PROBLEMS OF ENFORCEMENT IN THE MULTINATIONAL SECURITIES MARKET

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1. INTRODUCTION

Regulators are faced with a growing number of problems as a result of the internationalization of capital markets. The general view is that the emergence of the "international" market is beneficial for the world economy because it provides increased access to capital for economic development and creates more efficient markets. A loss of confidence in the integrity of international markets due to abusive transactions will, accordingly, impact on capital formation. There is therefore a very real and urgent need to ensure that these markets are properly regulated to maintain liquidity, continuity, and confidence.

The facilities which permit investors access to foreign markets and corporations access to world capital can be used by those engaged in illegal conduct to hide transactions through the use of multiple jurisdictions and institutions and the channeling of transactions to jurisdictions with blocking and/or secrecy legislation.

The most effective manner for a jurisdiction to prevent capital market crime is to deny access to non-residents. This, obviously, would have a chilling effect on the internationalization of such markets. The preferable approach is to create methods of detecting, investigating, and prosecuting improper conduct, regardless of jurisdiction.

The economic crimes involved include conduct such as fraud and the laundering of profits from illegal activity, as well as securities law breaches such as insider trading and market manipulation.

1.1. Hypothetical Cases

Two hypothetical fact situations have been provided to which this paper is addressed:

1. The first situation involves the disclosure of improper earnings for a foreign subsidiary in a Securities and Ex-

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change Commission (SEC) filing. These earnings were alleged to be the result of the falsification of earnings by unknown individuals in the foreign subsidiary. The effect was to avoid disclosure of unfavorable results. The SEC examines the situation but requires documents located at the foreign subsidiary as well as testimony from foreign-based officers.

2. The second situation involves an allegation of insider trading with respect to trades placed through the foreign office of a United States registrant prior to the announcement of a merger. The dealer conducting the trades is located in the same foreign country in which negotiations for the merger occurred. The SEC needs to obtain the trading records of the dealer and examine the dealer and persons making the trades as well as the individuals taking part in the merger negotiations. The SEC also requires documents, such as telephone records, from third parties.

1.2. Issues

In the context of these two hypothetical situations, three specific questions are to be addressed:

1. the extent and basis of foreign resistance to SEC enforcement needs;
2. possible modes of negotiation of needed assistance agreements; and,
3. the need for a multinational regulatory system.

The papers prepared by Messrs. Greene and Pitt provide an extensive analysis of the implications of these two fact situations under United States law. They also provide a review of the powers of the SEC in investigating these matters, the problems encountered in other jurisdictions and the requirements of the SEC in investigating these types of cases. This paper will not address these matters as they are a matter of United States law.

2. Reasons for Resisting SEC Enforcement Needs

As can be observed from Mr. Pitt's paper, United States securities laws purport to have extraterritorial application, and the United States courts have been aggressive in taking jurisdiction over activities occurring outside the geographical boundaries of the United States. This claim of jurisdiction by the United States, both in its legislation and by
its courts, is justified by what is known as the "impact theory." Under this theory, no matter where the conduct at issue occurs, if it has sufficient effect on United States trading markets, then the United States is justified in claiming jurisdiction and applying United States laws regardless of the laws of any other jurisdiction.

Although the impact theory is only one basis for claiming jurisdiction, it is the most prevalent basis the United States uses to justify the extraterritorial application of its laws. This approach, of course, ignores the concerns of the other jurisdiction which may have a valid concern with the conduct assailed. There may be situations where the effects of the conduct in question are sufficiently great in the United States to merit the United States’ application of its laws extraterritorially. Equally, there will be situations where the concerns of the other jurisdiction will be greater in which case United States laws should not apply. The problem is that each jurisdiction may view the case differently. Moreover, as national economies are increasingly interrelated, the impact theory will become an even more expansive doctrine.

When the United States attempts to apply its laws to persons or to conduct in other jurisdictions, it often will be viewed by that other jurisdiction as an infringement of sovereignty. The cornerstone for determining jurisdiction is the territorial theory. This provides that a country has complete and exclusive jurisdiction over conduct occurring within its boundaries and over persons located therein. The impact theory is the exception to this general rule. The courts or government of the other jurisdiction will recognize United States jurisdiction only if, in its opinion, the intrusion upon its sovereignty is justified. This is a determination that the foreign jurisdiction must make itself. Any determination by United States authorities is not binding upon the foreign jurisdiction in any way.

Other jurisdictions are less likely to accept the extraterritorial application of United States law when that law is in the area of economic regulation. The history of United States enforcement of its antitrust laws provides the best example of how jurisdictional conflicts can arise. The United States has maintained that it has the right to regulate activities in any nation which affect competition in the United States. Canada, however, has not accepted the impact theory as a proper basis for extraterritorial jurisdiction.

In March of 1947, by direction of the Attorney General of the United States, subpoenas were issued pursuant to United States antitrust laws against fifty Canadian pulp and paper companies and cer-
tain officers. The subpoenas were under the heading "The President of the United States of America," and were intended to compel evidence before a Grand Inquest. The evidence sought regarded Canadian companies doing business in Canada except to the extent they exported newsprint to the United States. As discussed later, the Business Records Protection Act (Business Records Act) (Ontario) was enacted to specifically block compliance with these subpoenas. The Ontario government found this unilateral action by the United States to be an unacceptable affront to its sovereignty.

The issue of the application of United States law beyond United States borders concerns the subject matter jurisdiction over the alleged conduct. This issue will, however, also affect the willingness of a jurisdiction to assist the United States in investigating such conduct.

Although Ontario may not be the best example to use in reviewing the reasons for not assisting the SEC due to its long history of close cooperation with the SEC, this paper will consider the response of Ontario and the Ontario Securities Commission (OSC) to the enforcement needs of the SEC.

In Ontario, without the help of the OSC or the Ontario Government, the SEC will have substantial difficulty in obtaining the information it requires. If the person or corporation has no assets in the United States which would permit the SEC to bring coercive pressure to bear on Ontario entities, the SEC has no independent ability to compel the evidence. If the SEC commences court proceedings, it can use the procedure known as "letters of request" (formerly known as "letters rogatory"). This is a formal request from the United States court to the Ontario court for assistance. Pursuant to this request, the Ontario court will make a determination as to whether or not it is an appropriate case for assistance. This process is slow, however, and is only applicable to obtaining evidence for purposes of trial. The process is of little use in an investigation context since, in the preliminary stages of an investigation, it is unlikely that the SEC would have sufficient facts to commence any type of action. The usual problem for the SEC is that it is unable to get the preliminary information that it needs to evaluate whether or not it should bring proceedings. Therefore, as a practical matter, there is no option for the SEC other than to seek the assistance of the OSC.

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1 This factual situation is taken from Legislature of Ontario Debates, 22 Parl. (3d sess.), 11 George VI (1947), 946. See infra text accompanying notes 16, 17 and 18.
3 See infra notes 12-18 and accompanying text.

https://scholarship.law.upenn.edu/jil/vol9/iss3/7
The OSC has a tradition of providing assistance to the SEC when requested, on the basis of an informal arrangement. This informal arrangement operates on a case-by-case basis and can be attributed to the fact that there is significant similarity in the securities laws and a similarity of philosophy of regulation of the two jurisdictions. In fact, this cooperation was formalized as a result of the linkage of the Toronto Stock Exchange and the American Stock Exchange. When this link was negotiated, both the OSC and the SEC were concerned that proper measures be put into place to ensure that the necessary surveillance could be carried out and that the information could be obtained. The OSC and the SEC exchanged letters through which there was an acknowledgement of the reciprocal intention to assist one another through information gathering and sharing.4

2.1. The Investigatory Powers of the OSC

In spite of this willingness to assist, there are certain limitations on the ability of the OSC to provide the requested assistance. Some of these limitations are familiar to the SEC as problems they face in assisting other jurisdictions. Before addressing these constraints, however, a brief description of the investigatory powers of the OSC is necessary.

The OSC has extensive investigative powers which are available to assist the SEC with investigations of cross-border transactions. The Enforcement and Market Regulation Branch of the OSC conducts informal investigations based on staff review of documents filed, spot audits, daily market surveillance and information or complaints from industry participants and the general public. Although evidence is obtained on a voluntary basis at this stage, the OSC’s experience has been that parties cooperate and provide requested information. In certain circumstances, the OSC may appoint a staff member to audit the financial affairs of a registrant or reporting issuer.

If the Enforcement Branch is resisted in its efforts to obtain information necessary to determine whether violations have occurred, the OSC may issue a formal order of investigation. A formal order may be made where it appears that there has been a breach of the Securities Act (Ontario),5 a criminal offense has been committed under the Criminal Code6 in connection with a trade in securities, where the due administration of the Securities Act (Ontario) so requires, or in order to

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4 See Pitt, Problems of Enforcement in the Multinational Securities Market, this issue, p. 413 and accompanying note 160.
5 Securities Act, ONT. REV. STAT. ch. 466 (1980) [hereinafter Securities Act (Ontario)].
investigate any matter relating to trading in securities.

Those named in the formal order are granted the power to compel witnesses to attend, to give evidence under oath and to produce documents. The OSC may authorize an audit of the subject party's affairs, freeze the property and assets of the subject party, institute administrative proceedings, prosecute for an offense, or seek a compliance order from the court. In some cases, the OSC will participate with other securities administrators and law enforcement agencies in an investigation and may refer matters for criminal prosecution.

The OSC's extensive investigatory powers under the Securities Act (Ontario) only extend to compelling the evidence of witnesses and the production of documents by persons within Ontario. The OSC, however, has a close working relationship with the securities administrators in other provinces and territories of Canada. Information may be obtained and shared interprovincially on an informal or formal basis. In the latter case, OSC staff may participate in the investigation authorized by a formal order issued by an extraprovincial securities administrator. Accordingly, the OSC would be able to assist the SEC in obtaining relevant documents located either in Ontario or in other provinces and territories of Canada by relying on its long-standing relationships with other Canadian securities regulators.

2.2. Difficulties in Obtaining a Formal Order Solely to Assist the SEC

As was stated above, the OSC's investigatory powers are constrained by the terms of the Securities Act (Ontario). The ability to compel evidence depends upon the issue of a formal investigation order. This can only be issued by the OSC for the reasons previously listed. Although the issue has not been resolved, there could be an argument that the OSC cannot obtain a formal investigation order solely for the purpose of assisting the SEC. Thus, difficulty could arise where the conduct under investigation involves solely a breach of United States laws with no Ontario connection. This problem arises as a result of the jurisdiction given to the OSC under the Securities Act (Ontario) rather than through any lack of desire by the OSC to provide assistance to the SEC.

It is possible that an investigation order could be based upon a breach of United States securities laws as a matter relating to trading in securities generally. That argument, however, is very tenuous. The OSC has indicated in a policy statement that registrants who breach the securities laws of another jurisdiction can be subject to an investigation.
into their fitness for continued registration in Ontario. This policy stance could give the OSC sufficient nexus to issue a formal investigation order, however, only with respect to Ontario registrants.

In broader terms, the OSC has indicated that the ability to trade in Ontario is a privilege, not a right. The OSC has the power to deny trading exemptions to any person if it deems a denial to be in the public interest. Again, improper conduct in another jurisdiction might be sufficient reason for an investigation into whether a person's exemptions to trade in Ontario should be denied. The OSC has also stated that it is prepared to issue a "cease trade" order in Ontario against an issuer who has been "cease traded" in another jurisdiction for failure to meet reporting or disclosure requirements.

It is difficult for the OSC to use its investigative powers solely to provide assistance to the SEC. There may, however, be sufficient reason to permit such an investigation, even when the conduct alleged is solely a breach of United States law. The matter has not been tested in Ontario's courts and is not free from doubt. The OSC could be open to challenge if it attempted to compel evidence pursuant to a formal order to assist the SEC. The person subject to such investigation could seek injunctive relief to prevent disclosure on the grounds specified above. The ability of the OSC to provide such information is obviously subject to the jurisdiction of the courts. In addition, the investigation is governed by the laws generally applicable in Ontario with respect to the collection of evidence.

With respect to the problem of a formal order to assist the SEC, the Securities Act (Ontario), supra note 5, specifically provides that the Quebec Securities Commission has the authority to order an investigation with respect to the contravention of the securities legislation of another legislative authority. The OSC is currently preparing a series of amendments to the Securities Act (Ontario) and will consider whether or not this type of specific authority should be included.

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8 Pursuant to the Securities Act (Ontario), supra note 5, no person can trade in securities unless the person is (a) a registrant or (b) has an exemption for the trade. This includes the right to place trades through a registrant. Consequently, a denial of exemptions effectively prevents that person from making any trades in the province.
10 Securities Act, QUE. REV. STAT. ch. V-1 (1977) [hereinafter Securities Act (Quebec)].
2.3. Complications with United States Rules of Evidence

The SEC must be conscious of the rules of evidence of the United States when obtaining information from the OSC in an effort to avoid information being inadmissible in an American court. This issue arose in a case of OSC assistance where the SEC wanted to be present at an examination conducted by the OSC. However, due to the confidentiality requirement of a formal investigation, the OSC was of the view that the individual representing the SEC should be named in the investigation order. The SEC, to the contrary, did not want to be named because it would then be necessary to provide the witness the United States constitutional right to protection from self-incrimination.

In a similar vein is the decision of In Re Campbell v. Bell. An investigation by the British Columbia Superintendent of Brokers was being conducted concurrently with an independent United States investigation. The witness wanted to be assured that his evidence would not be disclosed to the United States authorities on the basis that it was self-incriminating. The British Columbia court required that the witness answer the questions asked and ruled that the Superintendent of Brokers had the authority to disclose the testimony obtained to United States authorities. This type of situation is offensive in that it allows the SEC to obtain information under oath without providing the same level of protection that would be required in the United States. This could affect the type of information that the OSC would give the SEC and could also lead to further challenges in the courts.

2.4. Ontario Blocking Statutes

In addition to these abovementioned constraints, there are also certain blocking statutes applicable in Ontario. Although in the final analysis these statutes would not appear to prevent the OSC from providing its assistance or disclosing information to the SEC, a brief description is merited. These statutes must be addressed when information is disclosed and in order to obtain an indication as to the reaction of the federal and provincial governments as to the extraterritorial application of United States laws. There are three statutes to consider: the Business Records Act; the Foreign Extraterritorial Measures Act (FEMA); and, the Freedom of Information and Protection of Privacy Act.

12 Business Records Act, supra note 2.
RESPONSE PAPER: D. CHARTER & S. BECK

The Business Records Act was enacted in 1947 specifically in reaction to a United States grand jury's issuing subpoenas against fifty Canadian pulp and paper companies and their executive officers, all of whom were in Ontario, to further a United States antitrust investigation. When this act was presented for first reading, the Honorable George A. Drew stated that the action by the United States:

implies the right of the Government of the United States to invade the territorial integrity of Canada without application to the Canadian Government, to any provincial government, to any Canadian Court, or to any established channel of international representation in regard to international business.

These proceedings are particularly improper in view of the fact that we have our own Anti-Combine [antitrust] laws in Canada under which there are just as wide powers to prevent improper combinations in restraint of trade as are contained in the Anti-Trust laws of the United States.

This government objects very strongly to fishing expeditions through our own Courts, and it is certainly not prepared to approve of fishing expeditions of this nature into the affairs of our companies through the Courts of the United States in regard to something which is not properly before these Courts.

Clearly, Ontario did not accept the United States claim to jurisdiction over Canadian companies. Ontario does indicate, however, that the Ontario Government is open to diplomatic or agreed solutions to these problems.

The Business Records Act provides that no person shall, pursuant to or in a manner consistent with any requirement of any authority outside Ontario, send specified records outside Ontario. There are no reported cases which apply to the Business Records Act. It appears to

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15 Supra note 1.
16 Id.
17 Id.
18 Id.
be aimed at the involuntary removal of records from Ontario. The provision of information on a voluntary basis pursuant to an informal SEC investigation does not involve any requirement of an authority outside Ontario and would not appear to be pursuant to or consistent with any such requirement.

If a formal investigation is being conducted by the SEC, then the provision of information pursuant to a request from the SEC could be considered as being consistent with the requirement of a foreign authority. If, however, the SEC has requested the information from the OSC and the OSC considered it appropriate to obtain the information and to supply it to the SEC, the Government of Ontario has had the opportunity to consider the matter and, therefore, the mischief complained of in enacting the Business Records Act is not present. It can also be argued that such disclosure would fall within the exemption that permits disclosure provided for by any law of Ontario (in this case the Securities Act (Ontario)) or of the Parliament of Canada. Accordingly, it is not likely that this statute would prevent the OSC from assisting the SEC and from providing information. The statute is intended to prevent United States authorities from taking unilateral action and, as such, will only operate to stop the SEC from conducting a direct formal investigation.

FEMA came into force on February 14, 1985. It empowers the Attorney General of Canada to prohibit the disclosure to a foreign tribunal of certain records which exist in Canada where, in the opinion of the Attorney General, a foreign tribunal is exercising or is proposing to exercise jurisdiction in a manner that has or is likely to adversely affect significant Canadian interests or that otherwise has infringed or is likely to infringe Canadian sovereignty.

The Minister of Justice, in explaining the purpose of the Act, emphasized that FEMA is a "mechanism of last resort" and would be used "if there are outstanding problems which arise principally from the extraterritorial application of United States law which United States and Canadian officials cannot [otherwise] handle in a satisfactory manner." 19

In the Senate debates, the Honorable Nathan Nurgitz identified three previous instances where Canada had grappled with extraterritoriality issues. 20 The first instance involved the uranium cartel investigation where there were allegations that the Canadian Government itself had sanctioned an illegal cartel. In this situation there was some pres-

20 130 Parl. Deb. (No. 18), Senate (1st ser.) 359 (Dec. 18, 1984).

https://scholarship.law.upenn.edu/jil/vol9/iss3/7
sure to disclose secret government information to the United States.

The second instance involved the Siberian pipeline sanctions of the United States. The United States directive was politically motivated and was aimed at economic arrangements which Canadian corporations might enter into for the economic benefit of Canadians, but with which those corporations with an American affiliate might be loath to proceed.

The third instance involved a drug investigation and money laundering. The Bank of Nova Scotia was confronted with either violating Cayman Island bank secrecy laws or with disregarding an order of a United States Federal Court.

Senator Nurgitz stated that "cooperation and consultation" would be the preferred routes for resolving any extraterritorial disputes. FEMA would be used "defensively and as a last resort, when cooperation and consultation failed to resolve the policy differences involved." Nurgitz further commented that the Act "[was] clearly designed to protect national sovereignty in exceptional cases, after diplomatic efforts have been exhausted and irreconcilable differences remain."

Due to the similarity of United States and Ontario securities laws, it is unlikely that the Attorney General of Canada would form the opinion necessary to interfere with an exchange of information between the OSC and the SEC pursuant to an investigation carried out in a reasonable manner.

FIPPA has had a second reading and has been referred to committee for further discussion. Consequently, it is not known when it will be enacted as law.

The purpose of FIPPA is expressed as twofold: (1) to provide a right of access to government information; and (2) to protect the privacy of individuals. With respect to information received from the SEC, the OSC can refuse to make public disclosure provided the information was received in confidence. The OSC may also refuse to disclose information obtained in an OSC investigation. Of concern with respect to the OSC's providing assistance to the SEC is the prohibition of the OSC from disclosure of "personal information" to third parties which would include the SEC. There are, however, a number of exemptions to the prohibition. The relevant exception states that disclosure of personal information is permitted:

Where disclosure is by a law enforcement institution;

(i) to a law enforcement agency in a foreign country

21 Id.
22 Id.
23 Id.
under an arrangement, a written agreement or treaty or legislative authority, or (ii) to another law enforcement agency in Canada.24

As currently drafted, the intention of FIPPA is to provide access by Canadians to government files and also to protect the basic right of an individual to privacy. However, with respect to the SEC, the right of privacy is expressly subject to the overriding rule that investigations by law enforcement agencies not be hindered. The net effect of FIPPA is that providing information to the SEC is not prohibited; the provision of such information must, however, be done within the context of FIPPA.

2.5. Practical Difficulties

In addition to the legal constraints discussed, the SEC should understand that there are more practical matters which will also affect the ability of the OSC to provide its assistance.

Before providing the assistance to the SEC, the OSC would require that the SEC provide the OSC with the details of the SEC investigation. There are two reasons for the OSC's requirement: (1) the OSC needs to be sure that it considers the SEC investigation proper before lending its assistance; and, (2) the OSC would like to be aware of possible improper conduct in Ontario to determine whether Ontario laws have been breached and whether an OSC investigation is warranted. The more that Ontario law has been contravened, the easier it is for the OSC to justify intervention. Unfortunately, it is sometimes the case that the SEC decides that the situation merits investigation and does not take the time nor see the necessity for anyone else to make the same determination.

The SEC must also be specific as to the information they require. The gathering of information is a time consuming process. For instance, a general request for all trading records requires a great deal of time and expense on the part of the dealer. The OSC is reluctant to make this type of request unnecessarily and thereby possibly jeopardize its working relationship with registrants. Similarly, general requests require extensive use of OSC resources which the OSC will be reluctant to commit if a more precise request is possible.

The SEC should approach the OSC first and not make any direct attempt to obtain information from persons in Ontario. Once information is gathered and forwarded by the OSC, the SEC must maintain its

24 See FIPPA, supra note 14.
confidentiality. This confidentiality is important because the OSC will not wish to disclose information if such information passes completely out of its control and could thereby be used in a manner not contemplated.

The SEC should, as a courtesy, keep the OSC advised as to the progress of the investigation as it pertains to Ontario. If any follow-up investigation is required, this should be conducted through the OSC as well. In a previous situation, the OSC provided trading records to the SEC to permit the SEC to determine who had been placing trades. The OSC then began receiving complaints from Ontario residents that the SEC was questioning them directly. Although the OSC is willing to assist the SEC, it does not take the view that the SEC has the right or that it is proper for the SEC to obtain evidence directly through an investigation in Ontario.

The OSC has developed a strong relationship with the SEC with respect to investigation matters and is generally willing to assist the SEC in the most effective manner. However, the seizing of jurisdiction by the SEC and the application of United States laws to conduct in Canada is an encroachment upon the sovereignty of Canada. This encroachment creates a valid objection to United States investigations, particularly where the result would be the application of United States laws to Canadians for conduct in Canada sanctioned by Canadian law. The impact theory of jurisdiction has been rejected in Canada, particularly with respect to economic regulation. Although the United States and Ontario securities laws are similar, the experience in other areas, such as antitrust, creates a reluctance on the part of Ontario to recognize impact theory jurisdiction. Also, where the conduct relates to a breach of Ontario laws, the OSC will apply its laws and not surrender jurisdiction to the United States.

The lack of support for the extraterritorial application of United States laws is demonstrated by the blocking statute in Canada. The willingness to help the United States is also demonstrated by the fact that these statutes will not prevent cooperation. They are enacted to ensure the protection of Canadian sovereignty. There is no advantage to Canada to be viewed as a sanctuary for those participating in illegal conduct.

2.6. The United States-Canada Mutual Legal Assistance Treaty

A recent example of the desire of Canada to cooperate with respect to international criminal activity is the United States-Canada Mutual
Legal Assistance Treaty (MLAT).\textsuperscript{25} This Treaty will be most important for future OSC/SEC cooperation.

The Treaty between the Government of Canada and the Government of the United States of America on Mutual Legal Assistance in Criminal Matters was signed on March 18, 1985.\textsuperscript{26} Its stated purpose is to "improve the effectiveness of both countries in the investigation, prosecution and suppression of crime through cooperation and mutual assistance in law enforcement matters."\textsuperscript{27}

MLAT provides that the United States and Canadian governments shall provide mutual legal assistance in all matters relating to the investigation, prosecution, and suppression of offenses. "Assistance" is defined to include examining objects and sites, exchanging information and objects, locating or identifying persons, serving documents, taking the evidence of persons, providing documents and records, transferring persons in custody, and executing requests for searches and seizures. Such assistance shall be provided without regard to whether the conduct under investigation or prosecution in the requesting state constitutes an offense or whether such conduct may be prosecuted by the requested state.

"Offense" is defined for Canada as an offense created by a law of Parliament that may be prosecuted upon indictment, or an offense created by the Legislature of a Province specified in the Annex,\textsuperscript{28} and, for the United States, as an offense for which the statutory penalty is a term of imprisonment of one year or more, or an offense specified in the Annex. The Annex specifically includes securities violations. However, other assistance may be provided pursuant to other agreements, arrangements or practices, and in respect to illegal acts that do not constitute an offense within the definition.

Any request for assistance must be made under the MLAT. Thus, only the Attorney General or officials designated by the Attorney General may make requests on behalf of the United States, and such requests must be made only to the Minister of Justice or to officials designated by the Minister of Justice in Canada. The request is to be kept confidential unless otherwise permitted by the requesting state.

The requested state is to promptly execute the request or, when appropriate, to transmit it to the competent authorities, who shall make

\textsuperscript{25} Treaty on Mutual Legal Assistance in Criminal Matters, Mar. 18, 1985, United States-Canada, \textit{reprinted in} 24 I.L.M. 1092 (1985) [hereinafter MLAT] (as of this writing, neither signatory has ratified this treaty).
\textsuperscript{26} Id.
\textsuperscript{27} Id.
\textsuperscript{28} Id.
best efforts to execute the request. The courts of the requested state shall have jurisdiction to issue subpoenas, search warrants or other orders necessary to execute the request. A request shall be executed in accordance with the law of the requested state and, to the extent not prohibited by the laws of the requested state, the requested state may require that information or evidence furnished be kept confidential or be disclosed or be used only subject to terms and conditions it may specify. The requesting state shall not disclose or use such information or evidence furnished for purposes other than those stated in the request without the prior consent of the requested state.

The signing of the MLAT provides further comfort with respect to the Canadian Federal Government's use of FEMA. This can be seen as a further indication that FEMA was enacted only to afford protection in the future for some unforeseen and unilateral intrusion upon Canadian sovereignty. Once in force, MLAT will govern requests for assistance from the OSC by the SEC. However, each of these agencies can be designated under MLAT to permit direct communication. This would be the preferable manner to administer this treaty.

3. Fact Situations

The foregoing demonstrates that, subject to some restraints, the OSC is able to assist the SEC and, generally, is willing to provide that assistance. The following is a discussion of the position of the OSC on the hypotheticals provided.

3.1. Hypothetical 1: False Financial Statements

The Securities Act (Ontario) has a number of financial disclosure requirements and the Criminal Code of Canada has antifraud provisions.

3.1.1. Subsidiary as a Public Company

It appears that the concerns raised by the SEC indicate that there may have been fraud in Ontario. If the subsidiary is a reporting issuer (public company) in Ontario, then the OSC will have an immediate interest in the case and will investigate. If preliminary facts are strong enough, the OSC may issue a temporary cease trade order pending a hearing. If improper financial disclosure in Ontario is shown, the OSC will issue a permanent cease trading order pending proper disclosure. If the improper disclosure is due to more culpable conduct, the OSC may, pursuant to a hearing, sanction the parties involved.

If fraud is apparent, the case will be turned over to the Attorney
General for criminal prosecution. The OSC will, therefore, be conducting its own investigation, in the course of which the testimony the SEC seeks will be compelled.

The Securities Act (Ontario) does not directly prohibit the OSC from providing to the SEC the evidence obtained. Normally, the OSC would be willing to provide it. However, such disclosure could be challenged in the Ontario courts by the persons involved. As was discussed, there is no precedent for this type of challenge. The area of individual rights is changing rapidly in Canada, due in large part to the recently enacted Charter of Rights. As counsel becomes increasingly aware of the potential to challenge this type of disclosure by the OSC, the more likely it becomes that a challenge will occur. In fact, the current level of cooperation now existing between the OSC and the SEC could be curtailed as a result of such a challenge. Until there are developments in this area of law, there will be uncertainty as to the OSC's ability to disclose this type of information. The OSC would also expect the assistance of the SEC with respect to information located in the United States relevant to the investigation in Ontario.

3.1.2. Subsidiary Not as a Public Company

If the Ontario subsidiary is not an Ontario reporting issuer (not a public company in Ontario), then it is unlikely that the Securities Act (Ontario) has been breached. However, the potential for fraud within the jurisdiction still exists sufficiently for the OSC to investigate. The OSC would normally be willing to provide the obtained information to the SEC. Such disclosure would, however, be subject to the same possible challenge as has already been discussed. This challenge becomes more problematic if it is necessary to compel the evidence. The OSC is not authorized to commence a formal investigation into criminal code offenses unless they relate to a securities trade. Once the OSC believes that a case for fraud exists, it would approach the Attorney General to determine how the case would proceed. At this point it would become a criminal matter and the SEC would have to look to the law enforcement agency conducting the investigation in order to obtain any evidence the OSC was unable to provide.

3.2. Hypothetical 2: Insider Trading

3.2.1. Public Companies

The Securities Act (Ontario) has a prohibition on insider trading which has been recently amended. If Company X is an Ontario reporting issuer, then the conduct alleged would constitute a breach of Ontario's securities laws. The OSC would commence an investigation into the matter with a view to applying Ontario insider trading rules. If it were necessary to compel evidence this would be accomplished by a formal investigation order. The OSC would normally be willing to provide information it obtained to the SEC; however, as discussed above, the ability of the OSC to disclose the information is subject to challenge by the persons involved. The OSC would expect the assistance of the SEC with respect to information relevant to the investigation located in the United States.

3.2.2. Private Companies

If Company X is not an Ontario reporting issuer (not a public company in Ontario), then Ontario securities laws have not been breached. However, as indicated by the Ontario prohibition on insider trading, the OSC finds this type of conduct offensive. The OSC would normally be willing to provide assistance to the SEC in its investigation. The OSC would seek to obtain the required information voluntarily. If this were not successful, and there would be no reason for an individual to cooperate, the use of a formal order to compel evidence would have to be considered. As was indicated previously, there is no clear authority in the Securities Act (Ontario) to enable the OSC to issue a formal order for the sole purpose of assisting the SEC. The OSC may be willing to make such an order on the basis that a breach of United States laws by participants in the Ontario capital markets is a valid concern of the OSC. This order, however, would be subject to challenge by the persons affected. The challenge would involve not only the questions of individual rights, discussed in Hypothetical 1 above, but also the actual authority of the OSC to make the order. In this scenario, those affected could seek recourse under FEMA on the basis that, as there has been no breach of Ontario laws, this order would be an unjustified encroachment on Canadian sovereignty. The willingness of the OSC to issue the necessary order will be influenced by the perceived likelihood of a valid challenge and whether or not a person's rights under Canadian laws would be adversely affected by the order.

The outcome of the SEC investigation could result in the OSC's determination that the individuals involved should not enjoy continued
access to Ontario’s capital markets, in which case an order denying such individuals exemptions to trade in Ontario could issue.

It must also be noted that once the MLAT is ratified, requests for information will have to follow the provisional guidelines. This procedure includes the parties between whom the requests must be handled. Such a procedure may expedite the cooperation if the SEC and the OSC are designated under the MLAT by the Attorney General and Minister of Justice, respectively, as “Central Authorities” for securities related matters. This designation would avoid delays created by involving at least two more government agencies in the process.

4. SOLUTIONS

There are serious impediments to conducting a multijurisdictional investigation. Problems exist even between countries with similar securities legislation, a similar philosophy of regulation and a mutual desire to provide assistance. The solution to such problems depends on mutual confidence and cooperation, as well as respect for national interests and different approaches to similar problems. The SEC’s investigations are primarily aimed at the protection of the United States capital markets and United States participants. This quite proper national approach may, however, ignore the concerns of other jurisdictions and be viewed as only furthering the position of the United States markets and not that of the international marketplace.

To some extent, it can be argued that the United States, for its own national advantage, is promoting its own capital market as the “international marketplace.” This characterization is obviously counter to other countries’ desires to have such economic activity occur within their own borders. This concern, as well as the reluctance of nations to accept wholeheartedly the United States’ application of the impact theory of securities law jurisdiction extraterritorially, must be addressed. The experience of United States actions in other areas of economic regulation, such as in antitrust, unfortunately will have an effect on other countries’ receptiveness to United States concerns in the securities area.

The solution must lie in a negotiated approach among the countries involved. Although unilateral action by the SEC provides short term gains in some instances, in the long term, such action will not facilitate future cooperation and agreement. The SEC’s “waiver by conduct” proposal, whereby any person trading in the United States would be deemed to have surrendered to United States laws and waived any protection otherwise availed by blocking or secrecy legislation, is an example of unilateral action which is aimed only at United States requirements, and ignores any sovereign sensitivities.
The situation which most frequently arises for the SEC is where the person or institution possessing required information is based, or such information is located, in a jurisdiction with blocking or secrecy statutes. That person or institution may also have assets in the United States. The current approach of the United States is to be very aggressive in applying sanctions against the institution to force disclosure, even though such disclosure would be unlawful in the home jurisdiction. The institution is placed in the impossible position of choosing which law to break. Again, this is a unilateral approach which ignores the valid concerns and the sovereignty of the other jurisdiction.

The position that United States concerns are paramount is, of course, offensive to the other country. The problem is only marginally less acute when there are no assets in the United States because the United States can still apply sanctions which will, in effect, bar the person or institution from entering the United States. This approach for obtaining immediate results is harmful to any long term hopes for mutual cooperation.

Mr. Pitt, in his paper, demonstrated the success of a negotiated solution to Bahamian secrecy laws when seeking information regarding the Levine investigation. The first step is to recognize that countries have valid reasons for their blocking and secrecy laws and that such laws have not necessarily been enacted to provide sanctuary for those seeking to breach the laws of other countries. Any agreement must recognize these concerns. It is equally important to recognize that other jurisdictions have laws with respect to securities which they believe are appropriate and which may not be similar to those laws of other jurisdictions. The differences in securities regulation, as well as in laws with respect to due process and evidence must be recognized and addressed in the effort to reach bilateral agreements.

Bilateral negotiations should identify and concentrate on securities related problems and specific concerns within the area. The logical starting point is investigatory assistance for insider trading or market manipulation cases. Problems will still exist as to the extraterritorial applications of law and sanctions. From the SEC perspective, however, the ability to obtain the necessary information is paramount. Once the SEC is able to identify a wrongdoer, even if no penalty can be brought to bear, the individual or company can be excluded from the United States capital markets. This exclusion, of course, applies to each jurisdiction.

The agreements can be either bilateral or multilateral. The type of agreement can vary. There can be formal treaties between governments, formal agreements between governments, memoranda of understanding
between the enforcement agencies or informal arrangements between enforcement agencies. The SEC has been active in seeking bilateral agreements and a number of them exist. From the SEC's point of view, the most logical first step is to enter into as many bilateral arrangements as possible. These agreements are easiest to achieve if a combination of formal agreements between governments and memoranda of understanding between enforcement agencies are used.

This is no quick fix for the SEC's needs. The long term solution lies in the ability of the countries involved to reach a multilateral agreement for multijurisdictional investigations. If four or five countries with major capital markets are able to reach such an agreement, then it might be possible to exclude others from participating in any of these countries' markets without agreeing to the same rules. Again, the multilateral solution is aimed at investigatory matters and is not based on a rationalization of securities laws.

There has also been a suggestion of a "super enforcement agency" concept. This may be a useful concept in terms of facilitating the exchange of intelligence and evidence. It is not likely, however, that it would be given a broader mandate since the question of enforcement is still a matter of territorial jurisdiction, and is likely to remain so.