Regulation of Insider Trading: Problems and Solutions in the United States and Switzerland

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Abstract

In this comparative study a broad view of insider trading in the United States and Switzerland will be presented. The goal is to compare the developments in two different nations with different legal traditions.

While in the United States a long tradition of literature and cases already exists and a development of cases can be shown, the situation in Switzerland is completely different because the law was enacted only a year ago.
It is the task of this thesis not only to outline the different developments but also to demonstrate the influence the United States had on to the process of legislation in Switzerland.

It may be the price of the internationalization of the capital market that a nation such as Switzerland with some importance in this field is no longer completely free to legislate.

RESUME

Dans cette étude comparative, on examinera les opérations d'initiés d' une manière plutôt superficielle. L'intention est de comparer les développements des opérations d'initiés de deux nations ayant des traditions légales différentes.

Alors qu'on peut trouver une longue tradition en littérature et des arrêts aux Etats-Unis, la situation en Suisse est complètement différente car la loi concernant ces opérations date seulement d'une année.
Le but de cette thèse n'est pas seulement de démontrer les développements différents mais aussi l'influence des Etats-Unis sur la procédure de législation en Suisse.

C'est peut-être la conséquence de l'internationalisation des marchés boursiers qui empêche une nation d'une certaine importance de n'être plus complètement libre de légiférer à sa guise.

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CHAPTER 1 : INTRODUCTION

Until a year and a half ago, a Swiss lawyer could say: "Insider trading? What is wrong with that? Our law does not forbid it!"

Those days are history. There is a new law in Switzerland, and its development is unusual. Insider trading is certainly not something that was considered by the majority of the Swiss to be an urgent matter requiring legislation.

The Swiss are in general very reluctant to enact new laws, and it can take decades until a new law is passed.

The Swiss are also quite sensitive, considering their sovereignty. Even though it is a very small nation, Switzerland sometimes legislates in an independent way, regardless of what the neighbour nations may think or how they may react to a Swiss single-handed effort.

One could also say that the Swiss are opportunists. They always try to escape from commitments and try to find special solutions for themselves (e.g. UNO, EC).

How is it then, that since the first of July 1988 there is in force a law referred to as "Lex Americana"? Why is it that a law, which most probably does not have the support of the public, was enacted in such a relative hurry ? Who was behind this enactment?

As the nickname suggests, "the Americans" must have had a certain influence on the enactment. How does another nation influence Swiss legislation? If we look back ten years ago, we can see where the differences concerning this matter between the two nations began.

In the United States, insider trading has been outlawed for over fifty years since the Securities and Exchange Commission (SEC), a supervisory board with regulative power, was established. It is the duty of the SEC to investigate unusual transactions on the stock markets. During investigations of some cases related to subsidiaries of Swiss banks in the United States, the lack of legislation in this area in Switzerland became an obvious obstacle.
As a result, there was a confrontation between a strong and powerful nation and a small nation for which the access to capital markets is essential. There was also a confrontation between a common law nation with a long history of literature and cases concerning insider trading and a civil law nation allowing insider trading.

Switzerland has an important place in the international capital market, with Swiss banks playing an important role worldwide, and the Swiss were interested in finally finding a satisfying solution with the United States and the SEC.
Malicious tongues could say that in this case it was more important to legislate in an international way than to

insist on sovereignty. The small nation could no longer justify not banning insider trading and had to act under the pressure of the United States. But, on the other hand, it is very well possible that sooner or later Swiss common opinion would have considered insider trading illegal and may have seen the necessity to legislate.

Between these two extreme modes of development, we find nations like Canada, where the problem was recognized early as well but not regulated as quickly and as vigorously as in the United States.

While in Canada banks are under federal legislation, securities law control falls under provincial legislation. The first Canadian securities law regulations in Manitoba in 1912 were influenced by the United States, then by English examples.[1]

Ontario, as the largest marketplace in Canada, was the first province to have significant securities law regulations, thus it was a model for other provinces.[2]

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[1] R. L. Simmonds, P.C. Mercer, An Introduction to Business Associations in Canada: Cases, Notes and Materials (Toronto: Carswell Legal Publications, 1984) at 149

[2] L. LaRochelle, M. Braunet, R.L. Simmonds, "Sontinuing Securities Reforms in Canada: Amendments to Quebec's Act" (1985-86) 11 Can. Bus. L.J. 147 at 148

It is the task of this thesis to concentrate on two "extremes", these being the American and Swiss examples. It will give an overview over the development of Rule 10(b) and the case law in the United States and the ongoing struggle for a definition of insider trading.

Furthermore, it will outline the difficulties that consequently had to arise between the United States and Switzerland and show how the United States finally was able to convince Switzerland to legislate in this field.

Finally, it will show how the Swiss regulated insider trading. However, emphasis will be placed on the reasons why Switzerland banned insider trading.

This thesis should be looked at from two sides:

From the North American point of view, it will show how the United States could initiate and influence Swiss legislation, and it gives an overview of Swiss legal mechanisms.

From the Swiss (or European) point of view, it gives an introduction to how the United States have been dealing with insider trading over the decades, discuss the development of Rule 10b-5 and shows how highly sophisticated literature and case law have become in the last decades.

CHAPTER TWO : INSIDER TRADING REGULATION IN THE UNITED STATES

In a comparative study, it is both interesting and important to see the developments of legislation in both nations. Particularly in this study, where one nation had an influence to the other nation, it is important to see why one nation already had a statute, case law and sophisticated literature regarding to this problem. Therefore, the development of regulation in the United States as well as the cases will be discussed.
The two following chapters may be more interesting for a civil lawyer, confronted for the first time with the North-American approach to insider regulation.

In this chapter, the development of insider trading regulation in the United States will be sketched out. Some cases which had a direct or indirect influence on legislation will be identified, but the cases themselves will be discussed in the third chapter.

2.1 Common Law Rules

According to the general rule of common law, insider trading in publicly held corporations was permissible.[1]

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[1]D.W. Carlton and D. R. Fischel, "The Regulation of Insider Trading" (1984) Stan. L. Rev. 857 at 883

(Footnote Continued)

The courts were divided on the common law duty of disclosure owed by an officer or director in purchasing the shares of his corporation. According to the "majority" or "strict" rule, officers and directors had a fiduciary obligation only to the corporation and to the stockholders in their dealings with or on behalf of the corporation.[2] They were free to trade as individuals in the securities of the corporation without any obligation of disclosure as long as there was no misrepresentation or active concealment by word or deed.[3] Under the "fiduciary" or "minority" rule, corporate insiders were held to fiduciary standards in their dealings with stockholders and therefore had to make full disclosure of all material facts.[4]

This general rule had some exceptions, however, expressed through a small group of cases from the beginning of this century. Some jurisdictions allowed suits against insiders for trading if the plaintiff could prove "special circumstances". This special circumstances doctrine is manifestly based on the existence of a relationship between

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(Footnote Continued)
See also H.G. Manne, "Insider Trading and the Stock Market" (New York: The Free Press, 1966) at 1-15

[2]Louis Loss, Fundamentals of Securities Regulation, 2d ed., (Toronto: Little, Brown and Co., 1988) at 723

[3]*Ibid.* at 724

[4]*Ibid.*

director and stockholder that is different from the relationship between arm's-length traders.[5]

Typically, the plaintiff sought to extend the tort of misrepresentation to reach material nondisclosure of corporate information in transactions involving a corporate official of the issuer.[6]

This "special circumstances" theory was enunciated in Strong v. Reside[7]. In this case, a former shareholder of a Philippine sugar company had been induced to sell her shares to a person she did not know, the company's general manager. This official knew that the company was about to enter into an extremely profitable contract with the Philippine government.

In this case, the Supreme Court granted rescission under the "special circumstances" doctrine. It was recognized that the defendant's insider position and the significance of the information compelled disclosure.

In later cases this rule was refined and expanded to place on all corporate officers and directors a general obligation of affirmative disclosure when dealing with shareholders, in

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[5] Ibid. at 725

[6] D.C. Langevoort, "Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement" (1982) 70 Calif. L. Rev. 1 at 4

[7] Strong v. Repide, 213 U.S. 419 (1909)

recognition of the fiduciary status that exists between them.[8]

2.2 The Securities and Exchange Commission

During the period of the New Deal, President Franklin D. Roosevelt created several independent regulatory agencies, one of them being the Securities and Exchange Commission (SEC). Its broad competence to protect and maintain a fair and orderly market grew out of the stock market crash of 1929.

Fraud, security price manipulation, short selling, bear raids, pooling, and other unsavory investment practices were considered to be the main reasons for the crash, and the public was asking for more protection in the market.[9]

Prior to the establishment of the SEC there was little government regulation, but certain rules and codes of conduct were established by a wide range of self-regulatory bodies.[10]

The SEC is an independent agency, its five members appointed by the President and confirmed by the Senate. It exercises

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[8] D.C. Langevoort, supra note 6, at 5

[9] Susan M. Philips and J. Richard Zecher, The SEC and the Public Interest (Cambridge, Mass. and London, England: The MIT Press, 1981) at 5

[10] Ibid. at 6,7. The earliest such agreement was the Buttonwood Tree Agreement, signed in 1792, to which the New York Stock Exchange (NYSE) traces its roots.

not only executive but also quasi-legislative and quasi-judicial powers.[11] The responsibilities of the SEC fall in two major areas:

(a) The SEC is active in assuming control of the corporate disclosure programs of the self-regulatory bodies, via oversight of accounting organizations and exchanges;

(b) The SEC establishes and enforces codes of conduct for brokers and dealers, particularly with respect to fraud and stock price manipulation.[12]

After dramatic growth its activities in the 1930s, the SEC almost disappeared from the regulatory scene during the 1940s and 1950s.

The Securities Act Amendments of 1964 gave new regulatory powers to the SEC, and in the ensuing years the SEC went through periods under different chairmen with varying influence upon the regulation of the market.[13]

2.3 Insider Trading under the Securities Exchange Act 1934

In the Securities Act of 1933, the disclosure philosophy of the British prospectus provisions of 1929 were

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[11] L. Loss, supra note 2, at 35

[12] R. L. Simmonds, P.C. Mercer, An Introduction to Business Associations in Canada: Cases, Notes and Materials (Toronto: Carswell Legal Publications, 1984) at 149

[13] L. LaRochelle, M. Braunet, R.L. Simmonds, "Sontinuing Securities Reforms in Canada: Amendments to Quebec's Act" (1985-86) 11 Can. Bus. L.J. 147 at 148

adapted by requiring registration with the SEC of distributions of securities.[14]

The Securities Exchange Act of 1934, aimed at post-distribution trading, was by far the most important act concerning insider trading. The roots of the legislation are found in common law concepts and state corporations law.

Since then, insider trading regulation has developed principally under section 10(b)[15], the general provision, and rule 10b-5[16] promulgated thereunder.

To make clear the difference between the two acts, it must be noted that the Securities Act of 1933 regulated, first of all, the emission of new shares, the 1934 Act on the other hand regulated trading in existing shares.

The purpose of the Act was (and is) "to maintain free and orderly markets on national securities exchanges and over-the-counter markets (1) by eliminating excessive speculation, (2) by prohibiting unfair practices and

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[14] L. Loss, <u>supra</u> note 2, at 36

[15] 15 U.S.C. para. 78j (1982)

[16] 17 C.F.R. para. 240.10b-5 (1982)

manipulation, and (3) by requiring full disclosure of all material facts regarding shares traded."[17]

Section 10(b) is a very general provision governing the purchase and sale of securities.

In 1942, the SEC became aware of a case in which a company president was buying up company stock by telling shareholders untruths about the company's activities. The SEC then took advantage of its broad authority based on Section 10(b) to issue regulations to prohibit any "manipulative or deceptive device or contrivance" and adopted the now-famous Rule 10b-5.[18] This rule reads as follows:

> It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:
> (a) To employ any device, scheme, or artifice to defraud
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
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> in connection with the purchase or sale of any security.[19]

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[17]Wu Hsiu-Kwang, "An Economist Looks at Section 16 of the Securities Exchange Act of 1934" (1968) 68 Colum. L. Rev. 260 at 261

[18]Kenneht E. Scott, "Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy" (1980) 9 J. Legal Studies 801 at 802

[19]17 C.F.R. para. 240.10b-5 (1982)

Rule 10b-5 was developed even though neither the rule nor the statutory provision expressly prohibited insider trading.[20] Because it is almost entirely the product of judicial and administrative construction, the contours of the law can be considered somewhat ill-defined, even if the core misconduct it addresses has been largely agreed upon.[21]

Rule 10b-5, a federal anti-fraud provision, designed to protect the integrity of individual shareholder investment decisions and of the marketplace in general, became the central mechanism for insider trading enforcement.[22]

Therefore, it can be said that the provisions simply give an insider the option of either disclosing the non-public information or refraining from trading.[23] Consequently, this rule has been called the "disclose-or-abstain-from-trading" rule.

It must be noted that this rule applies only if a defendant trades on the basis of "material" inside information such as

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[20] Donald C. Langevoort, supra note 6, at 3

[21] Ibid.

[22] Donald C. Langevoort, Insider Trading Regulation, Securities Law Series (New York: Clark Boardman Co. Ltd., 1988) at 11

[23] D.W. Carlton and D.R. Fischel, supra note 1, at 885

knowledge of an oil discovery, impending merger,[24] or a major change in earnings. Therefore, the effect should not be exaggerated.[25]

In 1968 the Supreme Court of the United States was confronted for the first time with the disclose-or-refrain rule in SEC v. Texas Gulf Sulphur Co.[26]

Professor Scott has identified three different conceptions from the material available concerning rule 10b-5.[27]

The first and most common view is that the rule is principally intended to serve the ends of fairness and equity. In Cady, Roberts & Co.[28] the Commission expressed this view by arguing that the rule was made to prevent "the inherent unfairness involved where a party takes advantage of [inside] information knowing it is unavailable to those with whom he is dealing."

According to the second view, the rule facilitates the flow of information to the market so that it may better perform its functions of security evaluation and capital allocation. This view does not differ much from the first view, but the

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[24]See e.g. Basic Inc. v. Levinson, 108 S.Ct. 978 (1988), see infra, chapter 6.1.4.

[25]Ibid. at 886

[26]see infra, 3.1.5

[27]K.E. Scott, supra note 18, at 804

[28]40 S.E.C. 907, at 912 (1961)

emphasis is rather on the entire market than on a particular trading partner.

Thirdly, the rule affords protection to the property rights of the firm in inside information. In <u>Cady, Roberts</u> this was described as "information intended to be available only for a corporate purpose and not for the personal benefit of anyone."[29]

Another important section concerning insider trading is section 16 of the Securities Exchange Act of 1934.[30] The Commission described the situation before the enactment as follows:

> Prior to the enactment of the Securities Exchange Act profits from 'sure thing' speculation in the stocks of their corporations were more or less generally accepted by the financial community as part of the emolument for serving as a corporate officer of director notwithstanding the flagrantly inequitable character of such trading.[31]

Section 16(a) requires directors, officers, and large stockholders (owning over 10% of the firm) to report trades in equity securities of their firm on a monthly basis.

Section 16(b) provides the firm with a cause of action to recover any profits made from the purchase and sale of

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[29] <u>Cady, Roberts & Co.</u> 40 S.E.C. 907, at 911 (1961)

[30] 15 U.S.C. s 78p(b) (1982)

[31] 10 SEC Ann. Rep. 50 (1944) in: L. Loss, <u>supra</u> note 2, at 541

securities in a six-month period, and it prohibits short-selling.

This "10% thumb-rule" or "insiders' short-swing profit" rule has been made for specific insider practices. An insider who waits until the six-month period is over, for example, is not liable under Sec. 16. On the other hand, its simplicity has had a substantial deterrent effect.[32]

There are some major differences which Loss describes as being "at opposite jurisprudence poles on the objective-subjective or predictability-fairness continuum".[33] These include the differences between Section 16 and Rule 10b-5:[34]

- Section 16 does not require trading on inside information for an action to lie; any short-term profits made by buying and selling are recoverable
- Sec. 16's scope is limited to a six-month period
- Sec. 16 makes only specific insiders liable
- Sec. 16 allows only the firm to recover.

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[32] L. Loss, _supra_ note 2, at 550

[33] L. Loss, _supra_ note 2, at 543

[34] D.W. Carlton, D.R. Fischel, _supra_ note 1, at 891

2.4 Insider Trading Sanctions Act 1984

Until the enactment of the Insider Trading Sanctions Act of 1984 (ITSA),[35] governmental enforcement of the prohibition against insider trading was an uncertain deterrent to such activity.

In September 1982 the SEC submitted a draft legislative proposal that would allow it to seek three times the profits made or losses avoided as a civil penalty, and would increase the maximum criminal penalty for all securities law violations from $ 10,000 to $ 100,000.[36]

The Insider Trading Sanctions Act was drafted by the SEC, and Congress simply adopted, with a few additions, the Commission's recommendations. This legislation meant much more than the addition of a new form of remedy; it was the first Congressional reconsideration of the insider trading problem since 1934.[37]

Until this Act, criminal prosecutions were relatively rare, since there was no comparable enforcement commitment at the Department of Justice.[38]

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[35] Pub. L. 98-376 [H.R. 559], 98 Stat. 1264, Aug. 1984, codified at 15 U.S.C. para 78u(d)(2)

[36] D.C. Langevoort, "The Insider Trading Sanctions Act of 1984 and Its Effect on Existing Law" (1984) 37 Vand. L. Rev. 1273 at 1277

[37] D.C. Langevoort, supra note 22, at A-1

[38] D.C. Langevoort, supra note 36, at 1275

The new Act added a new section 21(d)(2) to the Securities Exchange Act of 1934, providing for a civil penalty against persons found to have violated Rule 10b-5, Rule 14e-3 or any other provision or rule under the Exchange Act that prohibits insider trading.

This penalty is in addition to the possibility of an injunction and dislodgement of the actual profits made.

Section 21 of the Securities Exchange Act of 1934 was amended as follows:

> Whenever it shall appear to the Commission that any person has violated any provision of this title or the rules or regulations thereunder by purchasing or selling a security while in possession of material non-public information in a transaction (i) on or through the facilities of a national securities exchange or from or through a broker or dealer, and (II) which is not part of a public offering by an issuer of securities other than standardized options, the Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by such person, or any person aiding and abetting the violation of such person. The amount of such penalty shall be determined by the court in light of the facts and circumstances, but shall not exceed three times the profit gained or loss avoided as a result of such unlawful purchase or sale, and shall be payable into the Treasury of the United States.[39]

The Insider Trading Sanctions Act has its limits, however. Private parties cannot seek relief based on the provisions of this Act. Moreover, it is a civil penalty, therefore:

- proof of the violation has to be only a preponderance of the evidence
- non-payment of the penalty will not result in

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[39] Insider Trading Sanctions Act of 1984, Pub. L. 98-376, 98 Stat. 1264, 15 USC 78u(2)(A)

imprisonment.[40]

While the Insider Trading Sanctions Act itself is not difficult to understand, some interpretive issues are left open, including the question of what constitutes unlawful trading. While the Act is to some extent a ratification of current insider trading doctrine, the bill's drafters believed that the prevailing law in general provided an acceptable structure to carry out the objective of deterring abusive trading.[41]
A definition of insider trading was deliberately omitted in the draft of the SEC, and during the hearings in the Houses, no definition was added. In order to assure prompt enactment, the issue was left open.[42]

The starting point for the 1984 Act was the rule to disclose or abstain, which was established in <u>Re Cady, Roberts & Co.</u> and then confirmed in <u>Chiarella</u> and <u>Dirks</u>.[43] Therefore, a person must refrain from trading on inside information if he owes a fiduciary duty of disclosure to the class of

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[40] H.S. Bloomenthal, <u>Securities Law Handbook</u> (New York: Clark Boardman Co. Ltd., 1985-86) at 188

[41] D.C. Langevoort, <u>supra</u> note 36, at 1286

[42] Ibid. at 1287

[43] see <u>infra</u>, chapter 3

marketplace traders who are disadvantaged by not knowing those facts.[44]

While there is no question that corporate directors, officers, and employees are insiders, there is also a class of "temporary" insiders such as attorneys, accountants, underwriters and other agents who owe common-law fiduciary obligations of loyalty and care to the issuer during the course of the relationship.[45]

The ITSA held that corporate entities and employers are directly liable for a penalty under circumstances in which the "corporate entity itself was the trader" or the tipper.[46]

The ITSA did not, however, extend liability for a penalty to corporate entities, employers or controlling persons for violations by their employees or controlled persons.[47]

Section 20(d) of the Act makes it explicitly unlawful to trade options and other derivative instruments while in possession of material non-public information, whenever trading the underlying security would be unlawful.

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[44] Ibid. at 1288

[45] <u>Dirks v. SEC</u>, 103 S. Ct. 3255, 3261 n.14 (1983)

[46] Federal Securities Law Reports, No. 1304, September 1988, at 17

[47] <u>Ibid.</u>

This issue was not resolved prior the the Act, and some courts were "badly split on this question, with at least four courts allowing option position holders to bring such an action, at least in an affirmative misrepresentation context, and at least two courts denying them standing."[48]

It was argued that the option holder was not owed any fiduciary obligation by the corporation or its insiders per se (there is no fiduciary relationship between the company and the option holder prior to the exercising of the option).

The explicit inclusion of derivacive instruments in the Act of 1984 must therefore be seen as a recognition, at least in some cases, of the disclosure obligation absent any pre-existing fiduciary duty.[49]

In the conclusion of his comment on the 1984 Act,[50] Professor C. Langenvoort expresses his concern about the aggressive use of the new law to curb the misuse of information. In his view, this "result-oriented direction fits uncomfortably within the confining conceptual structure for Rule 10b-5 built in recent years by the Supreme Court. Lower courts therefore must flesh out the law of insider

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[48]Gregory S. Crespi, "Private Rights of Action for Option Position Holders Under Section 20(d) of the Securities Exchange Act" (1988) 16 Sec. Reg. L. J. 21 at 22

[49]D.C. Langevoort, supra note 36, at 1290

[50]Ibid. at 1298

trading based on inconsistent mandates, which will make the future path of the law both unpredictable and interesting."

2.5 The 1988 Legislation

The intention in this chapter is to highlight some of the new provisions, without conducting an exhaustive review of the new law.

In September 1988, the "Insider Trading and Securities Fraud Enforcement Act of 1988" was enacted. This act represents the response of the House Committee on Energy and Commerce to a series of illegal practices on Wall Street. Particularly as a consequence of the stock market crash in 1987 this new legislation was seen as an "essential ingredient in a program to restore the confidence of the public in the fairness and integrity of our securities markets."[51]

In this act, a new Section 21A of the Exchange Act is created, replacing and expanding the former Sec. 21(d)(2).

Section 3 "Civil penalties of controlling persons for illegal insider trading by controlled person" is an

[51] Federal Securities Law Reports, No. 1304, September 1988, Part II, at 7

amendment to the Securities Exchange Act of 1934 (15 U.S.C. 78a it Sec.) and the new Sec. 21A(a) reads as follows:

> Authority to impose civil penalties.-
> "(1) Juaicial actions by commissions authorized. - Whenever it shall appear to the Commission that any person has violated any provision of this title or the rules or regulations thereunder by purchasing or selling a security while in possession material, nonpublic information in, or has violated any such provision by communicating such information in connection with, a transaction on or through the facilities of a national securities exchange or from or through a broker or dealer, and which is not part of a public offering by an issuer of securities other than standardized options, the Commission-
> (a) may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by the person who committed such violation; and
> (b) may, subject to subsection (b)(1), bring an action in a United States district Court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by a person who, at the time of the violation, directly or indirectly controlled the person who committed such violation."

In this context, "controlling persons" are likely to include broker-dealers and investment advisers, but may also include other individuals who exercise effective control over the activities of a violator.

As a change to previous law, in this subsection liability for civil penalties has been extended beyond primary violators of the law to those who violate their duty to take reasonable steps to prevent that behavior.

In subsection (b) of Section 3 an affirmative obligation on regulated securities firms is established to supervise their employees. Broker-dealers and investment advisers must establish, maintain and enforce written policies "reasonably designed" to "prevent misuse of material, nonpublic information by the firm or any of its employees or associated persons".

This amendment was a significant change from the former law, where no affirmative obligation existed to adopt procedures designed to prevent insider trading and other misuse of material, nonpublic information.

Section 6 regulates "International enforcement cooperation authority". This Section provides the SEC with expanded statutory authority to assist foreign governments in investigation concerning violations of foreign securities laws and regulations.

The term "foreign securities authority" expressly recognizes that different countries have different approaches to securities law enforcement. The Swiss Federal Department of Police is expressly named in the list of foreign securities authorities which the SEC may assist.[52]

2.6 Conclusion

We have seen in this chapter how early the problem of insider trading was recognized. Although insider trading was allowed at common law, it had its limits with the duty to disclose owed by officers or directors concerning shares of the company. The majority and minority rule were established, and later also the "special circumstances" doctrine was defined. The first case of insider trading,

[52] see infra, chapter 4, for conflicts between Switzerland and the United States

Strong v. Reside dates back to the first decade of this century.

In the aftermath of the stock market crash in 1929, the SEC was established and given broad powers to protect and maintain a fair market.

Although there is no statutory definition of "insider trading", this activity was proscribed by provision of the securities laws, including Section 17(a) ff of the Securities Act of 1933, Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, and the case law that has developed over time interpreting those provisions.
Section 10(b) and Rule 10(b)-5 promulgated thereunder by the SEC have been subject to extensive judicial interpretation.

Under the Insider Trading Sanctions Act of 1984 the SEC was granted authority to seek imposition of a civil penalty against insider trading violators. The intention of Congress was to expand the tools available to the SEC in combatting insider trading.

The 1988 legislation, finally, was the response to various serious cases of insider trading in the mid-eighties. The main reason for this legislation was to improve the enforcement of the securities laws, particularly in the field of insider trading and to provide greater deterrence, detection and punishment of violations of insider trading.

The number of persons with fiduciary duties was enlarged to include "controlling persons".

CHAPTER THREE: U.S. CASE LAW AROUND RULE 10b-5

As we have seen in the foregoing chapter, insider trading regulation in the United States developmed through a long history of cases, laws, regulations and literature.
In this chapter, the development of case law shall be described. For the North American lawyer these cases are the well-known basics, however, for the European lawyer these cases are not known. In order to understand better the North-American arguments for the whole problematic surrounding insider trading, it is important to be familiar with the most important cases, especially taking into consideration that the cases influenced law and legislation. This is contrary to the development in Switzerland, where the U.S. was the "motor" for legislation.

Considering the fact that the development of American legislation and case law can be divided between the time before and after the decisions in Chiarella and Dirks, the cases before these two important cases will be reviewed only briefly, and more emphasis will be placed on the more recent developments.

3.1 Cases before Chiarella and Dirks

3.1.1 Ward La France Truck Corporation

Shortly after the promulgation of Rule 10b-5, the Commission had the opportunity to consider the new rule's limitations on insider trading in the case of Ward La France Truck Corporation[1]. In this case, two individuals who were officers, directors, and controlling shareholders engaged in a plan to purchase outstanding shares. At the same time, they negotiated to sell the company to a third party. The two insiders did not disclose the proposed sale and liquidation of the corporation at an inflated price. Furthermore, they did not disclose to the shareholders from whom they acquired shares the fact that the company's financial situation was greatly improved.

The Commission reviewed the facts under the new Rule 10b-5 and held that

> there was a clear necessity, in order not to take unfair advantage of shareholders, for the issuer and those in control to make timely disclosure of the identity of the purchaser, of the improved financial and operating condition of the issuer, and of the full terms of the transfer .. and .. liquidation.[2]

The Commission concluded "without elaboration as to its reasoning, and apparently relying on some fuzzy notions of

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[1] 13 S.E.C. 373 (1943)

[2] Ibid. at 381

fairness"[3], that the purchase of these securities violated Rule 10b-5.[4]

3.1.2 Kardon v. National Gypsum[5]

This case is considered to be the first one to imply a private right of recovery under Rule 10b-5. This was also the first instance in which the interpretation of the affirmative duty to disclose under federal securities law was related specifically to common law fiduciary principles.[6]

The facts of Kardon involved a closely held corporation in which insiders acquired shares from shareholders without disclosing an existing contract for the sale and liquidation of the company.

For the court, the insiders were analogous to trustees with a duty under "well-known and well-established equitable principles governing fiduciary relationships" not to profit personally from their position as trustees at the expense of shareholders.[7]

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[3] Hugh T. Wilkinson, "The Affirmative Duty to Disclose after Chiarella and Dirks", (1985) J. of Comp. L. 581 at 584

[4] 13 S.E.C. at 381

[5] 73 F. Supp. 798 (E.D.Pa. 1947)

[6] H.T. Wilkinson, supra note 3, at 584

[7] 73 F. Supp. at 803

Consequently, the court, relying on common law principles, held for the first time that an insider who uses non-public information for his personal enrichment will be liable under Rule 10b-5.[8]

3.1.3 Speed v. Transamerica Corp.[9]

Axton Fisher, a Kentucky tobacco company, had an inventory market price far greater than the value showed in the firm's financial statements. This fact was known by Transamerica, an investment company and the majority stockholder of Axton Fisher. Using its insider knowledge, Transamerica bought out the minority shareholders for a price below the liquidation value of the shares. Then Transamerica dissolved the company and reaped the benefit of the enhanced value of the tobacco.

Two separate suits were brought against Transamerica. One was a common law action for deceit.[10] This motion was dismissed because the company had not made active misrepresentations to the plaintiff and thus was not liable under Kentucky law.[11]

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[8] Wilkinson, supra note 3, at 584

[9] 99 F. Supp. 808 (D.Del. 1951)

[10] Geller v. Transamerica Corp., 53 F. Supp. 625 (D. Del. 1943)

[11] Ibid. at 630

The other suit, brought by Speed, was based on Rule 10b-5.[12] This suit "ultimately resulted in a substantial judgement against the corporation."[13]

In his reasons, Judge Leafy could not identify a particular rule grounding his decision, but he justified his decision with the argument that the rule was meant to prevent stockholders from being treated unfairly.

> The duty of disclosure stems from the necessity of preventing a corporate insider from utilizing his position to take unfair advantage of the uninformed minority stockholders. It is an attempt to provide some degree of equalization of bargaining position in order that the minority may exercise an informed judgement in any such transaction.... One of the primary purposes of the Securities Exchange Act of 1934 ... was to outlaw the use of inside information by corporate officers and principal stockholders for their own financial advantage to the detriment of uninformed public security holders.[14]

This broad concept of a "fairness" justification for insider trading has necessary limits.[15] In reality, one party will often have an advantage or better knowledge, intelligence or expertise than the other party, and if the "fairness" justification were taken to its logical extreme, the vision would ban virtually all trading activity.[16]

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[12] Speed v. Transamerica Corp., 71 F. Supp. 457-58 (D. Del. 1947)

[13] Jonathan R.Macey, "From Fairness to Contract: The New Direction of the Rules against Insider Trading", (1984) 13 Hofstra L. Rev. 9 at 14

[14] 99 F. Supp. at 829

[15] J.R. Macey, supra note 13, at 16

[16] Ibid.

3.1.4 In Re Cady, Roberts & Co.

In this case[17], the SEC further developed the "rudimentary notions of the affirmative duty to disclose"[18] which had been defined in the earlier cases. Furthermore, the Commission had expanded the 10b-5 duty to disclose in three aspects:[19]

1) A non-insider could have an affirmative disclosure obligation;
2) Insider trading in the impersonal market can violate Rule 10b-5 (this in contrast to the face-to-face transactions in Ward La France, Kardon and Speed);
3) There is a duty to disclose to persons not previously shareholders but who, by virtue of fraud in connection with the sale, became shareholders of the company.

The Commission did not follow the common law majority rule imposing no disclosure duties upon insiders in transactions with shareholders. It also accepted a much broader duty to disclose than the common law minority rule by applying the rule to non-insiders and to impersonal transactions. This is now known as the "access test".[20]

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[17] 40 S.E.C. 907 (1961)

[18] H.T. Wilkinson, supra note 3, at 585

[19] Ibid.

[20] H.T. Wilkinson, supra note 3, at 586

3.1.5 SEC v. Texas Gulf Sulphur

In this case,[21] the U.S. Court of Appeals had the opportunity to develop the "disclose-or-refrain" rule. According to this rule, persons, or at least some persons, who possess material non-public[22] information about the value of securities cannot trade the securities unless they first disclose the information.

Employees and officials of the Texas Gulf Sulphur Company (TAGS) bought its shares on the New York Stock Exchange, in full knowledge of a copper strike. At that time, this information was not even known to the company's full board of directors. This information was considered to be non-public as well as material.

The court based its decision solely on the second part of the "access test" - the generalized notion of market fairness and equality of information.[23]

The requirement of fairness was modified insofar as it would be satisfied if both parties could have acquired the relevant information. The court found that

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[21] 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969)

[22] Victor Brudney, "Insiders, Outsiders, and Informational Advantages under the Federal Securities Laws", (1979) 93 Harv. L. Rev. at 322, note 2. "Non-public" in this context means information that investors may not lawfully acquire without the consent of the source. To this category also belongs information which may be lawfully acquired but is not yet generally available.

[23] H.T. Wilkinson, supra note 3, at 586

> .. the Rule is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information.[24]

There was no need for the court to determine precisely who had been defrauded, apparently assuming that a fraud "on the marketplace" was enough to support an SEC injunctive action.[25]

3.1.6 <u>Shapiro v. Merrill Lynch, Pierce, Fencer & Smith, Inc.</u>

In <u>Cady, Roberts & Co.</u>[26] the question of who should be subject to the prohibition was left open.[27] In <u>Shapiro v. Merrill Lynch, Pierce, Fencer & Smith, Inc.</u>[28] the Second Circuit imposed liability on certain institutional investors.

In this case, the information about an impending decline in Douglas Aircraft Company earnings had passed properly from Douglas to Merrill Lynch in the course of Merrill Lynch's preparation for an underwriting of Douglas debentures. This

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[24] 401 F. 2d at 848

[25] D.C. Langevoort, "Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement", (1982) 70 <u>Calif. L. Rev.</u> 1 at 9

[26] 40 S.E.C. 907 (1961)

[27] D.C. Langevoort, "Insider Trading Regulation", Securities Law Series, 1988 Edition, at 47

[28] 495 F. 2d 228 (2d Cir. 1974)

confidential information was given to some of Merrill Lynch's favorite institutional clients.

The court found that these "tippees" were subject to the abstain-or-disclose rule, reasoning that such persons were subject to the same duties as the traditional insider by virtue of their special access to inside information resulting from their insider contacts.[29] Having violated that duty, they were required to respond in damages to all persons who purchased during the time period when the insiders were selling.

The Shapiro case adds another aspect because it involved a private suit for damages. The court had to decide who had the right to sue the insiders in a private action under Rule 10b-5.

Consequently, the court had to decide to whom the duty to disclose was owed. It concluded that since the only effective disclosure called for in a marketplace trading situation is public disclosure, the class of persons who bought Douglas stock between the date of the defendants' trading and date of public disclosure could demonstrate the requisite injury and its causal connection to the defendants' breach.[30]

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[29] Ibid. at 237

[30] 495 F. 2d 228 (2d Cir. 1974) at 238-41

However, this reasoning had been strongly criticized by the Sixth Circuit as not only artificial but harsh, given that the award of damages to the marketplace under any compensatory measure would be far in excess of any profits made by the defendant.[31] Thus the decision underscored the "in terrorem" potential of the insider-trading prohibition under Rule 10b-5.[32]

Shapiro was rejected by the Sixth Circuit in Frederick v. Bravoed[33]. The court was unable to find a causal connection between the defendants' purchases and the plaintiffs' lost opportunity in selling before favorable news.[34] The court found that if the defendants had not traded, they would not have had any obligation to disclose and the plaintiffs would have lost money in any event.[35] Consequently, the court dismissed as beyond the scope of judicial authority the damage limitation strategy set out in Shapiro.[36]

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[31] D.C. Langevoort, supra note 25, at 10

[32] Ibid.

[33] 542 F. 2d 307 (6th Cir. 1976) cert. denied, 429 U.S. 1053 (1977)

[34] M.P. Dooley, "Enforcement of Insider Trading Restrictions", (1980) 66 Va. L. Rev. 1 at 22

[35] 524 F. 2d at 318

[36] Ibid. at 321-22

3.2 **The Breakthrough**

3.2.1 Chiarella v. the United States

The Supreme Court of the United States was confronted with an insider trading case for the first time in the Chiarella case.[37]

Chiarella was employed as a "mark-up man" by Pandick Press, a well-known financial printer, which prepared soliciting material for bidders in tender offers. Pandick used false names or blanks in place of the true names of the target and offerer companies. The true names were sent to Pandick only on the night of the final printing.[38] Fully aware that his actions were prohibited by his employer, Chiarella broke company codes for the material being printed and deciphered the names of the target companies before the final printing and before the information became public.

Based on this non-public information, in the years 1975/76 Chiarella bought shares in the target companies, made no affirmative disclosure, and "sold the shares immediately after the takeover attempts were made public."[39] Chiarella was able to realize more than $30,000 in a period of 14 months.

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[37] 445 U.S. 222 (1980)

[38] Ibid. at 224

[39] Ibid. at 224

He was eventually convicted of criminal violations of Sec. 10(b) and SEC Rule 10b-5. Furthermore, he was investigated by the SEC and consented to an injunction and dislodgements of these profits.[40]

Chiarella's conviction was affirmed by the Second Circuit.[41] The court held that his status as an outsider was irrelevant to his duty to disclose under Rule 10b-5 and said that

> anyone - corporate insider or not - who regularly receives material non-public information may not use that information to trade in securities without incurring an affirmative duty to disclose.[42]

The court emphasized considerations of market fairness and equality of information among market participants. Additionally, the fact that the information had been misappropriated was itself a separate basis for finding his actions to be fraudulent.[43]

The first position, that general notions of market fairness and equality of information are sufficient to create an affirmative duty to disclose, was rejected by the Supreme

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[40] SEC v. Chiarella, No. 77 Civ. Action No. 2534 (GLG) (S.D.N.Y. May 24, 1977)

[41] 588 F. 2d 1358 (2d Cir. 1978)

[42] Ibid. at 1365

[43] 588 F. 2d at 1368 n.14

Court. For the Court, more important than equality of information is the existence of a duty to disclose.[44]

The government emphasized the second position, however, and argued that Chiarella had misappropriated confidential information from Pandick's clients and in so doing had defrauded the clients. However, because this theory of liability had not been properly presented to the jury, the court refused to consider it. Rejecting the first theory, the court reversed Chapel's conviction by a vote of six to three.

According to the majority, there is a duty to disclose or abstain from trading only if a fiduciary relationship between the actor and those with whom he deals existed.

In this particular case, Chiarella had no prior dealings with the sellers and was therefore not obliged to disclose his superior knowledge; thus, his purchases were not in violation of Rule 10b-5.

Chiarella could not be considered an insider because he had not received inside information from the company whose shares he brought. Consequently, Chiarella was under no duty of disclosure to the public.

Justice Powell wrote that the court had

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[44] 445 U.S. at 225

> failed to identify a relationship between petitioner and the sellers that could give rise to a duty.[45]

Justice Powell continued:

> He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions.
> We cannot affirm petitioner's conviction without recognizing a general duty between all participants in market transactions to forego actions based on material, non-public information. Formulation of such a broad duty, which departs radically from the established doctrine that that duty arises from a specific relationship between two parties, ... should not be undertaken absent some explicit evidence of congressional intent.[46]

According to Chief Justice Burger's dissenting opinion, liability arises when a person trades on the basis of undisclosed information, "obtained not by superior experience, foresight, or industry, but by some unlawful means."[47]

The duty not to trade is owed to the public, and the Chief Justice based his finding on the common law of torts and the language and legislative history of Section 10(b) and Rule 10b-5, as well as on the Commission's <u>Cady, Roberts</u> decision.[48]

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[45] 445 U.S. at 232

[46] <u>Ibid.</u> at 232-33

[47] <u>Ibid.</u> at 240

[48] D.C. Langevoort, <u>supra</u> note 25, at 15

According to M.P. Dooley[49], the most important doctrinal contribution of this case is its recognition of the important distinctions between affirmative misrepresentation and non-disclosure. Although the former is by definition "fraudulent", neither the language nor the legislative history of Section 10(b) suggests the circumstances under which non-disclosure constitutes a "manipulative or deceptive" device.[50]

In the opinion of D.C. Langevoort, the holding of Chiarella is narrow:

> a rejection, as a matter of statutory construction, of the idea that mere possession of material, non-public information gives rise to a duty to abstain or disclose. While the court emphasized the "pre-existing duty" notion, arising from the fiduciary relationship of trust or confidence, as the basis of the affirmative disclosure obligation, its opinion need not have meant that this is the exclusive source of the duty.[51]

What is most striking about the judgement - still according to Langevoort - is the Court's dissatisfaction with a federal statute and rule, which gives rise to severe criminal and civil liability consequences for their violation, that provide no clear indication of what securities-related activity is prohibited.[52] In short, the

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[49] M.P. Dooley, supra note 34, at 69

[50] Ibid.

[51] D.C. Langevoort, supra note 25, at 16

[52] Ibid. at 17

court expressed its concern with the lack of notice offered by Rule 10b-5.[53]

Shortly after Chiarella, in 1980, the SEC promulgated Rule 14e-3.[54] It forbids trading by those with material information about an impending tender offer if they know or have reason to know that the information is non-public and comes from the target company or the agents of either.[55] The rule applies as soon as someone has commenced or has taken a substantial step toward commencing a tender offer.[56] In addition, this rule also covers tipping.

It is clear that the SEC responded to Chiarella by adopting this specific rule prohibiting most trading and tipping based on non-public information about tender offers. However, the validity of this rule has not been settled.[57]

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[53] Ibid., note 68: 445 U.S. at 235 n. 20 ("a judicial holding that certain undefined activities 'generally are either prohibited' by para. 10(b) would raise questions as to whether either criminal or civil defendants would be given fair notice that they have engaged in illegal activity.")

[54] 17 C.F.R. para. 240.14e-3 (1982)

[55] William K.S. Wang, "Recent Developments in the Federal Law Regulating Stock Market Inside Trading", in: Contemporary Issues in Securities Regulation, Butterworth Legal Publishers, 1988, 59 at 75

[56] Ibid.

[57] Ibid. at 76

3.2.2 Dirks v. SEC[58]

Shortly after Chiarella, the Supreme Court had another opportunity to focus on Rule 10b-5, this time with an emphasis on the tippee's liability.

Raymond Dirks was employed as an officer and analyst for a brokerage firm that dealt primarily with institutional investors. He received non-public information from a former officer of a large life insurance company that the assets of the company were overstated as the result of fraudulent practices at the company. Previous reports of the fraud to regulatory agencies had had no effect. Dirks investigated in this case and received corroboration of the existence of fraud. Neither Dirks nor the company owned or traded any of the company's shares. However, Dirks disclosed his information to some of his clients, who sold their shares of the company. Additionally, Dirks informed the Wall Street Journal of the massive fraud. The Journal did not disclose the fraud for about two weeks but by the time it did, rumors of fraud were widespread and the company's stock price fell. Although the SEC recognized Dirk's assistance in exposing the fraud, the SEC censured him under 10b-5 for disclosing non-public information to his clients.

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[58] 681 F.2d 824 (D.C. Cir. 1982), rev'd 463 U.S. 646 (1983)

The Court of Appeals upheld the Commission's finding.[59] It was argued that duties of corporate fiduciaries are inherited by their tippees, or, alternatively, Dirks had a special position as an employee of a broker-dealer.[60]

The Supreme Court reversed the Second Circuit. In its finding, the court relied primarily on Chiarella and Cady, Roberts & Co.

Justice Powell reaffirmed that principles of market fairness are insufficient to create an affirmative disclosure obligation[61]. He stated that

> .. mere possession of non-public information does not give rise to a duty to disclose or abstain; only a specific relationship does that.[62]

The court recognized that complete fairness and equality of information in impersonal markets is an unrealistic goal and "investors act inevitably on incomplete or incorrect information; there are always winners and losers."[63] Consequently, there must be a pre-existing fiduciary relationship running directly or indirectly from the

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[59] Dirks v. SEC, 681 F. 2d 824 (D.C.Cir. 1982)

[60] Ibid. at 840

[61] H.T. Wilkinson, supra note 3, at 592

[62] 103 S.Ct. at 3264

[63] 103 S.Ct. at 3267 n.67

defendant to one or more marketplace traders in order to establish a liability.[64]

The majority opinion made it clear that tippee liability arises only when tipper and tippee join together in a "co-venture" to exploit inside information for personal gain.

The court held that the tippee's liability derives from the insider's duty:

> Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material non-public information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.[65]

The court then discussed further the nature of the breach that would give rise to liability, and added a second requirement for finding tippee liability.

> Thus, the test is whether the insider will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders .... This requires courts to focus on objective criteria, _i.e._, whether an insider receives a direct or indirect personal benefit from the disclosure, such as a peculiar gain or reputational benefit that will translate into future earnings. There are objective facts and circumstances that often justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests a _quid pro quo_ from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of non-public information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.[66]

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[64] 463 U.S. at 654-55

[65] _Ibid._ at 660

[66] _Ibid._ at 662-64 (citations omitted)

In light of the Supreme Court's considerations, Dirks had no affirmative duty to disclose.

However, it can be assumed that usually there will be a liability in the tippee case because the insider can be expected to act either for his personal gain or in order to bestow a gift.[67] It seems that the only persons who can escape an affirmative duty to disclose are the tipper who has no ulterior motive and his tippee, such as the cab driver or football coach, who overhears an insider and trades thereafter.[68]

3.2.3 The United States of America v. David Carpenter, Kenneth P. Felis, and Foster Winans[69]

In this case, the United States Court of Appeals, Second Circuit, had another occasion to decide on Section 10(b) and Rule 10b-5.

This was an appeal from a conviction in the United States District Court[70], where Felis and Winans were found guilty of securities fraud by misappropriating material, non-public information from the Wall Street Journal in connection with

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67 H.T. Wilkinson, supra note 3, at 594

68 Ibid.

69 791 F. 2d 1024 (2nd Cir. 1986)

70 The United States v. Winans, et al., 612 F. Supp. 827 (S.D.N.Y.1985)

the purchase and sale of securities, and of mail and wire fraud. Carpenter was convicted of aiding and abetting in the commission of securities fraud and mail and wire fraud.

Winans was a Wall Street Journal reporter and one of the writers of the "Heard on the Street" column. Carpenter worked as a news clerk at the Journal. Felis was a stockbroker at the brokerage house of Kidder and Peabody.

Both Winans and Carpenter knew about the "The Insider Story", a forty-page manual distributed to all employees of the Wall Street Journal, where seven pages described the company's policy on conflict of interest. This policy required employees to treat non-public information learned on the job as confidential. Notwithstanding this policy, Winans gave in advance securities-related information to Brant (another stockbroker) and Felis, who bought or sold the subject securities. Carpenter served primarily as a messenger between the conspirators. Accounts were established in different names, and during 1983 and early 1984 the defendants made pre-publication trades on the basis of their advance knowledge of approximately twenty-seven "Heard" columns. The net profits approached $690,000.

In the opening of the discussion, the court held once more that

> The fairness and integrity of conduct within the securities markets is a concern of utmost significance for the proper functioning of our securities laws. In broadly proscribing "deceptive" practices in connection with the purchases or sale of

securities pursuant to Section 10(b) of the Securities Exchange Act of 1934, Congress left to the courts the difficult task of interpreting legislatively defined but broadly stated principles insofar as they apply in particular cases.[71]

Once more, the "misappropriation" theory of Section 10(b) and Rule 10b-5 was discussed. Since 1980, when the Supreme Court had left open the question of the viability of that theory,[72] it had been applied twice by the Court of Appeals.[73]

According to the appellants, the misappropriation theory may be applied only where the information is misappropriated by corporate insiders or so-called "quasi-insiders". Therefore, it was not enough that Winans breached a duty of confidentiality to his employer by misappropriating and trading on material non-public information; he would have to have breached a duty to the corporation or shareholders thereof, whose stock they purchased or sold on the basis of that information.[74]

This interpretation of the misappropriation theory was considered to be too narrow, and the court cited what was

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[71]791 F.2d 1027

[72]Chiarella v. United States, 445 U.S. 222, 100 S.Ct. 1108, supra chapter 3.2.1

[73]SEC v. Materia, 745 F.2d 197 (2d Cir. 1984)
United States v. Newman, 664 F.2d 12 (2d Cir.1981), aff'd after remand, 722 F.2d 729 (2d Cir.), cert. denied, 464 U.S.863

[74]791 F.2d 1029

already said in Chiarella[75], namely that Section 10(b) of the 1934 Act, as implemented by Rule 10b-5, "was designed as a catch-all clause to prevent fraudulent practices."[76] The court found that Winans "misappropriated - stole, to put it bluntly - valuable non-public information entrusted to him in the utmost confidence."[77] It argued that

> it was the advance knowledge of the timing and content of these publications, upon which appellants, acting secretively, reasonably expected to and did realize profits in securities transactions. Since Section 10(b) has been found to proscribe fraudulent trading by insiders or outsiders, such conduct constituted fraud and deceit, as it would had Winans stolen material non-public information from traditional corporate insiders or quasi-insiders.[78]

In its conclusion the court repeated its opinion already expressed in Materia[79], that "the Congress' ideal in 1934 was 'an open and honest market' in which superior knowledge in the securities markets would be achieved honestly, fairly, and without resort to pernicious conduct."[80]

The fact that the court was divided four to four in this decision clearly indicates the controversy surrounding the

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[75]445 U.S. 226 (citing Ernst & Ernst, 425 U.S. at 202)

[76]791 F.2d at 1030

[77]Chiarella, 445 U.S. at 245

[78]791 F.2d at 1031-32

[79]745 F.2d at 203

[80]791 F.2d at 1036

misappropriation theory.[81] It also indicated the need for a legal definition of insider trading.

3.3 Conclusion

We have seen in the two foregoing chapters that "insider trading" is not defined in the securities laws, but the term is used broadly to refer to the purchase or sale of securities while

(a) in possession of "material" information (information that would be important to make a decision to buy or sell a security)

(b) that is not available to the general public.

To the category of possible "insiders" belong traditionally corporate directors, officers, employees, and other traditional "insiders" with a clearly defined fiduciary duty to shareholders to either disclose material nonpublic information about their corporation or to abstain from trading the securities of that corporation.[82]

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[81] United States v. Carpenter, 791 F2d. 1024 (2d Cir. 1986), aff'd on securities law counts by an equally divided court, 108 S.Ct. 316 (1987)

[82] See e.g. Strong v. Repide, 213 U.S. 419 (1090), SEC v. Texas Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (en banc), cert. denied, 404 U.S. 1005 (1971); In re Cady, Roberts & Co., 40 SEC 907 (1961).

Several major court cases have established clear boundaries for prosecution of insider trading violations. In Chiarella v. United States[83] the Supreme court held that a duty to disclose does not arise form the mere possession of nonpublic market information. It was held that a duty to disclose only arises from a fiduciary relationship of trust and confidence between parties to the transaction.

The same narrow approach was followed by the Supreme court in Dirks v. SEC.[84] Here the court held that recipients of material nonpublic information have a duty not to trade or communicate information only when it has been improperly made available to them.

These two cases established that there is no general duty to disclose material information before trading on it. Only traditional insiders and their tippees have such a duty, and some individuals may become "temporary insiders" (e.g. lawyers, underwriters, accountants).

The SEC and the Department of Justice have pursued insider trading using an alternative theory: that individuals have a duty not to misappropriate information from their employers

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[83] 445 U.S. 222 (1980)

[84] 463 U.S. 646 (1983)

or otherwise in breach of fiduciary or other relationships of trust and confidence, and commit securities fraud when they trade in possession of misappropriated information or tip others to trade.[85]

Consequently, the SEC must establish that the person misusing the information has breached either a fiduciary duty to shareholders or some other duty not to misappropriate insider information.

In the Carpenter case[86] the Supreme Court was divided 4-4 on whether the misappropriation theory was valid or not.

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[85] See e.g. United States v. Newman, 664 F.2d 12 (2d Cir. 1981), aff'd after remand, 722 F.2d 729 (2d Cir), cert. denied, 464 U.S. 863 (1983)

[86] United States v. Carpenter, 791 F 2d 1024 (2d Cir. 1986), aff'd in securities law counts by an equally divided court, 108 S.Ct. 316 (1987)

CHAPTER FOUR : CONFLICTS BETWEEN SWITZERLAND AND THE UNITED STATES

As a consequence of the internationalization of the capital markets, problems can arise between different jurisdictions. Prior to the enactment of Swiss insider legislation, a Swiss bank carrying on business in the United States found itself caught between two very different approaches to insider trading. In the United States, insider trading was forbidden, and the SEC was given a strong power to prosecute these cases; in Switzerland, no such law or prohibition existed.

Under US law, the SEC can ask the bank to reveal the name of a client who made suspicious transactions, and the bank is obliged to give that information to the SEC. If the transaction took place through a Swiss bank with a place of business in the United States, the bank was not allowed to give the requested information, according to the protection of secrecy of Swiss banks.

The SEC would then ask for a motion to compel discovery, and the bank faced the dilemma of either violating the banking secrecy provisions of the home country or being subject to the possibly draconian sanctions of US courts.

Prior to the enactment of the new law, the SEC used different ways to gain the desired information from Swiss banks. First there was the Treaty on Mutual Assistance in

Criminal Matters, then the Memorandum of Understanding, and finally the Agreement XVI.

4.1. Treaty on Mutual Assistance in Criminal Matters

On January 23, 1977, the treaty between Switzerland and the United States (completed in 1973) came into force.[1] It took four years of negotiations before the treaty was finally signed. Two circumstances are considered to be the reasons for the length of debate.

Firstly, it was the first judicial assistance treaty in criminal matters that was signed by two countries with two completely different systems of law, namely Anglo-Saxon common law and continental European civil law[2].

Secondly, the motives of the parties to enter into this treaty were quite different. While Switzerland wanted a comprehensive agreement covering all aspects of judicial assistance equivalent to the European Convention on Mutual Assistance in Criminal Matters, the United States wanted to lift Swiss banking secrecy, especially as concerns of tax violations, securities law offences and organized crime.[3]

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[1] Treaty between the United States of America and the Swiss Confederation on Mutual Assistance in Criminal Matters, 27 U.S.T. 2019, T.I.A.S. No. 8302 (1977), 12 I.L.M. 916 (1973)

[2] Peter C. Honegger, "Demystification of the Swiss Banking Secrecy and Illumination of the United States-Swiss Memorandum of Understanding", (1983) 9 N.C.J. Int'l L. & Com. Reg. at 13

[3] Bernhard F. Meyer, "Swiss Banking Secrecy and Its Legal (Footnote Continued)

However, the final formulation of the treaty was a compromise between the parties differing interests.[4]

In this treaty, the two nations agreed on mutual cooperation to enforce activity deemed criminal in both nations. Under certain conditions, the treaty allowed a disclosure of information upon formal request. These were "compulsory assistance" measures which made it possible for the requesting state to obtain information from the other state when a criminal offense was committed within the latter states jurisdiction.[5] It has to be noted, however, that the treaty never guaranteed disclosure of Swiss banking secrets.

The United States had to ask formally for information or assistance.[6] In a further step, the Swiss authorities had to determine if any of three preconditions were satisfied.[7]

(Footnote Continued)
Implications in the United States", (1978) 14 New England. L. Rev. 18 at 64

[4] Ibid.

[5] Note, "The Effect of the U.S.-Swiss Agreement on Swiss Banking Secrecy and Insider Trading", (1983) 15 Law and Pol. Int'l Bus. 565 at 585

[6] Treaty. art. 4, para. 1

[7] Art. 4. para 2(a): when the offense is criminally punishable under the requested state's laws if committed within its jurisdiction or included in the Schedule of Offenses attached to the treaty.
Art. 4 para 2(b): when the offense constitutes unlawful bookmaking, lottery, or gambling.
Art. 6, para 2(a): when the offender is involved in an organized crime.

Swiss banking secrecy is not explicitly specified in this treaty. It appears that the parties were of the opinion that the secrecy laws would not prevent the Swiss government from assisting U.S. investigations where disclosure of banking information was mandated by the treaty.[8]

Consequently, the SEC had difficulties implementing the treaty during its investigation of insider trading allegations.[9]

To receive assistance according to the treaty, the SEC had to convince Swiss authorities that there were provisions in Swiss law prescribing insider trading.

But soon it became obvious that the treaty could not satisfy the SEC's needs during investigations and consequently the SEC sought to compel discovery of customer identification in U.S. courts under rule 37 of the Federal Rules of Civil Procedure.[10]

The two following cases in which the SEC threatened to file Rule 37 motions against Swiss banks demonstrate the difficulties the SEC encountered while seeking assistance in

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[8]Hermine Meyer, "The Banking Secret and Economic Espionage", (1955) 23 Geo. Wash. L. Rev. 284 at 439

[9]Note, supra note 5, at 587

[10]Fed. Rule of Civ. P. 37. To bring a Rule 37 motion against a foreigner or non-resident party, the party must allege that the non-resident has sufficient contracts in the forum state to be subject of that state's jurisdiction.
Note, supra note 5, at 593

criminal matters, and the conflict between the two jurisdictions.

4.1.1. SEC v. Banca della Svizzera Italiana and Certain Unknown Purchasers of Call Options for the Common Stock of St. Joe Minerals Corp.[11]

The facts of this case consisted of certain transactions made in March 1981 just prior to the surprising public announcement of a cash tender offer by a subsidiary of the Seagram company for the St. Joe Minerals Corp. Even though this offer did not result in a take-over, some clients of the Banca della Svizzera Italiana (BSI) were able to realize an "overnight profit" of almost $ 2 million US.[12] Because of these short-term profits, the SEC presumed that either the BSI or its customers had dealt with insider knowledge.

The SEC issued a subpoena against the subsidiary of the BSI in New York in order to obtain the required information.

The SEC then applied to the United States District Court for the Southern District of New York and obtained, inter alia, a temporary restraining order against the Swiss bank to reveal the identity of the undisclosed principals. The legal

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[11] SEC v. Banca della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981)

[12] Ibid. at 112-113

proceeds from the sale of the call options and the St. Joe common stock were frozen.[13]

During the ensuing meetings with officials of the SEC, the BSI consistently refused to supply the requested information. The BSI argued that disclosing the identity of the clients would violate Swiss banking secrecy law and that the bank could become liable under Swiss criminal law.

In November 1981 the district court announced informally that it would order the bank to disclose the names of the principals and would apply severe sanctions if the bank did not comply with the order.[14]

The court then considered the possibility of applying the balancing test of Section 40 of the Restatement (Second) of Foreign Relations Law, which reads as follows:

> Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction in the light of such factors as
> (a) vital national interests of each of the states,
> (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,
> (c) the extent to which the required conduct is to take place in the territory of the other state,
> (d) the nationality of the person, and
> (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule

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[13] Ibid. at 113

[14] Ibid. The sanctions were, inter alia, a daily penalty of $ 50,000 US, the prohibition of the trade at American stock exchanges, the freezing of all financial assets in the United States, and a warrant of arrest for all the organs of the BSI.

prescribed by that state.

Therefore, the district court had to consider whether the vital interests of the United States in requiring disclosure were outweighed by the hardship suffered by the Swiss banks, thus relieving the BSI of its duty to disclose to the SEC.[15] First, the national interests at stake were analyzed. The court found that enforcement of securities laws was necessary to maintain the integrity of national financial markets. The court also emphasized the debilitating effects of the use of these secret institutions on Americans and on the American economy.[16]

On the other hand, the banking secrecy privilege was based on private considerations and was not necessary for the protection of the Swiss government or other public interests.[17]

The hardship for Swiss banks was also considered. The court found that the BSI would not suffer undue hardship by disclosing the identity of the customer. The next consideration was a determination of whether or not the BSI had acted in good faith. The court found that the BSI had acted in bad faith by deliberately using the "Swiss non-disclosure law to evade in a commercial transaction for

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[15] BSI v. SEC., <u>supra</u> note 11, at 118

[16] <u>Ibid.</u> at 117

[17] <u>Ibid.</u> at 118

profit to it, the structures of U.S. securities law against insider trading".[18]

Before any further steps were taken in this case, the clients of the BSI waived their secrecy laws and allowed the bank to disclose their names.

However, in Switzerland the threatened sanctions of judge Pollak against Swiss banks acting according to Swiss law have been heavily criticized as unilateral and extraterritorial.[19]

4.1.2. SEC v. Unknown Purchasers of the Santa Fe Corp.[20]

The subject matter of this case was a take-over offer of the Kuwait Petroleum Company for the shares of Santa Fe International Corporation (Santa Fe). Before this offer was announced publicly, large buying orders for shares and options had been placed at several Swiss banks and Swiss

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[18] Ibid. at 117

[19] see e.g. W. de Capitani, (1983) 35 Wirtschaft und Recht at 182; F. Vischer, (1983) 35 Wirtschaft und Recht at 98

[20] SEC v. Unknown Purchasers of the Santa Fe Corp., Federal Securities Law Reports (CCH), Para. 98 (Southern District of New York, October 26, 1981)

subsidiaries of Swiss banks.[21] After the public announcement of the take-over, the shares and options were sold with a profit of more than $ 5 million US.[22]

In October 1981 the SEC obtained a temporary restraining order to freeze the profits made from the sale of the Santa Fe shares and options.[23]

Unlike Judge Pollak in the BSI case, Judge Connor denied the SEC's application for an order compelling the nominal defendants to identify the purchasers and for expedited discovery.[24]

Consequently, the SEC had to seek formal judicial assistance. On March 22, 1982, the U.S. Department of Justice sent a request for judicial assistance to the Swiss Federal Office of Police.

The Swiss Federal Office of Police decided to grant mutual assistance under measures of constraint, but several bank clients appealed at the Swiss Supreme Court.

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[21] SEC v. Unknown Purchasers, 1981 Fed.Sec.L.Rep. (CCH) para. 98,323 (S.D.N.Y. October 26, 1981)

[22] BGE 109 Ib at 47, 48

[23] SEC v. Unknown Purchasers, 1981 Sec.Reg.L.Rep. (CCH) para. 98,323 at 92,026 (S.D.N.Y. October 26, 1981)

[24] Ibid. at 92,026

In its decision[25], the court had to decide whether or not the requirements under the treaty had been met. Here it stated that, in Switzerland, the abuse of privileged information is generally reprobate and considered morally offensive, but according to the law it does not constitute an offence per se. Accordingly, it had to be decided if such behavior could meet the requirements of other offences as defined by federal criminal law.

In its first decision, the court pointed out that the list of the treaty does not have to be interpreted broadly to include the violation of trade secrets committed through insider transactions. It was held that according to Swiss law, only an insider who gives his insider knowledge to a third party is subject to punishment. In this case, both the tippee and the tipper would be punished if the company filed a motion. However, the insider who acted on his own behalf did nothing illegal. Since the American writ of commission did not explicitly say how the information was abused, no mutual assistance was possible.[26]

In July 1983 the Department of Justice made a second request for mutual assistance.[27] In this second decision[28], the

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[25]BGE 109 Ib 47

[26]BGE 109 Ib at 56

[27]Published in (1985) 79 Am.J.Int'l L. 722 at 723-25
(Footnote Continued)

Swiss Supreme Court decided that the requirements for the punishability according to the criminal code were met. Furthermore, it argued that although it was not in the treaty list for mutual assistance in criminal matters, the subject matter was very important for the United States.[29] Mutual assistance was, in the end, granted.

The bank clients were not satisfied and found another avenve of appeal. They argued before a consulting commission that by granting this mutual assistance, important interests of Switzerland were infringed upon. The commission and the federal justice and police department granted mutual assistance nonetheless.[30]

The bank clients found a final aveuve of appeal against this administrative decision to the executive federal council, which confirmed the earlier decisions.[31]

Now it was possible to give the requested information to the American authorities, and a year later the bank clients and the SEC made a settlement according to which they reimbursed their gain in the value of US $ 7.8 million.[32]

(Footnote Continued)

[28] English translation in 24 I.L.M. 745 (1985)

[29] 24 I.L.M. at 322

[30] Verwaltungspraxis der Bundesbehoerden (Bern) (VPB) 49 (1985) at 197; see Neue Zuercher Zeitung Nr. 43, February 21, 1985, at 17

[31] VPB 49 (1985) at 197 Nr. 35

[32] Neue Zuercher Zeitung, Nr 49, February 28, 1986, at 20

4.2 The Memorandum of Understanding

The two cases of Santa Fe and Banca della Svizzera Italiana show that the Treaty on Mutual Assistance in Criminal Matters provided only limited help to the SEC.

A decision of the Swiss Federal Supreme Court ruled that assistance would be confined to tipping cases which could result in a violation of business secrets under Swiss law.[33]
If the SEC filed a civil complaint, as was done in the BSI case, and sought an order compelling the bank to identify its client without calling on judicial assistance according to the treaty, jurisdiction over the bank would first be required.[34]
On the other hand, American courts did not automatically compel Swiss banks to divulge the secrecy, as seen in the Santa Fe case.
According to a Supreme Court decision, such compulsion is appropriate only when a bank acts in bad faith.[35]

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[33] X. v. Federal Office for Police Matters, BGE 109 Ib at 49

[34] In this case it existed because the defendant had a subsidiary in New York, 92 F.R.D. at 111,112 (1981)

[35] Societe Internationale pour Participations Industrielles et Commerciales, S.A. v. Rogers, 357 U.S. 197 (1958)

Moreover, an order compelling discovery could be granted only when the vital national interests of the United States prevailed over those of Switzerland.[36]

The need for an additional agreement between the two nations was recognized by both parties, and a memorandum[37] was signed in August 1982 by representatives of the United States and Switzerland after relatively short negotiations in Berne and Washington in 1982.

The legal character of the Memorandum is not easy to determine. It is a declaration of intent, certainly not a formal, binding treaty.[38]

It was always considered to be a transitional agreement until the Swiss put into place their own legislation: a "promise" the Swiss made to the Americans.

However, the Memorandum of Understanding (MOU) can be seen as an effort to discourage the manipulation of Swiss banking laws without destroying the confidential relationship between a Swiss bank and its clients.

[36] see BSI supra note 11

[37] 22 I.L.M. at 1 (1983)

[38] P. Nobel, "Das Insidergeschaeft"; 79 Schweizerische Juristenzeitung, 1983, Heft 9, at 138

The MOU was signed to prevent insider trading in three principal areas.[39]

First, the MOU confirmed that the 1977 treaty would be used to the greatest extent possible to track down inside traders.

Secondly, some aspects of the treaty, such as the rights of the SEC to pursue securities regulations in Switzerland, were clarified.

Finally, it was set out that the Swiss legislature would consider making insider trading a criminal offense so that the treaty could be applicable to violations of US insider trading laws.

While the expectations for this MOU were high, the text of the Memorandum is disappointing.[40] Most significantly, it does not contain any procedural rules for handling future cases of insider trading by American and Swiss authorities.[41]

The Memorandum itself is divided into five parts:

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[39] Note. supra note 5, at 568

[40] P. C. Honegger, supra note 2, at 23

[41] Ibid.

(1) Introduction

In the introduction, it is stated that both nations recognize that there is a conflict of interest between the SECs investigative role and the Swiss banking secrecy law. It is further recognized that the recent cases involving insider trading are detrimental to the interests of both nations.[42]

(2) Exchange of Opinions Regarding the Treaty Between the United States and Switzerland on Mutual Assistance in Criminal Matters

Here, the importance of the treaty is affirmed and it is noted that it should be used to the greatest extent feasible.[43]

Assistance can be furnished as long as the investigation (i) relates to criminal conduct and (ii) the prosecuted offence is a crime under the laws of each nation.[44]

It is also acknowledged that insider trading could be a violation of Articles 148 (fraud), 159 (unfaithful management) or 162 (violation of business secrets) of the

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[42] Memorandum of Understanding, 22 I.L.M. (1983).at I. 1

[43] Ibid. at II. 1 & 2

[44] Ibid. II 3a & b

Swiss Criminal Code. Compulsory measures, such as lifting the banking secrecy, are also possible.[45]

(3) Discussion of the Proposed Private Agreement among Members of the Swiss Bankers Association

In this part, it is held that compulsory measures will not be available under the treaty if the available information fails to indicate the existence of an offence under the Swiss Penal Code.[46] This gap was to be filled by a proposed agreement of the Swiss Bankers Association which would permit participating banks to disclose the identity of a client and certain other relevant information, under specified circumstances.[47]

(4) Further Consultations

The SEC and the Federal Office for Police Matters understand that for the future they will have further contacts and consultations about certain matters.[48]

(5) Other Understandings

In this part, the two nations set out that the Memorandum does not modify or supersede any laws or regulations in either country.[49]

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[45] Ibid. at II 3b

[46] Ibid. III. 1

[47] Ibid.

[48] Ibid. IV. 2

[49] Ibid. V.1

It is also stated in the Memorandum that the Swiss Bankers' Association will do its utmost to obtain as many signatures of banks as possible for Agreement XVI.[50]

While the MOU can be regarded as a first step toward mutual cooperation between the United States and Switzerland in the enforcement of securities violations, it has its obvious weaknesses.

4.3 Agreement XVI

As noted in the foregoing chapter, the "key element" of the MOU was the Agreement between the Swiss Bankers' Association and its members. There are several noteworthy points in relation to the Agreement.

In a civil law country like Switzerland, one finds a principal distinction between public and private law. Public law regulates all questions concerning the sovereignty and public interest, and the parties are the state and an individual. On the other hand, private law regulates matters between individuals.

Between these two forms, however, a "mixed form" has been accepted in theory and practice. It is not always easy to define the legal status of a norm, and different theories have been elaborated.

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[50] *Ibid.* V. 3

One of these theories, the "subordination theory", is often used to define the legal norm of Agreement XVI.[51]

According to this, the equal or superior status of a party determines the nature of a contract. If there is a legal superiority of one of the parties, public law governs the contract. If both parties have the same status, it is a contract of private law.

The parties of Agreement XVI are, in the first place, the Swiss Bankers' Association and the member banks. The Swiss Bankers' Association is a private organization of the Swiss banks, which safeguards the interests of the Swiss banks against third parties and can regulate questions within its powers.

Besides these two "direct" parties, we also find other parties to the Agreement, who have no direct influence on or participation in the Agreement.

Clients of the bank, the Federal Department of Police and the SEC may be influenced by the Agreement, but they are never party to it.[52]

After the adoption of the Memorandum, the Swiss Bankers' Association asked its members and all other banks trading in

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[51] J.L. Goebl, "Rechtsprobleme der Konvention XVI der Schweizerischen Bankiervereinigung", Dissertation Zuerich, 1986, at 11

[52] Ibid. at 17

U.S. securities markets to become parties to the Agreement, which became effective on January 1, 1983.[53]

In the Agreement, the formal procedure for disclosing information in connection with an investigation concerning possible violations of U.S. insider trading laws is set down. According to the Agreement, the U.S. Department of Justice must send a written application to the Swiss Federal Office for Police Matters. The Department of Justice can act on its own behalf or on behalf of the SEC.[54] Further inquiry is conducted by a specially created Commission.[55]

The Agreement has a preamble and twelve articles. It can be subdivided into 5 parts:[56]

(1) A definition of insider trading and insider (Art. 1 and 5, subsec. 2)

(2) The Commission and the precondition of its inquiries (Art. 2 and 3)

(3) The procurement and transmission of information by the Commission (Art. 4,5,7, and 8)

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[53] It has to be noted that the Agreement does not cover transactions which took place before the signing because it is not only procedural law.

[54] Article 1 of the Agreement

[55] Art. 2

[56] P.C. Honegger, supra note 2, at 25

(4) The blocking of the client's account (Art. 9)

(5) Various other provisions (Art. 6, 10, 11 and 12)

As noted before, the Swiss Bankers' Association is a private association, and the banks do not have to be members of it. Therefore, it might have been possible for a smaller bank not to sign the Agreement and not fall under these provisions.

The Agreement was always meant to be a temporary solution. It was in force for a fixed period of three years, then renewable on a year to year basis. It was also stated that it would be abrogated in the event that the Swiss legislature enacted legislation on the misuse of inside information.[57]

4.4 Conclusion

This chapter outlined the difficulties that inevitably arose between two nations with different approaches to the same problem in an international market.

The Treaty on mutual assistance in criminal matters proved to be of limited use, because of the requirement of the dual punishability of an offense and the different interests that were behind this Treaty.

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[57] Art. 11

SEC v. Banca della Svizzera Italiana et al. and SEC v. Unknown Purchasers of the Santa Fe, demonstrated how complicated and complex these cases could be and how little assistance the Treaty could provide.

Finally, the Memorandum of Understanding, together with the Agreement of the Swiss Bankers' Association, were also of only limited utility and were always understood to be a temporary solution.

It was very obvious for both parties that the only solution for Switzerland was to adopt insider trading regulation .

CHAPTER FIVE : INSIDER TRADING REGULATION IN SWITZERLAND

5.1 Introduction

5.1.1 Development of the law

Unlike the situation in the United States and Canada, there was no regulation in the field of insider trading in Switzerland until very recently. Only in the 1970s did the discussion start as to whether it would be appropriate to regulate. Until then, it was not considered to be immoral to make profits through insider trading.

However, in the last one or two decades, this public opinion has changed.

In Switzerland the first important article concerning insider trading was written by Prof. P. Forstmoser in 1973.[1] In this article it was possible for him to enumerate several cases which occurred during the late Sixties and early Seventies in which insiders made a fortune with their knowledge.[2]

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[1] Peter Forstmoser, Prof. Dr., "Effektenhandel durch Insider", Schweizerische Aktiengesellschaft (SAG) 1973

[2] Ibid. at p 7; e.g. during a few weeks in 1967 the shares of the dyestuffs industry Durand and Huguenin went from Sfr 2900 up to 9200, just before the take-over by Sandoz took place. In 1973, just before Alusuisse took over Lonza, the price of shares of the latter went up by 34% and the price of "Partizipationsscheine" went up by 55% during the same period.

From the early 1970s, the financial press also considered insider trading "immoral and reprehensible, taking unfair advantage of the unsuspecting public at the share market".[3] One author, H. Herschsohn, had similar ideas to H.G. Manne. According to Herschsohn, insiders are the active forces in the companies and should therefore have the opportunity to make personal profit.[4]
However, his position was not widely accepted, and opinion developed in the opposite direction.[5]

In 1976, the government of the Zuerich canton requested the Federal Department of Justice and Police (Eidgenoessisches Justiz- und Polizeidepartement, EJPD) to propose a law against insider trading.[6] As a consequence, the Committee

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[3]Forstmoser, supra note 1, in note 1

[4]H. Herschsohn: "Zum Handel mit Aktien seitens der Mitglieder der Verwaltung", (1972) 44 SAG at 173

[5]For authors promoting insider trading regulation, see e.g. Brunner Max, "Wie kommt man den sogenannten Insider Transaktionen bei?", SAG 1976 at 179; Klainguti Ernst, "Die Regelung des Aktienhandels durch Insider im amerikanischen Bundesrecht", Dissertation Zuerich, 1971; Kramis Otto, "Insiderhandel in Effekten (Eine schweizerische Loesung)", Dissertation Zuerich, 1978; Koch Markus Benediktus, "Insiderwissen und Insiderinformationen in strafrechtlicher Sicht", Dissertation Bern, 1979; Fellmann Max, "Rechtliche Erfassung von Insidertransaktionen in der Schweiz: Eine Untersuchung der juristischen und oekonomischen Aspekte", Dissertation Basel, 1981

[6]Zuercher Amtsblatt 1976, at 1481

for Company Law Reform and the Committee for Criminal Law Reform were asked to make their proposals.[7]

During the same period, differences grew between Switzerland and the United States. The two cases SEC v. Banca della Svizzera Italiana[8] and Santa Fe[9] were of great interest not only to the legal community, but to the general public as well, and the lack of legislation in this field became an obvious problem.

The question was no longer whether there should be legislation against insider trading, the question was how and where to regulate it.

Private civil lawyers like Prof. Forstmoser[10] were of the opinion that it should be regulated in the criminal code, where it would have a deterrent effect and would be based on "guilty knowledge" (Unrechtsbewusstsein).

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[7] At the present time, winter 1989/90, none of these law reforms have passed through the Parliament yet and will (probably) not for the next few years

[8] SEC v. Banca della Svizzera Italiana, 92 F.R.D.111,112 (S.D.N.Y.1981)

[9] BGE 109 Ib at 47

[10] P. Forstmoser, supra note 1;
Also Dr. Max Brunner, "Wie kommt man den sogenannten Insider-Transaktionen bei?"; SAG, 1976, at 179

Criminal lawyers like Prof. Schubarth were reluctant to accept that solution.[11] While he did not negate the effects described by Prof. Forstmoser, and knowing that in the existing civil law provisions nothing could be done against insider trading,[12] he was of the opinion that an article in the criminal code alone could never be a satisfactory solution. Without regulation in public law, such as a duty to disclose, criminal regulation could not be effective.

In the fall of 1983, the Federal Department of Justice and Police (EJPD) presented a preliminary draft for the new law concerning insider trading.[13] In this draft, a new article for the Swiss criminal code was proposed. Furthermore, an amendment was suggested to the company law according to which financial benefits gained through insider trading must be surrendered to the company. It was also proposed that the board of directors have the duty to investigate and to collect.[14]

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[11] M. Schubarth, "Vom Vermoegensstrafrecht zum Wirtschaftsstrafrecht", Schweizerische Juristenzeitung, 1979, Heft 12, at 189

[12] Ibid., the stock exchange is anonymous and the trading with insider knowledge is probably not causal for a damage.

[13] Vorentworf und Erlaeuterung dazu fuer eine Gesetzgebung ueber missbraeuchliche Verwendung von Insiderwissen (Insidergeschaefte), EJPD Bern, October 1983

[14] Preliminary draft for company law (VE OR) articles 726a, 902a.

These proposals concerning changes in the company law were not accepted by the various commissions, and the Executive National Council decided to withdraw the proposal. It was decided that insider trading should be regulated in criminal law.

In May 1985 the Executive National Council (Bundesrat) presented its opinion concerning the draft article for the Criminal Code. Then, in 1986 and 1987, the draft article was debated in Parliament, and the different positions of the two chambers had to be reconciled. Finally, on December 18, 1987, the new law was accepted by both chambers. Article 161 of the criminal code was enacted on the 1st of July 1988.[15]

5.1.2 Remarks about the enactment

As a rule, it can be said that the Swiss legislature is reluctant to enact new laws. According to Swiss legislative tradition, laws as important as the criminal code are not to change "ohne Not", without a need.[16]

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[15] All federal laws are subject to a facultative referendum.

[16] Prof. Dr. Martin Schubarth, "Insidermissbrauch - zur Funktion und zum Hintergrund eines neuen Straftatbestandes", Gedaechtnisschrift fuer Peter Noll, Zuerich, 1984, at 304

There is a particular aversion toward the revision of a single article. The Swiss would rather have a loophole in a law for years than legislate in a narrow field.[17]

The Swiss criminal code, for example, has had hardly any changes in 40 years.[18]
Eleven changes have been made in the last four decades, including two partial revisions,[19] two in a particular field of jurisdiction[20]. Other changes were simple adjustments of the criminal law in light of other legislation.[21]

Obviously, the article concerning insider trading is an exception. Not only was it been enacted in a relatively short time, but it was also a single article. A partial

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[17] see e.g. improper use of computers: it has been known for years that there are no Swiss laws against the improper use and that it should be punishable. But instead of enacting some single articles we live with the loophole in the law until the criminal law for offences involving properties will be revised in a partial revision.

[18] The Swiss criminal code was put into force in 1937.

[19] 1951 and 1971/4 (years when the law was put into force)

[20] Art. 179bis - 179septies: reinforcement of the protection of the sphere of secrecy, 1969; art. 183-185 introduction of the elements of an offense of kidnapping, 1982.

[21] e.g. the repeal of Art. 161 old form because a new federal law concerning unfair competition was put into force in 1945.

revision for offences involving property is due in the early 1990s.[22]

With this information, it is easy to see that the regulation of insider trading was given "special treatment" and that probably beyond the legislative considerations, political considerations were also important.

This assumption is reinforced by the fact that this article stands alone, without any accompanying measures in private or public law. It has been shown by different authors that a criminal provision without these measures cannot be very effective.[23]

In contrast to many other nations,[24] there is no national authority in Switzerland to supervise the stock exchange. It is up to the cantons to legislate how and who is to investigate and supervise the stock exchanges.

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[22] Another new article in the criminal code concerning laundered money "Geldwaescherei" is now also having a special urgent treatment as a consequence of the "Lebanon connection"; Neue Zuercher Zeitung, May 11, 1989, at 22/23

[23] Prof. Dr. Martin Schubarth, "Vom Vermoegensstrafrecht zum Wirtschaftsstrafrecht", (1979) Schweizerische Juristenzeitung at 189; Markus Fellmann, "Rechtliche Erfassung von Insidertransaktionen in der Schweiz", (1981) Zuerich, at 322

[24] e.g. USA, Italy, Federal Republic of Germany, France and Denmark

With the decision not to establish a national supervisor at the same time as enacting the law against insider trading, the Executive National Council expressed indirectly the opinion that in Switzerland trades with insider knowledge are neither common nor important.[25]

Consequently, the question is why was this law enacted so rapidly and why do Swiss lawyers have the impression that the goal of this law is not the efficient scope of coverage of insider trading?

According to M. Schubarth,[26] the law has a single goal: to meet the preconditions for mutual assistance (Rechtshilfetatbestand). For Swiss criminal law, this is something completely new.
For Professor Schubarth, it is obvious that an effective penal provision has never been intended and that the only purpose of the new law is to satisfy the needs of the SEC and the Swiss banks.[27] According to him, it is a typical "Rechtsnorm mit Symbolcharakter", a rule of law which is

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[25] To my knowledge, there has been no research about the dimension and economic influence of insider trading in Switzerland.

[26] supra note 16, at 307

[27] Ibid., at 309

more symbolic than effective. These rules of law were never intended to address the real situation.[28]

This view had also been expressed more or less directly during the discussions in Parliament. It was said that without the pressure of the USA there would have been no law.[29] Furthermore doubts were expressed as to whether there was the requisite "guilty knowledge" (Unrechtsbewusstsein) among "the population" concerning insider trading. In other words, the majority of "the population" must be convinced that insider trading is something bad and therefore punishable. According to Swiss legal tradition, this "guilty knowledge" is a precondition for a new law.[30]

The "lex Americana", as it was referred to, was certainly not a matter of first priority for "the population" but was rather created because of American pressure and pressure from the Swiss banks.

5.2 The Situation before July 1, 1988

It can be said that for most Swiss people the enactment of a new insider regulation was not an urgent task. However,

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[28] see Peter Noll, "Symbolische Gesetzgebung", Zeitschrift fuer Schweizer Recht, 1981, at 347

[29] Nationalrat (NR), Bundesblatt (BBl) 1987, at 1371

[30] NR BBl 1987, at 1372

as far as the legal community was concerned, something that was considered to be immoral had to be proscribed.

Switzerland as a nation was asked several times for legal assistance by the United States in a matter that was morally wrong, but not illegal, and since there was no double punishability, (doppelte Strafbarkeit), no mutual assistance was possible.

Swiss banks, finally, were in between these two jurisdictions. If they did give the information requested by American officials, they violated professional discretion (banking secrecy) for which Swiss banks are famous and which is an important part of the banking system. On the other hand, if they refused to give the requested information, they faced the risk of having to pay, inter alia, daily penalties in the amount of US$ 50,000.[31]

5.2.1 The situation in civil law

In civil law the most important legal impediment against insider trading regulation is that one can sue only a known individual. No "unknown" exists in a civil suit, and the other party in the stock market is normally a bank, which is acting for a third party which, as already noted, is not allowed to identify its client.

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[31] see Jane E. Siegel, "United States Insider Trading Prohibition in Conflict with Swiss Bank Secrecy ", (1983) 4 J. Comp. Corp. L. & Sec. Reg. 353 at 362

In the law of obligations we do not find articles which deal directly with insider trading. The closest possibility lies in Article 41 and the following articles, where an obligation originates in an illegal action. According to Article 41, a person is liable for damages if he has imposed unlawful injury on another person. But one of the difficulties with insider trading is that it is often difficult to ascertain if one has lost a measurable amount of money. Trades with shares are made at a certain price, and in an anonymous market like the stock market, insider trading does not usually influence the decision to buy. Because it is almost impossible to say what amount of money one has lost, this article is ineffective in addressing insider trading.[32]

In Swiss company law (which is a part of the Law of Obligations), we find a clear distinction between the shareholders and the juridical person. According to common opinion, management must act prudently on behalf of the company, not on behalf of the shareholders.[33] Furthermore, the shareholders owe no loyalty to the company or to other shareholders. It can be argued that since management owes

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[32] Lutz Krauskopf, "Missbraeuchliche Insidergeschaefte", Der Schweizer Treuhaender, 1986, Heft 10, at 432

[33] Peter Nobel, Dr. PD; "Das Insider-Geschaeft", Schweizerische Juristen-Zeitung, (SJZ) 79 Jahrgang, Heft 8, 15 April 1983, at 125

its loyalty to the company, by using its insider knowledge it violates its duty because the company could be hurt. On the other hand, it is usually not the company that is hurt (except reputational damage) but other buyers and sellers on the stock market.[34]

The most effective provision of the Swiss law is probably Article 754 Sec. 1 of the Code of obligations, which provides:

> All persons appointed directors, managers or auditors are responsible to the company as well as to the individual stockholders and creditors of the company, for damage caused, intentionally or negligently, by a default of their duties.

Corporate inside information is confidential, and a manager using his insider knowledge to buy or sell shares may breach this duty. Consequently, a shareholder could bring an action against this manager, if his trading caused damage to the company. However, it may not be easy to prove that the company suffered damage. Furthermore, this article can be applied only against directors and officers in their official duties. Directors or officers of companies acting on their own behalf as well as on behalf of a third party cannot be sued under this article.

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[34] Ibid.

5.2.2 The situation in criminal law

In contrast to civil law, criminal prosecution is possible against an "unknown". A further advantage is that according to Swiss law, the bank has a duty to testify during the investigation and cannot rely on banking secrecy.[35]

The problem here is how to relate insider trading to substantive law. According to Swiss criminal law, only the actions explicitly described in the law are punishable.[36]

A number of articles defining particular crimes have been considered in the case of insider trading, the two most relevant will be briefly discussed below.

Article 148: Fraud

Fraud is committed under Swiss law when someone, in order to make a financial gain, malevolently misleads another person by fraudulent representation or by suppression of facts or uses the error so that the other person or a third person suffers financial damage.[37]

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[35] Ibid., at 123

[36] Article 1 of the Swiss Criminal Code from 1937

[37] Article 148 of the Swiss Criminal Code
"Fraud:
Any person who, with intent to make an unlawful profit for himself or another, shall fraudulently mislead another person by falsely representing or concealing facts or shall fraudulently use the error of
(Footnote Continued)

This article is not very useful for the purpose of controlling insider trading. Insiders usually do not actively mislead other share-buyers; they generally use their information to their own advantage. Non-insiders are in no way influenced by insiders in terms of what they choose to buy or sell. Furthermore it is very difficult to say that insiders act "malevolently". The fact that someone does not give important information to others cannot be regarded as malevolent.[38]

Another point deals with the suppression of facts. The question that arises here is whether everyone has a duty to disclose. But there is no such duty by law, by contract, or according to the principle of loyalty and good faith.[39] According to Stratenwerth,[40] only a guarantor (Garant) has a duty to disclose. At most, managers of a company could be guarantors, and this would give a very narrow definition of an insider.

(Footnote Continued)
another and thus cause the deceived person to act detrimentally against his own or another's property, shall be confined in the penitentiary for not more than five years or in the prison.
The offender shall be punishable with a penitentiary term of not over ten years and fined if he makes a business of committing frauds.
Defrauding a relative or a member of (one's) own family shall be prosecuted on petition only."

[38] L. Krauskopf, supra note 31, at 433

[39] BGE from 26.1.1983 Santa Fe, BGE 109 Ib 56 f.E.5c

[40] Guenther Stratenwerth, Schweizerisches Strafrecht, Bes. Teil, Bern, 1978, at 215

Article 162: The prohibition of treachery of business secrets

According to this article, one can be punished for divulging a business secret which should be kept confidential in accordance with a legal or contractual obligation. Those who use the confidential information are also punishable.[41]

Information which can influence the share quotation and is not yet made public can probably be considered to be a business secret.

Consequently, anyone who gives this information to a third party who then uses the insider knowledge can be punished as can the third party. One who uses his information but does not give it to a third party cannot be punished, because he did not betray any secret.

In any case, the company has the power to sue.

Other articles[42] had also been examined, but no satisfaction basis for punishment under the Swiss law was found.

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[41] Article 162 of the Swiss Criminal Code reads as follows: "Violation of the Business Secrets:
Whoever, despite a legal or contractual duty of discretion, gives a business secret away, whoever utilizes the betrayal, shall, on petition, be confined to jail of fined."

[42] e.g. Article 159 criminal law, "disloyal conduct of business", or rticle 157 criminal law, "usury"

5.2.3 The banking secret

In order to understand the concept of the Swiss banking secrecy laws, it is important to be aware of the individuals privacy protection under Swiss law.

In the civil code there are two articles[43] regarding the protection of every person, including legal entities.[44]

Against this background, which provides very strong protection for the individual, Swiss banking law creates a special confidential relationship based on the protection of a person's privacy.[45]

Therefore, every person is entitled to a "sphere of secrecy" (Geheim- or Intimsphaere).

It must be noted that the right to the private sphere is very important in Switzerland; therefore courts are reluctant to allow this to be infringed.[46]

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[43] Art. 27 and 28 of the civil code.

[44] While the "private" or "natural" person has a protection of the intellectual existence, health, family life and financial affairs, the legal or economic entities' sphere includes business secrets, products, consumers and customer lists, technical codes and formulas not patentable.

[45] Note, "The effect of the U.S.-Swiss Agreement on Swiss Banking Secrecy and Insider Trading", (1983) 15 Law & Pol. Int'l Bus. 565 at 569

[46] Ibid.

In this context Article 28[47] is important because it protects personal privacy.[48]

He who infringes the rights under article 28 of the Civil Code will be liable under articles 41 and 49 of the Code of Obligations.

The banker`s privilege is based on three different legal concepts under Swiss law: (1) personality rights; (2) contractual duties; and (3) banking law that criminalizes secrecy violations.[49]

The banking secret is recognized as an element of a citizen's personal rights, and the banker is therefore not allowed to disclose any information.

Until 1934, there was no banking law, and banking secrecy was regulated under the above mentioned articles. In other cases, criminal law was applied. However, in 1934 a new

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[47] Article 28 states: "Where anyone is being injured in his person or reputation by others unlawful act, he can apply to the judge for an injunction to restrain the continuation of the act. An action for damages or for the payment of a sum of money by way of moral compensation can be brought only in special cases provided by the law."

[48] Article 27 of the Civil Code protects the personality from excessive commitments or, in other words, from the person himself. Article 27 paragraph one says that no one can waive this legal capacity, while paragraph two states that no one can limit his liberty excessively.

[49] P C. Honegger, "Demystification of the Swiss Banking Secrecy and Illumination of the United States-Swiss Memorandum of Understanding", (1983) 9 N.C.J. Int`l L. & Com. Reg. 1 at 2

federal law relating to banks and savings banks was enacted.[50]

The primary purpose of the public banking law was to safeguard the confidential relationship between the banker and his clients.[51]

Article 47 of the Banking and Savings Banks Law reads as follows:

> 1. Whosoever discloses a secrect that has been entrusted to him or of which he has received knowledge in his capacity as official, employee, agent, liquidator or commissioner of a bank, as observer of the banking commission, as official or employee of a recognized auditing firm, or whosoever attempts to induce somebody else to commit such a violation of professional secrecy, shall be punished with imprisonment of up to 6 months or with a fine of up to 50,000 francs.
>
> 2. If the act has been committed by negligence, the penalty shall be a fine of up to 30,000 francs.
>
> 3. The violation of professional secrecy remains punishable beyond the termination of the official or professional relationship, or the exercise of the profession.
>
> 4. Federal and cantonal provisions concerning the duty to testify and the duty to present information to an official are exepted.

This Swiss banking secrecy legislation does not centre an absolute right because public law can pre-empt irreconcilable private law, and this legislation is founded primarily in private law.[52] Consequently, where public law requires the disclosure of particular information, banking

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[50] Revision took place in 1971

[51] H. Meier, "Banking Secrecy in Swiss and International Taxation", (1973) 7 Int. Law 16 at 18

[52] Ibid., at 17

secrecy cannot be invoked. There may be a public duty of disclosure in very different situations.[53]

According to the law, it is the client and not the bank that controls the banking secret. Consequently, only the client can give the right to the bank to disclose any information, and as long as the client refrains from waiving his secrecy rights, the bank must preserve them.[54]
From this we can understand the difficulties the SEC faced because Swiss banks protected their clients against non-disclosure by asserting the secrecy defense. There was simply no public Swiss law that superseded the private law duty of secrecy,[55] except the very limited article 162[56].

At this point it should be noted that Swiss banking secrecy has nothing to do with numbered or coded accounts receiving special treatment under Swiss law. Clients with coded accounts have to fulfill the same requirements as other clients in order to open an account. Purely anonymous accounts do not exist in Switzerland. The only purpose of coded accounts is to reduce the number of persons knowing

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[53]Note, supra note 44, at 575

[54]Bernhard Meyer, "Swiss Banking Secrecy and Its Legal Implications in the United States", (1978) 14 New England L. Rev. 18 at 29

[55]Note, supra note 44, at 576

[56]see supra, footnote 40

the holder of an account. In general, only the management or the oversight department knows the identity of a client, and numbered accounts are an internal device to help banks avoid secrecy violations by their employees.[57]

5.3 The New Law

On the first of July, 1988, a new law concerning insider trading came into force: Article 161 of the Swiss Criminal Code[58]. The SEC now has an article upon which mutual assistance can be founded.

Article 161 of the Swiss Criminal Code reads as follows:[59]

> **Taking advantage of confidential information**
> 1. Whoever, as a member of the board of administration, the management, the auditing body, or as an agent of a stock company, or of a company controlling it or depending on it,
>
> as a member of an authority or as an official
>
> or as their assistant
>
> is in possession of confidential information which, if made public, would in a foreseeable way considerably influence the price of shares, or other securities, book entry transactions, or options on such securities of the stock company traded in pre-market dealing, or on the stock exchange in Switzerland, and

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[57]P.C. Honegger, supra note 48, at 7

[58]The original Article 161 of the Swiss Criminal Code concerning unfair competition was repealed in 1943, when unfair competition was codified. Since then, Article 161 has been void (= blank) and because with Article 160 a chapter regulating crimes and criminal offenses against intangible objects of legal protection started, this was considered the best and most logical place in the Criminal Code.

[59]Unofficial translation by the Swiss Bankers' Association (Schweizerische Bankiervereinigung)

by taking advantage of this information produces a gain for himself or a third party

or who passes such information to a third party with the intent to produce a gain for himself or a third party

will be punished with imprisonment or a fine.

2. Whoever receives such information indirectly or directly from a person listed under para 1 and uses it to produce a gain for himself or another

will be punished with imprisonment up to one year or with a fine.

3. As information in the sense of subsections (1) and (2) are to be considered an impending issue of new shares or a merger or another fact of comparable importance.

4. In cases where two stock corporations plan to merge, the conditions listed under paras 1 and 2 apply to both corporations.

5. Paras 1-4 apply by analogy if the taking of advantage of confidential information refers to certificates of participation, other securities, book entry transaction, or corresponding options of a cooperative society or a foreign company.

5.3.1 Offence

As a precondition, the delinquent must have knowledge of a **confidential fact** which it is foreseeable will substantially influence the stock market rate when it becomes public. The delinquent has knowledge of this information only because of his special relationship in or with this company or because a third party in this relationship has disclosed the information.

The adjective "**foreseeable**" was inserted after the first draft to ensure that the delinquent knew about his insider information and knew the causal connection between his information and fluctuations of exchange.[60]

During the hearings in Parliament, the "knowledge of confidential facts" proved to be the most crucial issue.[61] While the Executive National Council (Bundesrat = the Government of Switzerland) had proposed a comprehensive clause, the majority of the members of Parliament wanted another solution.

Some members wanted only an enumerative solution;[62] others were afraid that this comprehensive clause could be interpreted too loosely.

In subsection 3 it is explained that information in the sense of subsections (1) and (2) includes the impending issue of new shares or a merger or another fact of comparable importance. It is therefore clear that the facts in subsection 3 of Article 161 are only exemplatory and not enumerative.

The phrase "another fact of comparable significance" is meant to exclude petty lawsuits and, on the other hand, to be open

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[60] Botschaft ueber die Aenderung des Schweizerischen Strafgesetzbuches (Insidergeschaefte) vom 1. Mai 1985 (hereafter BBl) II at 81

[61] Lutz Krauskopf, "Die neue Insiderstrafnorm", Der Schweizer Treuhaender, Heft 6, 1988, at 229

[62] Member of the Senate (Staenderat) Carlo Schmidt, Amtliches Bulletin des Staenderates (hereafter Amtl.Bull. SR) 1987 at 632

for other important cases which are comparable to the named cases.[63]

With his insider knowledge, the delinquent tries to make a capital gain because he buys or sells shares of a certain company. His capital gain may be a profit or an avoided loss.
If the market price of the shares does not change, the offence is not completed, but there is a punishable attempt. The insider is also punishable when he/she gives the information to a third party.

Contrary to Agreement XVI, there is no minimum level for the capital gain. In the Swiss Criminal Code we find no minimum level because generally every capital gain can fulfill the requirements for the offence.[64] A limit for the value would have been a novelty and would not fit in the system of the Swiss Criminal Code.[65]

A limit can be seen in the stipulation that the stock market rate must be influenced **substantially** by the facts the

[63] L. Krauskopf, supra note 59, at 230

[64] It has to be noted, however, that the amount of the capital gain will be taken into consideration for the criminal guilt and therefore determines the degree of penalty, Article 63 of the Swiss Criminal Code.

[65] Bundesblatt Band II, 1985, at 82

insider knows about. Consequently, there will be an investigation only if there are unusual fluctuations.

5.3.2 Possible delinquents

The Swiss Criminal Code contemplates two forms of offence - the "common offence" (gemeines Delikt) and the "special offence" (Sonderdelikt). While common offences can be committed by everyone, special offences can be committed only by persons with particular characteristics (Eigenschaften). As a consequence, insider trading has to be considered as a "Sonderdelikt" because not everyone has the particular information of an insider.[66]

(a) Insider

In contrast to the offence itself, we find an exact enumeration of possible insiders and their assistants in subsection 1 of the legislation.

Even if the insider acts through a dummy, he will still be punished as a principal offender and the dummy may be punished as an accessory.

Insider trading is also punishable when the trader is no longer in the special position but acquired his knowledge during that time.

[66] Bundesblatt Band II, 1985, at 82

(b) Tippee (third party)

The tippees do not have the same position of trust as tippers and therefore they cannot violate a duty owed to the company. However, if they are aware of the illegal disclosure by the tippers, they are also punishable under the new law, but with a milder punitive sanction.

The idea behind this is to protect not only the fiduciary duties of the insiders of the companies but also the credibility of the stock exchange and the equity of chances for the public.[67]

Third parties who accidentally gain insider information (e.g. by hearing a conversation on a train) are not punishable.

5.3.3 Definition of securities

In defining securities, the law cites first of all shares, as well as "other securities" which are protected by this law , e.g. participating receipt, obligations, bonus shares, without being exhaustive. The options for shares, participating receipts obligations and bonus shares also fall under this law.

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[67] Bundesblatt Blatt II, 1985, at 84

It was the intention of the lawmakers not to enumerate all possible securities so that future types of investments could also fall under this law.[68]

As a further requirement, the securities must be quoted on a Swiss stock exchange or in pre-market dealing.
The securities quoted outside the market do not fall under this law because, it was argued, it would be extremely difficult for the judge to determine whether or not the securities were quoted on a regular basis. Furthermore, the object of this article is the stock exchange, and the protection should not be extended too much beyond that.[69]
Another reason might also be that - besides the reputation of the stock market - the "small shareholder" who usually buys and sells quoted shares, is protected.
Foreign securities also fall under this law if they are quoted on a Swiss stock exchange or in pre-market dealing. This is in clear contrast to Rule 10b-5, where no such requirement exists.

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[68] e.g. if in the future it would be possible in Switzerland not to trade only the physical securities, but the rights on securities, see Bundesblatt Band II, 1985, at 84

[69] Ibid. at 85

5.3.4 <u>Offence requiring public prosecution</u>

The intention of the new article is to protect the stock market and the faith of the public in the market. The object is therefore in the public interest; consequently it requires public prosecution.[70]

If it were an offence requiring an application for prosecution, it would be hard to define who is the rightful petitioner because only the persons whose rights are infringed can demand prosecution. In cases of insider trading, it is rarely an individual who can claim an exact property loss.

5.3.5 <u>Sanctions</u>

Insider trading is a criminal offence and the sanctions are prison or penalties up to SFr. 40,000.-[71].

If the delinquent sought a profit (which is probably the main reason for insider traders), there is no limit for the penalty.[72]

The profit gain is illegal according to Article 58 subsection 1 lit. a, and the judge can confiscate it to the

[70] In Switzerland, this will be the police of the cantons with the stock exchange. It may be questionable, however, how the police with very small stock exchanges, like Berne and Basel and little experience with the stock exchange, will act in the future.

[71] Article 48, subsection 1, subpara. 1, Swiss criminal code

[72] <u>Ibid.</u> subpara. 2

benefit of the state. The judge may then award it to an injured party.[73]

5.4 Conclusion

This chapter has discussed the change of "public opinion" in the last twenty years concerning insider trading. It is obvious, however, that without the influence of the United States Article 161 would not exist today, and that insider trading would have been regulated at the earliest during the next revision of the Swiss Penal Code. The fact that there are no accompanying measures only reinforces this assumption.

It is too early, however, to draw any conclusions about this article, and at the moment (winter 89/90) there is only one case of insider trading pending.

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[73] Article 60 of the Swiss Criminal Code

CHAPTER 6 : THE PROBLEM

As was noted in a decision of the Supreme Court of the United States, it is the common opinion today that insider trading is morally wrong and "inherently unfair".[1] However, the assertion that something is morally wrong necessitates a discussion into why or how it is wrong.

Some commentators do not consider insider trading to be inherently unfair.

In the Chiarella case, we find the argument concerning fairness, but it is not explained why insider trading is inherently unfair. How is fairness to be defined? Or where do we have to draw the line? Does it mean that no one can appropriate the value of information he has created?[2]

As was already pointed out,[3] the "fairness" justification cannot be the basis for insider trading rules because in most cases, one party will have an advantage over the other in a given securities trade.[4]

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[1] Chiarella v. United States, 445 U.S. at 248

[2] F.H. Easterbrook, "Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information", (1981) The Sup. Ct. Rev., at 324. In the same article Prof. Easterbrook demonstrates that the discussion about fairness does not lead to any conclusion.

[3] see infra chapter 3.1.3

[4] This may be knowledge about a particular stock, greater sophistication, intelligence, or expertise. See J.R. Macey, "From (Footnote Continued)

Another commentator, K.E. Scott, also arrived at the conclusion that from a private standpoint, the fairness concept has surprisingly little substance.[5] The problem is that the court views only a single, isolated event and therefore not the whole game. He concludes that

> Since the individual transaction involves a gain in wealth by an insider and, to that extent, leaves others worse off in the immediate period, they make an implied jump to the conclusion that under such circumstances the game itself is unfair.[6]

The discussion in Switzerland was also based on the argument that it is morally wrong and reprehensible to trade with insider knowledge, but "fairness" was less used as an argument.

An important distinction must also be made between the legal and the economic definition of insider trading.[7] In an economic sense, insider trading is trading by parties that are better informed than their trading partners. Consequently, insider trading in an economic sense includes

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(Footnote Continued)
Fairness to Contract: The New Direction of the Rules against Insider Trading", (1984) 13 Hofstra L. Rev., 9 at 16-17

[5]K.E. Scott, "Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy", (1980) 9 J. Legal Studies. 1980, 801 at 809

[6]Ibid.

[7]D.W. Carlton, D.R. Fischel, "The Regulation of Insider Trading", (1983) 35 Stan. L. Rev. 857 at 860

all trades where the information is asymmetric. In this sense, insider trading need not be illegal.[8]

In the United States it was Prof. Henry G. Manne who, in his book Insider Trading and the Stock Market,[9] first expressed the opinion that insider trading is not only not wrong but could even be useful.

His main argument is that insider trading was permitted at common law - with the exception of trades in connection with fraud - and there is no reason to forbid insider trading today.

Another argument is that a manager will act more as an entrepreneur or a pioneer if he can trade with insider knowledge. The results of the innovative pioneer will be for the benefit of the company and therefore all shareholders.

A third argument is that insider trading can stabilize the market price of shares because the insider can trade before the news, so there are no abrupt rises and falls on the stock market.[10]

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[8] Ibid.

[9] H.G. Manne, Insider Trading and the Stock Market (New York: The Free Press, 1966

[10] On this point, an economist agrees, see Hsiu-Kwang Wu, "An Economist looks at Section 16 of the Securities Exchange Act of 1934", (1968) 68 Colum. L. Rev., 260 at 268

However, his ideas were not at all accepted by the legal community,[11] and the question is not **if** insider trading should be forbidden but rather **to what extent.**

In Switzerland there is only one author who expressed similar ideas to H.G. Manne, namely H. Herschsohn. In his article he argues, like Manne, that insiders are - with the exception of speculators - the active force of every company and that these active forces should have the possibility of personal gain.[12] His ideas were not well accepted by the legal community either, and this article remains the only one that expresses a positive view about insider trading.

Another important question is whether people are harmed by insider trading. M.P. Dooley wrote that

> The existing system cannot be justified by showing that insider trading is "wrong" in the sense of being undesirable, unethical, or even unfair. Insider trading must be shown to harm investors, directly or indirectly, in a particular way to fall within the proscriptive scope of Section 10(b).[13]

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[11] see for the list of negative commentators in: H.G. Manne, "Insider Trading and the Law Professors", 23 Vand. L. Rev., 1970, note 2

[12] H. Herschsohn, "Zum Handel mit Aktien seitens Mitglieder der Verwaltung", 44 SAG, (1972), at 173

[13] M.P. Dooley, "Enforcement of Insider Trading Restrictions", (1980) 66 Va. L. Rev. 1 at 30

He then goes on to demonstrate how difficult it is to find a direct connection between insider trading and the market losses experienced by other investors.[14]

In an anonymous stock market it is very hard to tell if someone has been harmed by insider trading.

The question is also whether it is society that is being harmed or one individual. Professor William K.S. Wang demonstrates clearly in his article how difficult it can be to determine who has been harmed.[15] He comes to the conclusion that supposed beneficial or harmful effects of insider trading on society are quite speculative. However, according to him, it may be sufficient reason to prohibit insider trading if it does harm individuals.[16]

According to common opinion in Switzerland, there is no harm in the sense of a measurable monetary loss because (with some rare exceptions) insider trading does not influence the decision to buy or sell on the impersonal market at a certain price.[17]

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[14] Ibid. at 31

[15] W.K.S. Wang, "Trading on Material Nonpublic Information on Impersonal Stock Markets: Who is Harmed, and Who Can Sue Whom under Sec. Rule 10b-5?", 54 S. Calif. L. Rev., at 1229

[16] Ibid.

[17] L. Krauskopf, "Missbraeuchliche Insidergeschaefte", Der Schweizer Treuhaender 1986, at 433

L. Krauskopf argues that the harm is immaterial (= reputational damage) because the insider has a better chance than the non-insider. The companies could suffer from another possible immaterial harm because insider trading create negative publicity.

The stock exchange as a marketplace could also suffer reputational damage when investors lose confidence in the marketplace.[18]

6.1 Summary of the Development in the United States

6.1.1 Sec. 10(b) and Rule 10b-5

In the U.S., the 1933 and 1934 Acts gave the SEC the power to develop rules and regulations concerning insider trading.

Consequently, the SEC played an important role in the prohibition of insider trading. There is some controversy, however, as to whether "Congress ever delegated to the SEC or the courts the authority to say whether insider trading is wise, fair or unseemly."[19]

Prof. H.G. Manne stated in his rebuttal to the critiques of his book, Insider Trading and the Stock Market, that "the

[18] Ibid.

[19] F.H. Easterbrook, "Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information", (1981) The Sup. Ct. Rev. 309 at 338

desirability of securities regulation is assumed almost as a matter of faith".[20] He goes on to argue that:

> For 35 years hardly a law professor in the United States wrote a piece really critical of the SEC, nor had anyone ever carefully analyzed the fundamental economic premises on which the Commission operates.[21]

Prof. Easterbrook noted that in the <u>Chiarella</u> case the court did not examine the language or legislative history of the 1934 Act in any detail.[22] The justices examined the decisions of the SEC and lower courts instead. He finds that

> The SEC took an important step in the development of Sec. 10(b) when it imposed penalties on a broker-dealer for trading on inside information.[23] It recited the central language of the SEC's decision and noticed that lower federal courts, too, had found violations of Sec. 10(b) where corporate insider used undisclosed information for their own benefit. That, apparently, was that.[24]

6.1.2 <u>Disclose-or-abstain</u>

In a further step, the disclose-or-abstain-from-trading rule was defined.[25] Thus the insider has the possibility of choosing either to disclose the non-public information or to

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[20] Henry G. Manne, "Insider Trading and the Law Professors", (1970) 23 <u>Vand. L. Rev.</u> 547 at 548

[21] <u>Ibid.</u>

[22] F.H. Easterbrook, <u>supra</u> note 2, at 317

[23] 445 U.S. at 226

[24] F.H. Easterbrook, <u>supra</u> note 2, at 318

[25] see <u>In Re Cady, Roberts Co.</u>, 40 SEC 907 (1961)

refrain from trading. However, if enforced, the rule is a complete prohibition against insider trading.[26]

In the Texas Gulf Sulphur case, the court decided that Rule 10b-5 does not require disclosure every time there is asymmetry of information among trading parties.[27]

The requirement of fairness is therefore satisfied if both parties could have acquired the relevant information.

The "equal access to information" view of fairness then became the dominant approach, "although some other conceptions were still alluded to from time to time".[28]

The question of who had a duty to disclose was clarified in Dirks v. SEC[29], where it was held that there is no affirmative disclosure obligation and that a specific pre-existing duty is required.

Like in Dirks, the Chiarella case held that the obligation to abstain from using valuable information "rests on the existence of a fiduciary relationship between the party using the information and the firms shareholders."[30]

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[26] D.W. Carlton, D.R. Fischel, supra note 7, at 885

[27] 401 F.2d 848-849, see supra chapter 3.1.5

[28] K.E. Scott, supra note 5, at 806

[29] 681 F. 2d 824 (D.C.Cir. 1982), see supra chapter 3.2.2

[30] D.R. Fischel, "Insider Trading and Investment Analysts: An Economic Analysis of Dirks v. SEC", (1984) 13 Hofstra L. Rev. 127 at 130

6.1.3 Insiders-Outsiders

There is no question that for corporate directors, officers, and employees, the fiduciary duty exists. These persons owe the duties of loyalty and care to the company and, consequently, to the shareholders.[31]

Persons who "are serving the issuer in a capacity that creates a relationship of trust and confidence with the company" are probably in the same position.[32]

A tippee has no pre-existing fiduciary relationship with the persons with whom he trades or with the company. However, it was established prior to the Chiarella case that tippees should be treated as if they were insiders for the purpose of the disclose-or-abstain rule.[33] The tippee was held liable if it could be shown that "the information was received from within the company and that it was material and non-public."[34]

In Chiarella, citing Shapiro, the court held that

> Tippees of corporate insiders have been held liable under Sec. 10(b) because they have a duty not to profit from the use of inside information that they know or should know came from a corporate insider.[35]

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[31] D.C. Langevoort, "Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement", (1982) 70 Calif. L. Rev. 1 at 20

[32] Ibid.

[33] Ibid., at 24

[34] Ibid.

[35] 445 U.S. at 230 n.12

Outsiders do not owe such a duty either to the company or to the shareholders and can consequently trade without violating Sec. 10(b) or Rule 10b-5. However, the distinction between insiders and outsiders is questionable.[36] There are outsiders with profound knowledge of a firm, such as outside suppliers or outside counsels. According to Carlton/Fischel, it is not helpful to invoke "fiduciary duties" because they are standard-form contractual terms that govern agency relationships.[37]

According to these authors, "The relevant question is whether trading on inside information is consensual, not whether the trader is an insider or outsider."[38] According to this theory, it should be left to the company to decide if the management should be allowed to trade with their inside information or not. Where so allowed, it should be possible without interference from judicial or legislative notions of fiduciary duties.[39] On the other hand, a firm which intends to make a tender offer would only make a printing contract excluding the right of advanced purchases of shares.[40]

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[36] D.W. Carlton. D.R. Fischel, _supra_ note 7, at 888

[37] _Ibid._

[38] _Ibid._ at 889

[39] _Ibid._

[40] _Ibid._

6.1.4 Material Information

A further element must be fulfilled before Rule 10b-5 can be applied: inside information must be "material", e.g. knowledge of an oil discovery, impending merger, or major change in earnings.[41] The authors note that, as studies have demonstrated, inside trading by knowledge of "bombshell" events are not the rule, and inside traders have returns just slightly above average. Trades based on non-material information do not fall under Section 10(b) and Rule 10b-5.

The definition of "material information" is not easy to specify. In Basic v. Levinson[42] the Supreme Court had the opportunity to define the point at which information becomes material. In this case, Basic stockholders sued the company by claiming that they had sold their shares at unduly low prices during a period in which the company had denied, not merely failed to disclose, a material fact, in this case the existence of merger negotiations.[43] The Court held that in each case only the reasonable investor's need for information should determine whether the information was

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[41] D.W. Carlton, D.R. Fischel, supra note 7, at 886

[42] 108 S. Ct. 978 (1988)

[43] Ibid. at 981

material and emphasized that "materiality" is an open-ended concept.[44]

6.1.5 From fairness to property interest?

As already mentioned, Sec. 10(b) and Rule 10b-5 were developed from notions of "fairness" and "equity".

According to one author, the latest Supreme Court analysis rejects the generalized notions of fairness and is rather based on the understanding of the fact that privileged corporate information is a valuable asset in the nature of a property interest.[45]

Professor Macey argues that the fiduciary relationship between the possessor of the privileged information and the defendant must be emphasized and that the real concern about insider trading is the proper use of valuable privately held information.[46]

Professor Macey starts with the point that from an economic point of view, information has a value, and inside information is a property right. This conception is fully consistent with the views of utilitarian theorists.[47] These theorists held that legal rules, particularly property

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[44] Ibid. at 987

[45] J.R. Macey, "From Fairness to Contract: The New Direction of the Rules Against Insider Trading", (1984) 13 Hofstra L. Rev. 9 at 11

[46] Ibid. at 29

[47] Ibid. at 30

rules, should be structured in such a way as to create incentives for individuals to use resources efficiently.[48] Macey argues further that Rule 10b-5 will certainly not be an incentive for firms to produce valuable information which cannot be internalized. The enforcement of property rights should facilitate a system of economic incentives that maximizes societal welfare, and should not assign property rights in information in ways that do not maximize societys welfare.[49]

The author finds this concept consistent with the decisions in Chiarella and Dirks.[50]
The source of this theory can be traced to the Chiarella decision, where the court found that the only possible source for a duty to disclose for Chiarella was his contract of employment. Chiarellas trading harmed Pandick Press by damaging the integrity of the firm. In the court's opinion, the information Chiarella used was a property interest, and this interest gave Pandick the right to prohibit Chiarella from trading.[51]

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[48] Ibid. at 30-31

[49] Ibid. at 32

[50] Ibid. note 47

[51] Ibid. at 27

In Dirks, the Supreme Court protected the property interests of those who took it upon themselves to investigate the validity of the insider information. The property rights of Dirks' investigation were allocated to Dirks because it was the profit from his labour:

> It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporations stockholders or the public generally.[52]

Professor Macey concludes in his article that the fiduciary duty is owed to the owner of the inside information, and it is this party that is harmed by insider trading.[53] The real concern is therefore the proper allocation of property rights in valuable information.[54] He suggests a proper subject of contract test as the means for assigning property rights in information. The application of this test would allow privileged corporate information to be used in the way that maximizes societal welfare.[55,56]

6.2 Development in Switzerland

The title "development in Switzerland" could be misleading. The law is only one and a half years old, and

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[52] 463 U.S. at 659

[53] J.R. Macey, supra note 43, at 47

[54] Ibid. at 63

[55] Ibid. at 64

[56] see also Carlton/Fischel, supra note 7, at 866-72

the very first case became public exactly one year after the enactment of the law.[57]

It is interesting to note, however, how insider trading regulation has been justified by the commentators. This serves shed some light on what is being protected under the new law.

P. Forstmoser, the first author to recognize the problem,[58] started from the point that insider trading is immoral and reprehensible. Forstmoser emphasizes the protection of the non-insider, the "outsider".[59] He does not go much further in defining what has to be protected and elaborates upon different ways to prohibit insider trading.

M. Brunner recognized in 1976[60] that an ethical reason was needed in order to qualify insider trading as a criminal act. According to him, it is not taking unfair advantage to trade with insider knowledge. He argues that the buyer or seller is completely free to do so at the time he wants.

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[57] Neue Zuercher Zeitung, "Zuercher Untersuchung ueber Insider-Vergehen", no. 150, 1./2. July 1989, at 33; and Tages-Anzeiger, no. 152, 4.July 1989, "Insider-Affaere weitet sich aus", at 1
The cantonal department for economic criminal offenses of the canton of Zuerich is investigating purchases of bearer shares of Credit Suisse. Immediately before the announcement of the restructuring of Credit Suisse in a holding, on March 3, 1989, an unusual number of call-options were bought in Zuerich, Frankfurt and London.

[58] P. Forstmoser, "Effektenhandel durch Insider", SAG, 1973

[59] Ibid. at 14

[60] M. Brunner, "Wie kommt man den sogenannten Insider-Transaktionen bei?", SAG, 1976, at 179

Instead, Brunner sees a tortious element in the breach of confidence the insider owes the company for which he works.[61]

For M. Schubarth, equality of opportunity is the object of legal protection.[62] He argues that a single outsider will not be harmed because he would have bought or sold with or without insider trading. On the other hand, all outsiders together are harmed in their right of equality in opportunity.[63]

In the early 1980s, however, it had not yet been defined to the satisfaction of everyone what exactly was to be protected by law, and a leading author asked the question whether the public was already of the opinion that insider trading as wrong.[64] Professor Nobel is one of the many authors who did not find it very useful to legislate with one single article.

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[61] Ibid. at 181

[62] M. Schubarth, "Vom Vermoegensstrafrecht zum Wirtschaftsstrafrecht", 75 Schweizerische Juristen-Zeitung, 1979, at 190

[63] Ibid.

[64] P. Nobel, "Das Insider-Geschaeft", 79 Schweizerische Juristenzeitung, 1983, at 140

Professor G. Stratenwerth outlined three different aspects of how insider transactions can have a negative influence:[65]

(1) Insider transactions can have a negative impact on the efficiency of the capital market. He argues that even though the knowledge of insider trading will not promote the willingness of the public to invest, this is not a real danger that would justify a law.

(2) The interests of companies can be in danger because investors lose confidence. But there are limits here, too. The interests of companies are not directly harmed. The negative publicity is more casual and indirect.

(3) The third aspect, finally, is the equality of opportunity. But this argument does not hold because the non-insider would have bought or sold in any case. Equality of opportunity is not guaranteed, and Swiss laws protect only against taking unfair advantage.

Schubarth concludes that misuse of inside information is an offence against the interests of undefined trading partners - that is, against their monetary interests.[66]

Since the enactment of the law, the debate has subsided. Articles published immediately after the enactment are quite

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[65] G. Stratenwerth, "Zum Straftatbestand des Insidermissbrauchs", Festschrift fuer F. Vischer, Zuerich, 1983, at 668

[66] Ibid. at 671

skeptical as to the possibile application and effectiveness of the law.[67]

6.3 Conclusion

Just it was difficult to compare the developments in the two nations, it is difficult to compare the actual problems raised by insider trading.

In the United States, discussions are still going on, and many problems have not yet been solved.

In Switzerland, the problem has - so far - been solved, and it will be possible only in the future to determine whether the new law was helpful (to the Banks, to the Switzerland - United States relationship, or to the Swiss community?) or not.

[67] Bilanz no. 6, 1988, at 15-16

CHAPTER 7 : CONCLUSION

The different legal systems, the different traditions, and the fact that Switzerland - in contrast to the United States - does not yet have any decided cases make the comparison of insider trading rules between the two countries extremely complex.

Switzerland, on one hand, has a rather clear and understandable law, based on which the United States can easily have access to important information through mutual assistance. One hopes that the relationship between the two nations - concerning this matter - will improve.[68]

On the other hand, Switzerland has no federal regulatory board or commission to supervise the enforcement of the new law. Only a single article in the criminal code exists which, according to most commentators, will not be sufficient for an effective fight against insider trading.

The impression that the law was enacted because of international relations or American intervention and the feeling that "something had to be done" has been reinforced during the research.

One reason for this impression is that although common opinion is against insider trading, there is no real

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[68]The new law has already been used for mutual assistance in criminal matters, Neue Zuercher Zeitung, no. 150, 1./2. July 1989, at 33

willingness to take all the necessary steps to fight against it, such as establishing a commission.

The Swiss banks had a vital interest in having a satisfactory solution because they were caught in between the legal regions. In the MOU, a first step was made to improve the Swiss-American relationship. Agreement XVI of the Bankers' Association was an additional support for the SEC's needs. Together with some leading lawyers, whose arguments were based on the "immorality" of insider trading, the banks worked to have a legislation enacted.

The internationalization of the capital market has its price and Switzerland, a country whose wealth is dependent on international businesses, can no longer act completely independently in this area.

We noted in the last chapter that in the United States, the problems raised by insider trading are far from solved.

First, the Supreme Court made it clear in Chiarella and Dirks that it did not follow the SEC's interpretation of the Securities Exchange Act.

The misappropriation theory, which was used by Chief Justice Burger in the Chiarella case, has become important.

Then, in the Carpenter case, where the Supreme Court examined this theory for the first time, the decision was divided four to four.

"Material information" also will need a definition, since the Supreme Court left that question open in Basic. Inc. v. Levinson.

In a conclusion we can say that the United States influenced Switzerland to regulate insider trading. It will take the next ten or twenty years to discover how effective this new article in the fight against insider trading in Switzerland will be. For now, it will be helpful for criminal assistance, in todays international capital market unquestionably an advantage and a first step.

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