

# Brooklyn Journal of International Law

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Volume 17

Issue 3

Symposium:

Transnational Insolvency: A Multinational View of  
Bankruptcy

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Article 11

12-1-1991

## *SEC v. Unifund SAL: A Thaw in the SEC's Use of the Asset Freeze to Prosecute Offshore Fraud*

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### Recommended Citation

Michael T. Prior, *SEC v. Unifund SAL: A Thaw in the SEC's Use of the Asset Freeze to Prosecute Offshore Fraud*, 17 Brook. J. Int'l L. 665 (1991).

Available at: <https://brooklynworks.brooklaw.edu/bjil/vol17/iss3/11>

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# **SEC v. UNIFUND SAL: A THAW IN THE SEC's USE OF THE ASSET FREEZE TO PROSECUTE OFFSHORE FRAUD**

## **I. INTRODUCTION**

On August 3, 1990, the United States Court of Appeals for the Second Circuit (Second Circuit) handed down a decision in *SEC v. Unifund SAL*,<sup>1</sup> partly vacating and modifying a preliminary injunction and freeze order issued by the Southern District Court of New York,<sup>2</sup> which may turn out to be a significant setback to the Securities and Exchange Commission's (SEC) efforts to enforce United States insider trading laws against foreign investors in the United States securities markets. In the decision, the Second Circuit ruled that a freeze ordered on the foreign defendant's United States-based brokerage accounts<sup>3</sup> was only proper for a "brief interval," and that in view of the time which had passed since the injunction was issued (over five months),<sup>4</sup> the freeze order would expire in thirty days from the date of the court's mandate<sup>5</sup> unless the SEC advised the district court within that time that it was ready for trial.<sup>6</sup>

Although the decision may prove to be helpful in some respects to the SEC in future civil enforcement actions,<sup>7</sup> the time

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1. 910 F.2d 1028 (2d Cir. 1990), *reh'g denied* 917 F.2d 988 (2d Cir. 1990).

2. *SEC v. Foundation Hai*, 736 F. Supp. 465 (S.D.N.Y. 1990); the published opinion contains a spelling error: the correct spelling of that defendant's name appears to be "Fondation Hai."

3. The allegedly illegal trades were made through these accounts.

4. The Securities and Exchange Commission (SEC) obtained a Temporary Restraining Order on January 17, 1990, which included an order freezing the defendants' accounts. *Unifund*, 910 F.2d at 1030. The preliminary injunctions against appellants Unifund SAL and Tamanaco Saudi & Gulf Investment Group were granted on March 1 and February 14, respectively. *Id.* at 1030-31.

5. The court's mandate ordinarily issues 21 days after the decision, so the SEC effectively had 51 days within which to declare its readiness for trial. Response of Unifund SAL to Securities and Exchange Commission's Petition for Rehearing at 2, *SEC v. Unifund SAL*, No. 90-6093 (2d Cir. Sept. 20, 1990) [hereinafter *Unifund's Response*].

6. *Unifund*, 910 F.2d at 1043.

7. The Court of Appeals for the Second Circuit (Second Circuit) affirmed the district court's finding of personal jurisdiction over defendant Unifund (Tamanaco did not appeal the district court's finding of jurisdiction), allowed the asset freeze to cover possible treble penalties as well as disgorgement, and accepted a "meager showing on the merits" as sufficient for the initial imposition of the asset freeze. The court also rejected the rule previously advanced by the courts of the Second Circuit that the SEC must satisfy a higher burden on the merits in seeking a preliminary injunction than private litigants. *Id.* at 1042-43. See also *infra* notes 110-11.

limit imposed by the Second Circuit on the asset freeze order may put an end to an aggressive strategy employed by the SEC in cases of suspected inside trading by foreign entities.<sup>8</sup> This new strategy, as evidenced by *Unifund* and several other "unknown purchaser" actions brought recently by the SEC,<sup>9</sup> is to seek injunctive relief<sup>10</sup> in federal court immediately following evidence of uncommonly large purchases of a company's securities — usually in the form of call options — by a small number of individuals or entities in the days or weeks preceding the public release of material information relating to that company.<sup>11</sup>

In cases involving foreign defendants in particular, the SEC also seeks the ancillary remedy of freezing any proceeds, unliquidated securities, or unexercised options which remain in the United States brokerage accounts through which the trades were made.<sup>12</sup> The SEC usually justifies its request for a freeze order

8. See *Remedies Bill Will Not Change Policy on Enforcement*, DAILY REP. FOR EXECUTIVES (BNA) No. 156, at A-5 (Aug. 13, 1990) ("[T]he commission has stepped up its 'unknown purchaser'-type cases," (quoting Gary Lynch, a former SEC Enforcement Director)) [hereinafter *Remedies Bill*].

See also Foust & Galen, *The Crackdown on Insiders Abroad*, BUS. WK., Aug. 27, 1990, at 74.

9. See, e.g., SEC v. Heider, 90 Civ. No. 4636 (CSH) (S.D.N.Y. filed July 20, 1990), SEC Litigation Release No. 12556 (July 20, 1990), 1990 SEC LEXIS 2692, an enforcement action initiated against known and unknown foreign purchasers of Contel securities only one day after GTE Corporation announced its offer to acquire Contel for \$6.2 billion and only several days after the alleged fraudulent purchases were made. See also *infra* notes 20-33 and accompanying text (Section IIA).

10. Pursuant to section 21(d) of The Securities and Exchange Act of 1934. 15 U.S.C. 78u (1988).

11. In seeking injunctive relief in such cases the SEC usually seeks an injunction which: (1) enjoins future violations of the insider trading laws; (2) enjoins the destruction or alteration of the defendants' books and records; and (3) freezes the accounts containing the proceeds of the defendants' trades. See, e.g., SEC v. Unifund SAL, 910 F.2d 1028, 1029 (2d Cir. 1990).

The SEC also frequently seeks asset freezes where the defendant is in the United States, in order to prevent the defendant from moving the funds offshore. See, e.g., SEC v. Worden, 90 Civ. No. 1790 (LBS) (S.D.N.Y. Mar. 15, 1990).

12. Two recent cases in the United Kingdom, *Derby & Co. v. Weldon*, 2 W.L.R. 412 (C.A. 1988), and *Securities & Invs. Bd. v. Pantell S.A.*, 3 W.L.R. 698 (Ch. 1989), involve the even more controversial practice of freezing the extraterritorial assets of individuals under a court's jurisdiction. In *Derby* (Donaldson, M.R.), the court, facing the possibility that the defendants might dissipate their assets before any potential judgment in favor of the plaintiff, held that the court could impose a freeze extending to overseas assets under extraordinary circumstances. 2 W.L.R. at 423.

In *Pantell*, the Vice-Chancellor provided for an asset freeze extending to a bank account in Guernsey. 3 W.L.R. at 704. The freeze was imposed with a lengthy and somewhat confusing proviso taken from the opinion of Donaldson, M.R. in *Derby* 2 W.L.R. at 429, which appeared to assure the foreign jurisdictions that the orders would not have

by pointing to attempts by the defendant to move assets out of the United States, and by appealing to the "inherent equitable power" of the court to protect a party's ability to obtain meaningful relief.<sup>13</sup> Ultimately, in such civil enforcement actions the SEC is seeking a permanent injunction against violation of the securities laws and an order of disgorgement of the profits the defendants derived from their illegal trades.<sup>14</sup>

The imposition of an asset freeze is a crucial step toward that goal. Without it, foreign defendants are highly likely to just "take the money and run,"<sup>15</sup> leaving no funds in the United States for the SEC to attach in the event of default. In addition,

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effect in those jurisdictions without local sanction, while at the same time specifically providing that the order would be enforceable against the Guernsey branch of an English bank. *Pantell*, 3 W.L.R. at 704.

The issue also came up in the SEC's civil injunctive action against inside trader Fred C. Lee when the Southern District Court of New York ordered Standard Chartered Bank Plc, a British bank with branches in both New York and Hong Kong, to transfer over \$12 million in frozen assets held by Lee in a Hong Kong branch into the court's registry. *United States v. Wang*, 699 F. Supp. 44 (S.D.N.Y. 1988); see also *infra* notes 21-26 and accompanying text.

See generally *United States v. First Nat'l City Bank*, 379 U.S. 378, 384 (1965) (freeze of Uruguayan corporation's assets, including account with Montevideo branch of United States bank).

Finally, there is the possibility of a foreign court agreeing to impose an asset freeze on accounts within its jurisdiction where there is a mutual legal assistance treaty in place. In response to an SEC request for information related to *SEC v. Tome*, 833 F.2d 1086 (2d Cir. 1987), under a U.S.-Swiss mutual legal assistance treaty, the Swiss Federal Court held that under the treaty a Swiss court could impose an asset freeze on Swiss accounts to prevent the dissipation of the proceeds of allegedly illegal trades in response to such a request by the SEC. *Recounted in Mann & Mari, Developments in International Securities Law Enforcement*, in *INTERNATIONAL SECURITIES MARKETS* 1990, 821, 889 (PLI, Corp. L. & Prac. Handbook Series No. 683, 1990) [hereinafter *Mann & Mari*].

For further information on mutual legal assistance treaties, see also *infra* notes 67-72 and accompanying text.

13. See, e.g., Supplemental Memorandum in Support of Plaintiff Securities and Exchange Commission's Application for . . . an Order Freezing Assets, *SEC v. Finacor Anstalt*, No. 89 Civ. 7667 (JMC) (S.D.N.Y. 1989) at 22-25.

14. The Second Circuit first held that the SEC could obtain noninjunctive relief similar to disgorgement in *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (so long as the relief was remedial and did not amount to a "penalty assessment"). That holding was subsequently relied on in allowing a freeze order to be imposed in *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1104 (2d Cir. 1972).

A permanent injunction against violations of the securities laws allows the SEC to go directly into court and seek criminal contempt sanctions in the event the enjoinee subsequently commits a securities law violation.

15. *Court Deals a Blow to SEC Global Insider Enforcement*, 22 WALL STREET LETTER (Institutional Investor) No. 34, at 5 (Aug. 27, 1990) [hereinafter *Court Deals a Blow*] (quoting Dan Goelzer, former SEC General Counsel). See also *infra* note 18.

with a freeze in place of amounts of up to three times profits earned,<sup>16</sup> the incentive for the defendants to come forward and litigate is much stronger.<sup>17</sup>

In the wake of *Unifund*, however, this strategy may no longer be viable, since many defendants will be able to outlast a brief freeze.<sup>18</sup> Because of the enormous practical difficulties of conducting discovery abroad and the SEC's limited resources, the SEC will rarely be able to go to trial quickly in insider trading cases where it has hastily put together an action based almost entirely on evidence of suspicious trading.<sup>19</sup> The *Unifund* decision is likely, therefore, to serve as a brake to the questionable use by the SEC — with the complicity of United States courts — of asset freeze orders as a means of avoiding the uncertainties, delay, and expense involved in conducting discovery or enforcing judgments abroad.

This Comment focuses primarily on two issues: (1) the effect of the Second Circuit's ruling in *Unifund* modifying the as-

16. The SEC is now entitled to seek a penalty equal to three times profits. 15 U.S.C. § 78u-1 (1988). Consequently, in *Unifund* the Second Circuit expressly approved the practice of allowing an asset freeze to cover an amount equal to three times profits. SEC v. *Unifund SAL*, 910 F.2d 1028, 1042 (2d Cir. 1990).

17. See *Remedies Bill*, *supra* note 8, at A-5.

18. In a March 15, 1990, article for the Practising Law Institute, Lee S. Richards, III, noted that:

In the past, the simple tactic of defaulting was often quite sensible because the SEC was less aggressive in asserting personal jurisdiction over foreigners, and it had not yet fully exploited its power to freeze assets located within the United States borders. However, today, the mere fact that a trade is executed across an exchange in this country normally provides the SEC with sufficient jurisdictional power to proceed and to freeze assets . . . Therefore, it now has a means to make defaults more painful to foreigners and thereby to induce them to appear and defend.

Richards, *Legal Representation in the International Securities Markets: Representing Clients in Securities and Exchange Commission, Department of Justice or Self-Regulatory Organization Proceedings Involving Foreign Citizens or Foreign Trading*, in *INTERNATIONAL SECURITIES MARKETS* 1990, 143, at 157-58 (PLI, Corp. L. & Prac. Handbook Series No. 683, 1990) [hereinafter Richards].

19. In *Unifund*, the SEC filed a complaint and obtained a temporary restraining order against *Unifund SAL*, a Lebanese investment company, and other purchasers of the common stock and stock options of Rorer Group, Inc. (Rorer) only two days after Rorer announced that it had engaged in discussions with an undisclosed party concerning the acquisition of 68% of Rorer's outstanding shares of common stock. SEC v. *Foundation Hai*, SEC LITIGATION RELEASE No. 12353 (Jan. 18, 1990), 1990 SEC LEXIS 144. The SEC still had not even identified the alleged tipper when they filed a petition for rehearing as to the freeze expiration order in August 1990. *Petition of the Securities and Exchange Commission for Rehearing as to the Duration of the Freeze Orders*, SEC v. *Unifund SAL*, Nos. 90-6057, 90-6091, 90-6093, 90-6103 (Aug. 1990) [hereinafter SEC *Petition for Rehearing*].

set freeze order on the SEC's ability to prosecute foreign violators of the United States insider trading laws; and (2) the propriety of that ruling in view of the SEC's showing in *Unifund*, and, in larger terms, whether that ruling was appropriate in view of the high utility of freeze orders to the SEC's successful prosecution of offshore fraud.

## II. THE ROLE OF THE ASSET FREEZE IN OTHER RECENT SEC ACTIONS AGAINST FOREIGN INVESTORS

### A. Asset Freeze Leading to Disgorgement

In several actions brought in the Second Circuit in recent years, the SEC has ultimately succeeded in obtaining disgorgement from foreign traders accused of violating United States insider trading laws despite having initiated many of the actions solely on the basis of evidence of "anomalous trading in advance of a major corporate announcement."<sup>20</sup> The court's willingness to impose an asset freeze on the foreign traders' accounts has played a critical role in those successes.

In *SEC v. Wang*,<sup>21</sup> for example, defendant Fred C. Lee, a Hong Kong investor, failed to answer the SEC's complaint and "flatly ignored" a preliminary injunction entered by the Southern District Court of New York (following an earlier asset freeze order issued as part of a temporary restraining order)<sup>22</sup> which enjoined him from transferring or suing for his assets.<sup>23</sup> Lee's assets included over 12.5 million dollars in a bank account in Hong Kong. When Lee sued in Hong Kong to recover his bank account, the district court took the controversial step of ordering the Hong Kong bank to deposit those funds in the court's registry.<sup>24</sup> The court, in denying Lee's belated attempt to set aside the default judgment, pointed out that Lee had "willfully disregarded the authority" of the court and had employed a litigation strategy which was "willfully contemptuous of [the] proceedings," by making a general appearance only after the 12.5 million dollars was deposited into the court's registry.<sup>25</sup> Hence, were

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20. *Id.* at 4.

21. 699 F. Supp. 44 (S.D.N.Y. 1988).

22. The freeze order was first granted as part of a temporary restraining order (TRO) issued on the same day the SEC originally filed the action. Mann & Mari, *supra* note 12, at 873.

23. *Wang*, 699 F. Supp. at 45.

24. *Id.* See *supra* note 12.

25. *Wang*, 699 F. Supp. at 45-46.

it not for the imposition of the asset freeze, it appears that the SEC would have had very little chance of recovering any of the proceeds from Lee's illegal trades.<sup>26</sup>

An asset freeze was probably the key to achieving disgorgement in *SEC v. Tome*<sup>27</sup> as well. In *Tome*, after noticing "undue activity in the options market" immediately preceding the public announcement of a tender offer for the stock of St. Joe Minerals Corporation, the SEC quickly instituted a civil enforcement action against Banca Della Svizzera Italiana (BSI), a Swiss bank, and certain unknown purchasers.<sup>28</sup> The SEC obtained an order freezing the proceeds from the trades, which were held in BSI's bank account with the Irving Trust Company in New York.<sup>29</sup> The SEC did not name Guiseppe Tome in the original complaint, but they wanted to speak with him since he was the registered representative on some of the trades.<sup>30</sup> Although he knew of the SEC's interest in speaking with him, Tome "left the country before they were able to track him down."<sup>31</sup>

Since Tome never returned to the United States,<sup>32</sup> the freeze on the proceeds ended up being critical to the SEC's successful recovery of the proceeds of Tome's illegal trades through a court order of disgorgement. *Tome* also illustrates how disgorgement has become an effective tool of enforcement for the SEC, acting as a deterrent to foreign investors contemplating violations of the United States insider trading laws.<sup>33</sup>

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26. Lee had allegedly obtained inside information about 21 "issuers" from defendant Stephen Wang, Jr., an employee of a New York investment banking firm. *SEC v. Wang*, 1989 FED. SEC. L. REP. (CCH) Para. 94, 727, n.2 (S.D.N.Y. May 22, 1989). The SEC ultimately received a disgorgement order of about \$19 million as part of a final judgment whereby Lee agreed to disgorge assets of over \$25 million. *SEC v. Wang*, No. 88 Civ. 4461 (S.D.N.Y. Aug. 2, 1989) (LEXIS, Genfed Library, Dist File).

27. 833 F.2d 1086 (2d Cir. 1987), *cert. denied sub. nom.*, *Lombardfin S.p.A. v. SEC*, 486 U.S. 1014 (1988).

28. *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 112 (S.D.N.Y. 1981).

29. *Id.* at 113.

30. *SEC v. Tome*, 638 F. Supp. 596, 600 n.4. (S.D.N.Y. 1986).

31. *Id.*

32. *Id.* at 601.

33. "Whether or not any investors are entitled to money damages is immaterial. The paramount purpose of enforcing the prohibition against insider trading by ordering disgorgement is to make sure that wrongdoers will not profit from their wrongdoing." *SEC v. Tome*, 833 F.2d 1086, 1096 (2d Cir. 1987).

"The [treble] penalty's deterrent purpose, to make an insider trader not just surrender his ill-gotten gains, but face severe penalties as well, is important to effective securities law enforcement." *SEC v. Wang*, 699 F. Supp. 44, 46 (S.D.N.Y. 1988).

### B. The Asset Freeze as a Litigation "Weapon"

While freeze orders have been instrumental in successfully achieving the recovery of the proceeds of fraudulent trades by foreigners on United States markets, the SEC has at times appeared to use the freeze as more of a weapon than as a protective shield of their possible right to recovery.

An asset freeze order has the immediate effect of preserving a fund for any potential recovery, yet quite often it also has the effect of compelling a defendant to appear in court rather than to continue to remain anonymous or outside of the court's jurisdiction.<sup>34</sup> Thus, in some cases, the rather innocuously termed *ancillary*<sup>35</sup> remedy of a freeze order can be used as a very effective strong arm tactic. While such a use of a freeze order may not seem unfair given the defense tactic it is acting to prevent — staying outside the court's jurisdiction and defaulting — it becomes more questionable where it is held in place for an extended time while the SEC slowly engages in what defense lawyers claim amounts to a "fishing expedition."<sup>36</sup>

Examples of both the "legitimate" and "illegitimate" use of a freeze order can be found in *SEC v. Finacor Anstalt*,<sup>37</sup> an action brought by the SEC in November 1989. The SEC brought suit in *Finacor* following suspicious trading in the stock and call options of Combustion Engineering, Inc. (CE), a United States corporation, just prior to the public announcement of a proposed tender offer for eighty percent of CE's outstanding common stock by ABB Asea Brown Boveri Ltd. (ABB), a Swiss corporation.<sup>38</sup> The SEC named *Finacor Anstalt*, a Liechtenstein-based entity, and "Certain Purchasers of Call Option Contracts for the Common Stock of Combustion Engineering" as defendants.<sup>39</sup>

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34. "[F]reeze Orders often compel a client to appear and defend when otherwise he might be inclined to default." Richards, *supra* note 18, at 188.

35. By definition, therefore, a freeze order is merely "incidental" relief. Indeed, in his opinion for the unanimous panel in *Unifund*, Judge Newman characterized the freeze order as ancillary relief which "[s]imply assures that any funds that may become due can be collected." *SEC v. Unifund SAL*, 910 F.2d 1028, 1041 (2d Cir. 1990) (emphasis added).

36. See, e.g., *Bigger Ante Needed to Settle Civil Cases*, *SEC Official Says*, 22 SEC. REG. & L. REP. (BNA) 41 (Oct. 19, 1990) [hereinafter *Bigger Ante*] (quoting an attorney who "suggested that the SEC brings a case first, then later determines whether in fact it was necessary to do so").

37. No. 89 Civ. 7667 (S.D.N.Y. filed Nov. 20, 1989).

38. *Id.*

39. *Id.*

The latter were two entities that had purchased CE call options: one through an account with a Toronto brokerage firm maintained by a Cayman bank, the other through an account with a United States brokerage firm maintained by a Luxembourg bank.<sup>40</sup> So, as in *Unifund*, the SEC did not name specific individuals in the original complaint.

Following a pattern repeated in many other recent civil enforcement actions, the SEC acted swiftly — filing a complaint and obtaining a temporary restraining order (TRO) and asset freeze within one week after the public announcement of the merger.<sup>41</sup> The asset freeze was imposed upon the defendants' trading accounts with United States brokerage firms, preventing the "disposition, transfer or dissipation" of any CE securities or proceeds from the sale of CE securities.<sup>42</sup> Unlike *Unifund* however, the SEC was able to learn the identity of a possible tipper quite quickly. Christian Norgren, a member of the board of ABB and Chairman of the Bank in Liechtenstein AG, admitted after being fired by the Bank in Liechtenstein and forced off the ABB board that he was a part owner of Finacor.<sup>43</sup> The SEC also was helped in this action by "unusual cooperation from the banks involved in Liechtenstein and the Cayman Islands," and by ABB officials.<sup>44</sup>

Nevertheless, despite the breaks it received in prosecuting the *Finacor* case, the SEC did not even amend the complaint to name Norgren until ten months after learning that he was a principal owner of Finacor.<sup>45</sup> Although Finacor had eventually consented to a preliminary injunction and an asset freeze,<sup>46</sup> unlike the defendant in *Unifund*, the length of time it took the SEC to amend the complaint (after nearly one year it was still not ready to go to trial) is illustrative of how long the courts have let such freeze orders stay in place and how long it has

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40. Verified Complaint for Injunctive and Other Equitable Relief, *SEC v. Finacor Anstalt*, 89 Civ. No. 7667 (S.D.N.Y. filed Nov. 16, 1989).

41. *Finacor Anstalt*, SEC LITIGATION RELEASE No. 12296, 1989 LEXIS 2242 (Nov. 20, 1989).

42. Temporary Restraining Order, *SEC v. Finacor Anstalt*, 89 Civ. No. 7667 (S.D.N.Y. filed Nov. 16, 1989), at 3.

43. Wall St. J., Nov. 28, 1989, at A3. Norgren was fired by the bank and forced off ABB's board because of suspicions that Norgren had engaged in insider trading. *Id.*

44. Tumulty, *Businessman Faces Civil Charges in Stock Probe*, Gannet News Service, Sept. 6, 1990 [hereinafter Tumulty].

45. *SEC Amends Insider Trading Suit, Names Owner of Liechtenstein Firm*, DAILY REP. FOR EXECUTIVES DER No. 175, at A-8 (Sept. 10, 1990).

46. Order on Consent, *Finacor* (89 Civ. No. 7667) (S.D.N.Y. filed Dec. 22, 1989).

taken the SEC to prepare for trial in such cases. Indeed, counsel for Finacor Anstalt claimed that if the SEC had not "adopted a rigid agenda unrelated to the merits of this action," the case would have been settled.<sup>47</sup>

Up until the *Unifund* decision, rather than balk at the use of the asset freeze as a litigation tactic, the courts have appeared to affirm and condone such tactics. For example, in *SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of, Santa Fe Int'l Corp.*,<sup>48</sup> in rejecting a request by an options market maker to modify a freeze of over 5.5 million dollars of the unknown purchasers' funds to allow execution of a default judgment, the district court stated that the court's "control over the funds acts as an *incentive* for the unknown purchasers to come forward and litigate the allegations."<sup>49</sup> Thus, where the identities of the defendants are initially unknown and the bank or brokerage firm containing the defendants' accounts refuses to divulge their identities on the ground that to do so would violate another country's bank secrecy laws, rather than relying on the cumbersome and uncertain procedures under the Hague Convention on Taking of Evidence (Hague Evidence Convention)<sup>50</sup> or some sort of mutual assistance treaty,<sup>51</sup> the SEC can attempt to lure foreign defendants into court by freezing their United States assets.<sup>52</sup>

### C. Conducting Discovery and Enforcing Judgments Abroad

Spurring defendants to come into court and litigate is vitally important because of two procedural realities: discovery abroad with a recalcitrant foreign party is arduous and problematic, and should the defendant refuse to litigate at all, getting a default judgment enforced overseas is difficult and often beyond

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47. Tumulty, *supra* note 44. For its part, the SEC alleged earlier in the case that Finacor refused to permit any discovery concerning "its role in the transaction or its relationship to Norgren." Supplemental memorandum in Support of Plaintiff Securities and Exchange Commission's Application for . . . an Order Freezing Assets . . . , SEC v. Finacor Anstalt, No. 89 Civ. 7667 (S.D.N.Y. 1989) at 21.

48. Fed. Sec. L. REP. (CCH) Para. 99, 424 [1983-84 Transfer Binder] (Aug. 10, 1983).

49. *Id.* (emphasis added).

50. Hague Convention on Taking Evidence, *opened for signature* Mar. 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444 (*entered into force* Oct. 7, 1972) [hereinafter Evidence Convention].

51. See *infra* notes 53-76 and accompanying text (Section II.C).

52. See *supra* note 18.

the SEC's resources.

Where a foreign defendant refuses to voluntarily provide the SEC with information, and unlike *Finacor*,<sup>53</sup> the SEC initially receives little or no cooperation from the foreign banks involved, the SEC will attempt to gather information under the Hague Evidence Convention, a Memorandum of Understanding (MOU), or a mutual legal assistance treaty.

The SEC, like any civil litigant, can attempt to obtain information abroad under the Hague Evidence Convention. That convention presents the SEC with several options: (1) requesting the district court to send a "Letter of Request"<sup>54</sup> to the government of a country, which forwards it to a court in that country where the evidentiary proceedings will take place;<sup>55</sup> (2) requesting that a United States diplomatic or consular officer in a certain country take evidence there;<sup>56</sup> or (3) requesting that a specifically appointed commissioner take evidence in that country.<sup>57</sup>

However, those procedures are slow<sup>58</sup> and are limited by the requirement that any requested evidentiary proceedings must be compatible with the law of the country receiving the request.<sup>59</sup> For example, many countries refuse to issue letters of request to compel pretrial document production.<sup>60</sup> In addition, in order to obtain testimony of witnesses before trial under the Hague Evidence Convention, the SEC must show that the testimony is

53. See *infra* notes 34-52 and accompanying text (Section II.B).

54. Commonly referred to as "letters rogatory."

55. Evidence Convention, *supra* note 50, at arts. 1-2.

56. Evidence Convention, *supra* note 50, at arts. 15-16.

57. Evidence Convention, *supra* note 50, at art. 17.

58. Goelzer & Sullivan, *Obtaining Evidence for the International Enforcement of the United States Securities Laws*, 16 BROOKLYN J. INT'L L. 145, 169 (1990) [hereinafter Goelzer & Sullivan] (recounting SEC's attempt to use the Hague Evidence Convention in *SEC v. Santa Fe*, 81 Civ. No. 6553 (S.D.N.Y. 1981), where letters of request sent by the court to France were rejected after over a two-year wait).

In *Unifund*, the SEC complained of extensive delays in attempting to obtain information in France under the Hague Evidence Convention — being stymied after attempts to obtain telephone records, and having to serve a "supplemental Hague Convention request" after the cousin of *Unifund*'s president refused to testify except in his capacity as chairman of Bank Audi France. SEC Petition for Rehearing, *supra* note 19, at 7-8. The SEC submitted affidavits of government lawyers to confirm its assertion that "responses to . . . [Hague Evidence Convention] requests are generally subject to delay." SEC Petition for Rehearing, *supra* note 19, at 7.

See Risenberg & Franco, *Discovery in Foreign Lands*, THE RECORDER June 6, 1991, at 4.

59. Evidence Convention, *supra* note 50, at art. 9.

60. Richards, *supra* note 18, at 157.

“relevant.”<sup>61</sup> This requirement restricts the fact-finding element of the more liberal United States discovery procedures.<sup>62</sup>

Obtaining evidence under an MOU can also be problematic. MOUs are nonbinding agreements, usually between the SEC and its counterpart within a certain country, which provide for mutual assistance in investigations of securities law violations.<sup>63</sup> MOUs vary in scope from those that generally facilitate requests for information in insider trading investigations to those that provide that each securities regulation agency will provide “the fullest mutual assistance,” including use of any and all compulsory powers to conduct an investigation on behalf of the requesting state.<sup>64</sup> The most recent MOUs concluded between the SEC and its counterparts have been of the latter, more effective variety.<sup>65</sup> In addition, all of the MOUs provide for assistance even where the authority requesting information is investigating conduct which is not an offense in the country receiving the request.<sup>66</sup>

Mutual legal assistance treaties are binding, bilateral agreements entered into between the United States and other countries, which provide for mutual assistance in criminal matters, including securities law offenses.<sup>67</sup> Because violation of the United States securities laws can result in criminal penalties, the SEC can rely on these agreements despite lacking the power to initiate criminal actions itself.<sup>68</sup>

The SEC now has MOUs and mutual legal assistance treaties with quite a few countries,<sup>69</sup> and has had some success re-

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61. Richards, *supra* note 18, at 157-58.

62. See Richards, *supra* note 18, at 158.

63. See Mann & Mari, *supra* note 12, at 892.

64. Goelzer & Sullivan, *supra* note 58, at 172-74.

65. Goelzer & Sullivan, *supra* note 58, at 173-74.

66. Mann & Mari, *supra* note 12, at 892.

67. See Goelzer & Sullivan, *supra* note 58, at 154.

68. Mann & Mari, *supra* note 12, at 877.

69. The SEC has MOUs or like agreements with Brazil, Switzerland, the United Kingdom Department of Trade and Industry, the Commission des Operations de Bourse (France), the Ministry of Finance of Japan, and the securities commissions of the Canadian provinces of Ontario, Quebec, and British Columbia. Mann & Mari, *supra* note 12, at 892. The SEC and the Commissione Nazionale per le Societa e la Borsa (Italy) have signed a “Communique on Exchange of Information.” Mann & Mari, *supra* note 12, at 904.

The United States has entered into various bilateral and multilateral treaties for the production of evidence with the United Kingdom, the Netherlands, Turkey, Italy, Canada, and the Cayman Islands. Mann & Mari, *supra* note 12, at 877-91.

For a discussion of the SEC's efforts in *Unifund* to obtain information under a mu-

cently obtaining evidence under those agreements.<sup>70</sup> On the other hand, gathering information under either of those methods can be slow, success is uncertain,<sup>71</sup> and the SEC is further hampered by limited funds to spend on obtaining evidence and deposing witnesses abroad.<sup>72</sup>

The reality of limited resources is also a reason why the SEC has had little success enforcing judgments abroad. The principle justification for imposing a freeze on the assets of a defendant in an SEC civil enforcement action is that a freeze acts to preserve the status quo by preventing the defendant from moving the funds offshore.<sup>73</sup> This justification rests on the recognition by the court that should the funds be moved offshore, the SEC may have great difficulty in attaching those funds overseas to satisfy any judgment it may receive.<sup>74</sup> In a November 1989 interview with the Bureau of National Affairs, Michael Mann, Associate Enforcement Director in the SEC's Office of International Affairs, said that the "globalization of the markets will result in a greater number of cases in which unlawful proceeds are deposited in foreign accounts, [and d]espite an

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tual assistance treaty between the United States and Switzerland, see *infra* note 113 and accompanying text.

70. See, e.g., *SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of Santa Fe International Corporation*, 81 Civ. No. 6553 (S.D.N.Y. 1981) (SEC obtains information from Swiss banks as to the identities of certain account holders after two-year-long battle).

For a more comprehensive review of the SEC's successes and failures obtaining evidence under international agreements see Mann & Mari, *supra* note 12, at 877-915.

71. See Goelzer & Sullivan, *supra* note 58, at 178.

72. "Applying for judicial assistance . . . [to a foreign court] is not a substantially equivalent means for obtaining production because of the cost in time and money and the uncertain likelihood of success in obtaining the order." *United States v. The Bank of Nova Scotia*, 691 F.2d 1384, 1390 (11th Cir. 1982), *cert. denied*, 462 U.S. 1119 (1983).

73. See *United States v. First Nat'l City Bank*, 379 U.S. 378, 385 (1965) (quoting language from *Deckert v. Independence Shares Corp.*, 311 U.S. 282, 290 (1940) in approving the district court's order in a tax lien foreclosure action freezing the accounts of a Uruguayan corporation which were located in the Montevideo branch of a United States bank). See *supra* note 12.

74. One defense attorney listed the factors favoring advising a foreign client to default as: "the SEC's past reluctance to seek enforcement of judgments abroad, the unenforceability of ITSA penalties [treble damages] abroad in most cases and the difficulty of locating the assets abroad." Richards, *supra* note 18, at 166. Given the SEC's willingness to ask United States courts to use contempt powers to compel foreign banks to divulge information in violation of foreign laws or court orders, see, e.g., *SEC v. Wang*, 699 F. Supp. 44 (S.D.N.Y. 1988), discussed in note 12, it is probably fair to assume that the SEC's "reluctance to seek enforcement of judgments abroad" stems from concerns over the expense of such efforts (financially and temporally) rather than worries about international comity.

increase in international agreements . . . the SEC will have greater difficulty in seeking jurisdiction over the illegal profits.”<sup>75</sup>

Thus, although it has had some success in recent years in obtaining evidence abroad under various international agreements, the SEC is faced with many practical difficulties in attempting to conduct discovery and enforce judgments abroad. Do these practical problems justify the imposition of an asset freeze for an unlimited duration? The court in *Unifund* apparently thought not.<sup>76</sup>

### III. SEC v. UNIFUND SAL

#### A. Facts Alleged

On January 17, 1990, the SEC filed a complaint in the Southern District of New York against Fondation Hai, Holding Protection Ltd.,<sup>77</sup> Robert Rossi,<sup>78</sup> Unifund SAL,<sup>79</sup> and “Certain Purchasers of the Common Stock of and Options to Purchase the Common Stock of the Rorer Group, Inc.”<sup>80</sup> The complaint alleged that between January 4 and January 11, 1990, the defendants purchased a total of 168,500 shares of the common stock of Rorer and 4,013 Rorer February call option contracts while in possession of material, nonpublic information regarding the negotiations between Rorer and Rhone-Poulenc, S.A. (Rhone) concerning the acquisition by Rhone of sixty-eight percent of Rorer’s outstanding shares of common stock for seventy-three dollars per share. Rorer publicly announced the existence

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75. *Global Recognition of Legal Judgments Next Big Enforcement Issue*, Mann Advises, DAILY REP. FOR EXECUTIVES (BNA) No. 220, C-1 (Nov. 16, 1989).

76. See *infra* notes 112-20 and accompanying text.

77. Holding Protection, Ltd. (Holding) is a Cayman Islands corporation, solely owned by Namek F. Idrissi, owner of an insurance agency with offices in Lebanon, Saudi Arabia, England, and Greece. The SEC’s request for a preliminary injunction and freeze order against Holding was denied in April. SEC v. Foundation Hai, 1990 FED. SEC. L. REP. (CCH) Para. 95, 248 (S.D.N.Y. Apr. 23, 1990).

78. Rossi, a Swiss investor, settled with the SEC in July. 22 SEC. REG. & L. REPT. (BNA) No. 28, at 1036 (July 13, 1990). In the consent agreement with the SEC, Rossi agreed to disgorge over \$1.4 million and was barred from securities law violations. *Id.*

79. Unifund is a Lebanese investment company. SEC v. Foundation Hai, 736 F. Supp. 465, 467 (S.D.N.Y. 1990).

80. Tamanaco was not named in the initial complaint. The SEC delivered the original complaint and TRO to Esperito Santo (through which Tamanaco had made the Rorer purchases) via the Swiss police. *Id.* at 469. The SEC later served papers on Tamanaco’s attorney after learning Tamanaco’s identity on January 30, 1990. *Id.* Tamanaco is a Panamanian corporation. *Id.* at 466.

of the merger discussions on January 15, 1990.<sup>81</sup>

According to the SEC, Unifund SAL purchased its Rorer shares and options through the Beirut office of a Merrill Lynch subsidiary.<sup>82</sup> After the public announcement, Unifund realized a gain of over 1.5 million dollars when it sold its Rorer holdings.<sup>83</sup> Tamanaco purchased Rorer call options through an account maintained with the Lausanne branch of a Dean Witter Reynolds Inc. by Compagnie Financiere Esperito Santo (Esperito Santo), a Swiss bank.<sup>84</sup> Tamanaco's profit was approximately 660,000 dollars.<sup>85</sup> Esperito Santo itself purchased 3,000 shares of Rorer's common stock through the Swiss branch of a Florida-based brokerage, Raymond James & Associates (Raymond James).<sup>86</sup>

In support of its allegations that defendant Unifund and Tamanaco were "tippees" who knowingly traded on misappropriated, material, nonpublic information, the SEC relied primarily on the unusual trading activity of the defendant,<sup>87</sup> but also on a possible connection between the defendants (Unifund and Tamanaco) and an unnamed tipper.<sup>88</sup> In a telephone interview with the SEC, Candid Peyer, Esperito Santo's broker at Raymond James, allegedly told the SEC that a friend<sup>89</sup> had told him in mid-December 1989 that "if you want a Christmas gift, buy February 60 calls in Rorer."<sup>90</sup> Peyer admitted to the SEC that

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81. *Id.*

82. *Id.* at 467.

83. SEC v. Unifund SAL, 910 F.2d 1028, 1030 (2d Cir. 1990).

84. *Id.*

85. *Id.*

86. *Foundation Hai*, 736 F. Supp. at 467.

87. Summed up by the district court as "[t]he sudden and timely interest these defendants had in Rorer securities . . ." *Id.* at 473.

88. *Id.* at 471-72. See also *infra* notes 89-94 and accompanying text.

89. Peyer said that his friend obtained the information from a stockbroker at a brokerage firm in Lausanne. *Unifund*, 910 F.2d at 1031. At some time subsequent to the date the parties appeared before the Second Circuit, the SEC apparently learned of the identity of Peyer's "friend," a Bruno Emmenegger. SEC Petition for Rehearing, *supra* note 19, at 6. The court in *Unifund* labeled Peyer's friend an "independent money manager in Geneva . . ." 910 F.2d at 1031. The SEC asserted that Emmenegger was "a broker for the bank where Tamanaco maintained its trading account . . .," SEC Petition for Rehearing, *supra* note 19, at 6, while Tamanaco rejected the SEC's assertion, stating that Emmenegger is "not a broker for that bank . . . or a broker at all . . ." Defendant-Appellant Tamanaco Saudi & Gulf Investment Group's Response to Petition for Rehearing (Nos. 90-6057, 90-6091, 90-6093, 90-6103) at 4 [hereinafter *Tamanaco's Response*].

90. *Unifund*, 910 F.2d at 1031. Tamanaco asserted in its response to the SEC's Petition for Rehearing that under oath Peyer denied that this statement was made to him.

he thought his friend had inside information concerning a takeover of Rorer, and later told the SEC that the information "came from . . . the direction . . ." of one of the entities connected with the *Unifund* action.<sup>91</sup> To connect this tip to Unifund, the SEC pointed to the fact that Ralph Audi, the principal shareholder of Unifund, was related to individuals who run Bank Audi and its Swiss affiliate, Bank Audi Suisse.<sup>92</sup> Bank Audi Suisse purchased call options through Raymond James in the week prior to the public merger announcement.<sup>93</sup> In its decision granting the preliminary injunction, the district court also noted that there was a "potential connection" between Unifund and Rhone in that the last name of the Rhone executive responsible for promotion in the Near and Middle East, Amer Khoury, is the same as that of Ralph Audi's attorney and Unifund founder, Farid El Khoury.<sup>94</sup>

### B. Procedural History

On January 17, 1990, the United States District Court for the Southern District of New York issued a TRO which restrained and enjoined the defendants from violating section 10(b) of the Securities Exchange Act of 1934<sup>95</sup> and Rule 10b-5<sup>96</sup> thereunder.<sup>97</sup> The TRO also froze defendants' brokerage accounts pending a hearing on the SEC's motion for a preliminary injunction.<sup>98</sup> The SEC served Unifund SAL by sending the complaint and the TRO to its New York broker for forwarding;<sup>99</sup> the SEC served Tamanaco by delivering the complaint and TRO to the Swiss police, who delivered them to Esperito Santo.<sup>100</sup> On February 14 and March 1, 1990, the district court granted preliminary injunctions against Tamanaco and Unifund SAL, respectively.<sup>101</sup> Tamanaco and Unifund SAL appealed from that

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Tamanaco's Response, *supra* note 89, at 4.

91. SEC v. Foundation Hai, 736 F. Supp. 465, 472 (S.D.N.Y. 1990).

92. *Id.*

93. *Id.*

94. *Id.*

95. 15 U.S.C. § 78j (1988).

96. 17 C.F.R. § 240.10b-5 (Apr. 1, 1990).

97. Foundation Hai, SEC LITIGATION RELEASE No. 12353, 1990 LEXIS 144 (Jan. 18, 1990).

98. *Id.*

99. SEC v. Unifund SAL, 910 F.2d 1028, 1033-34 (2d Cir. 1990).

100. SEC v. Foundation Hai, 736 F. Supp. 465, 469 (S.D.N.Y. 1990).

101. *Id.* In addition to a preliminary injunction against future violations of section

order.

### C. *The Decision on Appeal*

The Second Circuit vacated the part of the injunction which barred future violations, modified the freeze order by removing the requirement that all trading in the accounts be approved by the SEC,<sup>102</sup> and ruled that the freeze order would terminate thirty days from the issuance of its mandate if the SEC had not advised the district court by then that it was ready to go to trial.<sup>103</sup> The court, taking into account the time that had elapsed since the injunction was issued, stated that "[i]n view of the Commission's meager showing on the merits, it should not be entitled to interfere with the appellants' unrestricted use of their accounts for more than a brief interval."<sup>104</sup>

The court found that the SEC's showing contained a "fundamental gap" because while there was evidence of unusual trading which implied that defendants possessed inside information, the SEC had not identified the source of that information.<sup>105</sup> Citing *Dirks v. SEC*,<sup>106</sup> the court pointed out that "possession . . . of [inside] information without more does not give rise to a duty to disclose or abstain from trading . . . where the recipient of the information is an ordinary investor."<sup>107</sup> The

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10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, the court issued an order preventing the destruction or alteration of documents and an order freezing the defendants' brokerage accounts. *Id.* at 474. The freeze order provided that the brokerage accounts maintain amounts sufficient to pay a potential civil penalty of three times profit in addition to potential disgorgement of the profits, and that any trading in the accounts would be subject to SEC approval. *Unifund*, 910 F.2d at 1041-42. Unifund's account contained \$3.7 million; Tamanaco's account contained \$680,000. *SEC v. Foundation Hai*, SEC LITIGATION RELEASE No. 12399 (Mar. 5, 1990), 1990 SEC LEXIS 378.

102. So long as the amounts contained in the defendants' accounts did not fall below two times the profits they earned on the Rorer trades. *Unifund*, 910 F.2d at 1042.

103. *Id.*

104. *Id.* at 1042-43.

105. *Id.* at 1040-41.

106. 463 U.S. 646 (1983).

107. *Unifund*, 910 F.2d at 1041.

More specifically, the court explained that since under *Dirks* a "tippee's duty to disclose or abstain [from trading] is derivative from that of the insider's duty," . . . "without the SEC having identified the defendants' tipper "we do not know from whom such a duty might derive in this case." *Id.* at 1040 (quoting *Dirks*, 463 U.S. at 659).

Thus, without knowing the identity of the tipper, it is difficult for the court to determine whether or not the defendants knew or should have known that they were breaching a fiduciary duty by trading on material nonpublic information — a required element of an insider trading violation. *Unifund*, 910 F.2d at 1040. The court declined to decide at that time though, "whether the requisite breach of fiduciary duty . . . can be estab-

court did however approve the initial grant of the SEC's freeze request, stating that:

Though the Commission has not presented at this stage sufficient evidence to warrant a preliminary injunction of traditional scope, its evidence suffices to warrant some form of freeze order. There is a basis to infer that the appellants traded on inside information, and . . . the Commission should be able to preserve its opportunity to collect funds that may yet be ordered disgorged.<sup>108</sup>

Furthermore, the court found that, in view of the enactment of legislation by Congress amending the Securities Exchange Act of 1934 to allow the SEC to seek a penalty equal to three times profit gained through insider trading,<sup>109</sup> the imposition of a freeze order covering such an amount was appropriate.

Finally, although it is not within the main focus of this Comment, it should be noted that the court's opinion in *Unifund*, after extensive review of the often ambiguous and conflicting precedents in the Second Circuit, clearly laid out the standards that the SEC would have to meet in order to obtain preliminary injunctive relief in that circuit.<sup>110</sup> The court's hold-

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lished without identification of either the tippee's immediate tipper or the insider who first disclosed the nonpublic information to those relaying it to the tippee." *Id.* at 1040 n.12.

The latter comment by the court was apparently a reference to the controversial ruling by the Second Circuit in *United States v. Chestman*, 903 F.2d 75 (2d Cir. 1990). In that decision, the court reversed the insider trading conviction of a broker who traded on confidential information of an impending takeover of Waldbaum Inc. obtained through a chain of Waldbaum family members. *Id.* The court held in part that in order to convict Chestman under Rule 10b-5 as an aider/abettor (in the misappropriation of material, nonpublic information) or as a tippee, the government had to specifically prove that Chestman *knew* that the immediate tipper was breaching "a duty of trust and confidence." *Id.* at 79.

In August 1990 the Second Circuit took the unusual step of agreeing to hold an en banc review of the panel's decision in *Chestman*, FED. SEC. L. REP. Para. 95,439 [1989-90 Transfer Binder] (Aug. 24, 1990). The result of that review is important in weighing the court's holding in *Unifund*, because the SEC's strong circumstantial evidence of highly suspect trading by the defendants is not as "meager" if they do not have to prove that the defendants specifically knew that their tipper (when identified) was breaching a confidential duty.

108. *Unifund*, 910 F.2d at 1041.

109. See *supra* note 16.

110. *Unifund*, 910 F.2d at 1035-40. See *Resolution Trust Corp. v. Elman*, 761 F. Supp. 245, 249 (S.D.N.Y. 1991) (following *Unifund* in rejecting the application of the "serious questions on the merits" test to a preliminary injunction sought by "any government agency").

ing in that regard was largely favorable to the SEC.<sup>111</sup>

Following the August 3, 1990 decision, the SEC submitted a petition for rehearing as to the thirty-day freeze expiration order.<sup>112</sup> The SEC argued that the freeze order should stay in place for a longer period of time "in view of the difficulties and delays inherent in foreign evidence-gathering and the defendants' stonewalling tactics."<sup>113</sup> Unifund and Tamanaco vehemently denied the SEC's accusations of stonewalling in their responses to the SEC's petition for rehearing.<sup>114</sup>

The Second Circuit denied the petition for rehearing on October 23, 1990.<sup>115</sup> The court did not directly address the substance of the SEC's complaints about the slow pace of discovery abroad and the defendants' alleged stonewalling. Rather, the court pointed out that the SEC's arguments were based on the faulty premise that the court "intended to permit the freeze order to remain in effect until completion of discovery and that . . . [the court] must have considered the seven months that had elapsed since the filing of the complaint . . . as sufficient time for this purpose."<sup>116</sup> The court rejected that reading of the freeze expiration order, explaining that it was the SEC's "meager showing" which served as the impetus for the court's conclu-

111. Noting that the district court, following the lead of many other cases in the district courts of that circuit, had required that the SEC meet a "strong *prima facie* case" standard on the merits in seeking a preliminary injunction, the Second Circuit traced the requirement back to its genesis in a 1960 decision, *SEC v. Boren*, 283 F.2d 312, 313 (2d Cir. 1960). *Unifund*, 910 F.2d at 1036. The court concluded that there was no basis for requiring that the SEC meet any greater a burden on the merits than the "likelihood of success" standard traditionally applied to private litigants. *Id.* at 1037.

The court did however go on to say that for all litigants a "more substantial showing" of likelihood of success should be required "whenever the relief sought is more than preservation of the status quo." *Id.* at 1039. It was because the SEC's showing did not satisfy this added burden that the court vacated the preliminary injunction against future violations of the securities laws. *Id.* at 1040-41. *See infra* note 121.

112. SEC Petition for Rehearing, *supra* note 19.

113. SEC Petition for Rehearing, *supra* note 19, at 2. In particular the SEC pointed to its requests for assistance from the Swiss authorities (made pursuant to the U.S.-Swiss mutual assistance treaty), which had not yet been fulfilled, and its attempts to obtain testimony from witnesses located in France under the Hague Evidence Convention, which at that time had proved largely fruitless. SEC Petition for Rehearing, *supra* note 19, at 5-8. *See supra* notes 50-76 and accompanying text.

114. Tamanaco's Response, *supra* note 89, at 4; Unifund's Response, *supra* note 5, at 10-12.

115. On Petition for Rehearing, *SEC v. Unifund SAL*, Nos. 90-6093, 90-6057, 90-6091, 90-6103 (2d Cir. Oct. 23, 1990) (LEXIS Genfed Library, Ctapp File) [hereinafter Rehearing Decision].

116. *Id.* at 2.

sion that the SEC would have to choose whether to go "to trial . . . very rapidly with the benefit of the freeze order or . . . [prepare] for trial beyond . . . [the] thirty-day limit without the freeze order."<sup>117</sup>

The court also made it clear though that it "did not intend to establish any particular time period as the duration for freeze orders in subsequent insider trading cases."<sup>118</sup> In general, the court explained, the duration of freeze orders would be largely up to the district court's discretion.<sup>119</sup> In *Unifund*, however, because of the "circumstances" of that case an eight-month long freeze order was at the "outer limit of allowable discretion."<sup>120</sup>

#### D. Analysis

The actual extent to which the *Unifund* decision will impair the SEC's ability to prosecute offshore fraud cannot be precisely gauged at the moment. Much will depend on how the district courts of the Second Circuit interpret the key language in the *Unifund* opinion.<sup>121</sup> What, for instance, will the district courts determine to be a "brief interval" in future cases — six months? At what point in time will they decide that keeping a freeze order in place is approaching the "outer limits of allowable discretion?" Although in denying the SEC's petition for rehearing the Second Circuit took pains to point out that the *Unifund* decision was very fact specific,<sup>122</sup> the district courts may well see the decision as a warning to them not to stray too far in the use of

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117. *Id.*

118. *Id.*

119. *Id.* at 2-3.

120. *Id.* at 3.

121. In the short time since *Unifund* was decided and this Comment was written, two district courts have referred to that decision. Neither reference was related to the issue of the asset freeze duration.

In *SEC v. Heider*, FED. SEC. L. REP. (CCH) Para. 95, 651 (S.D.N.Y. 1990), the court rejected the defendants' Rule 12(b)(6) motion to dismiss on grounds that *Unifund* required that the SEC name a tipper in the complaint. The court disagreed with that reading of *Unifund*, citing *SEC v. Tome*, 833 F.2d 1086 (2d Cir. 1987), as evidence that the Second Circuit "recognized the process of discovery and amending the complaint the S.E.C. may go through, particularly where the defendants are foreign nationals." See *supra* notes 9-19 and accompanying text.

In *Resolution Trust Corp. v. Elman*, 761 F. Supp. 245 (S.D.N.Y. 1991) the district court cited *Unifund* for authority for the proposition that the more burdensome the preliminary injunctive relief, the more persuasive a showing the party seeking such relief must make. 761 F. Supp. at 249.

122. Rehearing Decision, *supra* note 115, at 2-3. See *supra* note 114 and accompanying text.

their equitable powers to assist government plaintiffs. This Comment takes the view that such an interpretation of *Unifund* is both correct and desirable. That is, by weighing the possible effect of a freeze order of long duration on the defendants against the SEC's showing on the merits against those defendants, the court's decision can and should serve to rein in judicial assistance in what often would more properly be called SEC "enforcement investigations," rather than "enforcement actions."<sup>123</sup>

As discussed above, the SEC typically brings actions against suspected violators of the insider trading laws within a few days following a major public announcement about a particular corporation, which makes an earlier surge in trading in that corporation's securities highly suspicious. William McLucas, SEC Enforcement Director, remarked in reference to cases such as *Unifund* that "[w]e have 24 hours, and then the money's gone," adding that, "[o]nce the money is gone, the case is basically gone."<sup>124</sup> In most cases, therefore, the SEC is not going to be able to begin such actions with a great deal of evidence amassed, and even with an expedited discovery order in hand the SEC may be hard pressed to gather enough information to go to trial in six or seven months. A former Enforcement Director, Gary Lynch has stated that, because of the court's decision in *Unifund*, he did "not think unknown purchaser cases will go forward because he doubts the commission can meet the burden imposed on it by the Second Circuit."<sup>125</sup> Consequently, the effect of the *Unifund* decision on the SEC's ability to pursue foreign investors may be profound.

Despite its likely harmful effect on the SEC's enforcement ability, the Second Circuit's decision was necessary to avoid potential unfairness in the use of the asset freeze. Judge Newman, writing for the unanimous court in *Unifund*, relied on general principles of equity in assessing how substantial a showing on the merits must be in order to justify an award of a particular

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123. One defense lawyer commented that "few, if any, of the SEC's efforts in the last few years to obtain evidence abroad or sue those who trade abroad seem to have met with any meaningful resistance from United States courts." Richards, *supra* note 18, at 145.

124. See *Remedies Bill*, *supra* note 8, at A-5. A former General Counsel of the SEC similarly remarked in reaction to *Unifund* that "[i]f the freeze is lifted, the foreign entities have no reason to cooperate with the investigation." *Court Deals a Blow*, *supra* note 15.

125. See generally *Bigger Ante*, *supra* note 36.

form of interim relief. For each component of the preliminary injunction, the court weighed the showing made by the SEC against the effect of that component upon the defendants. In modifying the freeze order by removing the requirement that the defendants seek SEC approval for any trades in their accounts, the court referred to the "basic principle that burdensome forms of interim relief require correspondingly substantial justification . . . ."<sup>126</sup> Thus, in reverse, the procedural unfairness of allowing a freeze on the assets of a defendant to remain in place for a long time without a showing of more than circumstantial evidence of securities violations outweighs the risk that the SEC will lose the opportunity to obtain disgorgement in the event violations are proven.

Moreover, the *Unifund* decision made it easier for the SEC to obtain an asset freeze order in the first place. As noted above, the Second Circuit held that the initial grant of the freeze order was proper despite the SEC's "meager showing" since there was "a basis to infer" that Unifund and Tamanaco had engaged in insider trading.<sup>127</sup> Although that image of the asset freeze cannot easily be harmonized with the actual effect of a freeze of a foreign defendant's assets,<sup>128</sup> such a relaxed standard is more appropriate for deciding whether to impose an asset freeze in a civil enforcement action. Given the fact that the SEC must bring insider trading actions against foreign traders as quickly as possible — often without having the time or the ability to even discover the actual identities of the traders — such a standard is necessary to ensure that the SEC can continue to bring such actions. However, since the freeze will only be imposed for a "brief interval" in many cases, the SEC may have to be more selective in choosing which probable violations to pursue.

#### IV. CONCLUSION

It is quite likely that the *Unifund* decision will limit the SEC's ability to enforce United States insider trading laws against foreign investors. While this Comment does not find fault with the SEC for aggressively pursuing possible instances

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126. SEC v. Unifund SAL, 910 F.2d 1028, 1042 (2d Cir. 1990). Therefore, the court appeared to have left it up to the district courts to allow an asset freeze for a longer period of time where the SEC has made a more substantial showing on the merits than the "meager" showing of the SEC in *Unifund*. *Id.*

127. *Id.* at 1041.

128. See *supra* notes 34-52 and accompanying text (Section II.B).

of offshore fraud, and recognizes the practical obstacles that the SEC faces in conducting discovery and enforcing judgments overseas, the courts should not go beyond the basic principles of equity and fairness to litigants in helping the SEC surmount those obstacles. Rather than allowing the use of the ancillary remedy of an asset freeze as a club against foreign defendants in insider trading actions, the courts should force the SEC to seek a more permanent and more sound solution to their practical problems.<sup>129</sup>

Such a solution may be forthcoming as a result of the SEC's continued efforts to negotiate more and better structured MOUs and mutual legal assistance treaties.<sup>130</sup> However, if the time needed to conduct discovery under such treaties cannot be shortened significantly, the SEC may need to push hard for international agreements on improving the procedure for recognition of foreign judgments,<sup>131</sup> lest future foreign defendants are able to outlast foreshortened freeze orders and default.

Michael T. Prior

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129. With respect to insider trading violations, it is unclear at this time whether the SEC will be able to employ its cease and desist power under the recent Securities Law Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, reprinted in FED. SEC. L. REP. (CCH) No. 1416, pt. II (Oct. 10, 1990), to impose asset freezes and, ultimately, orders of disgorgement. See Abramowitz, *From Regulation to Punishment: New SEC Power*, N.Y.L.J. Nov. 6, 1990 at 3.

130. See Mann & Mari, *supra* note 12, at 925-26.

Congress greatly enhanced the SEC's ability to negotiate reciprocal assistance agreements such as MOUs with other countries by passing the International Securities Enforcement Cooperation Act of 1990 (the Act). Pub. L. No. 101-550, reprinted in FED. SEC. L. REP. (CCH) No. 1422, pt. II (Nov. 21, 1990). The Act improved the ability of the SEC to provide foreign authorities with confidential information, preserved the confidentiality of evidence received by the SEC from foreign authorities — by exempting such evidence from the Freedom of Information Act — and made clear that the SEC and the self-regulatory organizations (the various securities exchanges and the National Association of Securities Dealers) had the authority to bar or suspend securities professionals on the basis of the findings of foreign authorities or courts. *Id.* The Act should enhance the SEC's bargaining position in negotiating mutual assistance treaties, therefore, since the SEC's ability to provide a foreign authority with meaningful assistance in the United States is greatly improved by its provisions.

131. See *supra* note 75 and accompanying text.