

THE NEWEST CONFIGURATION OF THE UGLY AMERICAN: A RESPONSE TO MR. FEDDERS

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1. Introduction

Mr. Fedders and his co-authors correctly note that unscrupulous persons occasionally capitalize upon foreign secrecy and blocking laws to circumvent the federal securities laws. In arguing that the mere act of effecting a securities transaction in the United States should act as a waiver of applicable foreign secrecy laws, Mr. Fedders suggests rather drastic reform without convincingly demonstrating the pervasiveness of the problem. In addition, even if adopted, his proposals would prove unworkable, and ultimately might harm both the U.S. economy and existing cooperative relationships with secrecy jurisdictions.

Moreover, the jurisdictional analogy Mr. Fedders offers to support these proposals is, at best, fatally simplistic. Finally, these proposals implicitly rest upon the assumption that the U.S. securities laws reflect values morally superior to those reflected in the laws of other nations – an assumption that is highly questionable, and that Mr. Fedders does not even attempt to prove.

2. The practical difficulties with Mr. Fedders' proposals

Mr. Fedders observes that there has been a substantial influx of foreign investment in the U.S. securities markets, and that this trend is likely to continue. He then discusses several matters in which secrecy or blocking laws have recently impeded SEC investigations. Based upon this influx of foreign dollars, and the existence of these several troublesome cases, Mr. Fedders then concludes that additional measures are necessary to counteract the adverse effects of foreign secrecy and blocking laws.

Mr. Fedders does not, however, demonstrate the pervasiveness of these problems. Although secrecy and blocking laws unquestionably may impede some SEC investigations, Mr. Fedders fails to demonstrate that these occur-

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rences represent the rule rather than the exception. In addition, as Mr. Fedders seems to concede, U.S. courts already have been reasonably successful in coping with these problems in ways that do not infringe substantially upon the sovereignty of other nations. In short, although a problem exists, Mr. Fedders has failed to demonstrate its severity.

Adopting Mr. Fedders' proposals also may trigger negative side-effects substantially outweighing any potential benefits. First, as other commentators have noted [1], foreign investors might withdraw their investments from the U.S. securities markets, and thus inflict extraordinary damage to the U.S. economy. Second, Mr. Fedders notes that the SEC and other governmental entities already have succeeded in negotiating certain cooperative agreements with Swiss authorities. If the SEC were to attempt unilaterally to strip foreign investors of protection guaranteed them by the laws of their own nations, this cooperative relationship, and the accompanying benefits, might disintegrate rapidly.

Indeed, in a recent article [2], two solicitors from the United Kingdom observe that the United Kingdom, Canada, Australia, and the Netherlands all have adopted measures designed to protect their nationals from attempts to expand the jurisdictional reach of the U.S. antitrust laws. There is no reason to believe that these, and other, nations would respond with greater enthusiasm if the United States were to attempt to expand the territorial reach of its securities laws.

Finally, as a practical matter, the SEC and U.S. courts would find it nearly impossible to force their will upon foreign persons or entities. Assume, for example, that the SEC wishes to compel a foreign citizen with a Swiss bank account to reveal to it information regarding certain securities transactions apparently effected on his behalf in the United States. Assume further that the SEC convinces a federal judge that there is reason to believe that the foreign investor may have traded on inside information. Now suppose that the court is persuaded by the SEC's argument and, buying Mr. Fedders' "waiver by conduct" argument, orders the foreign investor to give the SEC all information concerning these transactions. The SEC's ability to enforce such an *ex parte* order is highly questionable.

Even aside from any substantial threshold objections to the court's attempted exercise of *in personam* jurisdiction, absent the applicability of any treaty or other negotiated arrangement between Switzerland and the United States, neither the SEC nor the court will succeed in enforcing this order. The foreign investor probably would not effect these transactions directly, but more likely would use a foreign attorney or intermediary, who in turn might utilize one or more additional attorneys or intermediaries. Any self-interested foreign attorney would rather risk disapproval of a foreign regulatory body than the professional opprobrium he would bring upon himself if he were to violate applicable secrecy laws of his own country [3]. Moreover, the foreign investor

almost certainly will defy such an order. In short, the issuance of such an order will prove a hollow gesture, and one likely to offend others.

Like politics, sound jurisprudence is often the art of the possible. In the long run, convincing courts to issue unenforceable orders will not bring any credit to the SEC and, rather than expand the SEC's jurisdiction, will only emphasize its territorial limits.

3. Mr. Fedders' simplistic jurisdictional analogy

In seeking precedent for his proposals, Mr. Fedders devotes a substantial portion of his article to discussing the manner in which state courts in the United States formulated rules for asserting jurisdiction over citizens of sister states, and then suggests applying a similar analysis to relationships between nations. Although courts and commentators during the eighteenth and nineteenth centuries did refer generally to the sovereignty of particular states, all states were joined by one federal government, with one federal legislature, one federal court system, and one constitution. In addition, except for Louisiana, all states owed their legal heritage to centuries of English experience.

In contrast, the many jurisdictions containing secrecy or blocking laws vary widely regarding language, culture, and heritage. In addition, these nations are not linked by any controlling federal government, by any legislature, by any federal court system, or by any one constitution. In short, the sovereignty of states within the United States cannot reasonably be analogized to the sovereignty of nations, and Mr. Fedders' jurisdictional analogy therefore fails.

Finally, Mr. Fedders' jurisdictional analogy focuses on one side of the coin only. If the SEC or U.S. courts attempt to eviscerate foreign laws or impose their own rules of conduct upon foreign citizens, these other nations could retaliate by refusing, when otherwise appropriate, to apply U.S. laws, or by attempting to expand their own exercise of jurisdiction over U.S. citizens [4]. Although the scope and seriousness of this problem is unclear, at the very least Mr. Fedders' failure even to discuss this problem suggests a narrowness of focus and, as discussed in section 4, *infra*, a presumptuous view that the U.S. securities laws are intrinsically superior to laws of other nations.

4. Mr. Fedders' unwarranted value assumptions

The practical problems with Mr. Fedders' proposals are compounded by his unwarranted assumption that policy goals reflected in the federal securities laws or espoused by the SEC are somehow morally superior to policy goals reflected by the secrecy and blocking laws of other nations. For example, Mr. Fedders argues that "no nation should permit itself to be used as a base for

persons to perpetrate frauds upon their neighbors" [5]. He also speaks of "the mutual interest in fair and honest securities markets" [6], and refers disparagingly to secrecy jurisdictions that "seek to maintain their special status as secrecy havens" [7].

Blinded by moralistic fervor, Mr. Fedders fails to recognize that there is no universally acceptable definition of "fraud" or "fair and honest", and that the moral basis for his proposals thus is not compelling. Although U.S. citizens have been conditioned from paperback novels and "B" movies to suspect something intrinsically evil in any transaction involving a secret bank account, in fact, as Mr. Fedders himself seems to concede in his Appendix 1, secrecy jurisdictions have a long tradition, a tradition substantially predating the SEC. Many wealthy foreigners have employed secret bank accounts for centuries; such reliance does not necessarily reflect a buried or budding fraud. Accordingly, when Mr. Fedders asks "whether the secrecy laws or blocking statutes of one nation should be given extraterritorial application" [8], he misses the mark; it is Mr. Fedders, rather than foreign jurisdictions, who seems eager to export a value system.

Indeed, although some offenses would seem reprehensible to persons in any civilized jurisdiction, many violations of the federal securities laws would not fall within that category. For example, it is hard to see how short-swing trading, which the federal securities laws proscribe, could be viewed as *malum in se*. Does Mr. Fedders believe that the SEC should be permitted to eviscerate long-standing foreign secrecy laws if doing so would help to uncover a short-swing profit? Similarly, although the SEC requires that parties register certain securities before offering them for sale, the SEC also permits the promoter of an offering under certain circumstances to dispense with registration, thereby presumably acknowledging that one can fairly promote an offering even without registering it first with a regulatory body. In short, the federal securities laws hardly reflect the only reasonable way to regulate securities transactions.

By ignoring the legitimate interests of other nations, Mr. Fedders' proposals also conflict with principles of international comity, as reflected in Section 40 of the Restatement (Second) of the Foreign Relations Law of the United States (1965), which provides:

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

- (a) vital national interests of each of the states,
- (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,

- (c) the extent to which the required conduct is to take place in the territory of the other state,
- (d) the nationality of the persons, and
- (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

In focusing exclusively upon the interests of the United States – or, more accurately, upon what he perceives these interests to be – Mr. Fedders ignores totally the “vital national interests” of other nations, and his proposals thus violate principles of comity [9].

Finally, Mr. Fedders argues that adopting his proposals “is also in the interest of the many foreign investors who participate in the United States markets” [10]. If foreign investors really were wary of the integrity of the U.S. securities markets, they presumably would not be increasing their investments in these markets at the rate discussed by Mr. Fedders.

In any event, it is presumptuous for Mr. Fedders to suggest where the interests of foreign investors truly lie. If he is correct in suggesting that investors from secrecy jurisdictions would benefit from laws similar to the federal securities laws, these jurisdictions presumably will take appropriate steps to enact similar laws. Absent such steps, however, the United States has no legitimate basis for imposing on other nations its view of the proper shape of securities regulation.

Indeed, notwithstanding anything that Mr. Fedders, the SEC, or any commentators might say, the SEC will not be able to export U.S. securities laws to other nations unless it can convince these other nations that they have an *independent* interest in adopting similar laws. If the SEC truly wishes to overcome foreign secrecy or blocking laws, it will do so more effectively through negotiation and persuasion than through attempting unilaterally to impose its will on other nations through unenforceable legislative or judicial fiat.

5. Conclusion

The problems described by Mr. Fedders cannot be solved realistically through the unilateral adoption of his “waiver by conduct” proposals. These proposals, which conflict with principles of international law and comity between nations, would prove unenforceable, and might diminish foreign investment in the United States. In addition, adoption of these proposals would lead to the erosion, if not the elimination, of whatever cooperative relationships now exist between the United States and secrecy jurisdictions.

Indeed, after considering Mr. Fedders’ proposals, one is impressed less by them than by the resourcefulness that U.S. courts already have demonstrated

in dealing with the problems triggered by secrecy and blocking laws. In short, continued reliance upon creative, case-by-case solutions and upon cooperation between the United States and secrecy jurisdictions ultimately offers the best course in combatting these problems.

Notes

[1] Wall Street Journal, Nov. 6, 1981, at 55, col. 3. See also J.E. Siegel, *United States Insider Trading Prohibition in Conflict with Swiss Bank Secrecy*, 4 J. Comp. Corp. Law & Sec. Reg. 353, 364 (1983).

[2] See P.C.F. Pettit and C.J.D. Styles, *The International Response to the Extraterritorial Application of the United States Antitrust Laws*, 37 Bus. Law. 697 (1982). In this article the authors quote William French Smith, Attorney General of the United States, as indicating that the Reagan Administration does not wish to enforce the antitrust laws in such a manner as to impair the sovereignty of other nations:

We do not wish through our laws or their enforcement to impair the sovereignty or rights of other nations. We do not wish to police the world and proscribe foreign conduct merely because it fails to conform to our interests. Nevertheless, we intend to influence the conduct of those international activities that have a foreseeable and substantial impact on the legitimate concerns of our people. In many instances, we trust that multilateral or bilateral accords can ensure due regard for our interests as well as the interests of other governments and peoples.

Id. at 715 (Address by the Attorney General to the 29th Congress of the Union Internationale des Avocats in New York, August 31, 1981).

[3] In Italy, for example, attorneys cannot be compelled to divulge information received in connection with their professional responsibilities. *Id.* at 713 (citing Code of Civil Procedure, Article 249, and Code of Criminal Procedure, Articles 351, 352).

[4] Mr. Fedders focuses upon the possibility of undercutting secrecy laws in order to apply U.S. securities laws. He does not, however, discuss an equally logical result: other nations with laws we find reprehensible might attempt to undercut secrecy laws, triggering unfortunate results.

Many communist nations, for example, forbid their citizens from removing funds from the country. If secrecy jurisdictions were to abrogate their laws to permit the United States to attempt to enforce its laws, these secrecy jurisdictions similarly might permit communist nations to uncover the identities of those who had violated applicable laws regarding removal of funds, and retribution against these individuals (or their families) might result.

[5] Fedders, *Waiver by Conduct – A Proposed Response to the Internationalization of the Securities Markets*, 6 J. Comp. Bus. & Cap. Market L. 1, 24 (1984).

[6] *Id.* at 27.

[7] *Id.* at 28.

[8] *Id.* at 4.

[9] The U.S. Supreme Court first enunciated these principles of comity almost two centuries ago. See *Murray v. Schooner Charming Betsey*, 6 U.S. (2 Cranch) 65, 118 (1804) (“An act of Congress ought never to be construed to violate the law of nations if any other possible construction remains, and consequently can never be construed to violate neutral rights, or to affect neutral commerce, further than is warranted by the law of nations as understood in this country”).

[10] Fedders, *supra* note 5, at 24.

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