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Diane U. Mage Roberts†

I. Introduction

On October 5, 1993, Daimler-Benz AG (Daimler), Germany's largest industrial company, became the first German company to list its shares (in American depositary receipt¹ form) on the New York Stock Exchange (NYSE). In order to do so, Daimler had to reconcile its financial statements to U.S. generally accepted accounting principles (GAAP) and reveal a \$592 million 1993 first-half loss.² Despite that painful announcement, Daimler's willingness to "capitulate"³ to U.S.

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¹ American depositary receipts (ADRs) are certificates issued by a depositary (e.g., a bank) in the United States that represent ordinary shares of a foreign issuer that have been deposited with a custodian in the foreign issuer's home country. See American depositary receipts, Exchange Act Release No. 29,226, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,740 (May 23, 1991); Nancy Young, *Using American Depositary Receipts to Access the U.S. Capital Markets*, 8 INSIGHTS, No. 3, Mar. 1994, at 15.

² John Schmid, *Daimler-Benz Reports First-Ever Loss, Reflecting New Accounting, Lower Sales*, WALL ST. J., Sept. 20, 1993, at A10. See also Floyd Norris, *Daimler Says Profits Fell In First Half*, N.Y. TIMES, Sept. 18, 1993, at 35; Jay Palmer, *Daimler's Lost Profit*, BARRON'S, Sept. 20, 1993, at 6; David Waller, *Daimler-Benz pierces accounting mystique*, FIN. TIMES, Sept. 23, 1993, at 24.

³ See, e.g., Barry Riley, *Feeling of betrayal in corporate Germany*, FIN. TIMES, Sept. 22, 1993, at 27 (noting that other large German companies criticized Daimler for complying with the financial disclosure requirements mandated by U.S. regulatory authorities). Initially, Daimler tried to persuade the Securities and Exchange Commission (SEC or Commission) to waive the requirement that its financial statements be reconciled to U.S. GAAP. The SEC resisted such a waiver, however, based in part on objections to the German system of accounting that permits a company to create hidden or silent reserves, i.e., undisclosed balances which are increased in good years (thereby lowering the company's reported earnings) and

GAAP reconciliation in order to list its shares on the NYSE made sense in light of its contemporaneous need for capital and the U.S. capital markets' surging interest in foreign investment.⁴ In addition, Daimler's NYSE listing provides investors with the opportunity to invest directly in foreign securities in the United States without having to go abroad, and it bolsters the belief that the U.S. securities markets are the "world's best and most competitive."⁵

While the Securities and Exchange Commission (SEC or Commission) was not willing to compromise on its commitment to U.S. GAAP standards to accommodate Daimler's NYSE listing, it did demonstrate more flexibility in the application of other provisions of the federal securities laws.⁶ For example, to facilitate the offer and sale of German securities in the United States, the Commission granted class exemp-

decreased in bad years (thereby increasing the company's reported earnings). In the agreement reached with the SEC, Daimler was required to disclose to investors all hidden reserves in its U.S. GAAP reconciliation. See J. Michael Schell, *Daimler-Benz leads Germany to New York Stock Exchange*, INT'L FIN. L. REV., Dec. 1993, at 11, 13; *Daimler-Benz's Gerhard Liener: Accommodating (partly) U.S. disclosure rules*, INSTITUTIONAL INVESTOR (International Edition), June 1993, at 52.

Whether it is appropriate to require foreign issuers to reconcile their financial statements to U.S. GAAP is a subject that continues to generate debate. See Roberta S. Karmel & Mary S. Head, *Barriers to Foreign Issuer Entry Into U.S. Markets*, 24 LAW & POL'Y INT'L BUS. 1207, 1208-10 (1993) (arguing that the SEC's requirement that foreign issuers reconcile their financial statements to U.S. GAAP represents a significant barrier to entry to U.S. capital markets); William C. Freund, *That Trade Obstacle, the SEC*, WALL ST. J., Aug. 27, 1993, at A6 ("If the SEC continues to insist that foreign firms abide by America's anachronistic accounting standards, it will do harm to the U.S. as the world's financial center."); but see Richard M. Kosnik, *Comments on "Barriers to Foreign Issuer Entry Into U.S. Markets,"* 24 LAW & POL'Y INT'L BUS. 1237, 1256 (1993) (maintaining that the SEC has been aggressively removing barriers to entry for foreign issuers entering U.S. capital markets, including modifying U.S. GAAP reconciliation, in a manner consistent with its mandate to protect U.S. investors); *Roberts Discusses SEC Disclosure Requirements for Foreign Issuers*, 94-141 SEC TODAY, July 27, 1994, at 1 (maintaining that the SEC is willing to reexamine its disclosure requirements to accommodate foreign issuers, consistent with investor protection standards). In certain respects, the Commission has been facilitating the registration and reporting requirements for foreign issuers. See, e.g., *Selection of Reporting Currency for Financial Statements of Foreign Private Issuers and Reconciliation to U.S. GAAP for Foreign Private Issuers With Operations in a Hyperinflationary Economy*, Securities Act Release No. 7054, 59 Fed. Reg. 21,810 (Apr. 19, 1994) (providing foreign issuers with flexibility in their choice of reporting currencies used in SEC filings and streamlining financial statement reconciliation requirements for foreign issuers with operations in hyperinflationary economies); *Reconciliation of the Accounting by Foreign Private Issuers for Business Combinations*, Securities Act Release No. 7056, 59 Fed. Reg. 21,821 (Apr. 19, 1994) (streamlining financial statement reconciliation requirements for foreign issuers who have entered into business combinations).

⁴ See, e.g., *Foreign Firms Raise More and More Money in the U.S. Markets*, WALL ST. J., Oct. 5, 1993, at A1; Alex Taylor, III, *Daimler Benz: Making Up For Lost Time*, FORTUNE, Oct. 18, 1993, at 78; Craig Torres, *Latin American Firms Break With Past, Scramble to Be Listed on U.S. Exchanges*, WALL ST. J., Sept. 28, 1993, at C1.

⁵ *The SEC's Open Door Policy*, WALL ST. J., Sept. 23, 1993, at A17 (quoting Mary L. Schapiro, SEC Commissioner, in her *Letter to the Editor*). See also *Daimler Completes Its Rights Issue, U.S. Holders Grow*, WALL ST. J., July 8, 1994, at A5 (Daimler's stated goal is to integrate into the U.S. market by diversifying itself with a ten percent U.S. shareholder base.).

⁶ *Daimler bends*, ECONOMIST, Apr. 3, 1993, at 76; *Daimler plays ball*, ECONOMIST, Mar. 27, 1993, at 76. See also Robert Fisher, *SEC Chief Seeks to Clarify Agency's Role, Allay Fear of Firms Seeking U.S. Listing*, INT'L WALL ST. J., Feb 1, 1994, at A7.

tions from Rules 10b-6,⁷ 10b-7,⁸ and 10b-8⁹ (collectively, Trading Rules) under the Securities Exchange Act of 1934 (Exchange Act),¹⁰ in connection with U.S. distributions of actively traded equity securities of certain highly capitalized "blue chip" German issuers (German Exemptions).¹¹ The Trading Rules are the principal anti-manipulation provisions, promulgated under Section 10(b) of the Exchange Act, that regulate market activities during distributions of securities in the United States.¹² Generally, the Trading Rules, and Rule 10b-6 in particular, prevent market manipulation by restricting or regulating the market activities of participants in a distribution of securities in the United States before and throughout the period the securities are being distributed.¹³ To best achieve its purpose, Rule 10b-6 has been crafted to operate prophylactically.¹⁴ The Commission has taken the position that the Trading Rules apply on a worldwide basis whenever there is a distribution in the United States.¹⁵

The German Exemptions effectively replace the prophylactic measures of Rule 10b-6, as they are applied outside the United States,

⁷ 17 C.F.R. § 240.10b-6 (1994). See generally Review of Antimanipulation Regulation of Securities Distributions, Exchange Act Release No. 33,924, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,335 (Apr. 19, 1994) [hereinafter Review of Antimanipulation Regulation]; Prohibition Against Trading by Persons Interested in a Distribution, Exchange Act Release No. 24,003, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,055 (Jan. 16, 1987); Application of Rule 10b-6 to Persons Participating in Shelf Distributions, Exchange Act Release No. 23,611, 3 Fed. Sec. L. Rep. (CCH) ¶ 22,767 (Sept. 11, 1986); Prohibition Against Trading by Persons Interested in a Distribution, Exchange Act Release No. 19,565, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,326 (Mar. 4, 1983) [hereinafter 1983 Adopting Release]; 1 EDWARD F. GREENE ET AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES MARKETS—A GUIDE FOR DOMESTIC AND FOREIGN ISSUERS AND INTERMEDIARIES § 6.01[5] (2d ed. 1993); THOMAS L. HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION 261-67 (2d ed. 1990); CHARLES J. JOHNSON, JR., CORPORATE FINANCE AND THE SECURITIES LAWS 158-90 (1990); LOUIS LOSS & JOEL SELIGMAN, IX SECURITIES REGULATION 4015-44 (3d ed. 1992); Ward Foshay, *Market Activities of Participants in Securities Distributions*, 45 VA. L. REV. 907 (1959); Jack M. Whitney II, *Rule 10b-6: The Special Study's Rediscovered Rule*, 62 MICH. L. REV. 567 (1964). See *infra* notes 20-32 and accompanying text.

⁸ 17 C.F.R. § 240.10b-7 (1994). See *infra* notes 33-39 and accompanying text.

⁹ 17 C.F.R. § 240.10b-8 (1994). See *infra* notes 40-46 and accompanying text.

¹⁰ 15 U.S.C. §§ 78a-78ll (1988 and Supp. V 1993).

¹¹ Exemptions From Rules 10b-6, 10b-7, and 10b-8 During Distributions of Certain German Securities, Exchange Act Release No. 33,022, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,233 (Oct. 6, 1993) [hereinafter German Exemptions]. See also Patrick Harverson, *SEC tightens rule for brokers to disclose order flow payments*, FIN. TIMES, Oct. 7, 1993, at 30; Tracey Longo, *SEC Proposes to Ease Rules for Foreign Firms*, TRADERS MAG., Dec. 1993, at 44; *SEC Seeks to Ease Access to Markets For Foreign Firms*, WALL ST. J. (European Edition), Nov. 4, 1993, at 24; *Trading Rules Eased for German Firms, Other Countries Under Consideration*, 6 INT'L SEC. REG. REP., No. 22, Oct. 19, 1993, at 2.

¹² See also Securities Exchange Act of 1934 § 9(a)(2), 15 U.S.C. § 78i(a)(2) (1988) (general prohibition of manipulation of securities registered on a national securities exchange). See generally Lewis D. Lowenfels, *Sections 9(a)(1) and 9(a)(2) of the Securities Exchange Act of 1934: An Analysis of Two Important Anti-Manipulative Provisions under the Federal Securities Laws*, 85 NW. U. L. REV. 698 (1991).

¹³ Review of Antimanipulation Regulation, *supra* note 7, at 85,248.

¹⁴ See *infra* note 27.

¹⁵ See *infra* note 47 and accompanying text.

with a "kinder, gentler" form of regulation involving disclosure to the investing public in addition to notice, reporting, recordkeeping, and record production obligations (directly and indirectly) to the Commission. These exemptions also demonstrate the Commission's general recognition that, with respect to the regulation of market manipulation, it may be appropriate to impose strict conditions on transactions effected in "price discovery" markets (i.e., securities markets in which trading is likely to have a significant effect on the price of the security being distributed),¹⁶ and less stringent, or no conditions, on transactions effected in markets that are *not* likely to be "price discovery" markets (i.e., securities markets in which trading is not likely to have a significant effect on the price of the security being distributed). Significantly, these exemptions propose that "kinder, gentler" forms of market manipulation regulation in price discovery markets may be an effective substitute for proscriptions on trading and market activity. The German Exemptions also reflect a tacit acknowledgement that the market for actively traded equity securities of highly capitalized issuers may be more costly, and hence more difficult, to influence than the market for other securities.

While the effectiveness of this "gentle" form of regulation remains to be tested, it may prove to be the cornerstone of the next generation of market manipulation regulation. This is because, *inter alia*, with such regulation taxpayers save certain bureaucratic costs that accompany conventional regulatory oversight; the investing public receives more information to make well-informed investment decisions; and foreign issuers, underwriters, and their affiliates avoid the cost and coerciveness of the Trading Rules as they historically have been applied.¹⁷ The Commission recently confirmed that the German Exemptions are a harbinger of its policy with respect to U.S. distributions of foreign securities in a statement (Policy Statement)¹⁸ in which it announced that exemptions for actively traded and widely followed securities of highly capitalized issuers from other countries would be granted in the future, subject to terms and conditions substantially sim-

¹⁶ See DIVISION OF MARKET REGULATION, SEC, MARKET 2000: AN EXAMINATION OF CURRENT EQUITY MARKET DEVELOPMENTS III-2 (Jan. 1994) [hereinafter MARKET 2000 STUDY] ("Price discovery involves the determination of the price of a security through the interaction of supply and demand. . . . While price discovery can be said to occur wherever traders meet to bargain, the starting point (and often the market clearing price) is the price disseminated by the primary market.").

¹⁷ Josh Feltman, *Disclosure Laws Can Regulate Gently*, N.Y. TIMES, Oct. 3, 1993, at 9. See *infra* notes 109-13 and accompanying text.

¹⁸ Application of Rules 10b-6, 10b-7, and 10b-8 During Distributions of Securities of Certain Foreign Issuers, Exchange Act Release No. 33,137, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,248 (Nov. 3, 1993) [hereinafter Policy Statement]. See also *Developments in Rule 10b-6*, 27 SEC. & COMMODITIES REG., No. 1, Jan. 1994, at 7-8; *SEC announces new initiatives for foreign issuers*, EUROMONEY, Dec. 1993, at 20; Glenn M. Reiter et al., *SEC relaxes rules for non-US issuers*, INT'L FIN. L. REV., Dec. 1993, at 29.

ilar to those contained in the German Exemptions.¹⁹

This Article examines the international application of the Trading Rules, and Rule 10b-6 in particular. It briefly describes the Trading Rules and then examines the German Exemptions in detail, highlighting how they have helped to shape policy with respect to the application of the Trading Rules to multinational distributions of securities. This Article concludes that the German Exemptions may lay a foundation for a similar exemption or exception to be issued in connection with distributions of actively traded domestic securities of substantial U.S. issuers in the future.

II. The Trading Rules Generally

Rule 10b-6 protects "the integrity of the securities trading market as an independent pricing mechanism and promotes public confidence in the U.S. securities markets."²⁰ In very general terms, Rule 10b-6 prohibits those persons who have a stake in a "distribution"²¹ of

¹⁹ Policy Statement, *supra* note 18, at 84,655. See, e.g., Exemptions From Rule 10b-6, 10b-7, and 10b-8 During Distributions of Certain French Securities, Exchange Act Release No. 34,176, 59 Fed. Reg. 31,274 (June 7, 1994) [hereinafter French Exemptions] (granting exemptions from the Trading Rules to distribution participants and their affiliated purchasers in connection with distributions of certain actively traded securities of highly capitalized French issuers consistent with the German Exemptions). See also *French Firms Granted Certain Exemptions From Securities Laws*, WALL ST. J., June 15, 1994, at C18; *News in Brief*, 7 INT'L SEC. REG. REP., No. 15, June 28, 1994, at 7 (captioned *U.S. SEC Grants Trading Rule Exemption to Qualified French Securities*).

²⁰ Passive Market Making, Exchange Act Release No. 31,347, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,054, at 83,397 (Oct. 22, 1992) (*proposing release*). The Securities and Exchange Act of 1934 (Exchange Act) was passed by Congress to ensure that the U.S. securities markets "fulfill . . . their primary function of furnishing open markets for securities where supply and demand may fully meet at prices uninfluenced by manipulation or control." S. REP. NO. 1455, 73rd Cong., 2d Sess. 81 (1934). While the term "manipulation" is not expressly defined in the Exchange Act, it generally refers to any act or practice which is intended to mislead investors by artificially controlling or affecting the price of a security. See, e.g., *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, 426 F.2d 569, 577 (2d Cir. 1970) ("Manipulation was often accomplished by those about to sell securities or already engaged in selling securities bidding on the market for the same securities, thereby creating an unjustifiable impression of market activity which would facilitate the sale at artificially high prices.") (*quoting* *Securities and Exch. Comm'n v. Scott Taylor & Co.*, 183 F. Supp. 904, 907 (S.D.N.Y. 1959)); *In the Matter of Swartwood, Hesse, Inc.*, Exchange Act Release No. 31,212 (Sept. 22, 1992), available in LEXIS, Fedsec Library, Secrel File ("Manipulation is the creation of deceptive value or market activity for a security, accomplished by the intentional interference with the free forces of supply and demand."). The universe of trading activities that have as their purpose the artificial influencing of market prices is limited only by the imagination of market participants. Parking arrangements are a classic example of such activity. Parking arrangements generally are intended to conceal the beneficial ownership of a security and involve placing securities through a sham purchase or sale transaction in an account in the name of a third party or in the name of a nominee account under the control of the person or entity that parked the securities. See generally Lewis D. Lowenfels & Alan R. Bromberg, *Securities Market Manipulations: An Examination and Analysis of Domination and Control, Frontrunning, and Parking*, 55 ALB. L. REV. 293 (1991).

²¹ The term "distribution" means an offering of securities, whether or not subject to registration under the Securities Act of 1933 (Securities Act), 15 U.S.C. §§ 77a-77z (1988 and Supp. V 1993), that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods. 17 C.F.R.

securities, referred to as "distribution participants"²² and their "affiliated purchasers,"²³ from bidding for or purchasing, or inducing others to purchase (i.e., by stimulating or creating demand or buying interest that has the effect of artificially raising or maintaining a security's price) the offered security (or related securities)²⁴ until they have

§ 240.10b-6(c)(5) (1994). See also Review of Antimanipulation Regulation, *supra* note 7, at 85,248. For example, payment of compensation greater than that paid in connection with ordinary trading transactions to persons handling offers and sales in an offering may suggest the presence of special selling efforts and selling methods. See JOHNSON, *supra* note 7, at 166. Only that portion of the global offering being distributed in the United States is relevant to the determination of whether a "distribution" of foreign securities is subject to Rule 10b-6. Exceptions to Rules 10b-6, 10b-7, and 10b-8 Under the Securities Exchange Act of 1934 For Distributions of Foreign Securities to Qualified Institutional Buyers, Exchange Act Release No. 32,266, 58 Fed. Reg. 27,686, 27,689 n.43 (May 5, 1993) (*proposing release*). A Rule 10b-6 distribution can be found not only in offerings subject to the registration requirements of the Securities Act of 1933, but also in private placements exempt from the registration requirements of the Securities Act, in rights offerings, in exchange offers, in shelf registrations, and in merger transactions. See, e.g., U.K. Water Privatization, SEC No-Action Letter, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,495 (Nov. 22, 1989). In addition, Rule 10b-6(b) provides that the distribution of a security which is immediately exchangeable for or convertible into another security, or which entitles the holder immediately to acquire another security, also is deemed to include a distribution of such other security within the meaning of Rule 10b-6. 17 C.F.R. § 240.10b-6(b). For example, if an issuer is engaging in a distribution of immediately convertible debentures, the underlying common stock also is considered to be in distribution for purposes of Rule 10b-6.

²² "Distribution participants" are the issuer or other person on whose behalf the distribution is being made (such as a selling shareholder), underwriters, prospective underwriters, dealers, brokers, and other persons who have agreed to participate or are participating in the distribution. See 17 C.F.R. § 240.10b-6(c)(1)-(2) (1994). Generally, the restrictions of Rule 10b-6 commence with the decision to participate in the distribution, consistent with the notion that the incentive to engage in activities to facilitate the distribution also would arise at that time. Accordingly, an issuer or a selling shareholder becomes subject to Rule 10b-6 at the time a determination is made to go forward with a distribution of the issuer's securities. Underwriters and others become subject to the rule when they make a determination to participate in the distribution. See Review of Antimanipulation Regulation, *supra* note 7, at 85,251-52.

²³ 17 C.F.R. § 240.10b-6(c)(6) (1994). Generally, "affiliated purchasers" are persons acting in concert with a distribution participant (directly or indirectly) in connection with the acquisition or distribution of any security which is the subject of such distribution, or any security of the same class or series, or any right to purchase any such security, or affiliates who, directly or indirectly, control the purchase of such securities by a distribution participant, or whose purchases are controlled by a distribution participant, or whose purchases are under common control with those of a distribution participant, and affiliates that are a broker or a dealer. The definition does not include a non-broker-dealer affiliate: (1) that is a separate and distinct organizational entity from, with no officers (or persons performing similar functions) or employees (other than clerical, ministerial, or support personnel) in common with, the distribution participant; (2) that has separate employee compensation arrangements; and (3) whose bids for, purchases of, and inducements to purchase the securities subject to distribution are made in the ordinary course of its business. *Id.* See also VLI Corporation, SEC No-Action Letter, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,625 (Oct. 17, 1983) (permitting the issuer's directors (i.e., affiliated purchasers) to purchase, for investment purposes, distribution shares from the underwriter subject to the same terms and conditions offered to other persons in the distribution).

²⁴ "Related securities" are any security of the same class and series as the securities being distributed, or any right to purchase such security. 17 C.F.R. § 240.10b-6(a)(4) (1994). Related securities may include an option, warrant, or other right to acquire the security being distributed. See Gamble-Skogmo, Inc., SEC No-Action Letter (Feb. 10, 1974), available in LEXIS, Fedsec Library, Noact File (outstanding debt securities are not considered of the

completed their participation in the distribution,²⁵ unless otherwise excepted or exempted. Hence, Rule 10b-6 operates prophylactically. Consequently, there is no requirement that the trading activities²⁶ actually affect the market price of the security in distribution, or that they be engaged in for the purpose of manipulating the market for the securities.²⁷ Rule 10b-6 contains thirteen excep-

"same class and series" as those debt securities being distributed if the interest rates vary by at least one percent and the maturity dates vary by at least ten years). Rule 10b-6 also generally proscribes trading in securities baskets or indices that include the securities being distributed (or securities of the same class and series) as component securities. See *Basket Trading During Distributions*, SEC No-Action Letter, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,752 (Aug. 6, 1991) (permitting basket trading during a distribution subject to certain conditions).

²⁵ 17 C.F.R. § 240.10b-6(c)(3) (1994). With respect to an underwriter, the distribution is deemed to be complete when such underwriter has received, in good faith, bona fide and firm customer orders for all of its allocation of securities and when any stabilizing arrangements have terminated. See *Wall Street West, Inc.*, Exchange Act Release No. 20,557, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,477, at 86,523 (Jan. 12, 1984). The restrictions of Rule 10b-6 also cease to apply if the distribution is abandoned. In connection with firm commitment underwritings, the underwriting syndicate typically will sell more securities than it has to distribute in order, among other things, to cover canceled orders. The short positions that are created by overselling may be covered through the exercise of an over-allotment option (typically 15 percent of the registered securities) or by secondary market purchases, as long as the exercise of the over-allotment option or the secondary market purchases are made only to cover the remaining short position. If the over-allotment option is exercised for an amount in excess of the syndicate short position, the distribution will not be deemed to have been completed and any prior secondary market purchases that have been made would be a violation of Rule 10b-6. See 1983 Adopting Release, *supra* note 7, at 85,525; Review of Antimanipulation Regulation, *supra* note 7, at 85,256; NASD Manual, Rules of Fair Practice, Art. III, Sec. 1, para. 2151.01.

²⁶ In an expansive manner, Rule 10b-6 prohibits bids, purchases, and attempts to induce the purchase of the security being distributed and related securities. Review of Antimanipulation Regulation, *supra* note 7, at 85,252. A Rule 10b-6 "bid" has been found in price quotations, unpriced indications of interest in purchasing a security, public announcements of a tender offer or exchange offer, and the sale of put options. *Id.* Rule 10b-6 "purchases" have been found in the exercise of call options. *Id.* The use of research reports to effect a transaction during the distribution may constitute an "inducement to purchase" for purposes of Rule 10b-6, especially if such reports have been issued previously and are revised to contain a buy recommendation or more favorable earnings forecasts. *Id.*; Research Reports, Exchange Act Release No. 21,332, 3 Fed. Sec. L. Rep. (CCH) ¶ 22,766, at 16,631-32 n.25 (Sept. 19, 1984). Thus, in connection with a distribution of equity securities, the scope of market activities subject to Rule 10b-6 with respect to trading by a typical broker-dealer distribution participant and its affiliated purchasers in outstanding distribution and related securities includes, *inter alia*: market making activities; soliciting, as agent or principal, customers' orders to buy; purchasing for customers' accounts managed on a discretionary basis; and trading in derivative securities (i.e., purchasing call options or writing put options). In practice, however, Rule 10b-6 regulates purchasing activity and does not purport to regulate selling activity.

²⁷ The Commission interprets the Trading Rules to operate prophylactically, i.e., regardless of intent. See *Options and Option-related Transactions During Underwritten Offerings*, Exchange Act Release No. 17,609, 3 Fed. Sec. L. Rep. (CCH) ¶ 22,765, at 16,631-34 (Mar. 6, 1981) ("[T]he prophylactic restrictions of Rule 10b-6 apply to conduct that, in many cases, will have manipulative effects regardless of any subjective intent on the part of the purchaser."); Review of Antimanipulation Regulation, *supra* note 7, at 85,261 (seeking comment on whether certain "inadvertent" or "technical" violations of the Trading Rules should be excused for lack of manipulative intent). In addition, one author has commented:

If securities manipulation means anything in particular, it means conduct intended to induce people to trade a security or force its price to an artificial

tions²⁸ to its general prohibitions that are intended, among other things, to permit an orderly distribution of securities²⁹ or to limit disruptions caused by the rule's application in the market for the securities being distributed.³⁰ Rule 10b-6 does not apply to some

level. Section 10(b) does not authorize the regulation of manipulation, but rather, of the use of manipulative devices. Just as the Commission can regulate the use of deceptive devices by people who do not intend to deceive, it can regulate devices that are potentially manipulative regardless of the motives of the individuals that employ them.

Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 393-94 (1990) [hereinafter *Conception of Section 10(b)*]. However, the courts may deem scienter an essential element of a Rule 10b-6 violation in contrast to the Commission's position. See SEC v. Burns, 614 F. Supp. 1360, 1363 (D.C. Cal. 1985), *aff'd on other grounds*, 816 F.2d 471 (9th Cir. 1987) (finding that "scienter" is an essential element of a Rule 10b-6 violation).

²⁸ Distribution participants are able to utilize the exceptions to Rule 10b-6 so long as their transactions are not engaged in for the purpose of creating actual, or apparent, active trading in or raising the price of the security subject to distribution or related securities. Rule 10b-6(a)(4), 17 C.F.R. § 240.10b-6(a)(4) (1994). See also 17 C.F.R. § 240.10b-6(j) (enabling the Commission to grant administrative exemptions from Rule 10b-6 for transactions "not constituting a manipulative or deceptive device or contrivance comprehended within the purpose of [Rule 10b-6]").

²⁹ See, e.g., 17 C.F.R. § 240.10b-6(a)(4)(i) (1994) (permits distribution participants to purchase distribution securities from the issuer for resale); 17 C.F.R. § 240.10b-6(a)(4)(vi) (permits distribution participants to solicit indications of interest from purchasers for the securities being distributed).

³⁰ See, e.g., 17 C.F.R. § 240.10b-6(a)(4)(xi) (1994) (exception permitting, *inter alia*, an underwriter, prospective underwriter, or dealer participating in a distribution to effect solicited principal transactions prior to a specified two or nine business day "cooling-off" period before the commencement of offers or sales in the distribution); 17 C.F.R. § 240.10b-6(a)(4)(xii) (exception permitting, *inter alia*, an issuer, selling security holder, and others to effect bids or purchases prior to a specified two or nine business day "cooling-off" period before the commencement of offers or sales in the distribution). See *infra* note 166. The cooling-off period for stock with a minimum share price of \$5.00 and a minimum public float of 400,000 shares is two business days; the cooling-off period for the exercise of standardized call options on such stock is five business days; and the cooling-off period for all other securities (e.g., non-investment grade debt) is nine business days. The cooling-off periods are designed to allow the impact of market activities by distribution participants to dissipate before the commencement of offers or sales in the distribution. Thus, a distribution for purposes of Rule 10b-6 begins before the cooling-off period. See also 17 C.F.R. § 240.10b-6(a)(4)(v)(A) (1994) (exception for unsolicited brokerage transactions); 17 C.F.R. § 240.10b-6(a)(4)(v)(B) (providing cooling-off periods for solicited brokerage transactions); Rule 10b-6: Interpretation of "Business Day," SEC Interpretive Letter, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,751 (July 29, 1991) (discussing the calculation of a "business day" for purposes of Rule 10b-6). The Commission has taken the position that the cooling-off period exceptions under the rule are not applicable automatically to U.S. distributions of foreign securities. See Notice of Modification of Class Exemption Letter Regarding Application of Cooling-Off Periods Under Rule 10b-6 to Distributions of Foreign Securities, Exchange Act Release No. 33,862, 59 Fed. Reg. 17,125 (Apr. 4, 1994) [hereinafter *Cooling-Off Periods Exemption*] (clarifying the application of the cooling-off periods exceptions under Rule 10b-6 to distributions of foreign securities in the United States and making the two business day cooling-off period available to distributions of foreign securities where certain recordkeeping and record production requirements are satisfied, the security's world-wide average daily trading volume equals or exceeds \$250,000, and the security's principal market requires contemporaneous trade reporting to a securities regulator or authority), *superseding* Exchange Act Release No. 31,943, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,117 (Mar. 4, 1993). See *SEC Announces Modifications to 10b-6 Anti-Manipulation Rules*, 7 INT'L SEC. REC. REP., No. 11, May 3, 1994, at 3. Under the Cooling-Off Periods Exemption, foreign securities trading in the United States in the form of ordinary shares or ADRs that satisfy the

transactions that present little or no incentive to artificially condition the market for the security in order to facilitate a distribution.³¹ In addition, activities effected in accordance with Rules 10b-7 and 10b-8 are excepted from Rule 10b-6.³²

Stabilizing activities are governed by the application of Rule 10b-7.³³ Stabilizing activities are activities conducted by market participants to facilitate a securities offering, such as the placement of a bid or effecting a purchase, for the purpose of pegging, fixing or stabilizing a security's price.³⁴ While the Commission has recognized that stabilizing activities deliberately manipulate a security's market price,³⁵ it has also acknowledged that such activities can benefit the U.S. capital markets because they facilitate an orderly distribution of securities.³⁶ Accordingly, Rule 10b-7 was promulgated to permit stabilizing activities subject to certain conditions. Under Rule 10b-7, no stabilizing bid or purchase can be made for a purpose other than preventing or retarding a decline in the open market price of a security.³⁷ In other words, the exclusive purpose of stabilizing under Rule 10b-7 must be to

exceptions to Rule 10b-6 contained in paragraphs (a)(4)(v), (a)(4)(xi), and (a)(4)(xii) qualify, on a self-executing basis, for a two business day cooling-off period wherever such securities are traded. Cooling-Off Periods Exemption, *supra*, at 17,126 n.10.

³¹ See, e.g., 17 C.F.R. § 240.10b-6(e) (1994) (excepting distributions by an issuer to employees or shareholders pursuant to a "plan" as defined in Rule 10b-6, 17 C.F.R. § 240.10b-6(c)(4)); 17 C.F.R. § 240.10b-6(i) (1994) (excepting certain distributions of foreign securities to qualified institutional buyers (QIBs), as defined in Rule 144A(a) under the Securities Act of 1933, 17 C.F.R. § 230.144A(a)); Exceptions to Rules 10b-6, 10b-7, and 10b-8 Under the Securities Exchange Act of 1934 for Distributions of Foreign Securities to Qualified Institutional Buyers, Exchange Act Release No. 33,138, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,249 (Nov. 3, 1993) [hereinafter Rule 144A Distribution Exceptions]. See also Regulation S Transactions During Distributions of Foreign Securities to Qualified Institutional Buyers, SEC No-Action Letter, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,851 (Feb. 22, 1994) (extending the Rule 144A Distribution Exceptions to include side-by-side sales to QIBs pursuant to Rule 144A under the Securities Act of 1933 and non-U.S. persons as defined in Rule 902(o)(2) and Rule 902(o)(7) pursuant to Regulation S under the Securities Act of 1933, 17 C.F.R. § 230.902(o)(2),(7) (1994)).

³² 17 C.F.R. § 240.10b-6(a)(4)(viii)-(ix) (1994). See *infra* notes 33-46 and accompanying text.

³³ Review of Antimanipulation Regulation, *supra* note 7, at 85,255. See also George S. Parlin & Edward Everett, *The Stabilization of Security Prices*, 49 COLUM. L. REV. 607 (1949).

³⁴ 17 C.F.R. § 240.10b-7(b)(3) (1994).

³⁵ Statement of SEC on the Regulation of "Pegging, Fixing and Stabilizing" of Securities Prices, Exchange Act Release No. 2446, 11 Fed. Reg. 10,971 (Mar. 18, 1940); LOSS & SELIGMAN, *supra* note 7, at 3988-99. While some market activities, such as market making, may not be engaged in by distribution participants expressly to facilitate a distribution of securities, under some circumstances such activities may have the incidental effect of stabilizing or supporting the market for the security being distributed. See, e.g., German Exemptions, *supra* note 11, at 84,525 (requesting exemptive relief from Rule 10b-7 to the extent that efforts by distribution participants to "maintain an orderly market" constitute stabilizing activities).

³⁶ Permitting stabilizing activities provides public benefits in theory because, absent the ability to effect stabilizing transactions, underwriters would be less likely to agree to firm commitment offerings. This, in turn, would be detrimental to the capital formation process. See LOSS & SELIGMAN, *supra* note 7, at 3994-99; *Conception of Section 10(b)*, *supra* note 27, at 399 n.56.

³⁷ 17 C.F.R. § 240.10b-7(c) (1994). See generally JOHNSON, *supra* note 7, at 190-96.

maintain existing price levels or to prevent or retard a price decline. Rule 10b-7 regulates stabilizing transactions by, *inter alia*, limiting the price at which a stabilizing bid may be entered, thereby establishing rules of priority for the execution of independent bids at times when a stabilizing bid has been entered, and requiring disclosure of the stabilizing transactions to the market and investors.³⁸ The rule also regulates both the number of stabilizing bids that may be entered on any one market and the entry of stabilizing bids on markets other than the offered security's principal market.³⁹

Distributions of securities through rights are governed by the application of Rule 10b-8.⁴⁰ Rule 10b-8 applies to "any person participating in a distribution of securities being offered through rights issued on a pro rata basis to security holders."⁴¹ Generally in a rights offering, existing shareholders receive a transferable right that entitles them to purchase new shares at a discount from the current market price during the subscription period (customarily a period between twenty to forty days). Shareholders that do not want to subscribe for all of their entitlement may sell their rights in the market that develops during the subscription period.⁴² At the end of the subscription period, underwriters may be obligated to purchase any shares that remain unsubscribed.⁴³ Because a decline in the market value of the security underlying the rights during the subscription period can affect the success of the offering, issuers and underwriters may engage in certain market activities to shift and manage their capital risk during rights offerings.⁴⁴ Rule 10b-8 was adopted to accommodate these risk reduction activities in a manner consistent with the anti-manipulation

³⁸ 17 C.F.R. § 240.10b-7(d), (j), (k) (1994).

³⁹ 17 C.F.R. § 240.10b-7(e), (h) (1994). *See also* Stabilizing to Facilitate a Distribution, Exchange Act Release No. 28,732, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,704, at 81,226-28 & n.18 (Jan. 3, 1991) [hereinafter Stabilizing Release] (proposing amendments to Rule 10b-7 that would permit stabilization with reference to prices in the principal foreign market for a foreign security when the security's principal market in the United States is closed).

⁴⁰ Review of Antimanipulation Regulation, *supra* note 7, at 85,257-58.

⁴¹ 17 C.F.R. § 240.10b-8(a) (1994). Rights offerings are the primary method of equity financing for many foreign companies. *See infra* note 60 and accompanying text.

⁴² Review of Antimanipulation Regulation, *supra* note 7, at 85,257-58.

⁴³ *Id.* at 85,257.

⁴⁴ *Id.* These risk-reduction arrangements usually consist of either "Shields Plan" or "Columbia Gas Plan" activities. In a typical Shields Plan arrangement, the issuer shifts the risk that the rights will not be exercised (and the issuer will not raise the needed capital) by paying underwriters to enter into a standby underwriting agreement that commits them to purchase all shares left unsubscribed at the end of the subscription period. *See, e.g., id.*; Loss & SELIGMAN, *supra* note 7, at 4045. To reduce their risk, the standby underwriters seek to purchase rights, exercise them, and sell the securities they have acquired. They also may sell the issuer's shares short and use the revenues acquired from these short sales to cover their short position by buying the rights and exercising them. In a typical Columbia Gas Plan arrangement, the issuer retains a dealer-manager to solicit exercises of the rights. While the dealer-manager usually receives a fee for each right that is exercised, there is no obligation to purchase all shares left unsubscribed at the end of the subscription period. *See, e.g., id.* at 4045-46.

objectives of the Exchange Act.⁴⁵ During a rights offering, Rule 10b-8 places restrictions on the prices that the securities being distributed (or securities of the same class and series) may be offered or sold and, under some circumstances, the prices at which rights may be purchased.⁴⁶

Although the jurisdictional scope of the Trading Rules remains unclear, the Commission has taken the position that they have extraterritorial application.⁴⁷ As a result, while a security is being distributed in the United States, all distribution participants and their affiliated purchasers would need either to limit, curtail, or cease their market activities in such security (or related securities), as required by

⁴⁵ Review of Antimanipulation Regulation, *supra* note 7, at 85,257-58.

⁴⁶ See 17 C.F.R. § 240.10b-8(b) (1994); 17 C.F.R. § 240.10b-8(d); Review of Antimanipulation Regulation, *supra* note 7, at 85,257-58; LOSS & SELIGMAN, *supra* note 7, at 4045-57. See also Daimler-Benz Aktiengesellschaft, SEC No-Action Letter (June 22, 1994), available in LEXIS, Fedsec Library, Noact File (granting exemptions from Rule 10b-8(b) and (d) in connection with a rights distribution in which distribution participants and their affiliated purchasers also rely on the German Exemptions, subject to certain conditions).

⁴⁷ Review of Antimanipulation Regulation, *supra* note 7, at 85,259; Cooling-Off Periods Exemption, *supra* note 30, at 17,126 n.9; Stabilizing Release, *supra* note 39, at 81,226 & n.18. In theory, the possibilities for securities fraud and manipulation increase as world-wide securities trading increases, e.g., persons seeking to profit through manipulation may try to increase prices in a price discovery market and take profits on another market. The Commission's extraterritorial position is supported by court decisions holding that the general anti-fraud provisions of the federal securities laws apply to fraudulent or manipulative activity occurring outside the United States if such activities have an effect in the United States. See Consolidated Gold Fields PLC v. Minorco, 871 F.2d 252, 263 (2d Cir. 1989), modified, 890 F.2d 569 (2d Cir. 1989), cert. dismissed, 492 U.S. 939 (1989); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 991 (2d Cir. 1975); Schoenbaum v. Firstbrook, 405 F.2d 200, 208 (2d Cir. 1968), rev'd in part on other grounds, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied sub nom. Manley v. Schoenbaum, 395 U.S. 906 (1969). Moreover, the RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES (1987) cites authority for the United States to exercise subject matter jurisdiction when the exercise of such jurisdiction is "reasonable." Significantly, the authority to prescribe laws is extended not only to U.S. legislatures; it also can be extended to U.S. regulatory agencies and the courts where provided for by statute. *Id.* § 402, cmt. i. Nonetheless, the SEC's position that the Trading Rules have extraterritorial application is controversial and is frequently challenged by market participants. For example, some participants question whether the jurisdictional predicate for the application of the Securities Exchange Act of 1934 (i.e., that the activity involve the "use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange," 15 U.S.C. § 78j (1988); 17 C.F.R. § 240.10b-6(a)(4) (1994)) would be met with respect to the market activities of distribution participants and their affiliated purchasers outside the United States. See, e.g., German Exemptions, *supra* note 11, at 84,524. While seeking exemptions from the Trading Rules, some of these participants refuse to either acknowledge the SEC's basis for asserting jurisdiction or concede jurisdiction through their exemption request. See *id.* at 84,524 n.14. To date, no court has held that the Trading Rules have extraterritorial application. For a discussion of the extraterritorial application of the Trading Rules, see GREENE ET AL., *supra* note 7, § 6.01[5]. For a discussion of the extraterritorial application of the U.S. federal securities laws, see generally James R. Doty, *The Role of the Securities and Exchange Commission in an Internationalized Marketplace*, 60 FORDHAM L. REV. S77 (1992) [hereinafter *The Role of the SEC*]; Roberta S. Karmel, *The Second Circuit's Role in Expanding the SEC's Jurisdiction Abroad*, 65 ST. JOHN'S L. REV. 743 (1991); Roberta S. Karmel, *SEC Regulation of Multijurisdictional Offerings*, 16 BROOKLYN J. INT'L L. 3 (1990); Katherine T. Wallace, Note, *Alfadda v. Fenn: Expanding the Reach of United States Securities Laws*, 24 LAW & POL'Y INT'L BUS. 993 (1993).

the Trading Rules, wherever they are located or effect transactions, absent an exception or exemption. The rules apply even in foreign jurisdictions whose social, economic, and legal environments permit market activity by those persons before and during a distribution. U.S. market participants allege that this position creates tension between, on the one hand, the expectations of foreign market participants that U.S. securities laws do not apply in their markets and, on the other hand, a system of regulation that protects U.S. investors and securities markets from the effects of foreign market trading and other activities.⁴⁸ U.S. market participants assert that the extraterritorial application of Rule 10b-6 places the United States at a competitive disadvantage and imposes compliance burdens and costs on foreign issuers and underwriters.⁴⁹ They maintain that by removing active market participants from the market for the security being distributed for a minimum two business day period prior to the pricing of an offering,⁵⁰ liquidity and other support in that market is withdrawn or limited,⁵¹ thereby leaving the market vulnerable to abnormal price movements on low volume in the periods shortly before pricing.⁵²

⁴⁸ See Policy Statement, *supra* note 18, at 84,654.

⁴⁹ *Id.*; Review of Antimanipulation Regulation, *supra* note 7, at 85,259.

⁵⁰ Typically, the issuer and the underwriters reach final agreement on pricing after the market for the security has closed on the trading day preceding the offering. John S. D'Alimonte & David C. Peck, *Underwriting Documents, Their Purpose and Content*, in MECHANICS OF UNDERWRITING 1993, at 443, 487 (PLI Corp. Law and Practice Course Handbook Series No. B-810, 1993). While the price of the security being offered is usually a product of negotiation, factors such as the security's last sale information (including price and volume), closing bid and offer quotes, and the general condition of the securities markets are likely to be considered in the determination. In addition, institutional investors may also influence "the structuring and pricing of many securities offerings." Review of Antimanipulation Regulation, *supra* note 7, at 85,246.

⁵¹ Market participants maintain that if most of the major active market participants are forced to withdraw from the market because of Rule 10b-6, trading in the securities subject to distribution would virtually come to a halt and thereby severely deplete market liquidity during the distribution period, absent an exemption from Rule 10b-6. See, e.g., Wellcome plc, SEC No-Action Letter, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,268, at 76,958 (July 21, 1992) (stating that foreign market makers subject to Rule 10b-6 accounted for roughly 75% of the average daily trading volume in the Rule 10b-6 restricted shares on the LSE); British Telecommunications plc, SEC No-Action Letter, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,062, at 79,044 (Dec. 3, 1991) (stating that foreign market makers subject to Rule 10b-6 accounted for 90-95% of the average daily trading volume in the Rule 10b-6 restricted shares on the London Stock Exchange (LSE)).

⁵² Market participants allege that the contraction of liquidity both contributes to market volatility, making it difficult to maintain an orderly market for the security, and produces a depressing impact on the pricing of securities offerings. See Review of Antimanipulation Regulation, *supra* note 7, at 85,253 (acknowledging the perception of some market participants that Rule 10b-6 can adversely affect the normal "trading" market for a security). For example, the National Association of Security Dealers, Inc. (NASD) believes that this phenomenon is particularly true in the case of U.S. dealer markets because specialists on a U.S. securities exchange are less likely to be affiliated with a distribution participant or can "pass the book," i.e., give up or transfer specialist responsibility, if an affiliate is a distribution participant. See Passive Market Making, Exchange Act Release No. 32,117, [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,126, at 84,007-08 (Apr. 8, 1993) [hereinafter NASDAQ Passive Market Exemption]. See also Application of Rules 10b-6 and 10b-13 to Specialists Affiliated with NYSE Member Firms, SEC No-Action Letter, [1992 Transfer Binder] Fed. Sec.

These participants claim that foreign issuers (or underwriters) are reluctant to offer and sell foreign securities in the United States because of the application of Rule 10b-6 to all types of global offerings that have a U.S. tranche.⁵³

L. Rep. (CCH) ¶ 76,279 (Sept. 15, 1992) (exemption permitting certain NYSE specialists affiliated with broker-dealers to continue to function as specialists in connection with certain mergers or tenders offers in which the affiliated broker-dealer is participating as a dealer-manager of the tender or exchange offer, subject to certain conditions).

While a liquidity contraction may occur in any market to which the Trading Rules have application, it may be caused by factors other than the application of the Trading Rules. Logically, news of an impending offering may prompt potential buyers to delay their purchases and buy either in the offering or in the aftermarket. In addition, current holders of securities, especially institutional holders, may sell securities short prior to a public offering in certain foreign jurisdictions. Those short sellers will seek to cover their sales and realize a profit by purchasing the securities at a fixed price in the public offering. Both the general lack of buying interest and short sales effected in anticipation of a public offering may result in a decrease of the price of the security prior to pricing, and consequently a lower offering price (which may cause the issuer to forfeit substantial proceeds). See British Telecommunications plc, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,708 (July 15, 1993); Rosemary Bennett, *Treasury leads Warburg to anger big clients over BT3*, EUROMONEY, July 1993, at 68 [hereinafter *Anger over BT3*] (discussing short selling by institutions prior to the third privatization effort of British Telecommunications plc undertaken by the British government and commenting on conditions attached to the offering to protect the security's market price prior to the offering). In the United States, short sellers are prohibited from covering equity short sales effected prior to a public offering with securities purchased from an underwriter or other broker or dealer participating in the offering of such securities, subject to certain conditions. See 17 C.F.R. § 240.10b-21 (1994); see also Short Selling in Connection with a Public Offering, Exchange Act Release No. 33,702, 59 Fed. Reg. 10,984 (Mar. 2, 1994) (removing the "Temporary" designation from Rule 10b-21); Review of Antimanipulation Regulation, *supra* note 7, at 85,259. In addition, short selling in the United States generally is governed by an "up-tick" rule which is designed to prevent short selling in a falling or declining market. See 17 C.F.R. § 240.10a-1(a)(1); *Anger Over BT3*, *supra*, at 69. Not all jurisdictions regulate short selling; consequently, the practice of selling short prior to an offering may be commonplace in certain foreign jurisdictions.

⁵³ See Review of Antimanipulation Regulation, *supra* note 7, at 85,259. For example, in connection with the 1993 international rights offering of ordinary shares of Zeneca Group PLC, certain news reports were disseminated in the United Kingdom that commented on exemptions from the Trading Rules granted by the SEC and the potentially adverse effect that the application of the conditions of the exemptions would have on the success of the rights offering. See Zeneca Group PLC, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,655-56 (June 14-15, 1993) [hereinafter *Zeneca Exemptions*]; Paul Abrahams & Maggie Urry, *SEC Lifts Restrictions on Zeneca Shares Deals*, FIN. TIMES, June 15, 1993, at 21; Gail Counsell, *Fears grow over SEC threat to Zeneca rights*, THE INDEPENDENT, June 1, 1993, at 24; Russell Hotten, *US threat to Zeneca issue*, THE INDEPENDENT, May 30, 1993, at 1; Angus McCrone, *Zeneca Presses for SEC Leniency*, Sunday Telegraph Ltd., June 13, 1993, at 41. For a discussion of the alleged effects of the Trading Rules on foreign issuers, also see Securities Industry Association, SEC No-Action Letter, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,669, at 78,070 (Apr. 25, 1991) [hereinafter 1991 SIA Exemptions] (superseded by 17 C.F.R. § 240.10b-6(i) (1994); 17 C.F.R. § 240.10b-7(f) (1994); 17 C.F.R. § 240.10b-8(o) (1994)); Carl E. Stetz, Note, *International Equity Offerings and Market Making Activities on Foreign Stock Exchanges under Rule 10b-6: Has the Securities and Exchange Commission Gone too Far?*, 14 BROOKLYN J. INT'L L. 389, 408-10 (1987); Edward F. Greene & Sebastian R. Sperber, *Rule 144A: Room for Improvement*, 7 INSIGHTS, No. 2, Feb. 1993, at 30, 31-32.

In this regard, another commentator has stated:

U.S. Underwriters believe that they compete for mandates from foreign issuers with a hand tied behind their backs. What good is accommodation over disclosure requirements, they moan, if the application of Rule 10b-6 to the home market for a securities offering will put the entire transaction at risk? More-

In order to alleviate this tension, the Commission has granted in the past a number of exemptions from the Trading Rules, on both a transaction-specific basis⁵⁴ and an omnibus basis.⁵⁵ The German Ex-

over, competitive non-U.S. advisors have tried to undermine efforts to convince foreign issuers to include a U.S. tranche for offerings by playing up the difficulties of compliance with Rule 10b-6.

Charles Whitmann III, *International Transactions and U.S. Trading Rules, in FOREIGN ISSUERS AND THE U.S. MARKET: AN UPDATE ON LEGAL DEVELOPMENTS AND FINANCIAL OPPORTUNITIES* 3, 7 (Kenneth J. Bialkin & Edward F. Greene eds., 1993).

⁵⁴ See, e.g., British Telecommunications plc, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,708 (July 15, 1993) (privatization) (BT 3); Wellcome plc, SEC No-Action Letter, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,268 (July 21, 1992) (privatization); British Telecommunications plc, SEC No-Action Letter, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,062 (Dec. 3, 1991) (privatization) (BT 2); British Petroleum Company p.l.c., SEC No-Action Letter, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,660 (Oct. 13, 1987) (privatization); Norsk Hydro a.s., SEC No-Action Letter, June 2, 1994, available in LEXIS Fedsec Library, Noact File (rights offering); British Airways PLC, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,653 (May 19, 1993) (rights offering); Saatchi & Saatchi, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,652 (May 19, 1993) (rights offering); Attwoods PLC, SEC No-Action Letter, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,653 (Nov. 20, 1991) (rights offering); Attwoods PLC, SEC No-Action Letter, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,653 (June 26, 1990) (rights offering); Norsk Hydro a.s., SEC No-Action Letter, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,804 (May 5, 1988) (rights offering); Procordia Aktiebolag & Aktiebolaget Volvo, SEC No-Action Letter, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,433 (Mar. 30, 1990) (tender and exchange offers); Rhone-Poulenc S.A., SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,614 (Feb. 4, 1993) (exchange offers); Rhone-Poulenc S.A., SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,612 (Jan. 21, 1993) (options trading); Societe Nationale Elf Aquitaine, SEC No-Action Letter, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,734 (June 7, 1991) (options trading).

⁵⁵ See, e.g., Cooling-Off Periods Exemption, *supra* note 30; Distributions of Certain SEAQ and SEAQ International Securities, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,707 (July 12, 1993) [hereinafter LSE Passive Market Making Exemptions] (permits "passive market making" on the LSE's Stock Exchange Automated Quotation (SEAQ) system or SEAQ International system by registered market makers affiliated with underwriters of securities being distributed in the United States during the two business day cooling-off period pursuant to exemptions from Rules 10b-6 and 10b-7). The LSE passive market making scheme was created, in part, to accommodate LSE rules that used to penalize market makers who ceased their market making activities, and to alleviate concerns that removing market makers for a minimum two business day cooling-off period adversely affects the depth and liquidity of the market for the security being distributed. See *supra* notes 50-52 and accompanying text; Review of Antimanipulation Regulation, *supra* note 7, at 85,253. Very generally, a passive market maker's bids and purchases during the cooling-off period are limited by the level of bids of market makers that are not participating in the distribution, i.e., a passive market maker's bids or purchases may not be at a price that exceeds the highest independent bid. LSE Passive Market Making Exemptions, *supra*, at 78,050-51. Among other things, the exemptions require that market makers must not (a) lead the market in shares or price, (b) display quotations higher than independent bids, and (c) trade for the purpose of creating actual or apparent trading. *Id.* The exemptions also require that market makers provide notice to the LSE of their intent to engage in passive market making, and that they agree to certain record maintenance and record production obligations set forth in the exemptions. A variation of the LSE passive market making scheme was implemented in the United States in 1993 in connection with distributions of certain securities quoted on the Nasdaq Stock Market (commonly referred to as NASDAQ), the interdealer quotation system for the over-the-counter market operated by the NASD, during the Rule 10b-6 two business day cooling-off period. The U.S. passive market making scheme has certain security eligibility criteria, limitations on bidding and purchasing activity, including a net purchase limitation, and disclosure requirements. See, e.g., 17 C.F.R. § 240.10b-6A (1994); NASDAQ Passive

emptions are consistent with, yet broader than, any of these previous exemptions.⁵⁶

III. Background — The German Securities Market

As described in the Policy Statement, the purpose behind the German Exemptions was to accommodate customary market practices in Germany without compromising essential U.S. investor and market protections.⁵⁷ For this reason, it was incumbent on Deutsche Bank AG (Deutsche Bank), as the entity requesting the German Exemptions,⁵⁸ to describe in general, among other things, the activities constituting customary German trading practices, the operation of the German securities markets, and the existing securities law governing fraud and manipulation in Germany.⁵⁹ For example, securities are distributed in Germany most commonly through rights offerings.⁶⁰ In addition, the underwriters of a German offering will typically be the major commercial banks, which in the tradition of universal banking provide a full range of banking and securities services to clients that includes investment advice and portfolio management.⁶¹

Market Exemption, *supra* note 52. See also Eurotunnel P.L.C., SEC No-Action Letter, May 25, 1994, available in LEXIS, Fedsec Library, Noact File (clarifying the staff's position that the Rule 144A Distribution Exceptions (*see supra* note 31) did not supersede certain exemptions from the Trading Rules as they pertain to rights distributions to institutional accredited investors granted pursuant to the 1991 SIA Exemptions (*see supra* note 53)).

⁵⁶ Policy Statement, *supra* note 18, at 84,655.

⁵⁷ *Id.*

⁵⁸ A distribution made on behalf of a selling shareholder is subject to the Trading Rules. See *supra* note 22.

⁵⁹ Policy Statement, *supra* note 18, at 84,655-56.

⁶⁰ Traditionally, German companies have looked to German commercial banks or to the debt markets for financing. Nevertheless, the importance of equity financing in Germany is increasing. See *Learning to love equity*, ECONOMIST, July 3, 1993, at 71. Because of legal and judicial requirements in Germany, most securities distributions involve distributions through rights with a deeply discounted subscription price. German Exemptions, *supra* note 11, at 84,521. See also 10B INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 8C.07[2] (Harold S. Bloomenthal & Samuel Wolff eds., rev. ed. 1993) [hereinafter INTERNATIONAL CAPITAL MARKETS]. In addition, many substantial foreign issuers borrow capital internationally through a network of finance subsidiaries that are incorporated in jurisdictions with favorable tax laws, such as the Netherlands Antilles. The borrowing often will be structured as an issuance of notes by one of these subsidiaries, whose obligations under the notes will be guaranteed by the foreign parent. See George Adams & James Kiernan, *Private Placements in the US by non-US issuers*, INT'L FIN. L. REV., Oct. 1993, at 32. Consistent with this practice, subsidiaries of German companies, especially finance subsidiaries, also may be active in capital raising. See, e.g., German Exemptions, *supra* note 11, at 84,529.

⁶¹ In contrast, a separation between commercial banks and investment banks is mandated in the United States by the Banking (Glass-Steagall) Act, ch. 89, 48 Stat. 162, 12 U.S.C. §§ 221-522, 601-635n (1982). See, e.g., 12 U.S.C. § 24 (1988); 12 U.S.C. § 377 (1988). German banks also play a significant role in German business and industry, and bank executives commonly sit on the boards of large industrial companies. The banks also own substantial equity stakes in those companies and frequently exercise control over them through proxies from clients. See, e.g., Ferdinand Protzman, *Ex-Official Is Blamed for German Loss — Investors Vent Anger At Metallgesellschaft*, N.Y. TIMES, Feb. 25, 1994, at D3 (noting that the supervisory board chairman of Metallgesellschaft AG also serves on the board of Deutsche Bank, one of Metallgesellschaft's largest shareholders).

In Germany, before and during distributions, German banks customarily are active in trading all kinds of securities of the issuer (or derivative instruments related to such securities) in the cash market (e.g., rights, common shares, preferred shares, participation certificates, bonds with equity warrants, convertible bonds, and straight bonds) and in the options and futures market (e.g., equity options, futures, index options, and index futures).⁶² To provide liquidity to these markets, the underwriters execute orders for customers and trade securities and derivatives for their own account.⁶³ They also engage in arbitrage trading between the various national and international exchanges where the securities are listed as well as index-arbitrage and basket-trading.⁶⁴ In addition, their mutual fund management company affiliates continue to make investment decisions for the mutual funds that they manage.⁶⁵ In rights offerings, "German underwriters manage their underwriting risks, and the lead underwriter manages the risks associated with maintaining an orderly market, in two principal ways: by buying rights and selling shares short, and by hedging through the DTB [Deutsche Terminbörse (the listed options market)] and over-the-counter derivative markets."⁶⁶

Deutsche Bank concludes that among the consequences of the application of the Trading Rules to the market for the security being distributed in Germany would be a withdrawal or limitation on liquidity and other support in the markets for those securities since most, if not all, the German banks would be serving as underwriters.⁶⁷ This shortage of liquidity, in turn, would contribute to market volatility during the distribution and could also impact the calculation of the value of Deutscher Aktienindex (DAX).⁶⁸ In a similar manner, application of the Trading Rules also would restrict "customer facilitation activities," such as solicited brokerage activities.⁶⁹ Deutsche Bank argues

⁶² German Exemptions, *supra* note 11, at 84,522-23.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.* at 84,522 n.8.

⁶⁶ *Id.* at 84,523.

⁶⁷ *Id.* at 84,525. See *supra* note 51 and accompanying text.

⁶⁸ German Exemptions, *supra* note 11, at 84,525. The DAX is a continuously updated, market capitalization-weighted performance index of 30 German "blue-chip" issuers. See *infra* note 88. The DAX is computed using the Laspreyres formula and is adjusted for capital changes and ex-dividend markdowns. Its base date is December 31, 1987, and its base value was 1,000. See 1993 HANDBOOK OF WORLD STOCK AND COMMODITY EXCHANGES 1, 197-98 (1993) [hereinafter WORLD STOCK AND COMMODITY EXCHANGES].

⁶⁹ Review of Antimanipulation Regulation, *supra* note 7, at 85,252 (noting that some "customer facilitation activities" are prohibited under Rule 10b-6 as "inducements to purchase" because they are likely to cause people to bid for or purchase securities covered by Rule 10b-6 but that offers to sell or the solicitation of offers to buy the security being distributed are excepted by the rule); German Exemptions, *supra* note 11, at 84,525. Such activities are generally understood to be responding to customers' orders on a principal and agency basis as part of an underwriter's ordinary course of business and not to be activities resulting in an accumulation of an inventory in order to respond to future customer orders. See, e.g., British Airways PLC, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶

that these cumulative consequences are harsh, particularly in the context of rights offerings because of their long distribution periods (i.e., the period the restrictions of the Trading Rules would otherwise be applicable).⁷⁰

Deutsche Bank also comments on the eight regional stock exchanges⁷¹ and the over-the-counter trading markets that exist in Germany, including requirements governing quotation and transaction reporting and dissemination, market surveillance practices conducted by German securities regulators, and the recordkeeping obligations for transactions effected in Germany. For example, because German stock exchange members are required to report all floor trades for clearance and settlement purposes,⁷² the Frankfurt Stock Exchange (FSE) authorities (specifically, the Staatskommissar) have access to information regarding all such trading.⁷³ While there is no corresponding requirement to submit information on over-the-counter transactions, it can be done on a voluntary basis.⁷⁴ In addition, there is a screen-based electronic trading system IBIS (or Integrated Stock Exchange Trading and Information System), which is under the administration of the FSE, that is used in connection with institutional trading of "blue chip" German securities, including DAX component securities and some debt securities.⁷⁵

Deutsche Bank also describes the regulation governing fraudulent and manipulative practices existing in Germany as of October 1993. While there is no specific prohibition on manipulation of securities prices in Germany, German laws require that only a price that reflects the "actual state of business" can be determined as an exchange quoted price.⁷⁶ Other laws prohibit German stock corporations and their subsidiaries from purchasing shares in such a corporation, in-

76,653 (May 19, 1993); Saatchi & Saatchi, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,652 (May 19, 1993).

⁷⁰ German Exemptions, *supra* note 11, at 84,525.

⁷¹ These exchanges are located in Berlin, Bremen, Düsseldorf, Frankfurt, Hamburg, Hannover, Munich, and Stuttgart. The largest stock exchange is located in Frankfurt. See generally C.T. GUIDE TO WORLD EQUITY MARKETS 1994/5, 1, 181-93 (Euromoney Publications Plc & C.T. Management Plc eds., 1994) [hereinafter WORLD EQUITY MARKETS]; WORLD STOCK AND COMMODITY EXCHANGES, *supra* note 68, at 197-209.

⁷² See WORLD EQUITY MARKETS, *supra* note 71, at 189; WORLD STOCK AND COMMODITY EXCHANGES, *supra* note 68, at 198.

⁷³ German Exemptions, *supra* note 11, at 84,524.

⁷⁴ See *id.*

⁷⁵ *Id.* at 84,523. See also WORLD STOCK AND COMMODITY EXCHANGES, *supra* note 68, at 197-98; WORLD EQUITY MARKETS, *supra* note 71, at 188; Roberta S. Karmel, *Developments in the German Stock Market*, 206 N.Y. L.J. No. 119, at 3, 3-4 [hereinafter *German Stock Market Developments*].

⁷⁶ German Exemptions, *supra* note 11, at 84,523 (referring to the German Securities Exchange Act of 1896, § 29(3) (amended Dec. 16, 1986), reprinted in 2 INTERNATIONAL SECURITIES REGULATION, Booklet 2 (of Germany) (issued October 1991) (Robert C. Rosen ed., 1993)). Other investor protection laws include sanctions against those who issue inaccurate prospectuses and those who induce inexperienced persons to speculate. WORLD STOCK AND COMMODITY EXCHANGES, *supra* note 68, at 198.

cluding those in connection with a capital increase,⁷⁷ except in limited circumstances.⁷⁸ Germany has only recently enacted legislation creating a central supervising agency for securities markets, the Bundesaufsichtsamt für den Wertpapierhandel (Federal Securities Trading Supervisory Authority), and corresponding laws defining insider trading as a criminal offense subject to prosecution in Germany.⁷⁹ At the time the German Exemptions were issued, however, Germany did not have a national securities regulator comparable to the SEC. In addition, at the time the German Exemptions were issued, insider trading was not illegal in Germany. Rather than being deemed a "criminal" activity, insider trading was considered merely "unethical conduct" in Germany.⁸⁰

Finally, Deutsche Bank acknowledges that German secrecy laws would restrict or prevent the Commission from obtaining certain transaction information, including the identity of customers, with respect to securities transactions effected in Germany. Generally, bank secrecy laws protect customer interests by prohibiting the disclosure of any information regarding a customer's identity or banking activities, unless

⁷⁷ German Exemptions, *supra* note 11, at 84,524 (referring to the German Stock Corporation Act of 1965, para. 56 (amended December 16, 1986), *reprinted in* 2 INTERNATIONAL SECURITIES REGULATION, Booklet 2 (of Germany) (issued October 1991) (R. Rosen ed. 1993)).

⁷⁸ *Id.* (referring to the German Stock Corporation Act of 1965, para. 71).

⁷⁹ See *Finance Ministry Official Named to Head Central Supervisory Agency*, 7 INT'L SEC. REG. REP., No. 9, Apr. 5, 1994, Germany Section, at 1; *Financial Market Promotion Act Passed by Bundestag Lower Chamber*, 7 INT'L SEC. REG. REP., No. 15, June 28, 1994, Germany Section, at 1; Andreas J. Roquette, *Germany makes insider trading a criminal offence*, INT'L FIN. L. REV., July 1994, at 16; *News in Brief*, 7 INT'L SEC. REG. REP., No. 17, July 26, 1994, at 8 (captioned *Germany Passes Financial Market Promotion Act*); Julian Francis & Christoph von Bulow, *Germany tightens securities supervision*, INT'L FIN. L. REV., May 1994, at 32. See also U.S., *Germany Swap Diplomatic Notes to Facilitate Securities Fraud Investigations*, 7 INT'L SEC. REG. REP., No. 19, Aug. 23, 1994, International Cooperation Section, at 1 (noting that a mechanism for the SEC to obtain assistance through the German Ministry of Justice in connection with fraud investigations has been established).

⁸⁰ See INTERNATIONAL CAPITAL MARKETS, *supra* note 60, § 8C.11[1]-[2]; *Law Proposed In Germany To Stifle Insider Trading*, WALL ST. J., July 31, 1993, at A12. A much publicized insider trading scandal involved the head of the steel workers' union, and the suspected use of insider knowledge to purchase shares in Daimler's holding company prior to a merger. J. Eisenhammer, *Red faces at failure to enact EC law; The hard-bargaining, high-living former head of Germany's biggest union is a fallen hero after an insider dealing scandal*, THE INDEPENDENT, May 30, 1993, at 6; David Waller, *A shine on its financial face*, FIN. TIMES, July 8, 1993. In response to demands for legislative efforts to prevent abuses of information by insiders, certain guidelines banning insider trading were devised in 1976 and amended in 1988. INTERNATIONAL CAPITAL MARKETS, *supra* note 60, § 8C.11[1]. These insider trading guidelines existed only as recommendations of the German stock exchanges, and they were followed by German companies quoted for trade on the German stock exchanges and German banks involved in raising capital on a voluntary basis only. WORLD EQUITY MARKETS, *supra* note 71, at 192. Germany had been expected to implement the European Community Directive on Insider Trading by June 7, 1992 but failed to meet that deadline. See U.S. General Accounting Office, *Securities and Futures Markets - Cross-Border Information Sharing Is Improving, but Obstacles Remain*, GAO/GGD-92-110, July 1992, at 44 (Report to the Chairman, Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce, House of Representatives) [hereinafter GAO Report]; *German Stock Market Developments*, *supra* note 75, at 3.

the right of secrecy is waived.⁸¹

IV. The German Exemptions

The German Exemptions permit distribution participants and their affiliated purchasers (other than the issuer and its affiliated purchasers)⁸² to effect transactions⁸³ in "Relevant Securities"⁸⁴ outside of the United States during distributions of "Qualified German Securities" subject to certain "terms, conditions, and limitations." However, the general anti-fraud and anti-manipulation provisions of the federal securities laws continue to apply to transactions covered by

⁸¹ GAO Report, *supra* note 80, at 18. See also Peter Q. Noak, Comment, *West German Bank Secrecy: A Barrier to SEC Insider-Trading Investigations*, 20 U.C. DAVIS L. REV. 609 (1987). Barriers to information sharing, like privacy or secrecy laws or blocking statutes, can be reduced through the negotiation of information-sharing agreements (ISAs) between the SEC and foreign securities regulators. See, e.g., Securities Exchange Act of 1934 §§ 21(a)(2), 24(d), 15 U.S.C. §§ 78o(a)(2), 78x(d) (1988 and Supp. IV 1992) (SEC's statutory authority to enter into ISAs that provide for the exchange of confidential information). Some comprehensive ISAs permit the Commission to obtain surveillance and investigatory information in connection with, *inter alia*, suspected market manipulation. See U.S. SECURITIES AND EXCHANGE COMMISSION, 1991 ANNUAL REPORT 57, at 21-22 (1991); SEC Director Discusses Cooperative Efforts Among International Securities Regulators, 94-150 SEC TODAY, Aug. 9, 1994, at 1 (noting that in fiscal year 1993 the SEC made 213 formal enforcement requests to foreign authorities and received 232 requests for enforcement assistance). For example, in a situation in which the SEC would not always have clear authority to use administrative subpoenas, it can obtain the information necessary to determine if U.S. law has been violated, including disclosure of surveillance information and customer identifying information, through an ISA. These include the ISAs with authorities from the following jurisdictions: Argentina; Australia; Brazil; Ontario, Quebec, and British Columbia; Chile; France; Italy; Japan; Mexico; the Netherlands; Norway; Spain; and the United Kingdom. See Cooling-Off Periods Exemption, *supra* note 30, at 17,128 n.23. See also International Series Release No. 662 (Apr. 29, 1994), available in LEXIS, Fedsec Library, Secrel File (ISA between the SEC and the Chinese Securities Commission); Beese Welcomes SEC/China Agreement on Information Sharing in Financial Markets, 94-89 SEC TODAY, May 12, 1994, at 1.

⁸² For purposes of the exemptions, these entities are defined as "Relevant Parties." German Exemptions, *supra* note 11, at 84,533. The issuer and its affiliated purchasers are excluded because it is not customary, and for the most part it also is illegal, for them to be in the market for the issuer's securities during distributions in Germany. See *supra* notes 77-78 and accompanying text. While France does have laws that restrict the market activities of issuers and their affiliates during securities offerings, such laws are subject to exceptions that permit purchases to ensure the liquidity of the shares or to control excessive price fluctuations, subject to certain conditions. French Exemptions, *supra* note 19, at 31,275-76. Presumably, it was the absence of a strict prohibition on the issuer's market activity during a distribution of its shares that compelled the Commission to extend the French Exemptions, see *supra* note 19, to issuers and their affiliated purchasers in order to restrict and regulate their market activities in the same manner as other distribution participants and their affiliated purchasers, and have access to transaction information.

⁸³ The German Exemptions do not define precisely what it means to "effect transactions" in Relevant Securities. However, the Commission historically has interpreted that phrase to include more than merely performing the physical act of exchanging money and securities when used in the Exchange Act. See, e.g., John Polanin, Jr., *The "Finder's" Exception From Federal Broker-Dealer Regulation*, 40 CATH. U. L. REV. 787, 810 (1991).

⁸⁴ For purposes of the German Exemptions, the term "Relevant Security" means either a Qualified German Security (see *infra* notes 87-89 and accompanying text) or a security of the same class and series as, or a right to purchase, a Qualified German Security. German Exemptions, *supra* note 11, at 84,533.

the exemptions.⁸⁵

A. Distributions of Qualified German Securities

The definition of "Qualified German Security" embodies both issuer-related and security-related criteria such that only liquid equity securities of "blue chip" German companies are eligible for the German Exemptions.⁸⁶ First, the issuer (German Issuer) of a "Qualified German Security" must: (i) be a "foreign private issuer" within the meaning of Rule 3b-4 under the Exchange Act;⁸⁷ (ii) be incorporated under the laws of Germany; and (iii) have outstanding a component security of the DAX.⁸⁸ Alternatively, the issuer may be a subsidiary of a

⁸⁵ *E.g.*, Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a) (1988); Securities Exchange Act of 1934 § 9(a), 15 U.S.C. § 78i(a) (1988); Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1988); 17 C.F.R. § 240.10b-5 (1994). *See also* Policy Statement, *supra* note 18, at 84,655 & n.11; Richard M. Kosnik, *The Role of the SEC in Evaluating Foreign Issuers Coming to U.S. Markets*, 17 *FORDHAM INT'L L.J.* 597, 5109 (1994) (noting that the anti-fraud rules continue to apply with respect to activities conducted in foreign markets under the German Exemptions).

More specifically, Section 9 of the Securities Exchange Act of 1934 contains general prohibitions against the manipulation of security prices, including a general prohibition of manipulation of securities registered on a national securities exchange. Securities Exchange Act of 1934 § 9(a)(2), 15 U.S.C. § 78i(a)(2) (1988). Section 10(b) of the Exchange Act is a broad "catch-all" provision that prohibits the use of "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of any security. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1988). Rule 10b-5 is the broadest anti-fraud provision under the Exchange Act and is commonly relied upon by the Commission to prohibit insider trading and other types of fraudulent or manipulative practices. Rule 10b-5 makes it unlawful, in connection with the purchase or sale of any security, to: (a) employ any device or scheme to defraud; (b) make a materially false statement or misleading omission; or (c) engage in any act, practice, or course of business that would operate as a fraud or deceit on others. 17 C.F.R. § 240.10b-5 (1994). To prevail in a lawsuit under Rule 10b-5, a plaintiff must prove, among other things, that the defendant acted with "scienter." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976).

⁸⁶ The German Exemptions are not applicable to distributions of debt securities. German Exemptions, *supra* note 11, at 84,529. However, distributions of nonconvertible debt that is rated investment grade by a nationally recognized statistical rating organization, as that term is defined in Rule 15c3-1 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.15c3-1, are excepted from Rule 10b-6. 17 C.F.R. § 240.10b-6(a)(4)(xiii) (1993). In connection with the German Exemptions, the need to extend the terms of the exemption to distributions of debt may have been lessened because the debt issued by substantial German companies is likely to be rated investment grade. *See, e.g.*, Cooling-Off Periods Exemption, *supra* note 30 (clarifying the application of the cooling-off periods under Rule 10b-6 to distributions of, *inter alia*, foreign non-investment grade debt, subject to certain conditions).

⁸⁷ 17 C.F.R. § 240.3b-4 (1993). Rule 3b-4(c) defines the term "foreign private issuer" as:

any foreign issuer other than a foreign government except an issuer meeting the following conditions: (1) More than 50 percent of the outstanding voting securities of such issuer are held of record either directly or through voting trust certificates or depository receipts by residents of the United States; and (2) any of the following: (i) The majority of the executive officers or directors are United States citizens or residents; (ii) more than 50 percent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States.

Id.

⁸⁸ German Exemptions, *supra* note 11, at 84,533. In addition, securities that are added to the DAX after October 6, 1993 may qualify for "Qualified German Security" status pro-

German Issuer. Second, the offered Qualified German Security must: (a) be a DAX component security; (b) be an equity security of a German Issuer that has an average daily trading volume that equals or exceeds the equivalent of DM8 million (\$5 million); or (c) be a security that is convertible into, exchangeable for, or a right to acquire either a DAX component security or an equity security of a German Issuer that has an average daily trading volume that equals or exceeds the equivalent of DM8 million (\$5 million).⁸⁹

Thus, eligible issuers are limited to the thirty issuers whose securities make up the DAX and their subsidiaries. German companies that do not issue DAX component securities, but nonetheless issue equity securities having an average daily trading volume that equals or exceeds the equivalent of DM8 million, do not qualify as "German Issuers." In the same manner, equity securities issued by subsidiaries of German Issuers having an average daily trading volume that equals or exceeds the equivalent of DM8 million are not "Qualified German Securities." Rather, because subsidiaries of German Issuers do not have to be incorporated in Germany or qualified as "foreign private issuers" under the Exchange Act, qualifying securities of subsidiaries of German Issuers are limited to those that are convertible into, exchangeable for, or a right to acquire either a DAX component security or alternatively, an actively traded equity security of a German Issuer.⁹⁰

The German Exemptions use issuers of DAX component securities as a proxy to define a universe of highly capitalized world-class

vided that the issuer is a German Issuer and such security has an aggregate market value that equals or exceeds the equivalent of DM1.6 billion (\$1 billion) and an average daily trading volume that equals or exceeds the equivalent of DM8 million (\$5 million). The dollar figures used in the German Exemptions are as of September 10, 1993. See Policy Statement, *supra* note 18, at 84,656. As of October 1993, these issuers included: Allianz AG Holding; BASF AG; Bayer AG; Bayerische Hypotheken-Und Wechsel-Bank AG; Bayerische Motoren Werke AG; Bayer Vereinsbank; Commerzbank; Continental AG; Daimler; Degussa AG; Deutsche Babcock AG; Deutsche Bank AG; Dresdner Bank AG; Henkle KGaA-Vorzug; Hoechst AG; Karstadt AG; Kaufhof AG; Lufthansa; Linde AG; M.A.N. AG; Metallgesellschaft AG; Mannesmann AG; Preussag AG; RWE AG; Schering AG; Siemens AG; Thyssen AG; VEBA AG; VIAG AG; and Volkswagen AG. See German Stock Exchanges—1992 ANNUAL REPORT 4, 160 (1993). Similarly, subject to certain conditions, the French Exemptions are applicable to issuers that have outstanding securities of the CAC 40 index and their subsidiaries. French Exemptions, *supra* note 19, at 31,280. In order to parallel the performance of the Paris Bourse, the CAC 40 index contains 40 "representative" French stocks. WORLD STOCK AND COMMODITY EXCHANGES, *supra* note 68, at 188. The Paris Bourse is the official (and the only) securities market in France. As of 1994, there were approximately 726 domestic and 208 foreign companies listed on the Paris Bourse. WORLD EQUITY MARKETS, *supra* note 71, at 164. Trading on the Paris Bourse takes place on a centralized order-driven trading system, CAC, through members acting as brokers. WORLD STOCK AND COMMODITY EXCHANGES, *supra* note 68, at 188-89.

⁸⁹ German Exemptions, *supra* note 11, at 84,533 n.1.

⁹⁰ Technically, the German Exemptions are applicable to distributions of securities issued by certain U.S. issuers, such as U.S. subsidiaries of German Issuers (see *supra* note 60), when such securities are convertible into, exchangeable for, or a right to acquire a DAX component security or an equity security of the German Issuer that has an average daily trading volume equal to or exceeding DM8 million (\$5 million).

issuers whose securities are likely to be followed extensively by financial analysts and others in the investment community.⁹¹ The wide following that these securities are likely to have not only contributes to their liquidity but also helps ensure that price movements before and during the distribution will be scrutinized by the market.

B. The Importance of Where Transactions Are Effected

During distributions of Qualified German Securities, the extent to which distribution participants and their affiliated purchasers are permitted to engage in transactions in Relevant Securities depends upon the jurisdiction in which such transactions are effected. Pursuant to the German Exemptions, all distribution participants (including U.S. distribution participants) can effect transactions in various jurisdictions subject to the same terms and conditions. In this manner, the German Exemptions attempt to provide a level playing field to distribution participants and their affiliated purchasers on a jurisdiction-by-jurisdiction basis.

Generally, the German Exemptions permit transactions in Relevant Securities to be effected subject to various "terms, conditions, and limitations" depending upon the effect that such transactions are likely to have on the Qualified German Security's price and the need to protect U.S. investors from market manipulation.⁹² Transactions in securities markets that are not likely to contribute to price discovery are not subject to the Trading Rules.⁹³ Transactions effected in securities markets in which such transactions are likely to have an effect on the Qualified German Security's price (Significant Markets) are required to comply with the Trading Rules absent an exemption. Significant Markets are the securities markets and dealer markets⁹⁴ that account for ten percent or more of the published aggregate world-wide trading volume of the Qualified German Security in markets in which such security is listed.⁹⁵ However, transactions effected in securities markets

⁹¹ Policy Statement, *supra* note 18, at 84,656.

⁹² See, e.g., Review of Antimanipulation Regulation, *supra* note 7, at 85,260 (seeking comment on whether the Trading Rules should apply in markets that reasonably can be assumed not to have a price discovery function).

⁹³ *Id.* at 85,260 n.119.

⁹⁴ For example, one such market is the SEAQ International system which is the LSE's competitive market making system for trading foreign equity securities. See WORLD STOCK AND COMMODITY EXCHANGES, *supra* note 68, at 421-22.

⁹⁵ German Exemptions, *supra* note 11, at 84,535. For purposes of the exemptions, "Significant Market" technically means: "(i) SEAQ International or any other dealer market outside the United States and Germany for which price and volume information is published by an FFRA or (ii) any other securities market(s) in a single country other than the United States or Germany to which a German Issuer has applied for listing the German Qualified Security and been accepted[,] if during the Reference Period (as defined below) the volume in either (i) or (ii) in such Qualified German Security, as published by the relevant FFRA(s) in such securities market, is ten percent or more of the aggregate worldwide trading volume in that security published by all FFRAs in (i) and (ii), FFRAs in Germany, and U.S. securities markets to which such German Issuer has applied for listing such Qualified German Security

where such transactions are not likely to have much of an effect on the Qualified German Security's price (Secondary Markets) are not required to comply with the Trading Rules. Secondary Markets are those markets that account for less than ten percent of the published aggregate world-wide trading volume of the Qualified German Security in markets in which such security is listed.⁹⁶ Because the Trading Rules do not apply to transactions effected in Secondary Markets, distribution participants and their affiliated purchasers are permitted to engage in transactions in Relevant Securities in such markets pursuant to market expectations, customs, or practices.⁹⁷

The German Exemptions effectively treat the United States and the home country market (i.e., Germany) as "Significant Markets." They also anticipate that, in many cases, the United Kingdom (i.e., the SEAQ International system) also will be a "Significant Market" under the ten percent trading volume threshold with respect to many Qualified German Securities. Subject to certain conditions,⁹⁸ exemptions are granted for transactions in Relevant Securities in Germany and the United Kingdom. However, the German Exemptions do not grant exemptions for transactions in Relevant Securities in the United States or other Significant Markets.⁹⁹ Therefore, the Trading Rules continue to

and been accepted. "Reference Period" is a period of twenty consecutive business days in Frankfurt within sixty consecutive calendar days prior to the commencement of the Covered Period (see *infra* note 117 and accompanying text). *Id.* Under that definition, a security's average daily trading volume disseminated by an FFRA with respect to its trading in Germany may be available from a financial periodical, such as the *Börsen-Zeitung*, and also may be available through Bloomberg Financial Services Computer System which receives data directly from certain foreign securities exchanges through a system of computer-linkages.

An FFRA, or "foreign financial regulatory authority," is defined in Section 3(a)(51) of the Securities Exchange Act of 1934 as:

any (A) foreign securities authority, (B) other governmental body or foreign equivalent or a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for future delivery, or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent, or other financial activities, or (C) membership organization a function of which is to regulate participation of its members in activities listed above.

15 U.S.C. § 78c(a)(52) (Supp. V 1993). Given the breadth of the definition, it is likely that most foreign stock exchange authorities will qualify as FRAs.

⁹⁶ See Review of Antimanipulation Regulation, *supra* note 7, at 85,220 n.119.

⁹⁷ Because the German Exemptions are exemptions from Rules 10b-6, 10b-7, and 10b-8 only, transactions in all other markets, including Secondary Markets, remain subject to the general anti-fraud and anti-manipulation provisions of the federal securities laws. See *supra* note 85.

⁹⁸ See *infra* notes 109-44 and accompanying text.

⁹⁹ The German Exemptions do provide for use of a two business day cooling-off period in Significant Markets, consistent with the cooling-off periods exceptions contained in Rule 10b-6, 17 C.F.R. § 240.10b-6(a)(4)(xi)-(xii) (1994), subject to the record production and record maintenance requirements set forth in the Cooling-Off Periods Exemption, *supra* note 30. However, the record maintenance requirements are modified to permit Relevant Parties to use their best efforts to provide the Commission, at its request, with the identity of customers to the extent permitted by applicable law in each Significant Market. German Exemptions, *supra* note 11, at 84,536. Presumably, this modification was made to accommo-

apply in those markets unless otherwise excepted or exempted.

Because every subsidiary and affiliate of a distribution participant that satisfies the definition of affiliated purchaser is subject to the rule's proscriptions,¹⁰⁰ the number and geographic diversity of entities subject to Rule 10b-6 during any given cross-border distribution can be vast, thereby imposing significant compliance burdens and costs on distribution participants.¹⁰¹ Eliminating the application of the Trading Rules in Secondary Markets helps to mitigate the burdensome effects of Rule 10b-6 by making it easier for distribution participants to assure that they (and their affiliated purchasers) comply with the restrictions of the rule. Moreover, the use of trading volume as an indication of where manipulative trading is likely to take place represents an innovative approach to the regulation of market manipulation.¹⁰² However, whether the Commission's determination that a ten percent trading volume criterion (as opposed to a five percent or a twenty percent trading volume criterion) accurately captures the securities markets and dealer markets that perform a price-setting function is open to question.¹⁰³ Regardless, the notion that markets that account for a significant amount of trading volume are more likely to determine the price at which a company is able to issue additional securities than markets without much trading volume is intuitively persuasive.

Interestingly, the German Exemptions neither prohibit trading nor impose a cooling-off period¹⁰⁴ or any other trading restrictions on distribution participants and their affiliated purchasers with respect to transactions effected in Germany, which most likely is the principal price discovery market for Qualified German Securities. Instead, the trading and related behavioral restrictions of Rule 10b-6 are replaced with conditions relating to disclosure to the investing public and accountability to the SEC (and perhaps FSE authorities). These conditions are much less onerous to distribution participants and their affiliated purchasers than the ban on, *inter alia*, proprietary trading and solicited brokerage activities that the Trading Rules otherwise would have required (unless otherwise excepted or exempted), and they are less burdensome than the "passive market making" scheme

date any secrecy laws that may exist in Significant Markets. See *supra* note 81 and accompanying text.

¹⁰⁰ See *supra* notes 22-23.

¹⁰¹ The Commission has interpreted Rule 10b-6 to apply, absent an exemption or exception, to all distribution participants and their affiliated purchasers participating in a distribution of securities in the United States, wherever they are located or effect transactions because transactions on foreign markets can affect the U.S. offering price. See *supra* notes 47-53 and accompanying text.

¹⁰² See Cooling-Off Periods Exemption, *supra* note 30, at 17,218 (using, among other things, a \$250,000 average daily trading volume as a measurement of liquidity).

¹⁰³ See Review of Antimanipulation Regulation, *supra* note 7, at 85,260 (soliciting comment on how to identify accurately "secondary markets," i.e., markets that do not perform a price setting function).

¹⁰⁴ See *supra* note 30.

that also has been applied in connection with U.S. distributions of foreign securities.¹⁰⁵

At first glance, it appears odd that the German Exemptions do not impose substantive trading restrictions in Germany but yet do require that the Trading Rules be followed in the United States and Significant Markets absent exception or exemption.¹⁰⁶ Yet, there may be explanations for such a result. First, the German Exemptions were the first of their kind. At the time of their issuance, no other exemption or exception from the Trading Rules that is as broad as the German Exemptions existed for transactions effected in other markets. However, measures that relax the application of the Trading Rules in Significant Markets during distributions of Qualified German Securities may be applied in the future. For example, in Significant Markets where exemptions similar to the German Exemptions have been granted under the terms of the Policy Statement (such as in France), the Commission may permit distribution participants and their affiliated purchasers to follow the terms of that exemption rather than to observe the Trading Rules or another exemption or exception.¹⁰⁷ Second, the German Exemptions attempt to proscribe fraud and manipulation and to accommodate customary German market practices in a manner consistent with U.S. investor and market protections. The elements involving disclosure to the investing public and notice, reporting, recordkeeping, and record production obligations contained in the German Exemptions were developed to provide the U.S. investing public with protections against market manipulation absent application of the Trading Rules.¹⁰⁸ What is novel about the exemptions is that they try to accomplish this objective by using methods that are substantially different from, and more lenient than, the current structure of market manipulation regulation contained in the Trading Rules.

1. *Disclosure to the Investing Public*

The offering materials used in the U.S. distribution of Qualified German Securities are required to bear a legend¹⁰⁹ and to contain

¹⁰⁵ See, e.g., LSE Passive Market Making Exemptions, *supra* note 55.

¹⁰⁶ See Review of Antimanipulation Regulation, *supra* note 7, at 85,260 (soliciting comment on whether the United States should ever be considered a "Secondary Market" under exemptions such as the German Exemptions, i.e., whether the Trading Rules should ever not be applied in the United States in connection with such a distribution).

¹⁰⁷ See *supra* note 19 and accompanying text. The Policy Statement declares that exemptions for actively traded and widely followed securities of highly capitalized issuers from other countries will be granted in the future, subject to terms and conditions substantially similar to those contained in the German Exemptions. Policy Statement, *supra* note 18, at 84,655.

¹⁰⁸ See Review of Antimanipulation Regulation, *supra* note 7, at 85,260 (noting that relief from the Trading Rules in the international context has been premised on, *inter alia*, the availability of transaction information to the Commission, the significance of a particular market for price discovery, and disclosure of foreign market practices and transactions).

¹⁰⁹ German Exemptions, *supra* note 11, at 84,534. The inside front cover page of the offering materials used in the offer and sale in the United States of a Qualified German

both a description of the activities that may be undertaken by the Relevant Parties in the Relevant Securities during the distribution and a statement that such activities are being effected in accordance with the German Exemptions. The role that such disclosure is presumed to have in influencing an investor's investment decision is integral to the effectiveness of the German Exemptions. This disclosure informs U.S. investors that trading activities in foreign markets that otherwise would be prohibited by the Trading Rules would continue during the distribution in the United States and that, as a result, the market price for the security being distributed may be different from that which otherwise might have prevailed in the open market.¹¹⁰ For example, in connection with the German Exemptions, investors may be informed that German underwriters and their affiliates might continue (1) their proprietary trading activities for risk management, arbitrage, and other purposes, (2) their customer facilitation activities, including solicited brokerage activities through the use of research reports, (3) their securities lending transactions, and (4) their stabilizing activities.¹¹¹

Security must display a legend "in capital letters, printed in bold-face roman type at least as large as ten-point modern type and at least two points leaded" that is substantially similar to the following (subject to appropriate modification):

IN CONNECTION WITH THIS OFFERING, CERTAIN PERSONS MAY ENGAGE IN TRANSACTIONS FOR THEIR OWN ACCOUNTS OR FOR THE ACCOUNTS OF OTHERS IN (IDENTIFY RELEVANT SECURITIES) PURSUANT TO EXEMPTIONS FROM RULES 10b-6, 10b-7, and 10b-8 UNDER THE SECURITIES EXCHANGE ACT OF 1934. SEE "[IDENTIFY SECTION OF OFFERING MATERIALS THAT DESCRIBES THE TRANSACTIONS TO BE EFFECTED]."

Id. See also French Exemptions, *supra* note 19, at 31,218.

¹¹⁰ Policy Statement, *supra* note 18, at 84,656.

¹¹¹ Exhibit A to Deutsche Bank's letter requesting the exemptions contains an example of market activity disclosure that satisfies the requirements of the exemptions. See German Exemptions, *supra* note 11, at 53,224 n.4, 53,230-31. See also French Exemptions, *supra* note 19, at 31,280. Additional disclosure of market activity may be required pursuant to other exemptions relied upon to effect transactions in Significant Markets during the distribution. See, e.g., LSE Passive Market Making Exemptions, *supra* note 55, at 78,051.

The following market disclosure was provided to investors in connection with the first distribution to rely on the German Exemptions, an offering of 15 million ADRs of Daimler by Deutsche Bank, as selling shareholder, with its affiliate, C.J. Lawrence/Deutsche Bank Securities Corporation, serving as the lead underwriter:

Certain affiliates of the Underwriters will continue to engage in the transactions and other activities described below, in Germany and elsewhere outside the United States, in respect of the securities being distributed, securities of the same class and series as the securities being distributed, and securities convertible into, exchangeable for, or giving a right to acquire, the foregoing securities, and derivatives thereof (collectively, the "Relevant Securities"), during the distribution period, in accordance with exemptions obtained from the Commission from the application outside the United States of Rules 10b-6, 10b-7 and 10b-8 under the Exchange Act. Such exemptions are subject to certain exceptions, limitations and conditions set out in the Commission's exemptive order, including compliance with German law.

The activities referred to above are (a) buying and selling Relevant Securities for the accounts of such affiliates, whether for purposes of risk management in connection with the Offering, arbitrage or otherwise, (b) buying and selling Relevant Securities on behalf of customers, (c) advising customers as to the purchase or sale of Relevant Securities, including publication of specific com-

Because the Trading Rules are investor-protection rules that promote public confidence in the fairness and efficiency of the U.S. securities markets, the fact that U.S. investors may be purchasing in a market conditioned to facilitate the distribution may be viewed as material information.¹¹² Therefore, even if disclosure of the range of potential market activities to be undertaken by distribution participants had not been mandated by the German Exemptions, such activities might have been required to be disclosed to investors pursuant to the general anti-fraud provisions of the federal securities laws. Of course, disclosure of these activities also defines the parameters of acceptable behavior by distribution participants and their affiliated purchasers during the U.S. distribution under the general anti-fraud provisions of the federal securities laws.¹¹³

2. *Accountability to the SEC*

The German Exemptions also create a system of regulatory accountability that begins with the requirement that a notice (Notice) be provided to the Commission's Division of Market Regulation (Division) prior to the commencement of the distribution of the Qualified German Security in the United States.¹¹⁴ The Notice is to serve two

pany and industry research reports, (d) engaging in securities lending transactions in Relevant Securities and (e) stabilizing the market (as described below). As a result of these activities, such affiliates may at any time be short or long Relevant Securities.

It is general market practice in Germany for the underwriters in an offering involving German securities, and the lead underwriter in particular, to maintain an orderly market in existing shares, and it is expected that Deutsche Bank AG, an affiliate of C.J. Lawrence/Deutsche Bank Securities Corporation, the lead Underwriter, will take measures to avoid extreme price fluctuations in the Relevant Securities during the distribution period.

The activities referred to above may result in the market prices of the Relevant Securities being different from those that might otherwise have prevailed in the open market if Rules 10b-6, 10b-7 and 10b-8 had applied in Germany and elsewhere outside the United States. . . .

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¹¹² Rule 10b-7 also requires certain disclosure regarding stabilizing transactions. 17 C.F.R. § 240.10b-7(k) (1994). In addition, exception (xiv) to Rule 10b-6, 17 C.F.R. § 240.10b-6(a)(4)(xiv), requires disclosure for "passive market making" transactions effected on NASDAQ in accordance with Rule 10b-6A, 17 C.F.R. § 240.10b-6A. See also LSE Passive Market Making Exemptions, *supra* note 55, at 78,051; NASDAQ Passive Market Exemption, *supra* note 52, at 84,014.

¹¹³ *E.g.*, Securities Act of 1933 § 11, 15 U.S.C. § 77k (1988); Rule 10b-5 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5 (1994). Section 11 of the Securities Act of 1933 imposes liability for material misstatements or omissions contained in a registration statement filed with the Commission when it becomes effective. That section imposes strict liability on the issuer. Section 11 also imposes liability on a wide variety of other defendants, such as persons who signed the registration statement, directors of the issuer at the time the statement is filed, persons who consented to be named in the registration statement, experts who consented to be named in the registration statement, and underwriters. Securities Act of 1933 § 11, 15 U.S.C. § 77k (1988). See also Securities Act of 1933 § 12(2), 15 U.S.C. § 77l(2) (1988).

¹¹⁴ German Exemptions, *supra* note 11, at 84,536; Policy Statement, *supra* note 18, at 84,656.

functions. First, it will alert the Commission to the fact that a U.S. distribution of Qualified German Securities will be taking place. Second, it will provide the Commission with certain information that it can use to monitor the progress of the distribution.¹¹⁵

Consistent with the notion that the German Exemptions would permit customary market activities in Germany that otherwise would be prohibited by the Trading Rules, the German Exemptions require distribution participants and their affiliated purchasers to comply with German law when effecting transactions in Germany.¹¹⁶ However, the period during which distribution participants and their affiliated purchasers are subject to the "terms, conditions, and limitations" of the German Exemptions (Covered Period) varies, depending on whether the distribution is conducted by means of a secondary offering or by means of a rights offering. With respect to secondary distributions or any other non-rights distribution, the Covered Period commences three Frankfurt business days before the price is determined and then continues until the completion of the distribution in the United States.¹¹⁷ With respect to a rights offering, the Covered Period commences when the subscription price is determined and then continues until the completion of the distribution in the United States.¹¹⁸

Although distribution participants and their affiliated purchasers are free of absolute trading restrictions in Germany, they are required to provide some "transparency"¹¹⁹ to the market by either effecting or

¹¹⁵ The Notice must contain the following information:

- (i) the name of the issuer and the Qualified German Security; (ii) whether the Qualified German Security is a DAX component security or information with respect to the market capitalization and the average daily trading volume of the Qualified German Security to be distributed; (iii) the identity of the Significant Markets where the Qualified German Security trades; (iv) if the Notice is for more than one entity, the identity of all underwriters and selling group members relying on the exemptions; and (v) a statement that the Relevant Parties are aware of the terms and conditions of these exemptions.

German Exemptions, *supra* note 11, at 84,536. Underwriter compliance with the Trading Rules is usually implemented through underwriting documentation such as the intersyndicate agreement and the agreement among underwriters. Issuer compliance with the Trading Rules usually is implemented through the underwriting agreement. *See* GREENE ET AL., *supra* note 7, § 6.01[5]. Accordingly, it is expected that the lead underwriter or the global coordinator, as agent for the other distribution participants and their affiliated purchasers, will provide the Notice before the commencement of the distribution. *See also* Cooling-Off Periods Exemption, *supra* note 30, at 17,127 n.19 (implementing a similar requirement with respect to the notices to be supplied under that exemption).

¹¹⁶ German Exemptions, *supra* note 11, at 84,534.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ In equity markets, "transparency" is the degree to which real-time (i.e., immediate) trade and quotation information (including prices and volume) is made available to market participants after a transaction is completed or a quotation is entered. MARKET 2000 STUDY, *supra* note 16, at IV-1. In other words, transparency consists of the prompt or real-time dissemination of last sale reports (i.e., transaction prices and volumes) and firm quotations (i.e., bid and ask prices) along with size information. *See id.* at IV-2; U.S. Equity Market Structure Study, Exchange Act Release No. 30,902, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,012, at 82,919-20 (July 14, 1992). Transparency is said to play an important role in the fair

reporting¹²⁰ their principal transactions on the trading facilities of a German stock exchange (including IBIS) or the DTB during the Covered Period. Transparency during the U.S. distribution is crucial if market participants also are going to police the market. Moreover, knowing that their principal transactions are going to be reported and disclosed may have the corollary effect of discouraging distribution participants and their affiliated purchasers from engaging in manipulative activities during the U.S. distribution.¹²¹

Another vital aspect of the German Exemptions is the requirement that distribution participants and their affiliated purchasers report, in a uniform manner,¹²² certain transaction information with respect to their principal transactions (and some of their agency transactions) in Relevant Securities effected in Germany during the Covered Period to an "Independent Entity" (either the FSE or the Deutsche Börse AG, or alternatively, the lead underwriter's independent accountant).¹²³ The information that must be reported includes

and efficient functioning of securities markets because, *inter alia*, it helps participants assess the current value of securities. See *The Role of the SEC*, *supra* note 47, at 579-80.

¹²⁰ For example, transactions effected on an over-the-counter market "shall be reported on the trading facilities of a German stock exchange (including IBIS), or the DTB." German Exemptions, *supra* note 11, at 84,534. See *supra* notes 62-64 and accompanying text. See also INTERNATIONAL CAPITAL MARKETS, *supra* note 60, § 8C.04[1][b] (noting that "the market is provided anonymously in real time with price and volume" information through the immediate entry of a transaction into the IBIS system). In contrast to the notion of transparency, "regulatory reporting is the provision of quote or trade information to regulators or self-regulatory organizations (SROs) for audit trail or other market surveillance purposes." MARKET 2000 STUDY, *supra* note 16, at IV-2. This information is accessible only by regulators or SROs and generally includes the security identification, size of trade, price, time of trade, and executing, contraside, and clearing brokers. See *id.*

¹²¹ See Review of Antimanipulation Regulation, *supra* note 7, at 85,260 (soliciting comment on the role, if any, that transparency plays in exemptions such as the German Exemptions).

¹²² The German Exemptions require that the transaction information be provided by all distribution participants and their affiliated purchasers "in a Comma Delimited ASCII (American Standard Code for Information Interchange) format including a common record layout acceptable to both the Independent Entity and the Division." German Exemptions, *supra* note 11, at 84,534. The ASCII character set is a universal character coding set that consists of the first 128 (0-127) characters of the American National Standards Institute (ANSI) 8-bit character set. See USERS GUIDE—MICROSOFT WINDOWS OPERATING SYSTEM VERSION 3.1, at 599 (1990-92).

¹²³ German Exemptions, *supra* note 11, at 84,534. The Deutsche Börse AG operates the FSE and the DTB and is responsible for the settlement of all exchange transactions in securities and futures in Germany. See, e.g., WORLD EQUITY MARKETS, *supra* note 71, at 183. See also Zeneca Exemptions, *supra* note 53 (requiring an independent entity to collect and analyze trading information as a condition to exemptive relief). Accountants are to be "independent" as that term is used under Regulation S-X under the Securities Act of 1933, 17 C.F.R. § 210.2-01 (1994). See Policy Statement, *supra* note 18, at 84,657. In the future and with the consent of the SEC, Germany's newly created central securities trading supervisory authority, the Bundesaufsichtsamt für den Wertpapierhandel, may assume the role of an independent entity under the German Exemptions. See *supra* note 79 and accompanying text.

In contrast to the German Exemptions, the French Exemptions require reporting upon request to the Commission des Opérations de Bourse (COB), the administrative body responsible for the overall supervision of the securities, options, and futures markets in France. See French Exemptions, *supra* note 19, at 31,281. The French Exemptions do not provide

some of the essential elements of an audit trail.¹²⁴ In this regard, transactions effected by an underwriter for a customer account for which it has exercised discretionary authority are required to be reported as a proprietary trade.¹²⁵ Subject to the conditions discussed below, the transaction information supplied to the Independent Entity is to be made available to the Commission at its request.¹²⁶

The transaction information reporting requirements are subject to two important qualifications. These qualifications are consistent with the underlying notion of Rule 10b-6 that distribution participants have the greatest incentive to facilitate the distribution of securities by trading for their own accounts or accounts over which they have discretion. First, a de minimis customer exception exists such that only information relating to "large customer" transactions (i.e., those with a value equal to or in excess of DM500,000, or approximately \$350,000) must be reported to the Independent Entity.¹²⁷ The de minimis customer exception recognizes that German securities tend to trade at a high price per share¹²⁸ and that, since they are very liquid securities, only large transactions are likely to have a sustaining effect on the security's market price. Second, there is a counterparty qualification that accommodates Germany's secrecy laws.¹²⁹ Pursuant to the German Exemptions, distribution participants must waive their rights under Germany's secrecy laws. Therefore, counterparty identity is required to be reported to the Independent Entity if the counterparty is an underwriter or a selling group member; however, there is no corresponding requirement to identify customers or other parties.¹³⁰

For practical purposes, the transaction information reporting obligations will be mandatory for all U.S. distributions involving secondary offerings of Qualified German Securities. However, in the case of U.S. distributions involving rights offerings of Qualified German Securities,

distribution participants and their affiliated purchasers with the option of reporting to an independent entity. The COB is responsible for, among other things, monitoring transactions for violations of French law, including insider trading and price manipulation, and surveillance of the French financial markets, including equities, debt, options, futures, and commodities. *WORLD STOCK AND COMMODITY EXCHANGES*, *supra* note 68, at 190.

¹²⁴ The transaction information that must be reported includes the name of the security, date, time (of execution and reporting, when available to the Relevant Party), price, and volume of each transaction with respect to all principal trades and "large customer" trades; the exchange or inter-dealer quotation system on which the transaction was effected, if any; an indication whether such transaction was for a proprietary account (or a discretionary account) or the account of a customer; and the identity of a counterparty only when such counterparty is an underwriter or a selling group member. German Exemptions, *supra* note 11, at 84,534-35. See also Policy Statement, *supra* note 18, at 84,657 n.20.

¹²⁵ German Exemptions, *supra* note 11, at 84,535.

¹²⁶ *Id.*

¹²⁷ *Id.* at 84,534.

¹²⁸ *Regulator Says Banks are Derailing Proposal to Cut Average Share Price*, 6 INT'L SEC. REG. REP., No. 11, May 4, 1993, Germany Section, at 3 (noting that the average price per share of a German blue-chip company is DM450 (approximately \$325)).

¹²⁹ See *supra* note 81 and accompanying text.

¹³⁰ German Exemptions, *supra* note 11, at 84,535.

it is possible (and probable) that no transaction information reporting will be required. This is because the German Exemptions only require transaction information to be reported to the Independent Entity when the rights exercise price does not represent a discount of at least ten percent from the then-current market price of the security underlying the rights¹³¹ (i.e., the point in time at which the incentive for distribution participants to engage in price raising transactions is likely to arise).¹³² Even in that event, the German Exemptions provide that the transaction information reporting obligations are relieved if the rights exercise price rebounds to represent "a discount of at least twelve percent from the then[-]current market price of the security underlying the rights."¹³³ Thus, no transaction information reporting will be required during U.S. distributions involving rights offerings of Qualified German Securities if the German tradition of conducting deeply discounted rights offerings (twenty to thirty percent from the then-current market price) continues.¹³⁴

Reporting and recordkeeping obligations are only one aspect of the accountability program established by the German Exemptions. The other aspect is the Commission's access to the transaction information.¹³⁵ Specifically, the German Exemptions also require that the Independent Entity transmit the transaction information to the Division within thirty days of an information request.¹³⁶ Moreover, if the information is not available from the Independent Entity, each Relevant Party, if requested, is required to produce such information and make it available to the Division at its office in Washington, D.C.¹³⁷ In the event that questions arise with respect to the records of a particular

¹³¹ "[T]he market price for a security shall be the closing price on the floor of the FSE." *Id.* at 84,534.

¹³² *Id.*

¹³³ *Id.* See also Review of Antimanipulation Regulation, *supra* note 7, at 85,260 (noting the relevance in rights distributions of the lengthy rights exercise periods and the discount between the rights exercise price and the price of the underlying security).

¹³⁴ See *Learning to love equity*, *ECONOMIST*, July 3, 1993, at 71 ("A cumbersome system of pre-emptive rights for shareholders requires a gap of several weeks between the pricing and distribution of a new share issue. To reduce underwriting risk, companies must offer discounts to market prices of 30% or more.").

¹³⁵ Policy Statement, *supra* note 18, at 84,657. All documents produced or prepared in connection with the German Exemptions are required to be retained for a two-year period. German Exemptions, *supra* note 11, at 84,535.

¹³⁶ German Exemptions, *supra* note 11, at 84,535. The role of the Independent Entity under the German Exemptions is that of an information repository and a conduit to provide the information kept by the distribution participants to the Commission. The Independent Entity has no obligation to conduct an analysis of the information provided to it by the distribution participants.

¹³⁷ *Id.* The French Exemptions do not require distribution participants and their affiliated purchasers to make information available to the Commission. See French Exemptions, *supra* note 19. Presumably, this is because the SEC has negotiated an ISA (referred to as an Administrative Agreement) with the COB that permits the exchange of information, including customer identity if necessary, in the course of an investigation initiated by either the SEC or the COB. In the absence of the ISA with France, providing such information to the Commission would probably be illegal under the laws of France. See *supra* note 81.

party, the German Exemptions also require that representatives of such party be made available (in person at the Division's office or by telephone) to respond to inquiries relating to its records.¹³⁸

V. U.K. Exemption

Under the terms of the German Exemptions, the United Kingdom (i.e., the SEAQ International system) is potentially a Significant Market for many Qualified German Securities. As a Significant Market, market transactions would be prohibited during the distribution unless otherwise exempted or excepted.¹³⁹ While the Commission has granted omnibus exemptions from Rules 10b-6 and 10b-7 in the LSE Passive Market Making Exemptions for transactions effected in the United Kingdom,¹⁴⁰ there is no corresponding exemption from Rule 10b-8 to be used in connection with market activities during distributions of rights. Anticipating such a need, the German Exemptions also contain an exemption for transactions effected in the United Kingdom during a rights distribution of Qualified German Securities (U.K. Exemption). The U.K. Exemption generally permits Relevant Parties located in the United Kingdom to engage in customer facilitation activities and to bid for or purchase Relevant Securities as principal in market making transactions through the SEAQ International system during the rights distribution.¹⁴¹ However, if the difference between the rights exercise price and the market price of the security underlying the rights¹⁴² does not represent a discount of at least ten percent from the then-current market price of the security underlying the rights at any time during the inclusive period from five business days prior to the expiration date of the rights distribution until the expiration date, then the U.K. Relevant Parties must effect "passive market making" transactions in the Relevant Securities.¹⁴³ As is the case with rights distributions in Germany, it is unlikely that the discount calculation will trigger "passive market making" if the convention of conducting deeply discounted rights offerings continues.¹⁴⁴

¹³⁸ German Exemptions, *supra* note 11, at 84,535.

¹³⁹ See *supra* notes 94-95 and accompanying text.

¹⁴⁰ See *supra* note 55.

¹⁴¹ German Exemptions, *supra* note 11, at 84,535. As the German Exemptions were the first of their kind, there is no comparable exemption currently available for transactions effected in the United Kingdom.

¹⁴² *E.g.*, the mid-price between the highest bid and lowest offer quoted on the SEAQ International system for the security underlying the rights. See *id.*

¹⁴³ Such activity is to be effected in accordance with the LSE Passive Market Making Exemptions including the recordkeeping and production requirements set forth therein. See LSE Passive Market Making Exemptions, *supra* note 55. Consistent with the German Exemptions, a legend and disclosure of the proposed market making and customer facilitation activities in the Relevant Securities also are required under the LSE Passive Market Making Exemptions. *Id.* at 78,051.

¹⁴⁴ See *supra* notes 131-34 and accompanying text.

VI. Application to Distributions of Actively Traded Domestic Securities

The Commission's initiatives in Germany are based on its experience with issues raised in connection with foreign issuers' and underwriters' participation in the U.S. capital markets, and they reflect accommodations previously made to facilitate distributions of foreign securities in the United States.¹⁴⁵ Overall, the German Exemptions enhance the competitiveness of the U.S. capital markets by reducing costs and burdens on foreign market participants entering the U.S. capital markets. At the same time, the exemptions also seek to protect the U.S. investing public by incorporating specific safeguards as conditions to their use, increasing the quality of market and trading information made available to investors, and continuing to apply the general anti-fraud and anti-manipulation provisions of the federal securities laws to transactions effected in reliance on the exemptions.¹⁴⁶

In April 1994, the Commission published a concept release seeking public comment on the regulation of trading activities during distributions of securities.¹⁴⁷ The Trading Rules were promulgated in 1955.¹⁴⁸ While the rules have since been amended,¹⁴⁹ they are premised on an understanding of securities markets, trading practices, and surveillance capabilities that existed almost forty years ago. In the concept release, the Commission recognizes that securities markets and trading practices have undergone enormous changes since the time the Trading Rules were implemented; it also notes that the scope of the Trading Rules may be broader than is necessary to prevent market manipulation given the diversity apparent in today's securities markets, both in terms of the types of issuers and investors participating in capital markets and the types of securities and related products being offered.¹⁵⁰ The release suggests that a comprehensive review of the

¹⁴⁵ See, e.g., Cooling-Off Periods Exemption, *supra* note 30, at 17,125; Rule 144A Distribution Exceptions, *supra* note 31; LSE Passive Market Making Exemption, *supra* note 55. See also *supra* note 54.

¹⁴⁶ See *supra* note 85 and accompanying text.

[The SEC wants] to encourage use of U.S. capital markets as a center of global finance. We try to do everything that we can to allow financings here by foreign companies. On the other side of the coin, . . . there are critical protections for investors in the United States against manipulation and against fraud. We do not believe we should throw all these rules out the window in the name of internationalism. . . . [T]he Commission has not waived our anti-fraud standards. . . .

SEC Reauthorization: *Hearing of the House Telecommunications & Finance Subcomm. of the House Energy and Commerce Comm.*, 102d Cong., 1st Sess. 29-30 (May 2, 1991) (statement of Richard C. Breeden, Chairman, SEC, regarding the issuance of the 1991 SIA Exemptions, *supra* note 53).

¹⁴⁷ Review of Antimanipulation Regulation, *supra* note 7.

¹⁴⁸ *Id.* at 85,265.

¹⁴⁹ *Id.* at 85,265-68 (listing all releases that interpret, propose amendments, or adopt amendments to the Trading Rules).

¹⁵⁰ *Id.* at 85,245-47.

Trading Rules is warranted in light of the transformation of the securities markets and notes that, *inter alia*, some market participants have urged that the rules be simplified; especially in situations in which the risk of market manipulation is "highly attenuated."¹⁵¹ For instance, in connection with distributions of most equity securities, distribution participants and their affiliated purchasers generally must withdraw from the market for those securities for a two business day cooling-off period prior to the commencement of offers and sales in the distribution.¹⁵² Ostensibly, complete withdrawal is necessary to permit the impact of distribution participants' trading and market activities to dissipate prior to pricing and distributing the securities.¹⁵³ However, in connection with distributions of actively traded securities, i.e., securities with an average daily trading volume of \$5 million or more,¹⁵⁴ the market for those securities may not need two business days to ameliorate the impact of such trading.¹⁵⁵

Given that the German Exemptions permit distribution participants and their affiliated purchasers to operate abroad during a distribution of foreign securities according to rules that are less restrictive than the rules applied to distribution participants and their affiliated purchasers in the United States during a distribution of domestic securities, questions arise as to whether U.S. issuers are being treated unfairly and whether the relaxation in the rules made for foreign issuers also should be made applicable to them. An extension of the approach taken in the German Exemptions would be easily justifiable if relaxation of the Trading Rules were premised solely on the fact that actively traded securities of highly capitalized issuers are costly and difficult to manipulate because such factors are equally applicable in the context of distributions of actively traded securities of highly capitalized U.S. issuers. However, the German Exemptions were based on a multiplicity of factors, including a tacit pressure to increase the competitiveness of the U.S. capital markets.¹⁵⁶ Furthermore, the argument for a relaxation of the Trading Rules for distributions of actively traded domestic securities is simplistic without addressing investor protection

¹⁵¹ *Id.* at 85,247.

¹⁵² Generally, a stock qualifies for a two business day cooling-off period if it has a share price of \$5 or more and a minimum public float of 400,000 shares. 17 C.F.R. § 240.10b-6(a)(4)(xi)(A) (1994); 17 C.F.R. § 240.10b-6(a)(4)(xii)(A) (1994). *See supra* note 30. *See also* 17 C.F.R. § 240.10b-6(a)(4)(v) (1994).

¹⁵³ 1983 Adopting Release, *supra* note 7, at 85,813-15. *See supra* note 30.

¹⁵⁴ *See supra* notes 88-89 and accompanying text.

¹⁵⁵ *See Review of Antimanipulation Regulation, supra* note 7, at 85,253-54 (soliciting comment at Question 1.18 on whether distributions of securities "of very highly capitalized issuers [should] be subject to a cooling-off period of less than two business days").

¹⁵⁶ *See supra* notes 57-59, 145-46 and accompanying text. These factors also include "limiting the [German E]xemptions to actively traded securities of highly capitalized issuers, informing U.S. investors about the range of potential market activities by distribution participants, and including conditions enabling the Commission to obtain transaction information about those activities." Policy Statement, *supra* note 18, at 84,655.

concerns. U.S. investors expect the SEC to administer the federal securities laws to protect their interests when they buy or sell a security, domestic or foreign, in the United States, whether the purchase or sale is effected on a stock exchange or the over-the-counter market.¹⁵⁷ Therefore, a more correct formulation of the issue is whether it is appropriate to distinguish between distributions of foreign and domestic actively traded securities in the context of market manipulation regulation provided that investor protection concerns can be satisfied.

This question must be answered in the negative because it is likely that adequate investor protections can be provided. First, because an extension of the approach taken in the German Exemptions would be limited to distributions of domestic securities having an average daily trading volume of \$5 million or more issued by U.S. issuers with a market capitalization of \$1 billion or more, the risks of potential manipulative effects from transactions effected by distribution participants and their affiliated purchasers would be substantially diminished. The potential for manipulation involved in a distribution of such securities is reduced in part by the cost that would be required in order to produce a significant increase in the value of such securities or even to maintain or support the market price for these securities. Moreover, the market for such securities also is likely to be followed and scrutinized by analysts and others in the investment community who frequently disseminate information about the issuer and the market for its securities. By constantly policing the market for the security, such individuals would be aware of and publicize abnormal stock price patterns prior to and during an offering. Second, enhanced disclosure to investors of the range of potential trading and market activities that would be undertaken by distribution participants and their affiliated purchasers during the distribution would be required. Such information would enable investors to better evaluate offering prices and decide whether to purchase in the distribution. Third, transactions effected by distribution participants and their affiliated purchasers would remain subject to regulatory oversight to ensure compliance with the federal securities laws. Pursuant to such laws, information relating to transactions effected in accordance with an exemption or exception by distribution participants and their affiliated purchasers in the United States would be made available to the Commission upon its request.¹⁵⁸ Fi-

¹⁵⁷ See, e.g., Securities Exchange Act of 1934 § 11A(a)(1)(c), 15 U.S.C. § 78k-1(a)(1)(C) (1988). U.S. market participants have attacked attempts to relax rules relating to financial disclosure and reporting for foreign issuers on the grounds that investors want uniform quality information that they can use to make informed investment decisions. See, e.g., David Duffy & Lachlan Murray, *The Wooing of American Investors*, WALL ST. J., Feb. 25, 1994, at A14 ("A common sentiment, expressed to us by several large U.S. investors, is that German companies have to play by the rules of this market if they want to list here. The most important rule when in the U.S. is that everyone gets the same information at the same time.")

¹⁵⁸ See, e.g., Rules 17a-3, 17a-4, and 17a-5 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.17a-3 to a-5 (1994). Rule 17a-3 requires registered broker-dealers to make and

nally, at the same time, bids, purchases, or inducements to purchase made for the purpose of manipulating the market would be prohibited,¹⁵⁹ and the general anti-fraud and anti-manipulation provisions of the federal securities laws would remain applicable in the event that manipulative conduct does occur.¹⁶⁰

Together, the aforementioned investor protections ought to minimize the impact of trading and market activities by distribution participants and their affiliated purchasers on the security's market price in an active trading market. Nonetheless, these protections alone may be inadequate to prevent market participants from seeking to influence the price of the offered security. This potential inadequacy arises because a domestic exemption or exception patterned after the German Exemptions would provide distribution participants and their affiliated purchasers with the opportunity to engage in most of their normal market and trading activity before the security being distributed is priced. At the same time, the incentive for distribution participants, especially issuers,¹⁶¹ and their affiliated purchasers to engage in price-affecting market transactions to facilitate the distribution is likely to increase as the time of the pricing of the security being distributed nears.¹⁶² Such a situation presents distribution participants and their affiliated purchasers with a dilemma. On the one hand, distribution participants and their affiliated purchasers may be tempted to use the exemption or exception to "legitimize" activities that are otherwise prohibited by the Trading Rules. On the other hand, the general anti-fraud and anti-manipulation provisions under the federal securities laws would continue to apply to all transactions effected in reliance upon the domestic exemption or exception. Accordingly, distribution participants and their affiliated purchasers would run the risk of being called upon to defend their activities conducted in reliance upon the exemption or exception in a lawsuit brought under the general anti-

keep current books and records detailing, *inter alia*, securities transactions, money imbalances, and securities positions. 17 C.F.R. § 240.17a-3. Rule 17a-4 specifies record retention and preservation requirements for registered broker-dealers and requires that copies of such records promptly be furnished to the Commission upon its request. 17 C.F.R. § 240.17a-4. Rule 17a-5 requires broker-dealers to file periodic reports with the SEC, including quarterly and annual financial statements. 17 C.F.R. § 240.17a-5.

¹⁵⁹ See Rule 10b-6(a)(4), 17 C.F.R. § 240.10b-6(a)(4) (1994); *supra* note 26.

¹⁶⁰ See *supra* note 85.

¹⁶¹ See *infra* notes 168-70 and accompanying text.

¹⁶² For example, a similar type of prohibited manipulative activity is commonly referred to as "marking the close." "Marking the close" involves entering a quote or effecting a purchase or sale at or near the close of a trading session in order to affect artificially the closing quote or closing sale price of the security. See, e.g., In the Matter of Harry S. Pack and Philip Pack, Inc., Exchange Act Release No. 32,374 (May 27, 1993), available in LEXIS, Fed-sec Library, Secrel File (practice of marking the close found to be in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder); In the Matter of Myron S. Levin, Exchange Act Release No. 31,124, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,046 (Sept. 1, 1992) (practice of marking the close found to be in violation of Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder).

fraud and anti-manipulation provisions under the federal securities laws.¹⁶³ One simple way potentially to alleviate this dilemma and to augment the aforementioned investor protections for application to distributions of actively traded domestic securities is to impose an additional condition that would require distribution participants and their affiliated purchasers to cease their trading and market activities in the hour before pricing (last-hour restriction),¹⁶⁴ generally recognized as the most critical time for pricing an offering, except as otherwise permitted by Rule 10b-6.¹⁶⁵ While the time of pricing may be difficult to predict with exact precision, this time for an exchange-traded security is generally an hour before the scheduled close of exchange trading on the day preceding the commencement of offers or sales of the security in the distribution.¹⁶⁶ The last-hour restriction would minimize the impact of distribution participants' and their affiliated purchasers' trading and market activities on the security's offering price at a time when it is most susceptible to being affected, while not unduly limiting the utility of the approach taken in the German Exemptions and endorsed by the Policy Statement. In addition, because the general anti-fraud and anti-manipulation provisions of the federal securities laws will remain applicable to all transactions effected in reliance upon such a domestic exemption or exception, observance of a last-hour

¹⁶³ Theoretically this could happen under the German Exemptions with respect to activities conducted in Germany and elsewhere. Nonetheless, such an action could be challenged by distribution participants and their affiliated purchasers on, *inter alia*, jurisdictional grounds, even though the general anti-fraud provisions of the federal securities laws have been found to have extraterritorial application. See *supra* note 47 and accompanying text. In contrast, distribution participants and their affiliated purchasers relying on a domestic exemption or exception patterned after the German Exemptions would not be able to challenge a similar lawsuit on jurisdictional grounds.

¹⁶⁴ In order to minimize the potential effects of passive market making on the offering price, a last-hour restriction on trading was proposed in connection with the NASDAQ Passive Market Making Exemption. See *supra* note 52; Passive Market Making, Exchange Act Release No. 31,347, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,054, at 83,504 (Oct. 22, 1992). The NASDAQ passive market making scheme, however, was adopted without a last hour restriction. Commentators to the proposed exemption had opposed the last-hour provision on the grounds that it was too complicated and impractical because of the difficulty in determining the exact time of pricing. NASDAQ Passive Market Making Exemption, *supra* note 52, at 84,102. Compare 17 C.F.R. § 240.10b-18(b)(2) (1994) (under the safe harbor provisions of Rule 10b-18 under the Exchange Act equity purchases by an issuer must be made prior to "the one half-hour before the scheduled close of trading" either on an exchange or before the termination of the period in which last sale prices are reported to the consolidated transaction reporting system contemplated by Rule 11Aa3-1 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.11Aa3-1 (1994)). See *infra* note 167.

¹⁶⁵ In general, secondary offerings usually are priced based on the security's closing price (last sale information or closing bid) on the day preceding the offering. See *supra* note 50.

¹⁶⁶ Typically, the commencement of offers and sales occurs when the registration statement is declared effective in a distribution of securities required to be registered under the Securities Act. For a general overview of the Securities Act's registration requirements, see HAZEN, *supra* note 7, §§ 2.2-2.5. See also Review of Antimanipulation Regulation, *supra* note 7, at 85,249 (noting that a Rule 10b-6 distribution commences when the incentive to engage in manipulative conduct is first present and ends when the securities come to rest in the hands of the investing public); *supra* notes 21, 30.

provision may provide distribution participants and their affiliated purchasers with a certain level of comfort that their exempted or excepted activities will not be actionable under the general anti-fraud and anti-manipulation provisions of the federal securities laws.¹⁶⁷

Notably, the relief granted in the German Exemptions also was premised on the absence of market activities by the issuer and its affiliated purchasers.¹⁶⁸ Whether it is necessary or appropriate for an issuer, as the distribution participant with perhaps the largest financial stake in an offering of its securities (as opposed to the underwriters or other distribution participants), to engage in market activities in its securities before a distribution is controversial.¹⁶⁹ The issuer's marginally greater incentive to engage in market activities in its securities before an offering may require additional restrictions to be placed on the issuer and its affiliated purchasers.¹⁷⁰ Moreover, imposing additional restrictions on the issuer and its affiliated purchasers would add another layer of investor protection to the aforementioned protections. However, consistent with the notion that the effect of market activities by any distribution participant or affiliated purchaser would dissipate quickly in the market for securities with an average daily trading volume of \$5 million, issuers and their affiliated purchasers could be required to cease their trading activities for a slightly longer period than other distribution participants, such as two hours prior to pricing the security being offered. Alternatively, issuers and their affiliated purchasers could be required to refrain from trading on the business day their securities are expected to be priced.

¹⁶⁷ Rule 10b-18 provides a "safe harbor" from liability for manipulation in connection with purchases of an issuer's common stock by the issuer and certain related persons. 17 C.F.R. § 240.10b-18 (1994). Under Rule 10b-18, an issuer will not incur liability under the anti-manipulation provisions of Sections 9(a)(2) or 10(b) of the Securities Exchange Act of 1934, or Rule 10b-5 thereunder, if purchases are effected in compliance with certain conditions relating to manner of purchase, timing, price, and volume. Pursuant to this scheme, Rule 10b-18 prohibits purchases at the opening and during the last half-hour of trading. Rule 10b-18's timing requirement is designed to prevent an issuer from affecting the opening price or the closing price of its security. See Rule 10b-18(b)(2)(i)-(iii), 17 C.F.R. § 240.10b-18(b)(2)(i)-(iii) (establishing a time scheme for "reported," "exchange traded," and "NASDAQ" securities).

¹⁶⁸ See *supra* notes 77, 78, 82 and accompanying text.

¹⁶⁹ See Review of Antimanipulation Regulation, *supra* note 7, at 85,251 n.65 (noting that the financial risk and concomitant incentive to manipulate shifts from the issuer to the underwriters only once the underwriting agreement is signed (see *supra* note 115), which is typically less than one day before the commencement of offers and sales in the distribution, and is subject to various "market out" clauses that permit the underwriters to avoid proceeding with the distribution upon the occurrence of certain specified contingencies).

¹⁷⁰ Just as an avalanche of sales immediately prior to an offering may result in a decrease in the price of a security, and consequently a lower offering price, a rash of buying activity immediately prior to an offering may result in an increase in the price of a security, and consequently a higher offering price. In terms of capital raising, a lower price deprives an issuer of offering proceeds that would have been realized, while a higher price permits an issuer to receive offering proceeds that otherwise would not have been realized. Of course, the price of the security being offered is usually a product of negotiation, and the security's last sale information is only a factor in the pricing determination. See *supra* note 50.

VII. Conclusion

By issuing the German Exemptions and the accompanying Policy Statement, the Commission has created a new legal environment with respect to the regulation of market manipulation. Consistent with any newly developed scheme, there remain areas that may require clarification. For example, it may not be logical to issue broad exemptions for transactions effected in Germany, most likely the principal price discovery market for Qualified German Securities, and then apply Rule 10b-6 in other Significant Markets and the United States unless otherwise exempted.¹⁷¹ In addition, there may be no basis for limiting the terms of the exemptions to securities of substantial issuers that also issue a security that comprises a stock index (i.e., the DAX). Because stock indices often are comprised of representative companies from a cross-section of industry groups, some substantial issuers may be excluded from representation in a particular index. These excluded world-class companies may issue liquid securities that are followed widely by the investment community as well. Distributions of actively traded securities issued by these companies also may fit within the framework established by the German Exemptions. Moreover, because the German Exemptions generally replace the "pre-distribution" protections of Rule 10b-6 with the "post-distribution" protections of Rule 10b-5 and other provisions of the federal securities laws with respect to transactions effected in Germany and other jurisdictions, a danger exists that investor confidence might be adversely affected. However, given their terms, the German Exemptions ought not result in a diminution of investor confidence since they contain protections that should substitute for the Trading Rules.

Nonetheless, only time will tell whether the changes brought about by the German Exemptions will deter market manipulation or make it easier for the unscrupulous to gull the unwary. However, in the context of distributions of liquid, world-class securities of blue chip issuers, the "kinder, gentler" regulation represented by the German Exemptions should be given an opportunity to establish itself as effective against market manipulation. If the new regulation proves itself to be effective, perhaps the Commission should consider extending the terms of the German Exemptions and the Policy Statement, with the addition of a last-hour restriction and possibly certain additional restrictions imposed on the issuer and its affiliated purchasers, to qualifying distributions of actively traded domestic securities of substantial U.S. issuers.

¹⁷¹ For instance, under the German Exemptions, no cooling-off period is observed in connection with transactions effected in Germany. In contrast, a two business day cooling-off period must be observed in the United States and Significant Markets, absent an exemption or exception. German Exemptions, *supra* note 11, at 84,536.

