PAPERS PRESENTED

PROBLEMS OF ENFORCEMENT IN THE MULTINATIONAL SECURITIES MARKET*

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* This paper was presented at the Problems of Enforcement in the Multinational Securities Market Roundtable prior to the decision of the United States Supreme Court in Societe Nationale Industrielle Aerospatiale v. United States Dist. Court for the S. Dist. of Iowa, 55 U.S.L.W. 4842 (U.S. June 15, 1987). See infra notes 82-87 and accompanying text. Subsequently, the Supreme Court ruled in that case that the terms of the Hague Convention do not require its use to the exclusion of any other discovery procedures whether evidence located abroad is sought for use in a United States court. Id. at 4844-45. The Court also declined to impose on United States courts a requirement that they resort as an initial matter to the Hague Convention, i.e., the Court rejected a "first-use" doctrine. Id. at 4845, 4848. Instead, the Court prescribed a case-by-case comity analysis which would require a court to scrutinize "the particular facts, sovereign interests, and likelihood that resort to [Hague Convention] procedures will prove effective." Id. at 4848. Elsewhere the Court suggested that "an American court should resort [to the Hague Convention] when it deems that course of action appropriate, after considering the situations of the parties before it as well as the interests of the concerned foreign state." Id. at 4845. The Court therefore declined to uphold the judgment of the Court of Appeals for the Eighth Circuit, which had declared the Hague Convention simply inapplicable to the discovery at issue. Id. at 4847.

As to the proper weight to be accorded by United States courts to blocking statutes of foreign sovereigns, another issue in Aerospatiale (see infra note 108 and accompanying text), the Court stated in a footnote that "the enactment of such a statute by a foreign nation [cannot] require American courts to engraft a rule of first resort onto the Hague Convention, or otherwise to provide the nationals of such a country with a preferred status in our courts." Id. at 4849 n.29. The Court found that "[t]he blocking statute thus is relevant to the court's particularized comity analysis only to the extent that its terms and its enforcement identify the nature of the sovereign interests in nondisclosure of specific kinds of material." Id.

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**Hypothetical Example: Disclosure**

The subsidiary of a Delaware (United States) corporation is incorporated in and conducts significant operations in a foreign country, Country X. The subsidiary is one of the largest corporations in Country X, employing many nationals of that country. Allegations are made that certain officers of the foreign-based subsidiary may have falsely booked sales of the subsidiary in order to conceal losses of the subsidiary which would have materially affected the overall financial results of the corporation. Before the allegations were made, accountants in
Country X issued an opinion that the financial statements of the subsidiary had been prepared in accordance with generally accepted accounting principles.

Pursuant to United States securities laws, the corporation filed consolidated financial statements with the Securities and Exchange Commission (SEC or Commission). The statements were covered by a United States auditor's report that did not make reference to the report issued by the accountants in Country X.

The SEC investigates the allegations to determine their validity. The SEC staff takes the depositions of the corporation's United States-based officers and United States-based accountants. As a result, it obtains evidence which suggests that the earnings have been falsified by unknown individuals employed by the subsidiary and residing abroad. It is unclear whether the person or persons employed by the subsidiary who falsified the books were acting on their own or at the instance of United States-based officers. The SEC now needs access to documents and testimony of the foreign-based officers, employees, and accountants in order to conduct a thorough investigation and determine who, if anyone, is liable.

The United States and Country X have both ratified the Hague Convention for the Taking of Evidence (Hague Convention or Convention), but they have not negotiated any bilateral agreements that would relate to the investigatory activities of the SEC. Country X has enacted a "blocking statute" similar either to that of Great Britain or to that of France.

1. Introduction

Based on the above hypothetical, this paper will discuss the problems that arise when the SEC, during the course of an investigation, requires access to persons and documents that are not in the United States. In the hypothetical, the SEC clearly has domestic subject matter (prescriptive) jurisdiction over the United States securities laws with respect to the filing of false financial statements by a United States corporation. This subject matter jurisdiction in all likelihood extends to the actions of the foreign subsidiary abroad, primarily on the basis of the "effects" doctrine of prescriptive jurisdiction under principles of international law. We will assume, although the question is a close one,
that because the report of the foreign auditors covering allegedly false financial statements had effects in the United States, the foreign auditors may also fall within the SEC’s subject matter jurisdiction. The issues to be discussed, therefore, concern not the SEC’s general subject matter or prescriptive jurisdiction over the wrongful acts alleged to have been committed, but the difficulties that the agency may experience when it attempts to carry out investigative and enforcement activities with respect to persons and documents located abroad. Such difficulties sometimes involve limits to the SEC’s statutory enforcement power and sometimes implicate constraints of due process — the extent to which the SEC may, consistent with “traditional notions of fair play and substantial justice,” enforce the securities laws beyond the territorial borders of the United States. Also involved are conflicts that arise with the laws of other countries having concurrent prescriptive and enforcement jurisdiction over the individuals and entities involved.

Section 2 of this article describes briefly the disclosure requirements of the federal securities laws with respect to financial statements. Section 3 discusses the remedies available to the SEC if the financial statements are false. This section includes a discussion of the emphasis the United States places on prosecuting non-fraudulent conduct. Section 4 addresses some of the problems attendant on obtaining evidence and testimony abroad, and Section 5 discusses some possible solutions, with particular emphasis on various types of consent and bilateral or multilateral assistance agreements.

It may help the reader to keep in mind that there are two distinct phases to an enforcement action. The first is the investigation, which is done confidentially without any disclosure and during which evidence is gathered. The second is the proceeding itself, which may be an administrative proceeding before an administrative law judge or an action filed in federal district court requesting the judge to issue an injunction.

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and grant other equitable relief. These proceedings are generally open to the public and therefore may be widely reported. As a policy matter, we assume that mechanisms of international cooperation should not compel the SEC to commence public proceedings prematurely in order to obtain assistance — that is, the availability of foreign assistance should not automatically depend on whether the SEC is in its investigatory stage or whether formal proceedings have begun.

Problems of cooperation between the SEC and foreign authorities are particularly complex in the disclosure area. Because the United States considers accurate reporting to be essential to the operation of the market, the SEC may impose sanctions upon improper disclosure even if the error was unintentional. To the extent the violation was not willful, the sanctions are restrained — restatement of financial statements or correction of error, with no finding of fraud. Foreign nations do not necessarily have a comparable policy. Thus, in the short run, they are most likely to cooperate where the United States offense is fraud, such as insider trading. In the long run, improper disclosure may be viewed more harshly abroad as markets outside the United States expand.

2. REQUIREMENTS OF FEDERAL SECURITIES LAWS REGARDING FINANCIAL STATEMENTS

In general, regulations promulgated by the SEC require that reports and registration statements filed by issuers contain consolidated financial statements. These statements must include the issuer and all majority-owned subsidiaries. The SEC places great emphasis on accurate financial disclosure because it assumes that an efficient market prices securities in response to such information — false or accurate — whether or not an individual investor actually relied on such disclosure. Thus, the filing of materially false financial statements constitutes

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4 On the other hand, Rule 2(e)(7), 17 C.F.R. § 201.2(e) (1986), currently provides that all Rule 2(e) proceedings shall be nonpublic, unless the SEC on its own motion or on the request of a party otherwise directs. As discussed infra in Section 3.5, Rule 2(e) is used by the SEC to discipline attorneys, accountants, and other professionals.

5 A "majority-owned subsidiary" is defined as a "subsidiary more than 50% of whose outstanding voting shares is owned by a parent and/or the parent's other majority-owned subsidiaries." 17 C.F.R. § 210.1-02(m) (1986). A foreign issuer may, unless any applicable rule provides otherwise, prepare financial statements according to the generally accepted accounting principles [hereinafter GAAP] of its jurisdiction, so long as certain notes reconciling foreign GAAP with United States GAAP are provided. However, regardless of what accounting principles are applied, the SEC will not accept financial statements unless they are prepared according to United States generally accepted accounting standards.
fraud on the market.  

The professional standards of the American Institute of Certified Public Accountants (AICPA) generally provide that an accountant who examines the consolidated financial statements of an issuer when the statements of a subsidiary of that issuer have been examined by another accountant must determine whether or not to accept responsibility for such other auditor's examination. If the principal auditor accepts such responsibility, he need not refer to the other examination in his report. If the auditor does not accept responsibility, he must refer specifically to the other auditor's report. AICPA standards provide that an auditor may name another auditor to whose work he refers but only with the express consent of that auditor, and only if the other auditor's report is presented. In this connection, the AICPA standards also reference SEC Rule 2-05 of Regulation S-X,  

which requires that when reference is made to the work of another auditor, the other auditor's report must in most circumstances also be filed with that of the principal auditor. Filing the other auditor's report effectively reveals his identity. Therefore, although the AICPA standards do not state as much directly, it appears that, under the AICPA standards, the principal auditor, in complying with SEC Rule 2-05, must have obtained the consent of the other auditor.

The hypothetical example assumes that the United States auditors made no reference to the report of the foreign auditors. Under AICPA standards, this absence of reference does not relieve the foreign auditors of responsibility, but it may make the SEC's enforcement efforts more difficult. 

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8 If the foreign auditors had been named, which would have required their express consent, the SEC might have been able to take the position that such consent constituted "practicing before the Commission" for purposes of Rule 2(e) proceedings described infra in Section 3.5. It is unclear whether such consent would also confer on the SEC and United States courts personal jurisdiction over the accountant. Arguably, consent to use of its report falls short of consent to service of process. Since in the hypothetical the foreign auditors were not named, SEC recourse with respect to their actions may be limited.

3.1. SEC Investigations

The SEC relies on the staff of its Division of Enforcement and Regional Offices to develop facts and make appropriate recommendations as to whether an enforcement action should be brought. The SEC's staff often investigates possible securities law violations informally. In an informal investigation, the staff lacks subpoena power and must therefore seek voluntary compliance with its requests for information or documents. If a person or entity refuses to testify voluntarily or to provide requested documents, the staff may recommend to the Commission that it enter a formal order of private investigation. The SEC has broad statutory authority to conduct such investigations to determine whether any person or entity has violated, is currently violating, or is about to violate, any provision of the federal securities laws or rules thereunder. In particular, the SEC may investigate any matter where it appears to the Commission that: (1) the provisions of the Securities Act of 1933 (Securities Act) or the rules or regulations promulgated thereunder “have been or are about to be violated”; (2) any person “has violated, is violating, or is about to violate” the Securities Exchange Act of 1934 (Exchange Act), or its rules or regulations, or the rules of a national securities exchange, a registered securities association, a registered clearing agency or the Municipal Securities Rulemaking Board; (3) any person “has violated or is about to violate” the Investment Company Act of 1940 (Investment Company Act) or any rule, order or regulation thereunder; or (4) the provisions of the Investment Advisers Act of 1940 (Investment Advisers Act) or any rule, order or regulation thereunder “have been or are about to be violated.”

The introductory language to these sections is quite broad; “whenever it shall appear” is the phrase used in the Securities Act,

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10 See 17 C.F.R. §§ 202.5(a), 203.4-8 (1986).
and "in [the Commission's] discretion"\textsuperscript{20} is the Exchange Act language. Thus, these sections confer on the SEC a great deal of discretion as to which cases to investigate. Moreover, United States courts will not review what evidence the SEC had before it when it commenced its investigation.\textsuperscript{21} As a result, there is no standard such as "reasonable grounds to believe" a violation has occurred. Because of this wide latitude to investigate and because of the broad reach of SEC subpoena power, foreign nationals and governments may be concerned that the staff is conducting a "fishing expedition." Therefore, in the absence of definite, mutually agreed upon criteria, foreign governments may be reluctant to provide the SEC with assistance at the formal order stage. It should be noted that, notwithstanding the broad latitude granted by the statutory language, the SEC has long emphasized the discretion its staff, and the Commission itself, exercise in commencing investigations.

The ease with which a formal order can be obtained especially concerns foreigners in cases where the matter under investigation would not be a crime in the foreign country where evidence/documents are being sought. This concern over SEC formal orders may be further heightened because the contents of the formal order itself typically reveal little of the facts underlying the SEC's suspicions.\textsuperscript{22} This is in marked contrast to the considerable amount of detail found in a typical SEC court complaint.\textsuperscript{23} Overall, as discussed in Section 5 below, it is unlikely that the SEC can obtain effective assistance at the formal order stage unless standards governing such requests are mutually agreed upon by the SEC and foreign securities regulators.

The issuance of a formal order authorizes the SEC's staff to subpoena witnesses, take their testimony under oath, and require the production of any relevant documents. Investigative subpoenas may be judicially enforced with noncompliance resulting in fine or imprisonment, or both. The existence of an investigation and all information obtained during it are generally kept strictly confidential unless and until a pub-


\textsuperscript{21} See, e.g., SEC v. Howatt, 525 F.2d 226, 229 (1st Cir. 1975) (SEC has power of "original inquiry" and need not "limit its investigations to those against whom 'probable' or even 'reasonable' cause to suspect a violation has been established"); SEC v. Brigadoon Scotch Distrib. Co., 480 F.2d 1047, 1054 (2d Cir. 1973) (where investigation has legitimate purpose, SEC need not show "reasonable grounds" before issuing investigative subpoenas), cert. denied, 415 U.S. 915 (1974).

\textsuperscript{22} A sample SEC subpoena and a sample letter from the SEC seeking voluntary cooperation in an informal SEC investigation are attached as Appendix A, p. 539, and Appendix B, p. 541, respectively.

\textsuperscript{23} Complaints filed by private parties who, of course, cannot conduct investigations before filing, typically contain less detail than complaints filed by government agencies.

\url{https://scholarship.law.upenn.edu/jil/vol9/iss3/4}
lic enforcement action is brought. There are statutory24 and SEC25 rule restrictions on the disclosure of nonpublic information obtained by the SEC.26 Overall, the SEC has done an excellent job of maintaining the confidentiality of information provided to it during an investigation.

Once the staff has gathered sufficient evidence, it determines whether to recommend to the Commission that an enforcement action be brought. Should the Commission decide, based on the staff’s recommendation and any submissions by parties, that an action should be brought, it may authorize the staff to commence a civil injunctive action, institute an administrative proceeding, or refer evidence of criminal violations to the United States Department of Justice, the entity authorized to institute criminal proceedings.27

3.2. Commission Injunctive Actions

The SEC has specific statutory authority to bring a civil suit in federal district court to enjoin a company or other person from violations of the federal securities laws.28 To obtain a permanent injunction, the statutes require the SEC to demonstrate that the defendant is engaged or is about to engage in a securities law violation. The SEC must therefore convince the court that there exists a reasonable likelihood that the defendant(s) will engage in future violations of the securities laws. In an injunctive action, the SEC may seek equitable relief in addition to an order not to violate the law again.29

24 15 U.S.C. §§ 77uuu(b), 78x(b), 79v(c), 80a-44, 80b-10 (1982).
26 As discussed in Section 5 infra, foreigners may be concerned by the possibility that information about them in the SEC’s possession will be requested by a third party under the Freedom of Information Act, 5 U.S.C. § 552 (1982) [hereinafter FOIA]. While this is a legitimate concern once an enforcement proceeding is concluded, Exemption 7(A) under the FOIA does protect from disclosure to private parties “investigatory records compiled for law enforcement purposes, but only to the extent that the production of such records would (A) interfere with enforcement proceedings ....” Id. § 552(b)(7) (1982).
27 Violation of an injunction can also result in the imposition of civil or criminal contempt.
29 In addition to this possibility of equitable relief, including, for example, disgorgement, the entry of an injunction has significant collateral consequences. For example, an injunction obtained against a public company or one of its officers or directors must be disclosed by the company. Also, certain exemptions under the Securities Act become unavailable once an injunction is entered. The most immediate impact of an injunction, however, may frequently be the reputational harm to the subject of the injunction. An injunction against committing fraud is premised on a finding that fraud was committed and that there is a reasonable likelihood of future fraudulent acts. Clearly, individuals do not like to be thus characterized as persons likely to commit
3.3. Administrative Proceedings

Several provisions of the federal securities laws authorize the Commission to sanction a person or entity after an administrative hearing.30 While the greatest number of administrative proceedings are brought against broker-dealers or persons associated with such entities, of particular relevance to the disclosure area is the Commission’s authority under section 15(c)(4) of the Exchange Act31 to bring administrative proceedings against issuers of securities who fail to comply with the disclosure and certain other provisions of the Exchange Act. Also, a 1984 amendment to the Exchange Act32 authorizes the SEC to proceed administratively against officers or directors or other individuals who cause a failure to comply with the disclosure and several other provisions of the Exchange Act. This would apply to individuals who, through booking of nonexistent sales or otherwise, cause an issuer to file false financial statements.

There are several important differences between a SEC administrative proceeding and a SEC injunctive action. An injunctive action is brought before a federal district court judge who can, as noted above, impose a permanent injunction once a violation of the law and a reasonable likelihood of future violations is demonstrated.33 An administrative proceeding is brought by the SEC’s Division of Enforcement before an administrative law judge (ALJ) who is an employee of the SEC. A finding of fraud can only be made by a federal district court judge, not by an ALJ. An ALJ can only determine that there has been a failure to comply with the securities law provision in question, not whether such failure was fraudulent. For example, if the disclosure violations in our hypothetical are determined to be negligent or inadvertent, the SEC would be able to proceed before either a federal court or an ALJ, but the existence of fraud is a finding that could only be made by a court. In an administrative proceeding, the initial appeal is from the ALJ to the Commission itself, not to a court.34 After the Commis-

30 See, e.g., 15 U.S.C. §§ 78o(b), 78o-4(c), 79m(d), 80a-8(e), 80a-9(b), 80b-3(c) (1982).
33 No such requirement is imposed on the SEC in an administrative proceeding.
34 17 C.F.R. § 201.17 (1986).
sion has rendered a decision, it can be appealed to a federal court of appeals.\textsuperscript{35}

Sanctions imposed in an administrative proceeding vary according to the provisions violated, the seriousness of the violations, and the specific authority for the proceeding. For example, companies found to have made false filings with the SEC may be ordered to correct false reports by restating their financials and correcting any other aspects of the filing(s) that are false.\textsuperscript{36} Although an ALJ can order the correction of past filings, an ALJ cannot enjoin future conduct.

The authority to correct false filings through the use of an administrative proceeding is especially significant because of the importance the United States places on maintaining efficient national securities markets. Because of its emphasis on efficient markets, the SEC is determined to ensure the accuracy of information provided to investors in these markets. Thus, even if the improper disclosure were negligent or inadvertent, a sanction may still be appropriate. Such a sanction is imposed through an administrative proceeding in which the SEC makes findings as to the inaccuracy and orders correction. Because of the absence of intent, however, there would be no injunction, no fine, no penalty, just the correction of error. Indeed, there is considerable authority that the SEC may not, in such a proceeding, find a violation of any of the antifraud sections of the statute or the rules promulgated thereunder.\textsuperscript{37} Because such proceedings lack counterparts elsewhere, it is difficult to persuade other nations to render assistance unless the SEC alleges that the failure may have been willful and therefore fraudulent. As discussed in Section 5 below, as the securities markets of other nations expand and compete with the United States markets, foreign nations may as a policy matter develop comparable procedures to insure market efficiency which depends upon accurate information. This in turn could lead to more willingness to lend assistance in non-fraudulent matters.


\textsuperscript{36} In some administrative proceedings involving reporting violations in which the defendant(s) consented to negotiated settlements, the SEC has issued orders that go beyond compelling correction of such reports. For example, in section 15(c)(4) administrative proceedings, the SEC has ordered the issuer to retain independent consultants, or to adopt appropriate accounting practices and procedures. See McLucas & Romanowich, SEC Enforcement Proceedings Under Section 15(c)(4) of the Securities Exchange Act of 1934, 41 Bus. Law. 145, 151, 167-73 (1985).

\textsuperscript{37} In this regard, a SEC formal order will typically allege potential reporting and fraud violations in a disclosure investigation. Once the investigation is completed, a decision will be made whether to bring a civil action or to bring an administrative proceeding. Since at the outset fraud is included, foreign assistance may be rendered, absent objections to "fishing expeditions." However, additional foreign assistance may not be available for any subsequent proceeding not alleging fraud.
3.4. Criminal Referral Process

Although the SEC conducts its own civil litigation and administrative proceedings, it lacks the authority to bring criminal actions. Criminal actions are brought only by the United States Department of Justice, headed by the Attorney General. The SEC is authorized to refer evidence of criminal violations to the Attorney General, who may institute criminal proceedings. Criminal sanctions for federal securities law violations include fines and up to five-years imprisonment per violation. Both the SEC’s decision whether or not to refer a case to the Attorney General, and the Attorney General’s decision whether or not to prosecute, are discretionary in nature.

The SEC typically assists the Department of Justice and the appropriate United States Attorney by discussing cases with them and providing them with access to information and documents in the SEC’s nonpublic investigative files. In some instances, the SEC also provides the Justice Department with SEC personnel familiar with a case to assist in its presentation to a grand jury or at trial. SEC recommendation of criminal prosecution is generally reserved for more serious violations, such as fraud.

3.5. Rule 2(e) Proceedings

Rule 2(e) of the SEC’s Rules of Practice is the vehicle utilized by the SEC to discipline attorneys, accountants and other professionals with respect to activities undertaken in their professional capacities (e.g., auditing financial statements of a public company) or for violations of the securities laws involving improper professional conduct. In particular, Rule 2(e) authorizes the SEC to deny, temporarily or permanently, the privilege of appearing or practicing before it to any person, including an attorney or accountant, who is found by the Commission:

(i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws (15 U.S.C. §§ 77a to 80b-20), or the rules and regulations thereunder.

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39 17 C.F.R. § 201.2(e) (1986).
40 Id.
In recent years, the SEC has imposed a variety of sanctions on accountants and attorneys under Rule 2(e). Orders of the Commission imposing a sanction under Rule 2(e) are judicially reviewable by the appropriate United States court of appeals.

3.6. Section 21(a) Reports

The SEC is authorized by section 21(a) of the Exchange Act to publish information regarding alleged violations of that Act. Such publication informs interested parties about the SEC’s interpretations of the securities laws, and may provide the public with examples of conduct which, in the SEC’s view at least, fail to meet minimum required standards. A section 21(a) report may be accompanied by the institution of enforcement proceedings.

3.7. Other Remedies

3.7.1. Foreign Restricted List

The SEC has the authority to place a company on the foreign restricted list. This is a list of foreign companies whose securities the Commission believes are being traded in violation of the registration provisions of the Securities Act.

3.7.2. Stop-orders

If the Commission determines after a hearing that a registration statement contains material misrepresentations or omissions, it can issue a “stop-order” pursuant to Securities Act section 8(d). This would prevent or suspend the effectiveness of the issuer’s Securities Act registration statement.

3.7.3. Exchange Act Section 12(k)

Under this section of the Exchange Act, the SEC can, without any administrative proceeding, order the suspension of trading in a particular security for ten days. The section is typically used where adequate and accurate financial information about a company is not publicly available.

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42 Id.; see also Kukatush Mining Corp. v. SEC, 309 F.2d 647, 650-51 (D.C. Cir. 1962) (discussing effect of such a list and affirming statutory authority of SEC to publish it).
3.7.4. 12(j) Orders

The Commission has authority pursuant to Exchange Act section 12(j) to suspend or prohibit further trading in a security if it finds that the issuer has failed to comply with any provision of the Exchange Act. For example, if an issuer violates the disclosure obligations of the Exchange Act by filing false financial statements, the SEC can suspend or prohibit public trading in the issuer's securities. Unlike the SEC's summary powers under section 12(k), a hearing is required before the Commission can exercise its section 12(j) authority.


The discussion that follows will consider three different stages of Commission action, two of which have similar consequences in terms of gathering evidence. If we assume that the SEC is conducting an investigation under a formal order of investigation or, having completed its investigation, has commenced an administrative proceeding before an ALJ, the Commission will encounter significant barriers, described below, to obtaining the assistance it requires in gathering evidence abroad. If, on the other hand, the SEC, on completing its investigation, has filed a civil injunctive action, it will have greater resources for gathering evidence through both United States and international channels, but will, as also described below, nonetheless encounter problems that may best be solved by some of the mechanisms suggested in Section 5.

In connection with its investigation, administrative proceeding, or pretrial discovery for a civil injunctive proceeding, the SEC will wish to examine the books and records of the foreign subsidiary and the work papers of the foreign accountant. The SEC may also wish to depose the foreign accountant and the officers and employees of the foreign subsidiary. This discussion assumes that the United States corporation does not maintain the records and books of its foreign subsidiary in the United States. Similarly, we shall assume that the United States accountant does not possess the work papers of the foreign accountant. Typically, neither the United States corporation nor its subsidiary, nor the foreign accountant will be willing to cooperate and the SEC will be forced to compel production of documents and testimony.

4.1. Formal Order of Investigation

As described in Section 3.1, SEC proceedings under a formal order of investigation are nonpublic. The SEC may, under a formal order,
directly subpoena documents and testimony. The service of an investigatory subpoena effectively compels the person on whom it is served to produce documents or appear to testify. If such documents and testimony are not forthcoming, the SEC may apply to a United States district court for enforcement of its subpoena. The court may issue an order requiring the person to comply with the subpoena, and failure to do so may be punished as contempt of court. In order to issue an order compelling a person to respond to a SEC investigative subpoena and to sanction such person for noncompliance, a United States court must have both subject matter and personal jurisdiction over that person. However, United States courts have held that the statutory grant of jurisdiction on which the SEC relies for its investigatory subpoena power does not authorize the SEC to serve investigatory subpoenas on a foreign citizen in a foreign nation nor does it authorize a court to enforce such a subpoena. On the other hand, a subpoena properly served in the United States in connection with a matter the SEC may properly investigate may be used to compel a person to produce documents located abroad. An investigatory subpoena would thus not be available to the SEC for use against the foreign accountant, assuming that the accountant has no presence in the United States. Under certain circumstances, the SEC could properly serve its investigatory subpoena on the foreign subsidiary and a United States court could find it had subject matter and personal jurisdiction over the subsidiary. If the

46 If a corporation has failed to comply, it or its officers or agents may be held in contempt. Contempt of court is punishable by daily fines seeking to compel compliance and such fines may be secured by the assets of a recalcitrant person or corporation wherever they may be found and lawfully attached. If noncompliance continues, a person may be arrested and imprisoned for a stated amount of time or until he complies. See, e.g., FTC v. Compagnie de Saint-Gobain-Pont-a-Mousson, 636 F.2d 1300, 1312 (D.C. Cir. 1980). CFTC v. Nahas, 580 F. Supp. 245, 249 (D.D.C. 1983), vacated, 783 F.2d 487 (D.C. Cir. 1984), illustrates the power of a court to sanction for contempt, although in this instance the sanctions were overturned by the court of appeals.

47 15 U.S.C. §§ 77s(b), 77uuu(a), 78u(b), 79r(c), 80a-41(b), 80b-9(b) (1982).

48 See CFTC v. Nahas, 738 F.2d at 493. The court in Nahas construed a provision in the Commodity Exchange Act which at the time was nearly identical to section 21(b) & (c) of the Exchange Act, 15 U.S.C. § 78u(b)-(c) (1982), and similar to section 19(b) of the Securities Act, 15 U.S.C. § 77s(b) (1982), in such a way as to ensure that the provision would not violate international law. Cf. SEC v. A.H. Zangeneh, 470 F. Supp. 1307 (D.D.C. 1978). In Zanganeh the court held that the SEC could not subpoena the testimony of a foreign witness merely by serving the subpoena at the offices of a corporation organized to hold certain lands for his children. The court suggested that the result might be different if the person "had in some fashion submitted to the SEC's jurisdiction." Id. at 1307.

49 See, e.g., SEC v. Minas de Artemisa, S.A., 150 F.2d 215 (9th Cir. 1945).

50 See In re Marc Rich & Co., 707 F.2d 663 (2d Cir.), cert. denied, 463 U.S. 1215 (1983). In Marc Rich, which involved a grand jury subpoena, the court found both subject matter and personal jurisdiction over a Swiss corporation, since the viola-
foreign subsidiary did not comply with a court's order enforcing the SEC subpoena, the court could impose the sanctions described above, including holding officers and directors in contempt and freezing any reachable corporate assets as security for fines to be levied on the subsidiary or on its officers.

In effect, sanctions imposed by a United States court for failure to comply with an investigatory subpoena are the only remedies available, because foreign courts may not be willing to enforce subpoenas at the request of the SEC. The sanctions impose pressure to comply. This situation creates the conflict of laws described below if secrecy or blocking statutes apply, which they may at the investigatory stage. Moreover, foreign officials may be concerned because United States courts, in determining whether they have jurisdiction, may take a broad view of the reach of that jurisdiction without considering adequately the interests of the nation affected and without formally consulting the government involved. Thus, sanctions with respect to offshore entities are likely to produce a negative reaction among foreign sovereign states, especially if the entity has a substantial presence in the foreign jurisdiction.

If the SEC could not subpoena the subsidiary directly, it would have to serve its investigative subpoena on the domestic parent to compel it to produce the documents and personnel of the subsidiary. A court could impose the sanctions described above upon the parent for

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Note: The text continues with further discussion of personal jurisdiction and引用了Marc Rich and Hoffman v. United Telecommunications, Inc. cases.
noncompliance if it found that the parent exercised sufficient custody or control over the documents sought that it could produce such documents, or sufficient control over the subsidiary that it could be expected to be able to require the personnel of the subsidiary to comply with such a subpoena.\(^5\) It is likely that a court would find that a domestic parent of a wholly owned foreign subsidiary for which it filed consolidated financial statements with the SEC had sufficient control over the books and other documents of such subsidiary to be required to deliver such books and documents to the SEC in response to a subpoena served on the parent.\(^5\) However, whether or not a court would be willing to find that the parent had sufficient control over its foreign subsidiary to be able to compel the appearance and testimony of personnel of such subsidiary is a more difficult question. As a practical matter, especially with respect to the compelled testimony of the subsidiary’s personnel, a court would probably conduct an alter ego analysis in deciding whether the corporate identities were sufficiently separate to enable the parent to argue successfully that it could not compel its subsidiary to produce the desired testimony.

In summary, the SEC would almost certainly be unable to subpoena the work papers or the testimony of the foreign accountant. Its ability to reach the books and records and personnel of the subsidiary would depend either on the SEC’s ability to reach the subsidiary directly and/or on certain determinations regarding its relationship with its parent.

At the investigatory stage, the SEC will be unable to use the Hague Convention\(^5\) because that agreement applies only to judicial proceedings commenced or contemplated. Therefore, given the problematic nature of its investigatory subpoena power with respect to persons and entities located abroad, and the limited utility of and the public outcry caused by imposition of sanctions, the SEC, when operating under a formal order of investigation, will largely be dependent upon the kind of bilateral agreement exemplified in the Memorandum of

\(^5\) See Cooper Indus., Inc. v. British Aerospace, Inc., 102 F.R.D. 918, 920 (S.D.N.Y. 1984) (a domestic corporation having documents within its control cannot be allowed to shield such documents from discovery by storing them with a foreign affiliate). But see In re Messerschmitt Bolkow Blohm GmbH, 757 F.2d 729, 733 (5th Cir. 1985) (refusing to find that a domestic subsidiary has custody or control of a foreign parent’s records), cert. vacated, 106 S. Ct. 2887 (1986).

\(^5\) Alternatively, a domestic parent with a substantial presence in the United States might be willing to put considerable pressure on its subsidiary to cooperate with the SEC (ignoring, for the moment, the existence of a blocking statute that might prohibit such cooperation).

\(^5\) Convention, supra note 1. For a discussion of the application of the Convention to assistance in the securities field, see infra notes 63-108 and accompanying text.
Understanding with Switzerland (Swiss MOU), which provides for cooperation between the SEC and Swiss authorities, although the reach of some of these agreements is uncertain. Such bilateral agreements might also prevent the employment of secrecy laws and blocking statutes which may come into play at the investigatory stage of SEC enforcement efforts.

4.2. Administrative Proceeding

If the SEC, subsequent to its investigation, brings an administrative action against the corporation and its subsidiary (assuming the SEC has subject matter and personal jurisdiction over the subsidiary), the production of documents and testimony of witnesses will be conducted pursuant to the Commission's Rules of Practice. As a practical matter, the SEC will be unable to compel the production of evidence from the foreign accountants and will be able to compel the production of documents and testimony from the subsidiary only insofar as it would have been able to do so at the investigatory stage. In addition, the Hague Convention for the Taking of Evidence will be unavailable, because it applies only to judicial proceedings. Therefore, again, international agreements providing for assistance in such matters will be the most useful methods of obtaining evidence with respect to an administrative proceeding, provided such agreements are available in the case of administrative as well as civil proceedings.

4.3. Civil Injunctive Proceeding

Putting aside the question of the applicability of the Hague Convention for the Taking of Evidence, discussed below, if the SEC files a civil injunctive action in federal court, discovery is carried out under the Federal Rules of Civil Procedure (FRCP). Although discovery under the FRCP is largely conducted by the parties without recourse to the court, the FRCP do provide for means to compel parties and, to a limited extent, third-party witnesses in a civil action to participate in discovery. Indeed, the difficulties attendant on obtaining evidence under

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55 See infra Section 5, which discusses the advantages of bilateral and multilateral agreements as contrasted with case-by-case enforcement of investigatory subpoenas.
56 See infra notes 99-108 and accompanying text.
58 Convention, supra note 1, arts. 1, 15, 23 U.S.T. at 2557, 2564.
59 Sanctions available against persons refusing to participate in discovery are set out in Fed. R. Civ. P. 37.
https://scholarship.law.upenn.edu/jil/vol9/iss3/4
a formal order of investigation may encourage the SEC to file a civil injunctive action earlier or on less compelling evidence than it might otherwise have done. This is not necessarily a satisfactory result for either the SEC or those it investigates, because an investigation is non-public (and the SEC is considered to have an excellent record of keeping such investigations confidential), while an injunctive proceeding is not.

In order to adjudicate a controversy, a United States court must have both subject matter and personal jurisdiction over a party to the action. We will assume that the SEC has named as parties, and a court has found jurisdiction over, the corporation and its foreign subsidiary, together with individual officers or employees who are alleged to have committed the acts complained of. Therefore, under the FRCP, a court could compel production of documents, responses to interrogatories and appearance for depositions and could sanction, using Rule 37 of the FRCP, parties who did not comply. Sanctions under Rule 37 may include contempt as well as adverse findings against a party who does not cooperate in discovery. Adverse findings against the subsidiary may be an effective means of compulsion. A finding of contempt against officers and directors of the subsidiary or against individual defendants may be effective if assets of the subsidiary or the individuals are available to be frozen. The threat of imprisonment may also be effective if an individual officer or director may be reached. However, as a practical matter, the threat of imprisonment will be ineffective against individuals who are located outside the United States and are willing to remain

60 We have assumed that the SEC and therefore the court will have subject matter jurisdiction over the filing of false financial statements by a United States corporation and that such subject matter jurisdiction will extend to the subsidiary under the "effects" doctrine. Personal jurisdiction is generally based on a finding that a party has sufficient minimum contacts with the forum (in this case, with the United States) such that maintenance of a suit does not offend "traditional notions of fair play and substantial justice." See International Shoe Co. v. Washington, 326 U.S. 310, 316 (1945) (quoting Milliken v. Meyer, 311 U.S. 457, 463 (1940)). Personal jurisdiction may be based on the fact that the party does business in the United States, or has committed the act complained of there, or that its acts have "effects" in the United States (similar to the "effects" on which subject matter jurisdiction is based). See Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 998-1000 (2d Cir.), cert. denied, 423 U.S. 1018 (1975). In addition, a court must be able to effect service of notice on a party. Service of notice on foreign parties is provided for by Fed. R. Civ. P. 4.

abroad permanently.

On the other hand, we will assume that the SEC has not named the foreign accountant as a party.61 In this event, a court's power under the FRCP to compel either production of documents or the testimony abroad of mere third-party witnesses, who would not be amenable to local service and who are not United States citizens or residents, is limited to the issuance, at the discretion of the court, of letters rogatory to a foreign court.62 Letters rogatory, which are issued through the United States Department of State, are generally executed under local rules of procedure, which may have limitations on compulsion.

Instead of proceeding to carry out and compel discovery under the procedures authorized by the FRCP, which contemplate discovery carried on largely by the parties without judicial interference, except in instances where compulsion is necessary, the SEC may be required to obtain the evidence it needs, from both parties and nonparties, pursuant to the specific procedures authorized by the Hague Convention.63 The Hague Convention represents in part an effort to reconcile the differences between discovery procedures in civil law countries, where discovery is largely controlled by the court, and those in common law countries, where as described above, discovery is controlled by parties.64 As noted above, the Hague Convention may not be used to obtain evidence which is not intended for use in judicial proceedings commenced or contemplated.65 The Convention is, therefore, not available either at the investigatory stage or for use in SEC administrative proceedings. Indeed, it has been alleged that SEC civil injunctive proceedings, although denominated as civil proceedings, are not civil proceedings as contemplated by the Hague Convention.66

The Convention establishes three basic methods for obtaining evi-

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61 We have assumed that the foreign accountants have no presence in the United States. It is unclear whether a court would find that the accountants' acts have sufficient effects in the United States to warrant personal jurisdiction.

62 Letters rogatory are specifically authorized in Fed. R. Civ. P. 28(b)(3).

63 Convention, supra note 1. Twenty-five nations participated in negotiating and drafting this Treaty. To date, the Convention has entered into force in eighteen nations. 8 MARTINDALE-HUBBELL LAW DIRECTORY, pt. 7, at 15 (1987).


65 See supra notes 53, 58 and accompanying text.

66 The SEC has successfully overcome such an allegation in several instances. For example, in connection with letters of request issued by the court in SEC v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981), the Praetor's Court of Milan rejected such an argument. For a discussion of this case, see Mann & Sullivan, Current Issues in International Securities Law Enforcement: An Update in 2 COURSE HANDBOOK FOR PLI SECURITIES ENFORCEMENT INSTITUTE 1986, at 510-11 (1986).
dence in foreign nations: letters of request, use of diplomatic or consular officials, and use of designated private commissioners. Letters of request are the only method of obtaining evidence under the Convention that, as a practical matter, provides for compulsion by foreign authorities. This paper assumes for purposes of discussion that the persons involved in the hypothetical will not voluntarily provide documents and testimony, and that the SEC will need to utilize a method of discovery offering a means of compulsion. The discussion below will therefore concentrate on letters of request. The SEC could use letters of request, inter alia, to conduct examination of persons, address specific questions to witnesses, and inspect documents of both the subsidiary and the foreign accountants. The Convention provides that the receiving state's provisions for compelling discovery apply, and witnesses may assert privileges under the laws of either the requesting state or the receiving state. A receiving state may refuse to execute a letter of request if, inter alia, it considers its sovereignty or security would be prejudiced by complying with the request. A receiving state may not refuse to execute a letter either because it claims exclusive jurisdiction over the subject matter or because its laws do not recognize the cause of action involved.

One problem that the SEC has asserted as a factor complicating its attempts to use the Convention is Article 23, which permits a signatory to declare that "it will not execute Letters of Request issued for the purposes of obtaining pre-trial discovery of documents as known in Common Law countries." Twelve signatories have made Article 23

67 Letters of request are similar to letters rogatory authorized under Rule 28(b) of the FRCP, except that they are transmitted to the receiving court by means of Hague Convention procedures. Indeed, Rule 28(b) appears to contemplate the application of the Hague Convention to the taking of depositions abroad. The Convention, supra note 1, treats letters of request in arts. 1-14, 23 U.S.T. at 2557-64.
68 Convention, supra note 1, arts. 15-22, 23 U.S.T. at 2564-68.
69 Id.
70 Unless states declare that a diplomatic officer, consular official or commissioner may apply to the central authority for assistance in compelling testimony, the taking of evidence by such officials or private commissioners is confined to those situations in which the witness voluntarily testifies. Convention, supra note 1, art. 18, 23 U.S.T. at 2566. Five states have made a declaration permitting applications for assistance: Cyprus, Czechoslovakia, Italy, the United Kingdom and the United States. 8 Martin-Dale-Hubbell Law Directory, pt. 7, at 15-21 (1987). West Germany prohibits the taking of evidence of German nationals under this provision. Id. at 16.
71 Convention, supra note 1, art. 9, 23 U.S.T. at 2561.
72 Id. art. 11, 23 U.S.T. at 2562.
73 Id. art. 12, 23 U.S.T. at 2562-63.
74 Id.
75 Id. art. 23, 23 U.S.T. at 2568. For a discussion of SEC difficulties with this provision, see Mann & Sullivan, supra note 66, at 504.
declarations, although they differ in their terms. West Germany, for example, has adopted a declaration that repeats the terms of Article 23. France, which had originally taken the same course, recently modified its Article 23 reservation to permit documentary discovery in cases where "the requested documents are limitatively enumerated in the letter of request and have a direct and clear nexus with the subject matter of the litigation." The United Kingdom's declaration is by its terms designed to require specificity in letters of request. At early stages of litigation, it is questionable whether the SEC would be wholly successful in identifying documents with sufficient particularity to satisfy such anti-"fishing" limitations on discovery. Overall, in the SEC's view, "there remain some questions concerning the Convention's effectiveness as a general matter in producing needed discovery."
Considering the difficulties that the SEC perceives to attend the use of the Hague Convention, it will in all likelihood prefer to rely directly on the FRCP to conduct discovery, without the involvement of foreign authorities or courts. However, there has been some controversy among state and federal courts in the United States as to when and whether parties may forego Hague Convention procedures when conducting discovery among foreign nationals in the United States and abroad. While some courts have required litigants to use the Convention as a matter of international comity or judicial restraint, courts requiring use of the Convention have generally taken the view that, if resort to the Convention fails, the FRCP may be employed directly.

In the *Aerospatiale* litigation, the United States Supreme Court is currently considering the proper roles of the Hague Convention and the FRCP. In the opinion below, the Eighth Circuit followed the lead of several other courts in holding that the Convention has no application to pretrial discovery from parties subject to the in personam jurisdiction of the court (regardless of those parties’ nationality) where testimony is to be taken or documents are to be produced in the United States, even though such documents are found originally in a foreign country.

Similarly, with regard to interrogatories, these courts have taken the position that Hague Convention procedures do not apply where the interrogatories are served in the United States, even if the necessary information has to be obtained from parties outside the United States. The French court imposed a “minor fine.” The United States subsequently filed a letter with the Supreme Court correcting the statement in the brief with respect to the French request. That letter explained that the witness in France challenged the request before the local courts. The French government defended the validity of the request and ultimately prevailed. By then, however, the request for evidence had become moot because the witness had subsequently been named as a defendant and was engaged in settlement negotiations with the SEC. The proceedings had taken eighteen months. Letter from the Solicitor General of the United States to the Clerk of the Supreme Court of the United States (Dec. 19, 1986).

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formation is located abroad. According to these courts, the rationale for their distinction between discovery deemed to be taking place in the United States even if preparatory steps are taken abroad and discovery entirely taken abroad is that a foreign government’s sovereignty is not implicated by the former. At least one other court and several governments, including the United States, have specifically rejected the rationale of this line of cases.

The United States Supreme Court has recently heard oral arguments in Aerospatiale. Until the Court announces its decision, the question of under what circumstances the SEC must utilize Hague Convention procedures with respect to foreign parties will remain unclear.

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84 In re Anschuetz & Co., GmbH, 754 F.2d at 611.
85 Aerospatiale, 782 F.2d at 124-25. Courts taking this position have not specifically addressed the question of whether testimony given on foreign soil would necessarily require the use of the Hague Convention, even if the court in question had the power to require such testimony to take place in the United States. Dictum in In re Messerschmitt Bolkow Blohm GmbH, 757 F.2d 729, is suggestive. After ordering a party to produce an expert witness for deposition in the United States and holding that under these circumstances the Hague Convention did not apply, the court noted that the situation might be different if the deposition were to be given on foreign soil. Id. at 733. See also In re Anschuetz & Co., GmbH, 754 F.2d at 611 n.25 (violation of another country’s judicial sovereignty can be avoided by ordering that a deposition take place outside the foreign country). But see Laker Airways Ltd. v. Pan Am. World Airways, 103 F.R.D. 42 (D.D.C. 1984). In this case, which involved the taking of depositions of two directors of Lufthansa, the court held that “the Hague Convention does not constitute the exclusive means by which the plaintiff may secure discovery from Lufthansa, whether in the United States, in the Federal Republic of Germany, or elsewhere.” Id. at 51.
86 See, e.g., S & S Screw Machine Co. v. Cosa Corp., 647 F. Supp. at 614 (declining to adopt the geographic fiction that the FRCP require only gathering or preparation of evidence, but not its production, on foreign soil). See also Brief of the Republic of France as amicus curiae in Support of Petitioners, Societe Nationale Industrielle Aerospatiale v. United States Dist. Court for the Dist. of Iowa (No. 85-1695), cert. granted, 106 S. Ct. 2888 (1986). In its brief the French government asserted not only that the Convention applies to parties before a United States court but that, regardless of where production of documents actually takes place, preparation for such documentary discovery would take place on French soil and therefore such discovery, absent French assistance under the Convention, would infringe on French sovereignty. Brief at 12-17. See also Brief of the Government of the United Kingdom of Great Britain and Northern Ireland as amicus curiae in Support of Petitioners, Societe Nationale Industrielle Aerospatiale v. United States Dist. Court for the Dist. of Iowa, in which the United Kingdom stated that French interests would be implicated, regardless of whether documents are to be produced in the United States. Id. at 16-17.

In their joint brief in the same case, supra note 79, the United States and the SEC also rejected the lower court’s rationale that the Convention was meant only to apply to evidence produced abroad, as opposed to evidence gathered abroad and produced in the United States. Id. at 10. The SEC, however, argued that the required use of the Hague Convention should be determined on a case-by-case basis, and rejected a mandatory “first-use” rule. Id. at 6.
If the Eighth Circuit were upheld in *Aerospatiale*, and assuming that the foreign accounting firm was not a party but the subsidiary was, the SEC might be able to use the FRCP directly for obtaining documents of the subsidiary to be produced in the United States and for compelling officers, directors, and certain designated employees of the subsidiary to testify in the United States. However, the SEC would probably be required to use the Hague Convention to obtain both documentary evidence and testimony from the foreign accountant, who would not be amenable to service here and all of whose evidence would be given abroad. Moreover, if testimony from subsidiary personnel were to be given in Country X, the SEC might be required to employ the Hague Convention procedures to obtain such testimony. If the Supreme Court reverses the Eighth Circuit, the SEC would presumably be required to employ the Hague Convention procedures with respect to both parties and third-party witnesses. In such event, it is possible that the Court would provide guidance as to whether and under what circumstances the FRCP could be used where the Hague Convention procedures failed to produce discovery considered reasonable by a United States court.

Another factor bearing on the ability of the SEC to gather evidence abroad for an investigation, an administrative proceeding, or a civil injunctive proceeding may be the blocking statute enacted by Country X. In our hypothetical, Country X's blocking statute may be self-executing, as is the French statute, or, alternatively, it may be executed by the executive branch of the government, as is the case with the British statute.

Article 1bis of the French blocking statute provides that

subject to treaties, international agreements and laws and regulations in effect, *no person* may request, seek to obtain or transmit, in writing, orally, or in any other form, documents or information of an economic, commercial, industrial, financial or technical nature, intended for the constitution of evidence in connection with pending or prospective foreign judicial or administrative proceedings (emphasis added). The penalty for violation of Article 1bis is fine or imprisonment or

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*89 Article 1 of the French statute prohibits communication of documents or information of an economic, technical, financial, commercial or industrial nature, where such communication would threaten French sovereignty, security or essential economic interests. It seems unlikely that the information sought in the hypothetical would implicate Article 1.*
both. Article 1bis applies to any request for information of the kind described, if such information is to be used in the proceedings identified. Although Article 1bis does not mention foreign public authorities specifically, it applies to requests from such public authorities as the SEC as well as from courts.\(^9\) It is significant that Article 1bis makes it a crime to seek to obtain as well as to transmit documents or information. Article 1bis also covers subject matter relevant to the hypothetical and would prevent, except for what could be gathered through the Hague Convention, the SEC from taking testimony or obtaining evidence intended for use in any judicial or administrative proceedings from "any person," encompassing the foreign accountant and the subsidiary, its agents, employees and representatives. The French blocking statute operates automatically and, as a criminal enactment, cannot be the subject of any form of waiver.\(^91\)

Under the British blocking statute, the Protection of Trading Interests Act (1980 Act),\(^92\) if it appears to the Secretary of State that a person in the United Kingdom has been or may be required to produce to a court, tribunal, or authority of an overseas country any commercial document or information to be compiled from such documents,\(^93\) the Secretary may prohibit compliance. The Secretary could thus intervene to prevent compliance with a SEC subpoena, as well as with a discovery request.\(^94\) The Secretary is given considerable discretion as to the directive he may issue. Those failing to comply with a directive of the Secretary are subject to a fine.\(^95\)

Although the Hague Convention and the Evidence (Proceedings in Other Jurisdictions) Act (1975 Act)\(^96\) would apparently allow the tak-

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\(^91\) See Brief of the Republic of France as amicus curiae in Societe Nationale Industrielle Aerospatiale v. United States Dist. Court for the Dist. of Iowa, supra note 86, at 17.

\(^92\) Protection of Trading Interests Act, 1980, ch. 11. "Trade" includes "any activity carried on in the course of a business of any description . . . ." Id. § 1(6).

\(^93\) "Commercial document" and "commercial information" mean respectively a document or information relating to a business of any description . . . ." Id. § 2(6).

\(^94\) The Secretary may issue his direction prohibiting compliance if the requirement from the court or authority (i) infringes the jurisdiction of the United Kingdom; (ii) is prejudicial to the sovereignty of the United Kingdom; (iii) would, if complied with, be prejudicial to the security of the United Kingdom; (iv) would, if complied with, prejudice relations between the United Kingdom and the government of another country; (v) is made otherwise than for the purposes of civil or criminal proceedings which have been instituted in the other country; (vi) is not restricted to particular documents; or (vii) requires publication of any document or information that is characterized in (i) through (iv) above. Id. § 2(1)-(3).

\(^95\) Id. § 3(2).

\(^96\) The Evidence (Proceedings in Other Jurisdictions) Act, 1975, ch. 34. See supra https://scholarship.law.upenn.edu/jil/vol9/iss3/4
ing of evidence for a *contemplated* proceeding, the Secretary of State could, under the 1980 Act, prohibit compliance where the proceedings are contemplated but have not been instituted. Therefore, in addition to the limitations already provided to discovery by the 1975 Act, the 1980 Act provides other potential grounds for prohibiting the SEC from obtaining evidence from the subsidiary or the foreign accountant, were either a "person in the United Kingdom."

Section 4 of the 1980 Act provides that British courts shall not comply with a request from a foreign court under the 1975 Act, under which the Hague Convention is implemented, if the Secretary of State finds that the request infringes the jurisdiction of, or is prejudicial to, the sovereignty of the United Kingdom.

We have assumed thus far that the corporation, the subsidiary, and the foreign accountant have not consented to produce documents and have not been willing to testify. However, even if they did consent to cooperate, blocking statutes might prevent such cooperation. A blocking statute such as the French model is absolute, making it a crime for parties or witnesses to consent unless such persons are voluntarily providing documents and testimony in compliance with the Hague Convention. If the Hague Convention did not apply, as it does not at the investigatory stage and with respect to administrative proceedings, the blocking statute could apparently prevent the SEC from obtaining the information it required. The 1980 Act allows the British Secretary of State considerable discretion to tailor a direction under Section 2, which specifically permits the Secretary to take into consider-

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97 Protection of Trading Interests Act, 1980, ch. 11, § 2(1).
98 The Financial Services Act, 1986, ch. 60, grants the Secretary similar powers to prevent disclosure to "any person in a country or territory outside the United Kingdom" of "information relating to the business or other affairs of any person" obtained either by a governmental financial regulatory authority or a private self-regulatory organization. *Id.* § 181(1)-(3). Knowing disclosure of information in violation of an order by the Secretary is a criminal offense punishable by fine or up to two years imprisonment. *Id.* § 181(7). The Act's legislative history suggests that its purpose is not to prevent foreign financial regulators from gaining access to information, but to allow the Secretary to prevent information being used in foreign legal proceedings unconnected with regulation of financial services. 479 *Parl. Deb., H.L.* (5th ser.) 748 (1986). On the other hand, the Secretary would apparently have authority to block the transmittal of information that the entities had agreed by contract to provide to United States entities or authorities.
99 In this respect, blocking statutes are distinguishable from secrecy laws, which generally (although not always) are waivable by the person about whom information is sought.
100 To the degree that the SEC wishes to avoid the blocking statute and utilize the Hague Convention, it will have yet one more incentive to bring a civil action rather than an administrative action. This may mean seeking to allege fraud, as opposed to *confining its allegation to non-fraudulent disclosure violations.*
ation the consent of a party or witness to give evidence.

United States courts have sometimes been willing, in spite of a blocking statute, to use the FRCP to issue orders compelling discovery and to sanction noncompliance under Rule 37.101 The Supreme Court has so far addressed the issue only in Societe Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers.102 In that case the Court reversed a lower court's dismissal of the plaintiff's case. The dismissal had been imposed as a sanction against the plaintiff, which was blocked by Swiss secrecy laws from complying with discovery requests. The Court indicated that a showing of bad faith on the part of the plaintiff would have been an important consideration in the imposition of such a sanction but that no such showing had been made.103 The Court did suggest in dictum that in a trial on the merits, the court below might be justified in drawing inferences unfavorable to the plaintiff in the absence of documentary evidence to the contrary.104 Following Rogers, courts have often required a showing of good faith before refusing to sanction a noncomplying party. Such good faith may be demonstrated by, inter alia, efforts to secure an exemption from the foreign government and efforts to comply with the court's order outside of the territorial reach of the blocking statute.105 Courts have also often used the balancing test of section 40 of the Restatement (Second) of Foreign Relations Law of the United States106 to decide whether an

101 Presumably a court that was willing to compel discovery in the face of a blocking statute would be willing to do so against a nonparty as well as a party but, as noted in Section 4, absent foreign judicial assistance, federal courts have little power to compel the testimony of witnesses who are foreign nationals located abroad and who are not amenable to service of a subpoena.


103 Id. at 208-09.

104 Id. at 212-13.

105 Graco, Inc. v. Kremlin, Inc., 101 F.R.D. at 526. In Graco, the court, in issuing a discovery order, indicated that good faith efforts on the part of the party expected to raise the French blocking statute as a defense would be the key factor in determining which, if any, sanctions would ultimately be applied. See also Ohio v. Arthur Andersen & Co., 570 F.2d 1370 (10th Cir.) (upholding the imposition of sanctions that precluded Andersen from opposing Ohio's claims on two matters and that assessed Andersen the cost of the motion to compel and noting that Andersen had acted in bad faith and that the balancing factors were heavily on Ohio's side), cert. denied, 439 U.S. 833 (1978); In re Westinghouse Elec. Corp. Uranium Contracts Litigation, 563 F.2d 992, 996-97 (10th Cir. 1977) (employing Roger's good faith standard and balancing factors under section 40 of the Restatement (Second) of Foreign Relations Law of the United States (1965) to relieve petitioner of contempt sanctions where Canadian law forbade production of documents).

106 Section 40 provides that:

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,
order should issue or sanctions should be applied for noncompliance with an order.  

The combination of a balancing of interests under section 40 and the application of a good faith test on a case-by-case basis has led to an inconsistent pattern of enforcement of orders from United States courts for discovery of documents held abroad. However, more often than not, United States courts have found the balance weighted on the side of United States interests. The Aerospatiale case now before the Supreme

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\text{RFSTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965).}
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Tentative Draft No. 7 (1986) for a revised Restatement attempts, in section 437, to deal specifically with foreign discovery requests. Among the factors a judge should consider under section 437 are the importance of the documents or information, the specificity of the request, the origin of the documents, the extent to which each state's interests are implicated, and the possibility of securing the information through alternative means. Where there is a conflicting foreign law, under section 437, a court may enter an order requiring a party to make a good faith effort to comply with the discovery requests. Failure to comply should not be punished with contempt, dismissal or default if there has been a good faith effort. However, adverse finding of fact is permissible even if there has been such good faith.

\[107\] See, e.g., In re Westinghouse, 563 F.2d at 997; Aerospatiale, 782 F.2d at 127. Several early decisions in the Second Circuit appeared to view foreign law prohibitions as an absolute bar to ordering inspection or production of documents, at least in the case of third-party witnesses. See In re Chase Manhattan Bank, 297 F.2d 611, 613 (2d Cir. 1962); Ings v. Ferguson, 282 F.2d 149, 152 (2d Cir. 1960); First Nat'l City Bank of New York v. IRS, 271 F.2d 616, 619 (2d Cir. 1959), cert. denied, 361 U.S. 948 (1960).

That circuit, however, has subsequently adopted a balancing test in which the prohibition of foreign law is only one of several factors to be considered. See, e.g., Trade Development Bank v. Continental Ins. Co., 469 F.2d 35 (2d Cir. 1972) (holding that on balance the material sought was not important enough to the case to require disclosure in violation of Swiss bank secrecy laws); United States v. First National City Bank, 396 F.2d 897 (2d Cir. 1968) (upholding on balance a contempt citation against a bank and its vice president, which citation imposed a daily fine on the bank and 60 days imprisonment on the vice president for failure to comply with an ongoing grand jury inquiry into antitrust violations, even though compliance might subject the bank to civil liability in Germany); see also United States v. Bank of Nova Scotia, 740 F.2d 817 (11th Cir. 1984) (upholding sanctions to force compliance with grand jury subpoena after finding bad faith on part of bank and finding U.S. interest in narcotics convictions outweighs interest of Cayman Islands in bank secrecy), cert. denied, 469 U.S. 1106 (1985); SEC v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981) (holding that on balance the Swiss bank was deliberately using Swiss secrecy laws to prevent discovery and ordering the bank to comply with certain demands by the SEC for information). In Banca Della Svizzera, the bank eventually obtained a waiver of confidentiality from its customers.
Court involves the French blocking statute, which, petitioners claimed below, prevents compliance with discovery requests outside of the Hague Convention. The Court's decision in *Aerospatiale* may provide lower courts with more specific guidance than that offered by *Rogers* with respect to the weight to be accorded by United States courts to foreign blocking statutes.

The current attitude of United States courts toward blocking statutes and the attitude of some United States courts toward the Hague Convention has antagonized the governments upon whose corporate and individual citizens are imposed the orders and resulting sanctions, which may include adverse findings against the party or even fines and imprisonment until compliance is forthcoming. Indeed, such action by United States courts and their sometimes expansive assertion of jurisdiction is, arguably, a unilateral action of the kind that was so much resented when waiver-by-conduct was proposed. To the degree that sanctions are not effective, the SEC and other United States parties may not be able to make their strongest case; to the degree that they are effective, they create an antagonistic international atmosphere in which foreign governments are unwilling to cooperate. Therefore, even assuming that, using the Rule 37 enforcement powers of the federal courts (and the Hague Convention where possible or necessary), the SEC succeeded in obtaining at least some of the evidence it sought, the SEC is unlikely to consider the solution as wholly satisfactory in all cases. In the context of the hypothetical under discussion, a Rule 37 sanction seems a drastic remedy to contemplate when, as is likely to be the case, the ultimate outcome of the SEC's enforcement activities will be the requirement that the corporation correct its financial statements. Moreover, in general, the SEC may be loath to use a case-by-case method to enforce its requests for documents and testimony, both because it may be inefficient and because it is likely to have deleterious effects on the amicable working relationships the SEC desires to maintain with foreign governments and their enforcement authorities. Finally, neither the Hague Convention nor the FRCP will necessarily permit the SEC to gain access to all of the evidence it may require in a civil injunctive action. Where the SEC is carrying out a formal order of investigation or conducting an administrative proceeding, the Hague Convention will be unavailable, and the power of United States courts will be of limited use in gaining access to information located abroad.

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108 *Aerospatiale*, 782 F.2d at 126-27.

109 See infra notes 119-23 and accompanying text.

https://scholarship.law.upenn.edu/jil/vol9/iss3/4
5. Possible Solutions

5.1. Introduction

It should be emphasized that debate over international problems in the securities area has thus far taken place under circumstances in which the SEC makes most of the requests for assistance. As foreign markets, particularly those of Japan and the United Kingdom, begin to rival the United States markets, the SEC is likely to be the recipient of an increasing number of requests for assistance. In considering what the SEC and foreign nations will want from future bilateral and/or multilateral assistance agreements, both sides should keep in mind that the necessity for assistance is likely to become a two-way street. Therefore, although agreements for assistance may be a more tangible benefit to the SEC in the short run, both the United States and foreign nations are likely to desire such assistance in the long run. In that regard, Congress must give the SEC explicit authority to cooperate with foreign nations in situations where no violation of United States law is suspected. It is more appropriate to give such authority to the SEC than to the Department of Justice, because of the SEC's experience in securities matters.

This section briefly lists some possible solutions to international problems in the securities regulation area. The three most promising options — consent, bilateral agreements, and multilateral agreements, are discussed in depth in the remainder of this section.

(1) Status Quo. The SEC could continue to rely upon pressure on the United States issuer and the United States accountant to achieve its goals and continue to obtain evidence held overseas on a case-by-case basis. This "solution" presupposes a belief that problems of access to foreign-based evidence are relatively isolated and require no unusual measures to solve. Although others may disagree, it is apparent that the SEC does not view the problem as isolated. Also, these methods are unlikely to provide help to the SEC at the investigatory stage of its enforcement activities.

(2) Duplicate Records. The SEC could require that a United States issuer maintain in the United States duplicate copies of its foreign subsidiary's books and records. This solution would be enormously expensive and therefore unnecessarily burdensome on corporations.

With respect to the foreign accountants, the United States accountant could be required to maintain copies of the work papers of a foreign accountant if it relies on the report of such accountant but assumes responsibility for the report (that is, does not disclose its reliance). This requirement does not appear to be especially burdensome, but it would
not solve the problem of access to the testimony of the foreign accountants.

(3) **Foreign Accountants.** The SEC could promulgate rules requiring United States accountants to cease relying on foreign accountants. This solution seems impracticable because of workload and difficulty in gaining access to books and records.

(4) **Disclosure.** The SEC could require the United States accountant, as part of its auditor’s letter included in annual reports of a domestic corporation, to disclose the percentage of the issuer’s assets covered by a foreign accountant’s audit. This disclosure would state that access to the books and records of foreign accountants could be limited for enforcement purposes. Such a solution is unlikely to be acceptable to the SEC’s Division of Enforcement, which would still want to investigate when it believes that the disclosure made is false or misleading, and would therefore desire access to the testimony and work papers of the foreign accountants.

(5) **Rule 2(e) Proceedings.** The SEC might attempt to bring a Rule 2(e) proceeding, as discussed in Section 3.5, against the foreign accountant. However, this would not solve problems of access to testimony or documents; indeed, it could exacerbate them. Any attempt to bring such a proceeding would also raise jurisdictional issues.

The SEC could also conceivably bring a Rule 2(e) proceeding against the United States accountant on the theory that such accountant “improperly relied” on the foreign accountant. In such a proceeding, the SEC could argue that a failure by the United States accountant to produce the testimony and work papers of the foreign accountant should create a presumption that the foreign accountant’s testimony would be adverse to the United States accountant. This result could discourage United States accountants from relying on foreign accountants. Even if this were a desirable outcome, this type of Rule 2(e) proceeding could raise issues of due process and would not necessarily alleviate the SEC’s broader concerns over its ability to obtain documents and testimony from foreigners.

(6) **Section 21(a) Foreign Restricted List.** The SEC could make more frequent use of section 21(a) reports on foreign accountants or of a publication similar to the foreign restricted list. However, this would not solve the Commission’s basic concern over access to evidence abroad.

(7) **Consent.** The SEC could require consent of issuers and accountants in various circumstances. Consent as a solution is discussed

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110 See supra Section 3.6.

https://scholarship.law.upenn.edu/jil/vol9/iss3/4
in detail in Section 5.2 below.

(8) *International Agreements.* The SEC (or the United States Government) might negotiate assistance agreements under which subpoenas issued will be enforced and documents delivered. Such agreements would provide standards for providing assistance and/or would use the services of a third party to determine when assistance would be provided. Negotiation of bilateral and multilateral agreements is discussed in detail in Sections 5.3 and 5.4 below.

5.2. *Use of Consents*

As the earlier discussion illustrates, the SEC has expressed serious concerns over the differing legal standards for the exercise of jurisdiction and the production of evidence that currently exist between the United States legal system and overseas legal systems. One possible solution to the problems raised by such differing standards is the creation by the SEC of some type of consent requirement, which could be required of issuers and/or accountants. As discussed below, the imposition of a consent requirement by the SEC is likely to produce an adverse foreign reaction because a consent requirement, however mild, is by definition a unilateral United States action that excludes other nations from the process. However, we will assume for purposes of discussion that the SEC nonetheless chooses to consider the creation of a consent requirement. The discussion below focuses on (i) types of consents now required, (ii) areas where the SEC could expand consent requirements in the future\(^{111}\) and (iii) possible foreign reactions to SEC attempts to require consents affecting non-United States entities.\(^{112}\)

Consents have previously been used in the United States securities law area, both in the text of specific SEC rules and in no-action letters. The mildest type of consent currently required by the SEC is a consent to jurisdiction and appointment of an agent for service of process. For example, nonresident issuers engaging in a Regulation A offering, or any nonresident directors or officers of an issuer in a Regulation A offering, must file such a consent, naming the SEC as agent for service.

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\(^{111}\) This article does not discuss the area of negotiated consent agreements between the SEC and private individuals or entities. While such agreements may be helpful in the occasional individual case, they are not a comprehensive long-term solution.

\(^{112}\) This discussion assumes that the SEC's primary motivation for imposing a consent requirement is to enable it to obtain evidence abroad if it subsequently seeks to investigate parties that have been compelled to consent. This section does not deal with voluntary cooperation at the pretrial discovery stage, where Articles 15-17 of the Hague Convention, *supra* note 1, 23 U.S.T. at 2564-65, do allow voluntary discovery, even under the terms of some blocking statutes.
of process. Similarly, Exchange Act Rule 15b1-5 requires nonresident brokers or dealers and any nonresident general partners or managing agents of brokers or dealers to furnish a consent to service of process designating the SEC as agent for service. Nonresident investment advisers are also required to designate the SEC as agent for service of process. Most recently, the Commission proposed for comment Rule 6c-9 under the Investment Company Act, which would, under certain conditions, permit a foreign bank or the bank's finance subsidiary to offer or sell its own debt securities or nonvoting preferred stock in the United States without registering as an investment company. As one condition of the proposed exemption, the foreign bank and any foreign finance subsidiary would be required to file with the SEC a form appointing an agent located in the United States for service of process.

If the SEC seeks to expand the use of a consent requirement as a condition precedent to conducting particular activities in the United States, such expansion could take the following form: The SEC could require that any United States corporation whose foreign subsidiary contributed a specified percentage of the United States issuer's earnings must cause that subsidiary to file (as part of the parent's annual report to the SEC on Form 10-K) a consent to service of process designating the SEC as agent for service. Such a consent could be similar in form to the ones in Rule 15b1-5 and proposed Rule 6c-9 noted above. Once personal jurisdiction is obtained pursuant to such a consent, a court having subject matter jurisdiction can impose sanctions on a party whose consent has been so given.

If a consent to service of process does not appear sufficient to the SEC, more far-reaching types of consents could be proposed. For example, the Commission could require, as part of the Form 10-K, that the parent cause its foreign subsidiary to file a consent agreeing to provide books and records requested by the SEC if a formal order of investigation is entered against the parent. An even more drastic action

114 17 C.F.R. § 240.15b1-5 (1986).
115 17 C.F.R. § 275.0-2 (1986)
117 Id. at 34,225.
118 Consents whereby United States issuers agree to cause (or use their "best efforts" to cause) foreign subsidiaries to take certain actions or provide certain documents have also been entered into by the SEC in the no-action letter context. A recent example is the SEC's 1986 no-action letter with respect to Citicorp/Vickers da Costa Securities, Inc., in which Citicorp agreed, inter alia, to (i) designate its General Counsel's office in New York as agent for service of process for any SEC action involving certain
would be for the SEC to require, as part of the Form 10-K, that the parent cause the officers and directors of its foreign subsidiary to file a consent agreeing to appear in the United States to testify, as well as agreeing to produce books and records, if the parent company becomes the subject of a SEC formal order of investigation. The annual report would not be considered to have been properly filed and completed unless the consents the SEC chose to require were included. The SEC would essentially be exercising its authority to mandate the content of a filing.

With respect to accountants, analogous requirements could be imposed. If a United States accountant relies on a foreign accountant in preparing the parent's consolidated financial statements for the annual report (Form 10-K), the United States accountant could be required to cause the foreign accountant to (i) appoint the SEC, as agent for service of process, (ii) consent to provide books and records if so requested by the SEC, and/or (iii) consent to testify in the United States, and agree to provide books and records, in a SEC formal investigation.

Use of consent does not eliminate potential conflicts between (i) a United States court's demands for production of documents pursuant to the terms of the consent and (ii) a foreign blocking statute precluding the transmittal of such documents. Also, the use of consent as a condition precedent to ensure "voluntary" cooperation at the investigatory stage is likely to be seen as intrusive and unilateral by foreign governments, as the "waiver-by-conduct" experience illustrates. The "waiver-by-conduct" approach was proposed in July 1984. Under this concept, the sale or purchase of securities on a United States market, directly or indirectly, would be deemed by the SEC to constitute a waiver of any protections otherwise provided by foreign secrecy statutes.119 Such a purchase or sale would constitute "an implied consent to disclosure of information and evidence relevant to the transaction for purposes of any Commission investigation, administrative proceeding or action for injunctive relief authorized by the federal securities laws that may arise out of the transaction."120 Also, such a purchase or sale would constitute the appointment of the United States broker executing the transaction as an agent for service of process and "a consent to the exercise of in personam jurisdiction by the United States courts and the Commis-

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120 Id. at 31,300.

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The release states that the waiver-by-conduct approach does not address problems resulting from blocking statutes or problems arising in cases involving foreign subsidiaries of United States corporations or foreign broker-dealers or accountants.

Most comments received in response to this release were negative. The commentators felt that a waiver-by-conduct concept would (i) constitute an extraterritorial extension of United States law, (ii) drive business away from United States markets, and (iii) raise questions of enforceability.

In addition to their objections to unilateral United States action, foreigners are often concerned by the ease with which the SEC can meet statutory standards for commencing an investigation. Especially in the early stages of such an investigation, foreigners may fear that the Commission is conducting a "fishing expedition" based on mere suspicion. At least some of the concern in this area may stem from the fact that not all foreign nations authorize their securities agencies to investigate based solely on suspicion of wrongdoing. The United States, however, deems it necessary to grant the SEC broad powers of investigation to ensure that the flow of information needed for efficient markets is maintained.

Another reason for foreign concern over SEC-imposed consents, including milder types such as consent to service of process, is the perceived inability of the SEC to protect the confidentiality of any documents/information provided to the SEC by non-United States entities. Even if the SEC is willing to grant confidential treatment to some types of documents/information obtained by consent, under current law the granting of such treatment does not preclude disclosure in response to a congressional request and does not prevent a private party from requesting documents/information under the Freedom of Information Act (FOIA).

The FOIA generally creates a public right of access to United States federal agency records except when such records are protected from disclosure by any one of nine exemptions. Exemptions may apply to entire records, or only to portions thereof. Aside from Exemption 7(A), the FOIA exemptions most likely to be of some utility to issu-

121 Id.
122 See Mann & Sullivan, supra note 66, at 513.
123 Id.
124 See supra section 3.1.
126 5 U.S.C. § 552(b)(7)(A) (1982). As discussed supra note 26 and accompanying text, this exemption will not prevent the release of information once an enforcement proceeding is concluded. Therefore, if information is provided to the SEC at the investi-
ers (whether foreign or domestic) are Exemption 4, which exempts from disclosure under the FOIA "trade secrets and commercial or financial information obtained from a person and privileged or confidential"; and Exemption 7(C), which exempts from disclosure "investigatory records compiled for law enforcement purposes" if production of such records would "constitute an unwarranted invasion of personal privacy . . . ." In addition to their concerns about the possibility of a FOIA request, non-United States entities may also be concerned by the possibility of a request for information by the Internal Revenue Service or the United States Congress. In this respect, and to a large extent with respect to FOIA requests, the SEC can provide no absolute assurance that particular information will remain confidential.

Overall, SEC use of consents as a condition precedent is likely to be seen overseas as a unilateral United States intrusion. Even the milder alternative of consent to service of process does not give sufficient regard to comity between nations. Also, as a practical matter, when the SEC actually seeks to obtain documents or testimony from abroad, it is likely that, notwithstanding the existence of a prior consent, the Commission will need some amount of cooperation from the foreign government whose citizens are involved in the SEC investigation. Without cooperation the conflict will continue to exist between United States courts seeking to impose sanctions and foreign statutes precluding the production of evidence.

The crucial fact is that any SEC-imposed consent requirement, no matter how narrow in scope, is a unilateral United States action. It is such unilateral action, particularly when followed by the imposition of sanctions by United States courts, that is likely to produce a foreign backlash, perhaps via the passage of blocking statutes or secrecy laws by countries that do not currently have them. Even absent the possibility of retaliation by foreign nations, we would not recommend the expanded use of SEC-required consents because of the long-range vital
gation stage pursuant to a consent, Exemption 7(A) will not prevent its release pursuant to a FOIA request once the Commission has either concluded any enforcement proceeding, or has completed its investigation and determined not to bring a proceeding.

129 Because a private party may make a FOIA request at any time, a written request for confidential treatment should be submitted to the SEC at the time documents/information are first submitted to it. Should the SEC subsequently receive a FOIA request, it may ask that the request for confidential treatment be substantiated before its staff renders a decision on the FOIA request and related confidential treatment request.
130 Depending on the scope of such consents, concerns over the SEC's authority to require them could also be raised.
131 See supra notes 88-109 and accompanying text.
importance of establishing a cooperative relationship between the SEC and foreign securities officials.

5.3. Bilateral Agreements

Even if some international enforcement problems could be handled by consent, improvement of international enforcement cooperation is a far more promising area to explore. Given increased internationalization of the securities markets, greater cooperation at a government-to-government level is becoming more essential.

Two basic types of bilateral agreements have been developed: (i) formal bilateral assistance treaties and (ii) informal arrangements, as typified by the 1982 Swiss MOU and the 1986 SEC-Japan and SEC-United Kingdom agreements. However, informal agreements, including MOU's, have the advantage of not requiring ratification by either the United States Senate or the equivalent foreign entity. At least some informal agreements have the further advantage, from the SEC's perspective, of not involving other United States government agencies in the negotiations.

An informal understanding in the disclosure area would have the additional advantage of bringing together the SEC and its equivalent regulator in Country X in a more cooperative relationship. This, in and of itself, would be a significant accomplishment in view of our assumption that Country X not only has no bilateral or multilateral agreements with the SEC governing requests for documents, but also has a blocking statute. Ideally, the SEC and Country X's regulators would first reach an informal arrangement covering SEC requests for documents (i) during preliminary SEC investigations of disclosure violations, (ii) during the pretrial discovery stage and (iii) possibly at the.


133 Such informal agreements are essentially a statement of intent by the signatories.

134 Supra note 54.


137 As discussed infra notes 138-48 and accompanying text, there are likely to be
administrative proceeding stage. This practical short-term step could then be followed by the negotiation of either a formal, more comprehensive treaty or a treaty supplemented by a MOU. It should be noted that securities laws issues are likely to constitute only one aspect of formal treaty negotiations between the United States and Country X, particularly given foreign concerns with the Internal Revenue Service, the Federal Trade Commission, and the Commodity Futures Trading Commission.

In seeking to persuade Country X to begin negotiations on an agreement that will, as a minimum, provide for greater assistance at the investigatory stage, the SEC could stress that the current situation, where there is no bilateral agreement with Country X and therefore virtually no possibility of assistance at the investigatory stage, impels the SEC toward earlier use of its most stringent remedy, a civil action filed in federal court. In effect, the SEC's inability to get sufficient help from Country X at the investigatory stage, or for an administrative proceeding, forces it to “go public” and file a lawsuit in federal court if it believes it has a case. As noted earlier, potential defendants presumably would wish to avoid this publicity, especially if they believe themselves innocent.138

Regardless of the type of bilateral agreement negotiated, the SEC is likely to have certain minimum objectives:

i. The SEC would want Country X to designate a central authority to process SEC requests for documents and information. This would also presumably benefit Country X because, as discussed below, the SEC should be willing to agree to facilitate Country X's requests for documents and information.

ii. An understanding should be reached that the SEC can use any evidence obtained in its investigations, at the pretrial discovery stage, and in subsequent injunctive or administrative proceedings, even if it makes no criminal referral. As our disclosure hypothetical illustrates, improvement in the level of cooperation at the investigatory stage will be of primary importance to the SEC. The SEC might state to Country X's negotiators that an agreement which permitted SEC use of materials at the civil suit stage but not for administrative proceedings would impel the SEC to use the more severe remedy of a civil suit. Foreign concerns over SEC “fishing expeditions” and the lack of foreign familiarity with United States administrative proceedings will likely make this use of evidence area a difficult point to negotiate.

several types of violations (including disclosure violations) the SEC would seek to include in any agreement.  

138 See supra note 29.
Foreign lack of familiarity with administrative proceedings is a particular SEC concern in the disclosure area. As discussed earlier, the SEC is determined to ensure accurate disclosure in order to help maintain efficient trading markets. When such disclosure violations are not fraudulent, the SEC uses administrative proceedings as the vehicle to compel correction of such violations.

iii. The most difficult area to negotiate, even informally, may be the standard that must be met (e.g., relevancy, materiality) before a request for assistance in obtaining documents/information will be honored. In developing such a standard, at least five possibilities could be considered. First, a materiality test could be developed. In the financial disclosure area, this might be structured as a requirement that the financials of a foreign subsidiary have a specified percentage impact (e.g., fifteen percent) on the United States issuer’s consolidated financials. Second, a relevancy test could be used. Such a relevancy test could require, for example, that the information be essential to the SEC’s ability to withstand a motion to dismiss, or it could require the SEC (and Country X for its requests) to certify that the information being requested is significant. A third option could be to require that the information sought be sufficiently material as to be “essential” to the SEC’s ultimate presentation of its case. This test, like the motion to dismiss standard, may be more appropriate at the pretrial discovery stage because the SEC probably cannot meet these standards at the investigatory stage. A fourth option would be to require that the violation under investigation also be a violation of either the civil or criminal law of Country X, although the SEC, given its concerns over the “dual criminality” concept, may be unwilling to go this far. A fifth option would be the development of a bilateral letters of request procedure, analogous to that of the Hague Convention, which would be available at the investigatory stage. However, use of this fifth option still requires development of some type of standard.

The most practical alternative appears to be an agreement that some combination of the first four factors (relevancy, materiality, essen-

\[139\] See Section 2.

\[140\] "Material" is admittedly a subjective term. For example, SEC Rule 405 has defined the term as "matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered." 17 C.F.R. § 230.405 (1986).

\[141\] The United States discovery standard of "relevant to the subject matter" is set forth in FED. R. CIV. P. 26(b)(1).

\[142\] Such a certification concept is employed in the SEC-United Kingdom agreement, supra note 136.

\[143\] See infra notes 145-46 and accompanying text.

https://scholarship.law.upenn.edu/jil/vol9/iss3/4
tial to the SEC’s case, and foreign law violation) must apply before a request for assistance will be honored. An agreement could also be structured so that meeting any one of several factors would be sufficient. The combination of factors to be met could also be varied according to the particular type of United States securities law violation being investigated, and/or according to whether the SEC is at the investigatory or pretrial discovery stage. For example, foreign concerns over the scope of SEC formal orders may well cause foreign countries to require tougher standards before a request for assistance at the formal order stage is honored.

Ideally, from the SEC’s viewpoint, Country X would assist any SEC investigation. However, it is more likely that Country X will only be willing to assist the SEC when particular types of United States securities law violations are being investigated. A final potential point of disagreement could involve who makes the determination of when the applicable standards for assistance are met. The SEC and Country X may reach agreement on acceptable standards more readily if the determination as to when they are met is made by an existing body in Country X, rather than by the SEC or by Country X’s securities authorities. For example, under the Swiss MOU, such a role is performed by the Swiss Bankers’ Association. Given Country X’s probable distrust of SEC formal orders of investigation, the SEC may have to concede this point and agree to a designated third party making such determinations. Such a third party might also conduct the actual review of documents following its determination that the standards for assistance had been met.

iv. The SEC may be unwilling to enter any long-term agreement that requires, for all assistance requests, that the offense under investigation be a crime in both the United States and Country X. This requirement, found in some existing agreements, is typically referred to as the “dual criminality” concept. At least for an interim accord, the SEC and Country X should attempt to agree on particular categories of offenses for which requests for assistance will be honored without attempting to resolve the dual criminality problem for all types of offenses. This assumes that there are particular problem areas where the SEC is most anxious to reach an interim agreement and where Country X would be willing to provide assistance without requiring dual criminality.

To achieve a long-term comprehensive assistance agreement, the

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144 Swiss MOU, supra note 54, art. III, 22 I.L.M. at 4-6.
145 For a definition and general discussion of “dual criminality,” see 6 M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 773-79 (1968).
SEC should be willing to agree that although dual criminality will not be a prerequisite to obtaining assistance for specified categories of offenses, it will be required for offenses not specifically referenced by the agreement.\textsuperscript{146} It is simply not realistic for the SEC to expect foreign

\textsuperscript{146} This is essentially the approach taken in the United States-United Kingdom Treaty concerning the Cayman Islands (Treaty Between the United States of America and the United Kingdom of Great Britain and Northern Ireland Concerning the Cayman Islands Relating to Mutual Assistance in Criminal Matters, \textit{signed} July 3, 1986) [hereinafter Treaty]. This as yet unratiﬁed Treaty deﬁnes categories of offenses, including "fraudulent securities practices" and "insider trading," for which assistance will be provided, but offenses not speciﬁcally enumerated fall within the scope of the treaty only if they are punishable by more than one year's imprisonment under the laws of both the United States and the Cayman Islands.

Article 19 of the Treaty provides:

For the purpose of this Treaty:

3. “Criminal offense” which, except in the case of any matter falling within sub-paragraphs (d) and (e) of this definition, does not include any conduct or matter which relates directly or indirectly to the regulation, imposition, calculation or collection of taxes, but subject always to those exclusions, means:

(a) Any conduct punishable by more than one year's imprisonment under the laws of both the Requesting and Requested Parties;

(d) Willfully or dishonestly obtaining money, property, or valuable securities from other persons by means of false or fraudulent pretenses or statements, whether oral or written, regarding or affecting benefits available in connection with the laws and regulations relating to income or other taxes;

(c) Willfully or dishonestly making false statements, whether oral or written, to government tax authorities (e.g., willfully or dishonestly submitting a false income tax return) with respect to any tax matter arising from the unlawful proceeds of any criminal offense covered by any other provision of this definition, except sub-paragraph (f), or willfully or dishonestly failing to make a report to government tax authorities as required by law in respect of, or to pay the tax due on, any such unlawful proceeds;

(f) Willfully or dishonestly failing to make to the Government a report which is required by law to be made to it in respect of an international transfer of currency or other financial transactions connected with, arising from or related to the unlawful proceeds of any criminal offense falling within any provision of this Article, except this sub-paragraph or sub-paragraph (e) above;

(g) “Insider trading” which means the offer, purchase, or sale of securities by any person while in possession of material non-public information directly or indirectly relating to the securities offered, purchased, or sold, in breach of a legally binding duty of trust or conﬁdence;

(h) Fraudulent securities practices, which means the use by any person willfully or dishonestly of any means, directly or indirectly, in connection with the offer, purchase or sale of any security:

(i) to employ any device, scheme, or artiﬁce to defraud;

(ii) dishonestly to make any untrue statement of a material fact or to omit to state a material fact necessary in
assistance in every situation where it suspects a violation of United States securities laws. Such a bifurcated agreement may be advantageous to the SEC as well as Country X, because elimination of the dual criminality requirement for only certain specified offenses should provide flexibility to both sides.

There may also be types of offenses a foreign government wishes to investigate for which the SEC would be unwilling to provide assistance because, for example, it might believe that the foreign government was harassing a person or entity for political reasons. For example, the United States-United Kingdom agreement concerning the Cayman Islands (not yet ratified) excludes "a political offense" from the cate-

order to make the statement made, in light of the circumstances under which it was made, not misleading; or
(iii) dishonestly to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person;

147 The SEC would, in fact, be unable to provide assistance if doing so would violate the due process or other legal rights of a United States citizen.

148 Treaty, supra note 146, art. 3(2)(b). Article 3, which provides limitations on the assistance to be rendered under the Treaty, reads:

1. The assistance afforded by this Treaty shall not extend to:
   (a) any matter which relates directly or indirectly to the regulation, including the imposition, calculation and collection, of taxes, except for any matter falling within sub-paragraphs 3(d) and 3(e) of Article 19; or
   (b) any conduct not punishable by imprisonment of more than one year.

2. The Central Authority of the Requested Party may deny assistance where:
   (a) the request is not made in conformity with the provisions of this Treaty;
   (b) the request relates to a political offense or to an offense under military law which would not be an offense under ordinary criminal law; or
   (c) the request does not establish that there are reasonable grounds for believing:
      (i) that the criminal offense specified in the request has been committed; and
      (ii) that the information sought relates to the offense and is located in the territory of the Requested Party.

3. The Central Authority shall deny assistance where the Attorney General of the Requested Party has issued a certificate to the effect that the execution of the request is contrary to the public interest of the Requested Party.

4. Before denying assistance pursuant to this Article the Central Authority of the Requested Party shall consult with the Central Authority of the Requesting Party to consider whether assistance can be given subject to such conditions as it deems necessary. If the Requesting Party accepts assistance subject to these conditions it shall comply with the conditions.
gories of offenses for which assistance is available.

Assuming the SEC is willing to recognize that foreign governments will not agree to provide assistance for all types of United States securities law violations, the SEC must determine the areas where it believes foreign assistance is most vital and where it should, therefore, seek to avoid the imposition of a dual criminality requirement. These should include offenses involving (i) insider trading, (ii) market manipulation, and (iii) disclosure violations, including false financial statements and periodic reporting violations. However, given foreign concerns over SEC abuse of its formal order authority, foreign governments may be willing to provide assistance for only those disclosure violations that are fraud-based, at least at the investigatory stage. This view may change in the long run because, as foreign markets grow, foreign nations may increasingly share the SEC's concern with providing accurate information to such trading markets.

In order to reach an agreement, the SEC should demonstrate a willingness to provide "incentives" to Country X, both to assuage any fears about SEC "fishing expeditions" and to demonstrate its recognition that internationalization will require compromises by the United States and not just by foreign countries. Possible SEC "concessions," in addition to the dual criminality issue already discussed, could include the following:

i. The SEC should at least consider whether "smaller" cases (e.g., in terms of dollar value) could be excepted from the agreement. Alternatively, different standards could be applied to different sized cases. Negotiation of such standards could prove to be a sensitive matter, but the United States and Country X could possibly reach some type of informal agreement in this area.

ii. The SEC should agree to respond promptly to requests from foreign nations for assistance. Current bilateral agreements and the Hague Convention do provide procedures for foreign governments to obtain evidence in the possession of persons located in the United States, just as they provide procedures for the SEC to obtain evidence in the possession of persons located abroad. As discussed above, any changes to such procedures must leave both sides on an equal footing. The SEC cannot expect assistance from Country X in obtaining evidence in its investigations unless it is willing to help provide equivalent assistance to Country X's securities regulators. Assistance cannot be productive in the long run unless it works effectively both ways. As internationalization of the securities markets increases, foreign regulators' need for SEC assistance will increase. The SEC must be willing to provide such assistance, seeking congressional authorization where nec-
necessary, if it expects foreign regulators to be willing to enter into agreements providing the SEC with the assistance it needs. For example, the SEC could ask Congress for authority to obtain a formal order of investigation on behalf of those foreign governments with which the United States has signed a bilateral treaty providing for mutual assistance.

Another issue is the sharing of information in the SEC's possession. The SEC has already delegated to its staff authority to grant "foreign governmental authorities" access to its files concerning nonpublic investigations. Given the SEC's apparent readiness to assist foreign securities authorities, the SEC should be willing to negotiate the development of mechanisms to provide swift SEC action on such access requests. For example, the SEC's agreements with Japan and the United Kingdom provide for such SEC assistance.

A more difficult question is what the SEC will do if it receives a foreign request for information in its possession concerning a matter in which no SEC investigation has actually taken place. If the facts indicate possible United States securities law violations, the Commission can authorize a formal order of investigation and provide the foreign government with access to the information obtained in the investigation under the access procedures mentioned above. However, if the SEC has no basis to suspect violation(s) of United States securities laws, it cannot currently obtain a formal order on behalf of a foreign government. It may be necessary for the SEC to seek legislation authorizing it to conduct investigations in specified circumstances, pursuant to a formal order, on behalf of foreign governments which are equally willing to investigate on the SEC's behalf. This would go beyond an agreement in which assistance is provided simply to execute requests for production of evidence or to compel testimony.

iii. As discussed above, the SEC may need to agree to limit the scope of any agreement to particular types of violations, and will almost certainly have to agree that some entity other than itself will determine when the agreement's standards for assistance will apply. Also, the standards governing requests for assistance may need to be different at the formal order stage because of foreign concerns over possible SEC "fishing expeditions."

149 See 17 C.F.R. §§ 200.19b, 200.30-4(a)(7) (delegation to Director of Division of Enforcement); § 200.21(a) (delegation to General Counsel); § 202.5(b) (granting of access or referrals by the Commission itself) (1986).

150 In a case involving a broker-dealer, however, the SEC could use its Exchange Act inspection powers to obtain the desired information.

151 It will also be necessary to agree on whether the SEC, if it obtains assistance at the investigatory stage based on a determination that fraud-based violations may have occurred, can still use the information it obtains if it later determines that the

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iv. The SEC should agree that any agreement does not by its terms apply to private lawsuits. The SEC is probably also willing to agree to use its best efforts to ensure that information it receives under any agreement is not used by either private parties or other United States government agencies. However, the SEC cannot, on its own, preclude the possibility of FOIA requests, IRS requests, and congressional requests for information. In the case of the FOIA, action by both houses of Congress, not just the Senate as in treaty ratification, would be required to amend the statute to reduce foreigners' exposure under the FOIA.

v. The SEC should consider granting greater access to United States securities markets for Country X's companies or, at a minimum, for particular types of Country X companies. For example, a system could be developed to permit the more established companies in Country X easier access to United States markets.

Even a long-term bilateral accord is not the ultimate solution. Absent effective multilateral agreements there may eventually ensue a "race to the bottom" in which less reputable individuals and entities move their securities operations to nations with whom the SEC has no effective agreement. Therefore, although bilateral agreements are important, efforts to reach an effective multilateral accord should not be delayed if this flight to countries with the "lowest common denominator" of securities regulation is to be prevented.

5.4. Multilateral Agreements

The SEC would perform only a limited role in negotiations by the United States government to modify the Hague Convention or any other multilateral agreement. However, the following discussion concentrates on the SEC's likely objectives, assuming State Department agreement with them.

The SEC has expressed some dissatisfaction with the Hague Convention. This is reflected in the United States Government's Supreme Court brief in the *Aerospatiale* case, which discusses four SEC attempts to use the Hague Convention and concludes that "[t]he Commission's experience with Hague Convention procedures ... has not been entirely positive ... ." The United States brief does note that

violations were not fraudulent.

152 Presumably Country X would not object to SEC criminal referrals to the Department of Justice.


154 *Id.* at 18.
the SEC's experience with the Convention "may well be atypical" because requests under the Convention are more commonly made by private parties. Nevertheless, the United States opposes any rule that would force the United States government, or private parties, to make "first use" of the Convention in all cases.

The SEC has asserted that the Convention is of limited use because it is available for use only in actual civil litigation, and not for SEC administrative proceedings or SEC formal orders of investigation. In addition, the SEC has asserted that the application of Article 23 of the Convention is troublesome. A special commission on the operation of the Hague Convention in July 1985 also addressed Article 23. This commission reported that "serious problems [have] arisen as a result of the co-existence of blocking statutes and the Article 23 reservation. Indeed, the combined effort of a blocking statute and a general, unrestricted reservation under Article 23 may paralyze the Convention and has caused the courts in the United States not to use the Convention."

Negotiating amendments to the Hague Convention is likely to be a complex and difficult process. If this process is to have any chance of success, at least as it applies to SEC investigations, the SEC must be willing to offer something in return. As we suggested with respect to bilateral agreements, the SEC should be willing to negotiate multilateral agreements providing for prompt help to foreign governments requesting its assistance. Also, the SEC might have to accept an agreement that any changes in the Convention would apply only to particular types of United States securities law violations. Of course, other United States agencies may not be willing to accept changes to the Convention on a limited basis.

Given the difficulties inherent in negotiating multilateral agreements, the SEC may have to limit its goals. Minimum SEC objectives might include: (i) clarifying types of civil proceedings to which the Convention applies and (ii) extending the Convention to administrative proceedings, and perhaps to investigations, but only for specific types of suspected violations. In addition to restricting the types of violations, some combination of the variety of standards (e.g., materiality and relevancy) discussed in Section 5.3 might be necessary as a further limitat-

155 Id.
156 See Mann & Sullivan, supra note 66, at 504.
157 Id.
159 Id. at 1677.
tion on when the Convention will apply.

If negotiating changes to the Hague Convention does not appear to be a reasonable objective, the SEC should consider seeking a multilateral agreement, covering the same areas as the bilateral agreements discussed above, with the appropriate securities regulators of those nations (e.g., Japan and Western European nations) with the most sophisticated/active securities markets. Although this would not entirely prevent a race to the bottom, it might at least be more effective than a series of unrelated bilateral agreements.

6. CONCLUSIONS

Given that some blocking statutes render consent agreements ineffective at the investigatory stage, the optimum short-term solution, to at least begin the negotiating process, is a bilateral informal arrangement along the lines discussed in Section 5.3. This should be followed by a more formal bilateral agreement that may require a MOU as a supplement to clarify the intent of the two governments. As a long-range goal, efforts could be made to renegotiate the Hague Convention to enhance its effectiveness at the investigatory stage and thus prevent wrongdoers from simply moving to countries with less regulation and no effective agreements with the United States. Such a long-range multilateral agreement would prevent development of this “race to the bottom.” If Hague Convention renegotiation does not prove to be a realistic goal, efforts should be made to negotiate multilateral agreements among nations with the most sophisticated/active securities markets to at least increase the levels of international cooperation.

Regardless of whether the agreement being negotiated is bilateral or multilateral, foreign countries are likely to be particularly interested in the development of procedures to ensure effective SEC help in response to their requests for assistance. Although mutual assistance is currently of greater value to the SEC, this situation is likely to change because, as foreign markets grow, foreign countries will want to obtain evidence concerning the activities of United States citizens trading in such overseas markets. The SEC is likely to initially desire the establishment of (i) a central authority in each foreign country to handle requests for assistance and (ii) workable standards (perhaps varying at the investigatory, pretrial discovery and actual trial stages) governing what types of requests for assistance will be honored. Increased cooperation at the investigatory stage is likely to be of particular importance. The SEC is also likely to seek to limit application of the dual criminality requirement, for both negligent and fraudulent offenses, as an important long-term component of its efforts to deter disclosure violations.
and thus ensure a flow of accurate information to United States trading markets.

Growing internationalization of the securities markets is a reality. Bilateral and multilateral agreements offer a number of advantages over the case-by-case enforcement of subpoenas and discovery requests by United States courts, not only in terms of efficiency, but also in terms of improved relations among governments, regulatory agencies and judicial systems. Although negotiation of formal treaties may be a long-range goal, it is crucial that the process of developing such accords proceed as quickly as possible. Informal understandings are likely to be a key element of this process, because successful cooperation between the SEC and foreign regulators under informal agreements will help create the atmosphere of cooperation and growing trust necessary to negotiate long-range, comprehensive agreements, whether bilateral or multilateral.