knowledge by reason of his professional activity shall be punishable by imprisonment of up to six months or a fine up to 200,000 francs.

2. The disclosure shall remain punishable even when the office or employment has terminated or the person to whom the secret is entrusted no longer exercises his profession.

3. The disclosure is not punishable if made with the consent of the interested party or, if upon request of the person to whom the secret is entrusted, the Banking Commission has given its written authority.

4. The Federal and Cantonal provisions providing for the obligation to give information to an authority or to give evidence remain reserved.

(C. Deletra, trans.)

41. M. AUBERT, J-P. KERNEN & H. SCHÖNLE, *LE SECRET BANCAIRE SUISSE* 62-70 (2d ed. 1982).

42. *Id.* at 71.

43. Meyer, *supra* note 30, at 27.

44. "Banking secrecy" may be defined as the banker's particular obligation, inferred from private law protection of the personality, to treat confidentially secret facts learned in his professional capacity. "Secret" is generally defined as those facts which, known by a limited number of initiated parties only, shall, by the interest and will of the secrecy holder, remain solely accessible to this range of persons." *Id.* at 27, citing M. LUESCHER, *DAS SCHWEIZERISCHE BANKGEHEIMNIS IN STRAFRECHTLICHER SICHT* 5, 10 (1972).

45. *Id.*

nation of the witness.⁴⁶

Significantly, the Swiss Banking Law leaves the specific regulations concerning the obligation to testify and to furnish information to government authorities in the hands of both the federal government and the various Swiss cantons.⁴⁷ As a result, standards as to the amount and kind of information disclosure which can be compelled vary widely, depending upon the laws applied and the canton in which information is sought.⁴⁸

D. The Swiss-American Treaty on Mutual Assistance in Criminal Matters

Switzerland is not a party to either the Hague Convention of November 15, 1965⁴⁹ or to the Hague Convention of March 18, 1970⁵⁰, which refer to the taking of evidence abroad in civil or commercial matters. However, Switzerland is a party to the Hague Convention of 1954,⁵¹ and requests for civil assistance under the rules of that treaty are usually honored. Unfortunately, Switzerland has no uniform federal law regarding service of process or evidentiary questions in civil litigation. American requests for information are therefore handled under the relevant cantonal code of civil proce-

46. Frei, *supra* note 35, at 4.

47. The Banking Law of 1934, *supra* note 38, art. 47, para. 4.

48. All cantonal codes of criminal procedure stipulate a duty of third persons to testify in *criminal* cases. While all cantons exempt the accused, as well as enumerated holders of professional secrecy such as clergymen, physicians, and lawyers, bankers are not specifically exempt. Meyer, *supra* note 30, at 31.

However, while all cantonal codes of civil procedure also stipulate a duty of third persons to testify in *civil* cases, they differ as to exemptions for secrecy holders. The laws of the various cantons can be classified into three groups. In the first group of cantons, which includes, among others, Geneva, Vaud, Neuchatel, and Berne, persons bound by professional secrecy have no obligation to testify. The banker is included even though he is not explicitly mentioned in STGB, art. 321. In the second group, it is a matter for the judge to decide whether a banker has to give evidence. The cantons of Zurich and Zoug belong to this group. In the third group, the banker has an absolute obligation to give testimony. This group includes the cantons of Basel (City), Lucerne, and Grisons. M. AUBERT, J.-P. KERNEN & H. SCHÖNLE, *supra* note 41, at 91-97.

In addition to the civil and criminal codes, Swiss banking secrecy has been affected by private agreements among banks. In particular, the Agreement on the Observance of Care by Banks in Accepting Funds and on the Practice of Banking Secrecy (ACB) between the Swiss National Bank and the Swiss Bankers' Association of July 11, 1977, was followed by a new and expanded version applicable for five years following October 1, 1982, which established a code of conduct among bankers that appreciably alters the types and amount of information that bankers typically have had at their disposal when called upon to testify at criminal or civil proceedings. According to article 3 of this Agreement, banks are now obliged to verify the identity and circumstances of prospective customers, both individuals and various other legal entities, so as to ascertain the identity of the beneficial owners of accounts opened at their banks and the source of funds deposited. AUBERT, J.-P. KERNEN & H. SCHÖNLE, *supra* note 41 at 180-93.

49. Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, *supra* note 28.

50. Hague Convention on Taking Evidence Abroad in Civil or Commercial Matters, *supra* note 28.

51. Hague Convention Relating to Civil Procedure, March 1, 1954, 286 U.N.T.S. 265.

cedure, resulting in a confusing disparity of applicable standards.⁵²

A more flexible situation exists with respect to cases involving criminal proceedings. Switzerland is a party to the European Convention on Mutual Assistance in Criminal Matters.⁵³ While the United States is not a party to this Convention, Switzerland and the United States have signed a separate Treaty on Mutual Assistance in Criminal Matters (hereinafter MAT),⁵⁴ which serves as a basis for bilateral cooperation in criminal proceedings. Operation of MAT is triggered by a request for assistance by the appropriate foreign authorities to a central authority in the requested state.⁵⁵ The request must be fairly detailed and must identify both the subject matter of, and the need for, the information sought.⁵⁶ Requests, for the most part, are to be executed in accordance with the usual procedures followed in the requested State for the particular offense involved.⁵⁷ Necessary modifications in the procedures are possible if they are compatible with the law of the place where the request is to be executed.⁵⁸ Requests include assistance in:

- (a) ascertaining the whereabouts and addresses of persons;
- (b) taking the testimony or statements of persons;
- (c) effecting the production or preservation of judicial and other documents, records, or articles of evidence;
- (d) service of judicial and administrative documents; and
- (e) authentication of documents.⁵⁹

MAT correspondence refers to the issue of banking secrecy, although it is not separately addressed in MAT.⁶⁰ MAT also contains a "public order" clause, which makes assistance under the treaty discretionary if such assistance is likely to prejudice the sovereignty, security, public policy, or similar essential interests of the assisting state.⁶¹ The public order clause has been interpreted to mean "that the disclosure of facts which a bank is ordinarily required to keep secret could in exceptional circumstances also constitute facts the transmission of which would be likely to result in prejudice to 'similar essential interests' of the requested state. The requested state would

52. CONSTITUTION OF THE SWISS CONFEDERATION, art 64. See *infra* discussion accompanying notes 47-48.

53. European Convention on Mutual Assistance in Criminal Matters, April 20, 1959, 472 U.N.T.S. 185, Europ. T.S. No. 30. The Swiss ratification and reservations appear at 597 U.N.T.S. 352.

54. Treaty on Mutual Assistance In Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302, — U.N.T.S. — (entered into force Jan. 23, 1977) [hereinafter cited as MAT].

55. *Id.*, ch. VII, art. 28, General Procedures.

56. *Id.*, art. 29, Content of Requests.

57. *Id.*, ch. III, art. 9(1), General Provisions for Executing Requests. See also *id.*, ch. VII, art. 31.

58. *Id.*, ch. III, art. 9(2).

59. *Id.*, ch. I, art. 1(4)(a)-(e).

60. The correspondence in question concerns article 3(1), the public order clause. See Letter of May 25, 1973, 27 U.S.T. 2120, T.I.A.S. No. 8302 at 102, *reprinted in* 12 I.L.M. 969 (1973).

61. MAT, *supra* note 54, ch. I, art. 3(1)(a), Discretionary Assistance.

[then] have the right to refuse assistance."⁶²

Article 3(2) of MAT, however, suggests that refusal will be a rare exception.⁶³ Both MAT correspondence⁶⁴ and the Swiss Execution Law⁶⁵ confirm that the obligation to provide assistance must have priority. Cooperation will not be withheld simply because an assistance proceeding affects a banking secret. A refusal is justified only if the proceeding would cause a serious breach of secrecy protection; for example, if a bank were to disclose its relationship with a large part of its clientele not involved in the crime, or if large transactions, important to the Swiss economy, would have to be revealed.⁶⁶

E. The Limitations of MAT

The product of years of negotiation, MAT is a vehicle of compromise, and, as such, reflects the often diverse goals of its two signatory nations. Switzerland desired a comprehensive agreement, but could not agree to the comparatively intrusive discovery proceedings commonly used in the United States. On the other hand, the United States viewed MAT primarily as a vehicle to combat organized crime by piercing banking secrecy, and was therefore willing to accede to the Swiss viewpoint in many other areas.⁶⁷ Thus, MAT assures compulsory assistance only when the activity can be characterized as a crime in both countries.⁶⁸

MAT contains a schedule of thirty-five offenses for which compulsory measures are available, including such universal offenses as murder, kidnapping, rape, larceny, extortion, fraud, bribery, arson, and perjury.⁶⁹ Notably absent from the list are a number of activities considered government regulatory crimes in the United States. These include violations of antitrust laws, crimes of tax avoidance, and federal securities law violations.⁷⁰ While the Swiss do not necessarily condone these activities, Swiss law does not explicitly recognize them as crimes.⁷¹ Moreover, MAT incorporates the Swiss concept of speciality, which requires that information furnished under a legal assistance statute be used solely in regard to the charge for which it is requested.⁷² This requirement raises an important question as to

62. Letter of May 25, 1973, *supra* note 60.

63. Article 3(2) states: "Before refusing any request pursuant to paragraph 1, the requested State shall determine whether assistance can be given subject to such conditions as it deems necessary. If it so determines, any conditions so imposed shall be observed in the requesting State."

64. Letter of May 25, 1973, *supra* note 60.

65. Meyer, *supra* note 30, at 65.

66. *Id.*

67. *Id.* at 64.

68. MAT, *supra* note 54, ch. I, art. 4, Compulsory Measures.

69. *Id.*, Appendix.

70. MAT specifically refers to certain government regulatory crimes in ch. I, art. 2, para. 1(c)(4)-(5).

71. Meyer, *supra* note 30, at 55.

72. *Id.*

whether information furnished pursuant to the treaty may be used in related court or administrative proceedings.⁷³

II

THE APPROACH OF U.S. COURTS TO SWISS BANKING SECRECY LAWS

A. SEC v. Banca della Svizzera Italiana (BSI)

The exclusion of government regulatory crimes from compulsory assistance under MAT subjects SEC investigations of federal securities violations to the many problems that have traditionally plagued law enforcement authorities seeking Swiss cooperation. *SEC v. Banca della Svizzera Italiana (BSI)*,⁷⁴ a case involving SEC prosecution of a Swiss banking corporation, provides an important example of the stalemate that can occur in the prosecution of insider trading violations.

The Banca della Svizzera Italiana bought and sold call options and common stock of St. Joe Mineral Corporation on the Philadelphia and New York Stock Exchanges. The purchases were made immediately prior to the announcement, on March 11, 1981, of a cash tender offer by a subsidiary of Joseph E. Seagram & Sons, Inc. for all of St. Joe's common stock. Immediately following the announcement, the bank closed out its option purchases and sold two thousand of the three thousand shares of common stock it had bought, netting an overnight profit of approximately two million dollars.

After a preliminary investigation, the SEC filed suit in the United States District Court for the Southern District of New York in March 1981, alleging insider trading by the bank and its principals. The bank's frustra-

73. See MAT, *supra* note 54, ch. I, art. 5, Limitations on Use of Information:

1. Any testimony or statements, documents, records or articles of evidence or other items, or any information contained therein, which were obtained by the requesting State from the requested State pursuant to the Treaty shall not be used for investigative purposes nor be introduced into evidence in the requesting State in any proceeding relating to an offense other than the offense for which assistance has been granted.

2. Nevertheless, the materials described in paragraph 1 may, after the requested State has been so advised . . . , be used in the requesting State for the investigation or prosecution of persons who:

a. are or were suspects in an investigation or defendants in a proceeding for which assistance was granted and who are suspected . . . of having committed another offense for which assistance is required to be granted;

b. are suspected . . . of being participants in . . . an offense for which assistance was granted; . . .

3. Nothing in this Treaty shall be deemed to prohibit governmental authorities in the requesting State from:

a. using the material referred to in paragraph 1 in any investigation or proceeding concerning the civil damages connected with an investigation or proceeding for which assistance has been granted; or

b. using information . . . deduced from the materials referred to . . . in continuing any criminal investigation or proceeding

74. 92 F.R.D. 111 (S.D.N.Y. 1981).

tion of the discovery process forced the SEC to apply for and obtain a Temporary Restraining Order (TRO) against the bank, freezing the proceeds of the transactions in the United States.⁷⁵ The TRO also ordered immediate discovery proceedings, including the Bank's disclosure of the identity of its principals insofar as permitted by law.⁷⁶

The bank declined this request, citing Swiss banking and secrecy laws which subjected it to civil liability and/or criminal prosecution for compliance. Instead, it suggested use of letters rogatory or application of MAT. The SEC and the *BSI* court rejected these alternatives as either too cumbersome or not clearly applicable, as the suit involved only civil or administrative charges.⁷⁷ In an unusual twist, presiding Judge Milton Pollack announced an informal opinion requiring disclosure pursuant to Rules 33 and 37 of the Federal Rules of Civil Procedure, to be followed by severe contempt sanctions, including fines, for noncompliance.⁷⁸

B. *The BSI Court's Analysis*

The Court based its decision to order compliance by the bank on the decision of the United States Supreme Court in *Société Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers*.⁷⁹ In *Société*, a Swiss holding company sued for the return of property seized by the Alien Property Custodian during World War II. The District Court dismissed the complaint because the company refused to supply the court with certain bank records which it had requested. The United States Supreme Court reversed. It held that where the plaintiff was prohibited by Swiss law from

75. Over the next several months the SEC attempted to learn the identity of the Swiss bank's clients through interrogatories pursuant to FED. R. CIV. P. 33.

76. The bank was given three business days to comply with this request.

77. News and Comment, SEC. REG. L. REP. No. 628, at A-2 (Nov. 11, 1981). In support of its position, the SEC cited opinions of the bank's Swiss lawyers, which stated that using letters rogatory through diplomatic channels would be "cumbersome" and that it would be "quite doubtful whether a civil assistance request would allow relief from banking secrecy." The SEC also noted the bank's opinion that MAT could not be invoked because the SEC suit currently involved only civil or administrative proceedings.

78. 92 F.R.D. 111 (S.D.N.Y. 1981). This opinion was issued by Judge Milton Pollack following a November 6, 1981 hearing requested by the SEC, after the Swiss bank again refused to forward necessary information. The SEC argued that the court had clear jurisdiction over the bank, noting that the bank operated in the United States and had significant American investments, and that the St. Joe options traders were predominately domestic in nature and impact.

The SEC contended that compulsory disclosure was compatible with Swiss banking secrecy since it reflected governing choice of law principles and was consistent with principles of comity. Citing an opinion by the former Attorney General of Switzerland, the SEC argued that disclosure would not violate Swiss law so long as it was done under compulsion of a court order. Because the question of disclosure would be a procedural issue in the appropriate Swiss court, and because conflicts of law principles dictate that the forum court is the proper authority to determine procedural issues, the SEC also argued that the U.S. court could impose sanctions against the bank, in accordance with FED. R. CIV. P. 37. News and Comment, *supra* note 77, at A-3.

79. 357 U.S. 197 (1958).

complying with the discovery order and there was no showing of bad faith, the extreme sanction of dismissal was unjustified.⁸⁰ The *Soci t * Court, however, did not rule out the possibility of sanctions against a party who had deliberately used foreign law to evade United States prosecution.⁸¹ The *BSI* court interpreted this dictum to mean that foreign laws prohibiting discovery are not decisive in U.S. proceedings, but constitute only one factor to consider, along with the good or bad faith of the noncomplying party, in deciding whether to impose sanctions.⁸²

To further support its position, the *BSI* court also relied on two more recent Second Circuit opinions, *United States v. First National City Bank*⁸³ and *Trade Development Bank v. Continental Insurance Company*.⁸⁴ These decisions incorporated parts of the *Restatement (Second) Foreign Relations Law of the United States*, in an effort to refine the balancing test to be used in determining when contempt sanctions are justified in cases involving foreign law prohibitions against discovery. Section 40 of the *Restatement* indicates the important factors to consider in settling conflicts between the laws of different nations.⁸⁵

In *First National City Bank*, the Court of Appeals noted that, quoting section 39(1) of the *Restatement*, "[a] state having jurisdiction to prescribe or enforce a rule of law is not precluded from exercising its jurisdiction

80. *Id.* at 201-02.

81. *Id.* at 208-09.

82. 92 F.R.D. 111, 114 (S.D.N.Y. 1981).

83. 396 F.2d 897 (2d Cir. 1968). *See also* *In re First National City Bank*, 285 F. Supp. 845 (S.D.N.Y. 1968). The case involved the service of a subpoena duces tecum upon Citibank in connection with a federal Grand Jury investigation of certain alleged antitrust law violations by bank customers. Citibank complied with the subpoena insofar as it called for production of materials located in New York, but failed to produce any documents located in its Frankfurt, Germany office.

84. 469 F.2d 35 (2d Cir. 1972). This case involved a suit by the bank against an insurance company upon a fidelity bond for recovery of losses due to dishonesty on the part of the bank's employees. The manager of the Securities Department of the bank's branch in Switzerland had fraudulently used bank funds and the funds of bank customers to engage in a series of unauthorized securities transactions. The insurer sought records from the Swiss branch office to prove that the bank had learned or should have learned of the fraudulent conduct in sufficient time to avert the loss and to give timely notice to the insurer.

85. RESTATEMENT (SECOND) FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965). Section 40 reads as follows:

Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as:

- (a) vital national interests of each of the states,
- (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,
- (c) the extent to which the required conduct is to take place in the territory of the other state,
- (d) the nationality of the person, and
- (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

solely because such exercise requires a person to engage in conduct subjecting him to liability under the law of another state having jurisdiction with respect to that conduct."⁸⁶ The Court of Appeals then balanced the interests at stake, looking to section 40 of the *Restatement* for guidance. In deciding to order compliance, the Court of Appeals gave considerable weight to the national interests of both countries and to the hardship that the recalcitrant party would face in complying with United States discovery procedures.⁸⁷ The court also found noteworthy the fact that neither the United States nor the foreign government had expressed any opinion in the case.⁸⁸ Finally, the court stressed that the bank involved had brought the dilemma upon itself by accepting the "privilege" of operating in the United States.⁸⁹

Trade Development Bank required the Court of Appeals to weigh the same section 40 factors. In that case, the court decided not to order compliance by a Swiss bank with the defendant's request to release the names of its customers, stating that "the relative unimportance of the information as to the clients' identity in the present proceedings was entitled to be considered."⁹⁰

Using these two cases as a guideline, the *BSI* court concluded that "the factors in section 40 of the Restatement of Foreign Relations . . . tip decisively in favor of the SEC."⁹¹ These factors included the strength of the United States interest in enforcing its securities laws, the lack of Swiss government opposition, and the fact that the secrecy privilege involved could be waived without harm to the Swiss government.⁹² The *BSI* court also noted the transnational character of the affected bank, the fact that performance under the order could occur in either Switzerland or the United States, and its belief that a compliance order would "bring home the obligations a foreign entity undertakes when it conducts business on the American securities exchanges."⁹³ Harking back to *Soci t *'s reliance on the good faith of the party involved, the *BSI* court found the bank to be "in the position of one who deliberately courted legal impediments . . . and who thus cannot now be heard to assert its good faith after this expectation was realized."⁹⁴ To the bank's argument that it was only a "nominal" party to the suit and thus an inappropriate object of the court's wrath, the court responded by referring to "the well-established rule of agency law that an agent is liable as principal for the acts of an undisclosed principal."⁹⁵ Overall, the decision in *BSI* indicated the growing impatience of U.S. courts

86. 396 F.2d at 901.

87. *Id.* at 902.

88. *Id.* at 904.

89. *Id.* at 905.

90. 469 F.2d at 41.

91. 92 F.R.D. 111, 117 (S.D.N.Y. 1981).

92. *Id.* at 117-19.

93. *Id.* at 119.

94. *Id.* at 117, quoting *Soci t *, 357 U.S. at 208-09.

95. *Id.* at 117, n.4.

with the refusal to disclose necessary information on the basis of foreign secrecy laws, and the willingness of these courts to impose stiff sanctions if necessary to obtain disclosure.

C. *The Swiss Reaction to BSI*

Swiss reaction to the *BSI* decision was swift. *BSI* was the first case to involve such sanctions against a bank which had innocently traded in United States securities markets.⁹⁶ The sanctions suggested by the *BSI* court seemed to the Swiss to be disproportionately harsh in light of the bank's lack of scienter, and thus penal in nature. Moreover, the U.S. court threatened to block the bank's access to United States securities markets for noncompliance with the discovery order. This penalty seemed particularly burdensome in light of an upcoming case before the same court, *S.E.C. v. Certain Unknown Purchasers of the Common Stock and Call Options for the Common Stock of Santa Fe International Corporation et. al.*⁹⁷ (hereinafter *Sante Fe International*) Unlike *BSI*, *Santa Fe International* involved most of the major banks in Switzerland.⁹⁸ The possibility of a U.S. court imposing similar sanctions against all the involved banks clearly threatened the health of the Swiss banking and securities industries.

On the other hand, actual application of the type of sanctions threatened by the *BSI* court would substantially undermine the smooth functioning of the U.S. securities markets. Switzerland accounts for nearly one-fifth of the total foreign trading in U.S. securities markets.⁹⁹ Their withdrawal from trading would cause at least a temporary market upheaval. These circumstances rendered negotiations between the two countries mutually advantageous, and led to the signing of the MOU and the Bankers' Agreement.

III

THE SWISS-AMERICAN INSIDER TRADING AGREEMENTS

A. *The Memorandum of Understanding (MOU)*

The August 1982 MOU is the result of an exchange of opinions pursu-

96. Telephone Interview with Dr. Jurg Leutert, First Secretary, Legal Matters, Swiss Embassy, May 19, 1983.

97. [1981-1982 Transfer Binder] FED SEC. L. REP. (CCH) ¶ 98,323 (S.D.N.Y. Oct. 26, 1981). The SEC's complaint alleged that unknown buyers of Santa Fe International Corp. common stock and call options used Swiss banks to trade on inside information concerning the proposed 2.5 billion dollar sale of the oil and gas drilling concern to the Kuwait Petroleum Corp., thus making a five million dollar profit.

98. Named as defendants were: Credit Suisse, Swiss American Securities, Inc., Citibank, N.A., Lombard Odier & Cie, Morgan Guaranty Trust Company of New York, Swiss Bank Corp., Drexel Burnham Lambert, Inc., Chase Manhattan Bank, N.A., and Mosley, Hallgarten, Estabrook and Weeden, Inc. *Id.*

99. N.Y. Times, Sept. 1, 1982, at A1, col. 3 (figures for 1981).

ant to article 39 of MAT.¹⁰⁰ It is, therefore, a declaration of intent that does not have the binding force of an international treaty. With respect to MAT, the MOU makes three important clarifications. First, the MOU acknowledges that investigations by the SEC fall within the language of article 1 of MAT, which provides for mutual assistance when "the investigation relates to conduct which might be dealt with by the criminal courts."¹⁰¹ Prior to this acknowledgement it was unclear whether SEC investigations were eligible for mutual assistance, as these investigations often lead to civil suits or disciplinary proceedings, rather than to criminal indictments.¹⁰² Second, the MOU records the official Swiss position against insider trading and suggests a number of offenses under the Swiss Penal Code which may serve as substitutes for the crime of insider trading for purposes of obtaining assistance under MAT, at least until such time as the Swiss enact their own law prohibiting insider trading.¹⁰³ These substitutes include the crimes of fraud, unfaithful management, and violation of business secrets.¹⁰⁴

Third, the MOU helps to clarify certain provisions of article 1 of MAT, which provide for assistance in "certain ancillary . . . proceedings in respect of measures which may be taken against the perpetrator of an offense falling within the purview of [the MAT]."¹⁰⁵ MOU interprets this section as overcoming the Swiss presumption of speciality, thus allowing the use of information provided under MAT in certain administrative and judicial proceedings.¹⁰⁶ Switzerland and the United States agree that such information may be used as evidence in injunctive or disgorgement proceedings, as these actions do not fall within the Swiss concept of "civil" actions, but are instead classified as "penal" in nature.¹⁰⁷ The parties have yet to reach a formal agreement as to the use of MAT information in disciplinary and other SEC proceedings, but have agreed to an exchange of diplomatic notes on this subject.

100. MAT, *supra* note 54, art. 39(1), Consultation and Arbitrations.

101. MOU, *supra* note 10, art. II(3), Exchange of Opinions Regarding the Treaty Between the United States and the Swiss Confederation on Mutual Assistance in Criminal Matters.

102. *Id.*, art. II(1)(b). Dr. Frei claims this point had already been clarified in the Technical Analysis in the *Message of the President of the United States of America Transmitting the Treaty between the United States of America and the Swiss Confederation on Mutual Assistance in Criminal Matters*. Frei, *supra* note 35, at 17.

103. A proposed draft of a new law against insider trading was announced by the Federal Justice Ministry on November 16, 1983 and is expected to become law in the near future. *Swiss Government Proposes Law To Make Insider Trading Criminal*, 15 SEC. REG. & L. REP. 2136 (November 25, 1983). An official text of the draft law is available through the Swiss Department of Justice and Police, 3003 Berne, Switzerland. An english translation of the draft Penal Code and Code of Obligations articles appears at the end of this Article.

104. MOU, *supra* note 10, art. II(3)(b).

105. MAT, *supra* note 54, art. 1(3).

106. MOU, *supra* note 10, art. II(4).

107. Article 57 of the Swiss Penal Code is the Swiss equivalent of injunctive relief. Article 58 is the corresponding disgorgement remedy. The theory which supports the "punitive" categorization of these proceedings is that they necessarily deprive the wrongdoer of the profits of unlawful conduct and compensate the victims for losses. Frei, *supra* note 35, at 20.

Finally, the MOU refers to the Private Agreement among Members of the Swiss Bankers' Association (Bankers' Agreement), thus recording the understanding of the two signatory nations with respect to the Bankers' Agreement.¹⁰⁸ Specific points set out in the MOU include:

(a) that failure to meet the trigger levels set by the Bankers' Agreement for processing of information does not result in a presumption that the SEC does not have reasonable grounds to make a request for assistance under the Bankers' Agreement or MAT, but that success in meeting these criteria allows the Commission of Inquiry to conclude that reasonable grounds do exist;¹⁰⁹

(b) that failure of a bank's customer to rebut SEC allegations will not result in any presumption of guilt;¹¹⁰

(c) that information obtained via the MOU or Bankers' Agreement will be used as evidence only in administrative or judicial proceedings brought by the SEC or the U.S. Department of Justice relating to insider trading transactions and that each party will use its best efforts to prevent disclosure of the information to any unauthorized sources;¹¹¹

(d) that a conclusion by the Swiss Commission of Inquiry that a bank customer is not an insider trader will be judged as one made in good faith;¹¹²

(e) that in instances where a bank's report contains information the disclosure of which will cause considerable harm to Switzerland or innocent third persons, the Swiss Federal Office for Police Matters will use best efforts to adapt the report so that useful information can be provided without causing harm and will be judged to have done so in good faith;¹¹³ and

(f) that the MOU does not confer the right to judicial review in United States courts with respect to a customer of a signatory bank which processes information as a result of an SEC request pursuant to the Agreement.¹¹⁴

(g) the parties to the MOU agree to settle any questions or disputes arising between them regarding the operation of the MOU or the Bankers' Agreement by means of consultation.¹¹⁵

The MOU has its own set of advantages and disadvantages. The principal advantage of the MOU is that it provides assurances of public support which lend credibility to the Bankers' Agreement. The MOU's classification of certain terms appearing in MAT is also of considerable benefit. In particular, the MOU's interpretation of the word "investigation," as used in article 1 of MAT, to include SEC formal investigations removes uncertainty about the ability of the SEC to use information gathered under MAT or the Bankers' Agreement in later legal proceedings.

Unfortunately, recent decisions of the Swiss Federal Tribunal have cast some doubt upon the utility of the three Swiss offenses cited by the MOU as substitutes for the U.S. crime of insider trading. The *Sante Fe*

108. MOU, *supra* note 10, art. II(b)(4).

109. *Id.*, art. III(3).

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*, art. V(2).

115. *Id.*, art. IV(2)(c).

case¹¹⁶ involved an SEC request for information regarding its prosecution of insider traders. Although the transaction occurred prior to the effective date of the Bankers' Agreement, the Swiss Federal Office for Police Matters was willing to uphold the U.S. request for information, on grounds that the trading may have violated article 162 of the Swiss Penal Code protecting business secrets, and thus was subject to the jurisdiction of MAT.¹¹⁷ On appeal, the Swiss Federal Tribunal overturned the decision of the Swiss Federal Office for Police Matters by a three to two vote. The majority opinion underscored the fact that insider trading per se is not punishable under Swiss law. It noted, in addition, that fraud, another violation of the Swiss Penal Code listed in the MOU as a possible substitute for insider trading, implied a direct contact between the defrauder and the victim. The Court maintained that such contact was not possible in the public, computerized securities market.¹¹⁸

The Swiss Federal Tribunal did admit that if the insider trading results from tipping, assistance under MAT would be forthcoming, as both the tipper and the tippee would be guilty of violating article 162 of the Swiss Penal Code.¹¹⁹ This situation arose in another Swiss Federal Tribunal decision, the case of *Courtois/Antoniu*,¹²⁰ decided the same day and by the same panel of judges as *Sante Fe*. In that case, the two defendants, both subjects of grand jury indictments in New York, had used their positions as employees of two New York investment banks to trade in the securities of their clients who were involved in tender offers, mergers, acquisitions, and other reorganization transactions. The defendants had arranged with an outside broker to trade and divide the proceeds of these dealings. They often used various Swiss banks to effect the tainted transactions. The Swiss Court accorded assistance in the case only because both the tippers and the tippees had profited from secret business information, in violation of their article 162 fiduciary obligations.¹²¹ Together, these cases suggest limited cooperation from the Swiss courts under the provisions of MOU and MAT, at least until such time as the Swiss enact their own insider trading laws.

B. The Private Agreement Among Members of the Swiss Bankers' Association

The Bankers' Agreement is intended as a temporary measure to remain in effect for three years, or until the Swiss enact a law prohibiting insider

116. Decision of the Swiss Federal Tribunal of January 26, 1983, PRAXIS DES BUNDESGERICHTS (Pra) 1983, Heft 7, Nr. 181. A summary of the opinion in english translation appears at 22 I.L.M. 785 (July 1983).

117. 22 I.L.M. at 787.

118. *Id.* at 797.

119. *Id.* at 796-97.

120. Judgment of the Swiss Federal Tribunal of January 26, 1983 (as yet unpublished).

121. *Id.*

trading.¹²² It is aimed exclusively at those cases involving insider trading for which assistance cannot be provided under MAT. In brief, it provides that signatory banks, under certain circumstances and in conjunction with the Swiss Federal Office for Police Matters, may furnish the SEC with requested information without violating Swiss law.

According to the Bankers' Agreement, SEC requests for information are to be made through the United States Department of Justice and the Swiss Federal Office for Police Matters to a three member Commission of Inquiry (hereinafter the Commission) to be appointed and operated by the Swiss Bankers' Association.¹²³ The Commission is to forward the request for information to the affected bank, provided the request meets the conditions of the Bankers' Agreement. These conditions include:

(a) that the request be accompanied by documentation and by a confirmation of the U.S. Department of Justice or the SEC that it will place at the Commissioner's disposal all evidence or other appropriate information or relevant material which it or they are free to reveal;

(b) that the request be accompanied by a specific identification of the securities transactions which have led the SEC to conclude that a formal investigation of possible insider trading is warranted;

(c) that the SEC will undertake to protect the requested information from disclosures other than in connection with its formal investigation or a law enforcement action initiated by it against the alleged insider traders.¹²⁴

The type of transaction that triggers a request for information under the Bankers' Agreement is the purchase or sale of a company's securities within twenty-five trading days prior to the announcement of either a business combination¹²⁵ or "an acquisition of at least 10% of the securities of a company by open market purchase, tender offer or otherwise."¹²⁶ The Bankers' Agreement provides that the Commission will be satisfied that the SEC has established a prima facie case of insider trading if the daily trading volume of the affected securities increased fifty percent or more¹²⁷ at any time during the twenty-five trading days prior to the announcement of a proposed business combination or acquisition. Alternatively, if the price of the affected securities varied at least fifty percent or more during the twenty-five trading days prior to the announcement, the Bankers' Agree-

122. Bankers' Agreement, *supra* note 11, art. 11. The Bankers' Agreement became effective January 1, 1983.

123. Article 2 of the Bankers' Agreement describes the composition of the Commission.

124. Bankers' Agreement, *supra* note 11, art. 3.

125. Article 1(A) defines "business combination" as either a "proposed merger, consolidation, sale of substantially all of an issuer's assets or other similar business combination."

126. Bankers' Agreement, *supra* note 11, art. 1(B).

127. "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."

Bankers' Agreement, *supra* note 11, art. 3(4)(ii).

ment would apply.¹²⁸ Where no such significant fluctuations can substantiate an SEC request, the Commission agrees to make a more detailed study to determine whether enough evidence exists to warrant an inquiry of the affected bank.¹²⁹

If the Commission decides that an inquiry is warranted, it will require the affected bank to:

- (a) freeze the accounts of the bank's client(s) accused of insider trading up to the amount of profit realized in the suspicious transaction;¹³⁰
- (b) inform the bank's client of the Commission's inquiry;¹³¹ and
- (c) give the bank's client an opportunity to respond to the SEC's allegations within thirty days of being informed of the Commission's inquiry.¹³²

The affected bank itself has forty-five days to respond to the Commission's inquiry and, in particular, to report the name, address, and nationality of the bank's client, the client's transactions in the affected company's securities during the forty days preceding an announcement of business combination or acquisition, and any comments forwarded by the client.¹³³

Following the filing of the bank's report, the Commission must make its own report containing the evidence assembled in its inquiry of the affected bank.¹³⁴ The report is then forwarded to the SEC unless the bank or its client has established, to the reasonable satisfaction of the Commission, that the client did not place any of the specific purchases or sales identified by the SEC, or that the client is not an insider.

If any doubt remains about the bank's report, the Commission or the SEC may ask the Swiss Federal Banking Commission to examine whether the bank complied with its obligations under the Agreement.¹³⁵ If the bank has violated the Agreement, the Board of Directors of the Swiss Bankers' Association must issue a warning to the bank and, where repeated violations are found, must exclude the bank from the Bankers' Agreement and inform the Federal Banking Commission and the SEC of its action.¹³⁶ The Federal Banking Commission retains its disciplinary powers under the Banking Law.¹³⁷

To implement the Bankers' Agreement, participating banks have asked their customers to sign waivers of banking secrecy allowing the bank to comply with a request for information.¹³⁸ Without such a waiver, signatory

128. *Id.*

129. *Id.*

130. Article 9(2) requires the blocked funds to be held in an interest-bearing account until final disposition of the inquiry.

131. Bankers' Agreement, *supra* note 11, art. 4(2).

132. *Id.*

133. *Id.*, art. 4(3).

134. *Id.*, art. 5. *See also* art. 7.

135. *Id.*, art. 8.

136. *Id.*, art. 10.

137. *Id.*, art. 8.

138. Article 12 of the Bankers' Agreement requires signatory banks "to inform their clients in due form about the contents of the . . . Agreement."

banks will refuse to place a client's order for securities in United States markets.¹³⁹ However, the use of client waivers prevents retrospective application of the terms of the Bankers' Agreement. Consequently, the Bankers' Agreement applies only to securities transactions occurring on or after January 1, 1983, the effective date of the Bankers' Agreement.

The Bankers' Agreement is attractive to the Swiss banking community for several reasons. First, the Bankers' Agreement eliminates the traditional dilemma of a bank, involved in legal proceedings regarding insider trading in the United States, yet faced with conflicting Swiss and American disclosure laws. The Bankers' Agreement provides signatory banks with a way to avoid United States court-imposed asset freezes, and the concomitant fines and prohibitions on trading. At the same time, it shields cooperating Swiss banks from civil or criminal prosecutions for secrecy violations. Most importantly, however, the Bankers' Agreement provides signatory banks with a means to assure themselves of the cooperation of their competitors in any attempt to curb the use of Swiss banks as intermediaries for illegal activities. All the members of the Swiss Bankers Association which trade in the United States securities markets have signed the Bankers' Agreement,¹⁴⁰ thus apparently limiting the possibility of using a major Swiss bank as a harbour for illegal insider trading profits.

The extent to which signatory banks will honor their contracts remains to be seen, however. Sanctions against Swiss banks which refuse to honor the terms of the Bankers' Agreement are limited, both in number and effectiveness. The Swiss Federal Banking Commission may be requested to undertake an investigation of the recalcitrant bank, but its disciplinary powers are not automatically invoked by complaints about insider trading by banks.¹⁴¹ The SEC could also retaliate by bringing a motion to compel discovery under Rule 37 of the Federal Rules of Civil Procedure. The cumbersome mechanism for obtaining a discovery order and the disruptive effects of sanctions, however, make the threat of compelled discovery an inappropriate tool to dissuade breach of the Bankers' Agreement. Nor would Rule 37 necessarily prove effective in the long run, as the United States can expect that Swiss banks, particularly those which have not signed the Bankers' Agreement, will continue to protest any attempt by United States courts to impose sanctions for a bank's refusal to honor discovery orders.

139. Leutert, *supra* note 96.

140. "The Swiss Bankers' Association, the president of which is traditionally a private banker, is the most important trade organization in the banking field. It was organized in 1912 and maintains a permanent secretariat in Basel. Membership is extended to all presidents, vice presidents, delegates, managers and deputy managers of banks and similar financial companies, all private bankers and officers of private banks who are empowered to sign for their respective firms, and the partners of firms admitted to any one of the Swiss stock exchanges. All banking and brokerage firms of consequence are represented." BAR, *supra* note 34, at 39.

141. See *supra* notes 135, 136 and accompanying text.

The self-restricting nature of the Bankers' Agreement also limits its effectiveness as a tool against insider traders. The Bankers' Agreement applies only to cases of insider trading which involve business combinations or mergers and acquisitions of a particular character.¹⁴² Thus, the Bankers' Agreement would not apply to facts similar to those of *Texas Gulf Sulphur*,¹⁴³ a well-known insider trading case which involved a major discovery by the corporation that was certain to affect the value of its stock. Further, the Bankers' Agreement generally applies only to cases involving high levels of trading in the affected securities over a short period of time. The Bankers' Agreement does not preclude the processing of information when trading does not hit these high levels; however, the burden of proof for the SEC or the United States Department of Justice is correspondingly higher in these instances.¹⁴⁴

Another self-limitation of the Bankers' Agreement involves its use of the term "insider". As defined in the Bankers' Agreement, an insider includes any one who is:

"(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 an Acquisition or a Business Combination; or (c) a person who on the basis of information about an Acquisition or a Business Combination received from a person described in [(a) or (b)] above has been able to act for the latter or to benefit himself from inside information."¹⁴⁵

Presumably, this definition covers the entire spectrum of potential insider traders, including tippees.

The American definition of insider trading, however, has a long and expansive history in U.S. case law, and theories of liability under section 10(b) and Rule 10b-5 of the Exchange Act abound.¹⁴⁶ The 1980 decision of the United States Supreme Court in *Chiarella v. United States*¹⁴⁷ did limit liability for insider trading to instances in which the insider has a "duty to disclose" his confidential information to the person with whom he

142. SEC personnel have suggested that the Bankers' Agreement covers all forms of insider trading, not simply mergers or acquisitions. While there is nothing in the language of either the Bankers' Agreement or the MOU to explicitly preclude such an interpretation, the Swiss view is that only mergers or acquisitions of a specific nature will trigger cooperation by the Swiss banks. *Accord* Leutert interview, *supra* note 96.

143. *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262 (S.D.N.Y. 1966), *aff'd in part, rev'd in part*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); 312 F. Supp. 77 (S.D.N.Y. 1970), *aff'd in part, rev'd in part*, 446 F.2d 3101 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1971).

144. Bankers' Agreement, *supra* note 11, art. 3(4).

145. *Id.*, art. 5(2)(a)(b)(c).

146. See generally RIBER & FFRENCH, *THE REGULATION OF INSIDER TRADING* 74 (1979).

147. *United States v. Chiarella*, 588 F.2d 1358 (2d Cir. 1978), *rev'd* 445 U.S. 222 (1980). Vincent Chiarella was a markup man for a financial printer which was employed by various corporations for the purpose of printing documents to be used in connection with acquisitions. Although the names of the target companies were not provided to Chiarella until just before the announcement of a proposed acquisition, he was able to identify the companies and used

trades.¹⁴⁸ Even so, U.S. case law continues to label as "insiders" persons who may not fall within the bounds of the Bankers' Agreement definition. For example, the Bankers' Agreement includes the term "auditors" within its definition,¹⁴⁹ but does not include other similarly specific terms, such as "issuers," "attorneys," "investment bankers," or "controlling shareholders," all of who have been held at times to be insiders according to U.S. case law.¹⁵⁰ Under Swiss law, the phrase "a mandated person of the Company" serves as a catch-all for the possible varieties of persons or entities that

this information to purchase the target securities before any information had been released to the public. Chiarella later sold the securities, netting a large profit for himself.

Chiarella was charged with seventeen counts of violating section 10(b) of the Exchange Act and Rule 10b-5. The Court of Appeals upheld Chiarella's conviction holding that "[a]nyone—corporate insider or not—who regularly receives material nonpublic information may not use that information to trade in securities without incurring an affirmative duty to disclose (emphasis in original)." *Id.* at 1365. The United States Supreme Court later reversed, the majority opinion holding that, since Chiarella owed no duty of disclosure to the sellers of the target company, he could not be convicted of trading unlawfully. 445 U.S. 222 (1980). The majority opinion thus halted the prior trend of holdings which suggested that mere possession of material inside information imposes a duty to disclose before trading, and that fraud on the marketplace is an evil to be scrupulously avoided.

The *Chiarella* decision was very narrow; at the least, a fiduciary or similar relationship must exist before a duty to disclose may be imposed. Justice Stevens' concurring opinion, however, suggested that the court had "not necessarily placed any stamp of approval on what [Chiarella] did, nor . . . held that similar actions . . . be considered unlawful in the future . . ." (445 U.S. at 238.) Justice Brennan concurred only in the judgment (445 U.S. 238) agreeing with the construction of Rule 10b-5 set out in Chief Justice Burger's dissent (445 U.S. 239). Justice Blackman, joined by Justice Marshall, also dissented, setting forth his own analysis of Rule 10b-5 as applied to insider trading. (445 U.S. 245.)

Thus, the *Chiarella* opinion left in its wake a number of unanswered questions: (1) what kind of "fiduciary duty" is necessary to trigger applicability of Rule 10b-5; (2) must the relationship of trust and confidence exist prior to the transactions allegedly violating Rule 10b-5; (3) must there be a breach of the fiduciary duty or a violation of the existing trust and confidence in order to establish a violation of Rule 10b-5; (4) what factors must be considered once a fiduciary or similar relationship is established; and (5) do other theories of liability exist to impose sanctions in cases of similar transactions?

Thus far, the United States Supreme Court has had an opportunity to address at least one of the above-mentioned open questions. *See* SEC v. Dirks, 681 F.2d 824 (D.C. Cir. 1982), *rev'd* Dirks v. SEC, 103 S. Ct. 3255 (July 1, 1983) (tippee's liability for trading on inside information depends on whether the tipper *breached* his fiduciary duty to the shareholders of the corporation by disclosing the information to the tippee, and whether the tippee knew or should have known that there had been a breach). The *Dirks* decision suggests a further restriction on the scope of activities which the Supreme Court will find violative of Rule 10b-5. Certain lower court decisions, however, continue to support other theories of liability. *See, e.g.,* United States v. Newman, 664 F.2d 12 (2d Cir. 1981), *cert. denied*, 104 S. Ct. 193 (1981) (misappropriation of confidential information by an employee may constitute a fraud or deceit on the employer); SEC v. Lund, FED. SEC. L. REP. (CCH) ¶ 92,428 (9th Cir. 1982) (district court suggests several theories of liability, including novel breach of duty questions and the misappropriation theory as applied to both the defendant's own corporation and the selling corporation).

148. *Chiarella*, 445 U.S. at 222.

149. Bankers' Agreement, *supra* note 11, art. 5(2)(a).

150. *See, e.g.,* Strong v. Repide, 213 U.S. 419 (1909); Kay v. Scientex Corp., 719 F.2d 1009 (9th Cir. 1983); Rheem Manufacturing Co. v. R.S. Rheem, 295 F.2d. 473 (9th Cir. 1961). For a general discussion of persons held to be insiders, see RIBER & FFRENCH, *supra* note 146.

could be classified as insiders under the Bankers' Agreement.¹⁵¹ "Mandated person" is a term of art within the Swiss Code of Obligations, connoting a contractual relationship similar to that of principal and agent in United States law.¹⁵² Unless Swiss courts uphold the inclusion of a wide variety of persons as insiders, the Bankers' Agreement may not cover the wide range of potential insider traders that the SEC might wish to prosecute.¹⁵³

Uncertainty also remains as to restrictions on the use of information collected under the Bankers' Agreement. The MOU, in referring to the Bankers' Agreement, clearly states that information obtained "through the mechanism established by this memorandum and the private Agreement will be used or introduced as evidence only in *administrative* or *judicial* proceedings brought by the SEC or Department of Justice."¹⁵⁴ This language suggests that the information in question may be used in disciplinary actions brought by the SEC, as well as in disgorgement or injunctive proceedings. The Swiss, however, contest any interpretation which would allow information received via the Bankers' Agreement to be used in disciplinary proceedings, citing for support their long-standing principle of speciality.¹⁵⁵

IV

CONCLUSIONS

Despite their potentially limited applicability, the MOU and the Bankers' Agreement seem to reach some of the more egregious cases of insider trading which have taken place in recent years.¹⁵⁶ Indeed, they may even cover cases of business combinations or mergers and acquisitions that have not historically been the subject of SEC investigations for insider trading.¹⁵⁷ Undoubtedly, the MOU and the Bankers' Agreement have nar-

151. Leutert interview, *supra* note 96.

152. *Id.*

153. In the Santa Fe decision, the Swiss Federal Tribunal listed executives, directors, lawyers, bankers, auditors, tax experts, and others associated with the conversations or entrusted with special tasks in view of the merger all as insiders. In dicta, the Tribunal stated that trading by these actors on the basis of inside information would not violate Swiss law. 22 I.L.M. at 799.

154. MOU, *supra* note 10, art. III(3) (emphasis added).

155. Leutert interview, *supra* note 96.

156. A random sampling of about twenty-five of the more celebrated insider trading cases demonstrates that most of these cases would have triggered application of the Bankers' Agreement. Trading in *Santa Fe International*, *supra* note 97, showed five days of suspicious trading; in *BSI*, *supra* note 74, at least four such days and, if the Bankers' Agreement formula is not to take into account a stock dividend in the same trading period, as many as nine days. Whittaker Corporation's acquisition of Brunswick Corporation (see SEC v. Martin Cooper, et. al., Civil Action No. 82-3462 (C.D. Ca. July 15, 1982); SEC v. J. Robert Fabregas, et. al., Civil Action No. 82-3440 (C.D. Ca. July 14, 1982)) would have set off the Bankers' Agreement three times; Blue Bell, Inc.'s tender offer for Jantzen, Inc. (see SEC v. Frank H. Wyman, Civil Action No. 81-1025 (S.D.N.Y. March 4, 1981)) nineteen times.

157. It is interesting to note that an examination of trading fluctuations in the securities of a variety of corporations involved in non-suspicious tender offers, mergers, or acquisitions

rowed the options of insider traders who use Swiss banks to do their trading. Nevertheless, insider traders may still trade through other Swiss banks, particularly non-Association banks, which are not bound by the Bankers' Agreement. Insofar as these banks serve as adequate substitutes, the Bankers' Agreement and the MOU are only pieces of a larger, piecemeal solution.

Even if Switzerland eventually enacts its own insider trading legislation, determined insider traders will undoubtedly find other havens for their illegal dealings. While Rule 37 of the Federal Rules of Civil Procedure provides some means to counteract the outflow of insider trading to alternative outposts, it is slow, cumbersome, and applicable only on a case-by-case basis. Furthermore, application of the rule does little to foster improved U.S. relations with those nations which are potential candidates for MAT-like treaties, and indeed may exacerbate the existing world-wide resistance to American attempts to apply its legislation on an extraterritorial basis.

Most importantly, neither MAT, the MOU, nor the Bankers' Agreement provide a way to obtain information on insider traders at the time the actual tainted transactions occur. A more effective solution for preventing insider trading identity problems may already be foreshadowed by the current rules and regulations of the Commodities Futures Trading Commission (CFTC). For example, certain CFTC rules require that information identifying customers be provided by anyone who trades in United States commodities markets, including foreign brokers.¹⁵⁸ "Foreign broker" has been defined in such a way as to include any foreign bank which trades on behalf of a customer on a United States commodities market.¹⁵⁹

This solution seems preferable to any of the earlier proposals proffered by the SEC to combat the problems of obtaining information to identify

demonstrates that even innocent transactions might trigger the Bankers' Agreement. For example, an examination of the data shows a total of seven excess trading days in the trading period surrounding Martin Marietta's tender for Bendix Corporation stock, three excess trading days during the period applicable to Cities Services' tender for Mesa Petroleum stock; and fifteen excess trading days in Sears Roebuck's tender for Coldwell Banker and Co. stock.

An argument can be made that the excessive trading in these cases is the result of an unusually "hot" market. This phenomenon, however, suggests that the Bankers' Agreement formula may be overly simplistic. Without a control for general market trends, the formula may fail to register suspicious trading during slow trading periods, and may over-register otherwise innocent transactions during more active periods.

158. The rules of the CFTC require that a foreign commodities broker who trades in the United States securities markets must submit detailed daily transaction reports to the Commissioner, and must identify the names and addresses of all persons or entities on whose behalf the broker trades in commodities. See 17 C.F.R. § 17.00-01 (1983). Upon the CFTC's demand, known as a "special call", the foreign broker must deliver this information to the CFTC. *Id.* at § 21.02.

159. "'Foreign broker' means any person located outside the United States or its territories who carries an account in commodity options on any contract market for any other person." 17 C.F.R. § 15.00(a)(1).

customers,¹⁶⁰ and could prove especially useful if employed in conjunction with MAT, the MOU, and the Bankers' Agreement post-transaction rules. Like the Bankers' Agreement, CFTC-type rules would give the customer a choice. The customer may either submit to the policies designed to protect the securities markets in the United States or refrain from using these markets altogether. Unlike the Bankers' Agreement, such rules would aid the SEC in detecting and combatting all varieties of securities laws violations, not just insider trading.

While the MOU, the Bankers' Agreement, and any potential CFTC-type pre-transaction rules together provide a useful mechanism for SEC investigation and prosecution of insider trading transactions, they are only temporary in nature. This temporal concern looms larger as the Swiss prepare to enact their own prohibition against insider trading. All the uncertainties inherent in the MOU and the Bankers' Agreement pale in comparison with what may result from the proposed legislation outlawing insider trading in Switzerland.

The Swiss assert that any definition of insider trading in potential legislation will closely parallel the language now included in the MOU. The Swiss Federal Tribunal decision in the *Santa Fe* case suggests that insider trading is not fraud per se under current Swiss law, at least insofar as fraud implies some face-to-face contact which is purely illusory in the context of most securities market transactions. Swiss commentators also seem to reject the idea, once generally accepted by United States courts, that fraud on the marketplace is itself a distinct evil, and that innocent investors need special protection from unscrupulous insiders who exploit a failure in the market's information production system to reap great profits or avoid huge losses. The Swiss notion of a self-regulating securities market, say these Swiss commentators, is predicated upon the idea that investors are sophisticated businessmen, who do not require such patronizing special protections.¹⁶¹ As one Swiss critic of the United States system said recently:

An American observer . . . might find it difficult to accept that it is on the investor to decide whether or not to make an investment, simply by observing the market, by reading the information available (which is more than enough), and by relying on the integrity of the stockbrokers (mainly the banks), of the investment advisers and of the Stock Exchanges themselves. . . . of course no investor is proof against unsound business practices, but in

160. In January 1976, the SEC proposed for public comment an amendment to Exchange Act Rule 17a-3(a)(9), which deals with recordkeeping of brokers' and dealers' customers' margin and cash accounts. The amendment would have required that, as a condition of maintaining a joint account or the account of a non-natural person, an exchange member, broker, or dealer would obtain an agreement from the account holder to furnish the name and address of each beneficial owner of the account, upon request by the SEC. A member, broker, or dealer who failed to obtain such an agreement would violate the Rule, unless the account holder actually provided the name and address of the beneficial owner. The Rule met considerable opposition, largely due to problems of international law which might arise from its application, and was never promulgated by the SEC.

161. See generally Zurich Seminar, *supra* note 35.

such instances our very general fraud provisions in the Penal Code and about civil liability have proven sufficient.¹⁶²

Thus the Swiss position seems not far removed from that taken by U.S. courts early in the history of federal securities legislation in the United States. To the extent that no material misrepresentations have been made, the Swiss position seems to be that insider trading is, in fact, a "victimless" crime, and that perhaps the biggest "victims" of insider trading are the securities markets themselves, whose integrity is tarnished by each reported occasion of insider trading. In fact, assert the Swiss, the only crime of insider trading is that which the insider perpetrates on some person or entity to whom the insider owes some special, as yet not fully defined, "fiduciary" duty.

Indeed, current discussions of proposed insider trading legislation have begun to focus the debate in the United States on the crucial need for a standard definition of insider trading, which, after all these years, is still lacking. Ironically, some United States commentators have called for the creation of a new crime, very similar to article 162 of the Swiss Penal Code, to which the more stringent penalties against insider trading would not attach.¹⁶³ The implications of this proposal for the Swiss definition of insider trading remain to be seen. The situation does point out, however, that the United States has substantial definitional work of its own to accomplish if it desires that other nations continue to follow its lead in defining and regulating insider trading on the securities markets.

162. Capitani, *The Swiss Banks and the U.S. Securities Laws*, Remarks before the Zurich Seminar, *supra* note 35, at 2.

163. *Hearing on H.R. 559 Before the Subcomm. on Energy and Commerce*, 98th Cong., 1st Sess. 124 (1983) (statement of Freeman).

AVANT-PROJET DE LÉGISLATION RELATIVE
AUX ABUS EN MATIÈRE D'INFORMATIONS
PRIVILIGIÉES (OPERATIONS D'INITIÉS)¹

ARTICLE 161 CODE PENAL (nouveau)

Exploitation d'informations confidentielles.

1. Celui qui, en qualité de membre de l'administration, de la direction, de l'organe de contrôle, ou de mandataire d'une société anonyme ou d'une société dominant cette société anonyme ou dépendant d'elle, en qualité de membre d'une autorité ou de fonctionnaire, ou en qualité d'auxiliaire de ceux-ci,

obtient une information confidentielle dont la divulgation est de nature à exercer une influence notable sur le cours des actions, des bons de participation ou des autres titres de la société anonyme, négociés en bourse ou avant bourse, et se procure un avantage pécuniaire en exploitant cette connaissance, sera puni de l'emprisonnement ou de l'amende.

Si la reprise d'une société par une autre est envisagée, les alinéas 1 et 2 s'appliquent aux actions, aux bons de participation et aux autres titres des deux sociétés.

2. Le chiffre premier s'applique par analogie lorsque l'exploitation d'informations confidentielles se rapporte à des parts sociales, à des bons de participation ou à d'autres titres d'une société coopérative.

ARTICLE 726a CODE DES OBLIGATIONS
(nouveau)

XI. *Exploitations d'informations confidentielles.*

1. *Cession des avantages.*

1. Les organes ainsi que les personnes liées par un rapport de confiance particulier à la société doivent céder à cette dernière les avantages pécuniaires qu'ils ont réalisés en exploitant des informations confidentielles dont la divulgation était de nature à exercer une influence notable sur le cours des actions, des bons de participation ou d'autres titres de la société anonyme négociés en bourse ou avant bourse.

2. La même obligation incombe aux organes et aux personnes de confiance de sociétés contrôlant cette société anonyme ou dépendant d'elles ou de sociétés qui envisagent de la

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ARTICLE 161 PENAL CODE (new)

Exploitation of confidential information.

1. A person who, in his capacity as a member of the board, an officer, an auditor, or a mandated person of a company or of a corporation dominating this company or dominated by it, in his capacity as a member of a public authority or as a public officer, or in his capacity as an assistant to such persons,

obtains confidential information whose disclosure would be such as to have a significant influence on the price of the shares, profit sharing certificates, or other securities of the company, traded on or ancillary to the stock exchange, and obtains for himself a pecuniary advantage by exploiting this knowledge, shall be punished by imprisonment or by a fine.

If the takeover of one corporation by another is envisaged, the first and second paragraphs apply to the shares, profit sharing certificates, and other securities of both corporations.

2. Subsection 1 applies by analogy when the exploitation of confidential information relates to shares, profit sharing certificates, or other securities of a cooperative corporation.

ARTICLE 726a CODE OF OBLIGATIONS (new)

XI. *Exploitation of confidential information.*

1. *Surrender of advantages.*

1. The organs of and persons linked to the company by a particular relationship of trust must surrender to it any pecuniary advantages they have obtained by exploiting confidential information whose disclosure was such as to have a significant influence on the price of the shares, profit sharing certificates, or other securities of the company on or ancillary to the stock exchange.

2. The same obligation applies to the organs of and persons in a particular relationship of trust with corporations controlling this company or dominated by it or of corporations

1. Département Fédérale de Justice et Police, Doc. No. V.776/LK/HS/PS/SM, annexe 1. See also *id.*, annexe 2, Commentaire de l'avant-projet.

reprendre ou dont la reprise est envisagée.

3. Cette obligation incombe également aux tiers exploitant des informations confidentielles dont ils savent qu'elles ont été révélées, en violation du secret commercial, par des personnes mentionnées aux 1er et 2e alinéas.

ARTICLE 726b CODE DES OBLIGATIONS (nouveau)

2. *Obligations du conseil d'administration, prétentions des lésés.*

1. Le conseil d'administration veille à empêcher et à déceler l'exploitation d'informations confidentielles.

2. Si des avantages pécuniaires ont été réalisés par l'exploitation d'informations confidentielles, le conseil d'administration fait valoir le droit à la cession. L'actionnaire peut aussi intenter action en lieu et place du conseil d'administration; son action tend à une prestation due à la société.

3. Si des personnes ont subi un dommage du fait de l'exploitation d'informations confidentielles, leur droit à réparation prime le droit de la société à la cession des avantages.

ARTICLE 902a CODE DES OBLIGATIONS (nouveau)

2. *Exploitation d'informations confidentielles.*

Les dispositions concernant la société anonyme s'appliquent par analogie à l'exploitation d'informations confidentielles sur des opérations portant sur des parts sociales, des bons de participation ou d'autres titres de la société coopérative négociés en bourse ou avant bourse.

ARTICLE 903 CODE DES OBLIGATIONS (chiffre marginal).

envisaging its takeover or whose takeover is envisaged.

3. This obligation also applies to third parties who exploit confidential information which they know has been revealed, in violation of commercial secrecy, by the persons mentioned in the first and second paragraphs.

ARTICLE 726b CODE OF OBLIGATIONS (new)

2. *Obligations of the board of directors, claims by injured parties.*

1. The board of directors shall attend to the prevention and discovery of the exploitation of confidential information.

2. If pecuniary advantages have been obtained by the exploitation of confidential information, the board of directors shall assert the right to surrender. Any shareholder may also bring an action in lieu of the board of directors; his action is for a payment which is due to the company.

3. If persons have suffered damage from the exploitation of confidential information, their right to compensation has priority over the company's right to the surrender of advantages.

ARTICLE 902a CODE OF OBLIGATIONS (new)

2. *Exploitation of confidential information.*

The provisions regarding companies apply by analogy to the exploitation of confidential information in transactions of shares, profit sharing certificates, or other securities of a cooperative corporation traded on or ancillary to the stock exchange.

ARTICLE 903 CODE OF OBLIGATIONS (renumbered)

(Translated by Henry Peter and Patrick Wallace)