


Summer 1988

# Transnational Takeover Talk: Regulations Relating to Tender Offers and Insider Trading in the United States, the United Kingdom, Germany, and Australia

Roberta S. Karmel

*Brooklyn Law School*, [roberta.karmel@brooklaw.edu](mailto:roberta.karmel@brooklaw.edu)

Follow this and additional works at: <https://brooklynworks.brooklaw.edu/faculty>

 Part of the [International Trade Law Commons](#), [Other Law Commons](#), [Secured Transactions Commons](#), and the [Securities Law Commons](#)

---

## Recommended Citation

66 U. Cinn. L. Rev. 1133 (1997-1998)

This Article is brought to you for free and open access by BrooklynWorks. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of BrooklynWorks.

# **TRANSNATIONAL TAKEOVER TALK—REGULATIONS RELATING TO TENDER OFFERS AND INSIDER TRADING IN THE UNITED STATES, THE UNITED KINGDOM, GERMANY, AND AUSTRALIA**

*Roberta S. Karmel\**

## **I. INTRODUCTION**

Cross border acquisitions, both friendly and hostile, are increasingly international. Yet, the legal regimes governing acquisitions differ significantly, even where the purposes of relevant statutes or regulations, for example, the protection of investors, are compatible. Further, securities laws frequently are given extraterritorial effect and therefore regulatory disparities can lead to conflict and confusion.

This Article will focus on the control of information announcing a public tender offer in the United States, the United Kingdom, Germany, and Australia. There are three critical aspects of such control: the circumstances under which an announcement of a tender offer must be made public, the type of information that a bidder must disclose, and the suppression of such information by way of prohibitions against trading on inside information. Some of the mechanical and technical investor-protection regulations applicable to takeovers will also be discussed.

Although the United States, the United Kingdom, and Australia have developed from a common legal tradition, the way in which corporate and securities law have become fixed in statutory standards is quite different. The United States is a federal system in which corporate law is governed by the states and securities law is governed by a federal agency, the Securities and Exchange Commission (SEC) and the federal courts. Although the United Kingdom has a statutory corporation law with some room for court development of cases on a director's fiduciary duties, its regulatory system for tender offers is self-regulatory, and with rare exception, is not enforced by the courts. However, as a Member State of the European Union (EU), the United Kingdom is required to implement by statute relevant EU directives relating to insider trading

---

\* Roberta S. Karmel is a Professor and Co-Director of the Center for the Study of International Business Law at Brooklyn Law School and Of Counsel to the law firm of Kelley Drye & Warren LLP. She is a former Commissioner of the Securities and Exchange Commission. A summer research stipend from Brooklyn Law School was of assistance in the preparation of this Article. A Parsons research grant from the University of Sydney Law School is also gratefully acknowledged. The author is appreciative of the research assistance of Brooklyn Law School students Fred Van Remortel and Angela Soo.

and tender offers. Germany, by contrast, although also a Member of the EU, has a civil law tradition and a federal system. Yet, it has only a voluntary and primitive regulatory regime for takeovers, despite an insider trading law that prohibits trading on undisclosed information about a takeover. Australia, although it has a strong federal system, has a central government corporation and securities law, which includes regulation of tender offers and insider trading.

In addition to legal differences, countries have quite different cultural and economic approaches to capital formation. So called Anglo-Saxon countries—the United States, the United Kingdom, and Australia have equity-based systems of corporate finance where the shareholder is the center of regulatory and legal protections. Accordingly, tender offer regulation tends to be friendly to bidders and to encourage auctions for corporate control. Germany, by contrast, has a creditor-based system of corporate finance and a tradition of worker co-determination in corporate governance, which tends to make its tender offer regulations less hospitable to hostile bids.

Despite disparities in the securities laws relating to tender offers, globalization and the trend toward equity-based corporate finance systems are important forces for change in legal concepts and structures. Transnational tender offers are becoming more common and they inevitably lead to conflicts between differing regulatory regimes. Traditional concepts of international law jurisdiction are not always helpful in resolving such conflicts. Two of the ways in which conflicts can be reconciled are mutual recognition and harmonization. Yet in the tender offer arena, mutual recognition is a difficult policy choice because it is unclear whether the relevant factor is the law applicable to the governance of the bidder, the target corporation, or the law of the country where shareholders of the corporation are located. If, as increasingly is the case, a corporation's shareholders are located in several countries, what law should protect them in a tender offer? This Article will conclude that, in this area, international harmonization is an appropriate means to reconcile differences in the law, but the near term prospects for such harmonization are poor. Insofar as tender offer regulation is concerned, the law of the country of the target's incorporation should be respected to the extent this will foster investor protection, but not if investors will be disadvantaged. Insofar as insider trading violations are concerned, customary jurisdictional conflict of interest principles probably is the best current solution.

## II. A COMPARISON OF TAKEOVER REGULATION

A. *United States*

In the United States, the capital markets are structured and regulated to encourage capital formation by equity shareholders. Most large corporations are publicly owned and federal law protects investors primarily through mandated disclosure in capital raising and change of control transactions, and the prohibition of fraud and manipulation in the public securities markets.<sup>1</sup> Tender offers are regulated by the SEC pursuant to the Williams Act,<sup>2</sup> which amended the Securities Exchange Act of 1934 (Exchange Act) in 1968. Congress passed the Williams Act because it was concerned that block purchases and large rapid accumulations, which could result in changes in corporate control, were taking place secretly.<sup>3</sup> The Williams Act generally deals with the disclosure obligations of bidders and was intended to equalize the protection of investors in proxy contests and in takeover contests.<sup>4</sup> The Williams Act also gives investors equal or fair rights to participate in the tender offer.

Any person who acquires a beneficial interest of five percent or more of any class of equity security subject to the annual and periodic reporting provisions of the Exchange Act (essentially, the common stock of all publicly traded issuers) must file a statement of ownership with the SEC within ten days after such acquisition.<sup>5</sup> This statement, made on Schedule 13D, mandates disclosure about the person or group making the five percent acquisition, its officers, directors, and principal business, as well as any financing arrangements that have been entered into to finance the purchase.<sup>6</sup> Further, the filing must state the purchaser's future intentions with regard to the target company; that is, whether the purchaser intends to make a tender offer or engage in some other control transaction.<sup>7</sup> Any person planning to make a tender offer must file a disclosure statement on Schedule 14D containing essentially this

---

1. See Arthur R. Pinto, *Corporate Takeovers Through the Public Markets in the United States*, 42 AM. J. COMP. L. 339, 340-41, 351-53 (1994).

2. Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended at 15 U.S.C. §§ 78m(d)-(e), n(d)-(l) (1994)).

3. See Jill E. Fisch, *Imprudent Power: Reconsidering U.S. Regulation of Foreign Tender Offers*, 87 NW. U. L. REV. 523, 525-26 (1993).

4. See *id.* at 526.

5. See Exchange Act § 13(d), 15 U.S.C. § 78m(d) (1994).

6. See 17 C.F.R. § 240.13d-101 (1997).

7. See *id.*

same information.<sup>8</sup> A bidder must commence an offer within five days of a public announcement of an offer that includes the price and number of securities sought.<sup>9</sup>

The Schedule 13D filing requirement is aimed at creeping acquisitions and open market or privately negotiated large block purchases, whereas the Schedule 14D filing requirement is aimed at "tender offers." However, the term "tender offer" is nowhere defined in the Exchange Act. Initially, the SEC resisted any definition of the term in view of the dynamic nature of tender offer transactions and the need for a flexible interpretation of the Williams Act.<sup>10</sup> Thereafter, the SEC proposed a rule that would have defined a tender offer as any offer to purchase more than five percent of a class of securities made to more than ten persons (except for certain brokers' transactions) or an offer that is disseminated in a wide-spread manner, provides for a price which represents a premium in excess of five percent or two dollars above the current market price, and does not provide for a meaningful opportunity to negotiate the price and terms.<sup>11</sup> Three months later, the SEC asked Congress to legislatively define the term "tender offer," but no such legislation ever resulted.<sup>12</sup> In lieu of a definition of the term "tender offer," the SEC proffered an eight-factor test so that a tender offer would be characterized by: active and widespread solicitation of public shareholders for the shares of an issuer, solicitation of a substantial percentage of the issuer's securities, offer of a premium over prevailing market price, fixed rather than negotiable terms, limited duration of offer, offer contingent on the tender of a fixed number of shares, offerees subject to pressure to sell their stock, and a public announcement preceded or followed by a rapid accumulation of stock.<sup>13</sup> This definition has been accepted by the courts,<sup>14</sup> but results in situations where there can be a change of control in a privately negotiated transaction that deprives public shareholders of the protection of the Williams Act.<sup>15</sup>

The Williams Act and implementing SEC regulations also address certain substantive or procedural aspects of tender offers. These include making tendered shares withdrawable for a specified period of time,

---

8. *See id.* § 240.14d-100.

9. *See id.* § 240.14d-2(b).

10. *See* Tender Offers, Exchange Act Release No. 34-12676, 41 Fed. Reg. 33,004 (1976).

11. The rule proposed was Proposed Rule 14d-1(b)(1). *See* Tender Offers, Exchange Act Release No. 34-16385, 44 Fed. Reg. 70,349 (1979).

12. *See* THOMAS LEE HAZEN, 1 THE LAW OF SECURITIES REGULATION § 11.13, at 617 (3d ed. 1996).

13. *See id.* at 619.

14. *See, e.g.,* Wellman v. Dickinson, 475 F. Supp. 783 (S.D.N.Y. 1979).

15. *See* Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985).

requiring pro rata acceptance when an offer for less than one hundred percent of shares is made, requiring that tender offers be made to all security holders, and that all offerees be paid the same price.<sup>16</sup> In addition, § 14(e) of the Exchange Act<sup>17</sup> contains a general tender offer antifraud provision prohibiting the use of all fraudulent, deceptive, and manipulative acts and practices in connection with a tender offer and gives the SEC authority to define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative. Pursuant to such authority, the SEC adopted Rule 14e-3<sup>18</sup> which, among other things, prohibits anyone in the possession of insider information about an unannounced tender offer from trading on such information.

The Williams Act generally facilitates tender offers, but corporate governance in the United States is left to state law. Further, corporate fiduciary duty regulation under state law is not, as a general matter, preempted by the Williams Act, so the SEC does not regulate the defenses available to a bidder.<sup>19</sup> In *Schreiber v. Burlington Northern, Inc.*, it was argued that a renegotiation by a target company of the terms of a tender offer breached the company's fiduciary duty to its shareholders, was manipulative, and violated the antifraud provisions of the Williams Act.<sup>20</sup> The United States Supreme Court rejected this argument, however, holding that the Williams Act dealt with disclosure, not unfairness in the takeover context. As a matter of state law, although directors are obliged to exercise due care and loyalty,<sup>21</sup> and must obtain the highest price once a company is on the auction block,<sup>22</sup> they have considerable latitude in resisting a takeover bid.<sup>23</sup> Further, state statutory law can be quite protective of directors attempting to block an unwelcome bidder.<sup>24</sup>

---

16. See Exchange Act § 14(d), 15 U.S.C. § 78n(d); 17 C.F.R. § 240.14d-10 (1997).

17. 15 U.S.C. § 78n(e) (1994).

18. 17 C.F.R. § 240.14e-3 (1997).

19. See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 79 (1987); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977).

20. 472 U.S. 1, 8 (1985).

21. See DENNIS J. BLOCK ET AL., *THE BUSINESS JUDGMENT RULE 52-55*, 124-26 (4th ed. 1993).

22. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1985).

23. See BLOCK ET AL., *supra* note 21, at 233-708.

24. See Roberta S. Karmel, *The Duty of Directors to Non-Shareholder Constituencies in Control Transactions—A Comparison of U.S. and U.K. Law*, 25 WAKE FOREST L. REV. 61, 66-68 (1990); Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987).

*B. The United Kingdom*

In the United Kingdom, as in the United States, shareholders are regarded as the owners of corporate enterprise, and shareholder interests take precedence over all other corporate constituencies.<sup>25</sup> A significant portion of company and securities law is based on judicially-developed theories of fiduciary duty. The British strongly prefer financial self-regulation to statutory regulation, viewing the latter as insufficiently flexible.<sup>26</sup> Takeovers in the United Kingdom, therefore, are regulated by the Panel on Takeovers and Mergers, a self-regulatory body that operates pursuant to the City Code on Takeovers and Mergers (City Code). Nevertheless, public companies adhere to the City Code and rulings by the Panel on Takeovers and Mergers are respected.

The term "tender offer" is not defined in the City Code. Rather, the City Code requires persons who have acquired thirty percent of the voting stock of any company to make a cash offer for the entire company, which is conditioned upon receiving at least fifty percent of the voting securities.<sup>27</sup> Once the bidder has received fifty percent of the voting securities, it can make the offer unconditional, but cannot do so until then.<sup>28</sup> If the offer lapses without becoming unconditional, the bidder and persons acting with them cannot, without the permission of the Panel on Takeovers and Mergers, make a further bid for a period of twelve months.<sup>29</sup> Once the bidder has acquired ninety percent of the shares for which the offer was made, it can force the remaining ten percent to accept the same terms as the takeover bid.<sup>30</sup> Acquisitions of fifteen percent of an issuer's securities trigger a requirement to notify the issuer and the London Stock Exchange of this fact by the next day.<sup>31</sup> Further, under the Companies Act, movement in either direction across a three percent ownership threshold requires notice to the issuer within two days of dealing and to the London Stock Exchange "without delay."<sup>32</sup>

---

25. See PETER XUEREB, *THE RIGHTS OF SHAREHOLDERS* 10-11 (1989).

26. See 4 RICHARD M. BUXBAUM & KLAUS J. HOPT, *LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE* 190 (1988).

27. See City Code on Takeovers and Mergers, in 2 WEINBERG & BLANK ON TAKE-OVERS AND MERGERS 7001, at Rule 5.1 (Laurence Rabinowitz ed., 5<sup>th</sup> ed. 1989) [hereinafter City Code on Takeovers and Mergers].

28. See *id.* at Rule 10.

29. See *id.* at Rules 9.1-9.3, 10.

30. See *id.* at Rule 9.3

31. See *id.* at Rule 17.1.

32. Companies Act, 1985, §§ 185-210 (4<sup>th</sup> ed. Halsbury's Statutes of England and Wales 1991) (Eng.).

Mandatory bids are somewhat rare, but hostile takeovers are not.<sup>33</sup> There are no specific disclosure requirements for cash bids. The City Code consists of ten "General Principles" and thirty-eight specific "Rules" which are applicable to all offers. The City Code further provides that it is "impracticable to devise rules in sufficient detail to cover all circumstances which can arise in offers. Accordingly, persons engaged in offers should be aware that the spirit as well as the precise wording of the General Principles and the ensuing Rules must be observed."<sup>34</sup> Among the technical requirements are that the bidder must first make the offer to the board of the target company. If the bidder has made a firm determination without preconditions to make a bid or has to make a bid because it and the concert parties have acquired thirty percent of the outstanding shares, the bid must be publicly announced.<sup>35</sup>

Detailed disclosure by the bidder is required in the offer document with regard to, among other things, all of the terms and conditions of the offer, financial and other conditions concerning the offeror, including shareholders in a company formed to conduct the bid, the bidder's financial resources, and agreements, arrangements, or understandings between the offeror and directors or shareholders of the offeree.<sup>36</sup> The bidder must post its offering documents to the shareholders within twenty-eight days of the announcement.<sup>37</sup> The board must then obtain competent independent advice.<sup>38</sup> Approximately fourteen days after the bidder posts the offering memoranda, the board must furnish the shareholders with its view of the offer, along with the advice received from the independent advisor.<sup>39</sup> The offer must remain open for twenty-one days from the date the offering documents are initially posted.<sup>40</sup>

---

33. See Edward F. Greene et al., *Toward a Cohesive International Approach to Cross-Border Takeover Regulation*, 51 U. MIAMI L. REV. 823, 838 (1997).

34. City Code on Takeovers and Mergers, *supra* note 27, General Principles.

35. See *id.* at Rule 2.2.

36. See *id.* at Rule 24.

37. See *id.* at Rule 30.1.

38. See *id.* at Rule 3.1.

39. See *id.* at Rule 30.2. Detailed disclosure requirements for this document, similar to those imposed upon the bidder, are also specified. See *id.* at Rule 25.

40. See *id.* at Rule 31.1. If there is an increase in offering price or another material change, the offer must be kept open for at least an additional 14 days. See *id.* at Rule 31.4. The offer is generally conditioned upon the bidder obtaining at least 50% of the target's voting rights; this condition must be satisfied within 60 days of the date on which the initial offer was made. See *id.* at Rule 35. In addition, the offer cannot continue if it has not become unconditional as to acceptances within 60 days. In either case, if the offer lapses without meeting these requirements, the bidder and persons acting in concert with it cannot make a new offer for a period of 12 months without the consent of the Panel. See *id.* at 35.1.



Withdrawal and fair pricing requirements are set forth. One who tenders his acceptance can withdraw his acceptance only if the offer has not become unconditional as to acceptance by twenty-one days after the initial closing date (hence, generally, forty-two days from the commencement of the offer). The right to withdraw after that time continues until the offer becomes or is declared unconditional as to acceptances.<sup>41</sup> The initial offering must be at a price equal to or greater than the highest price paid by the bidder for any of the target's shares purchased in the prior three months. If the bidder acquires shares in the target during the pendency of the offer at a price higher than the offering price, then it must both immediately disclose the terms of the transaction and increase the offering price to equal or exceed that paid in the transaction.<sup>42</sup>

More important than these technical requirements, however, are the principles that shareholders of an offeree company must decide whether or not an offer should succeed, and that all equity holders must be treated equally.<sup>43</sup> In addition, after an offer is communicated to the board, or even if a board has reason to believe an offer is imminent, the offeree board is prohibited from taking any action without the approval of shareholders at a general meeting "which could effectively result in any bona fide offer being frustrated or in the shareholders being denied the opportunity to decide on its merits."<sup>44</sup>

### C. Germany

Under the German system of codetermination, employees are represented on the supervisory board of the corporation and have as great a claim to corporate profits as shareholders. Commercial banks are major shareholders of the most significant public companies, so lenders, rather than shareholders, have traditionally taken the lead in allocating capital.<sup>45</sup> Following German reunification and the greater pressures for capital experienced by German corporations, changes are slowly being exerted upon German public corporations, but hostile

---

41. *See id.* at Rule 34.

42. *See id.*

43. *See* Simon MacLachlan & William MacKesy, *Acquisitions of Companies in Europe—Practicality, Disclosure, and Regulation: An Overview*, 23 INT'L LAW. 373, 387-88 (1989).

44. City Code on Takeovers and Mergers, *supra* note 27, General Principles.

45. *See* 4 BUXBAUM & HOPT, *supra* note 26, at 181-82; *New Dreams at Deutsche Bank*, ECONOMIST, June 22, 1991, at 79.

takeovers are still rare and equity investors are not as protected as they are elsewhere.<sup>46</sup>

Germany has a new Takeover Code, but it does not automatically apply to all takeovers. The German Takeover Commission is comprised of appointed members from the capital markets and financial community, including lenders and academics. None of the voluntary guidelines for takeover bids are binding or give rise to any sanction if breached.<sup>47</sup> The voluntary guidelines merely expect the bidder to notify the target and the stock exchange prior to making a bid, and to publish the offer immediately thereafter. Minimal disclosure standards are prescribed.<sup>48</sup>

#### D. Australia

Australia has an active equity market, dominated by institutional investors. Because of scandals in the securities markets in the 1980s, Australia now has an extensive scheme of takeover regulation. It is embodied in a federal law which is implemented by each state adopting the federal legislation; this serves as a means of assuring uniformity among states.<sup>49</sup> A National Companies and Securities Commission (NCSC) has authority to monitor trading in target company securities, and to administer the takeover legislation.

Prescribed information must be set forth in tender offer materials, which must be registered with the NCSC and served on the target company and appropriate securities exchange before it can be used and before a tender offer can commence.<sup>50</sup> The target company then must prepare and file with the NCSC a statement containing its recommendation and prescribed information, including unpublicized changes, if any, in its financial condition.<sup>51</sup> Both the bidder's materials

---

46. See Greene et al., *supra* note 33, at 835; see also David J. Berger, *A Comparative Analysis of Takeover Regulation in the European Community*, LAW & CONTEMP. PROBS., Autumn 1992, at 53, 68-74.

47. See Takeover Code of the Exchange Export Commission at the Federal Ministry of Finance, July 14, 1995, translated in the New German Takeover Code, Cleary, Gottlieb, Steen & Hamilton, Annex 1 (1996), at 7.

48. See *id.* at 835.

49. See Companies (Acquisition of Shares) Act, 1980 (Austl.), *Australasian Legal Information Institute: Commonwealth Numbered Acts* (last modified Mar. 11, 1997) <[http://www.austlii.edu.au/au/legis/cth/num\\_act.html](http://www.austlii.edu.au/au/legis/cth/num_act.html)> [hereinafter National Takeovers Code]; J.P. Hambrook, *Australia*, in 10C INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION §10.11(3) (Harold S. Bloomenthal & Samuel Wolff eds., 1997).

50. See National Takeovers Code, *supra* note 49, § 18(1); Hambrook, *supra* note 49, § 10.11(5).

51. See National Takeovers Code, *supra* note 49, § 22(1); Hambrook, *supra* note 49, § 10.11(5).

and the target company's materials must be transmitted to the shareholders.<sup>52</sup>

There are special procedures if the takeover is to be effectuated by purchases on a stock exchange.<sup>53</sup> There are also detailed substantive provisions governing, among other things, the period the offer remains open, conditions to the offer, market purchases, and best price requirement.<sup>54</sup> If specified percentages are acquired, then the bidder can compel the remaining shareholders to sell on the same terms,<sup>55</sup> and, if ninety percent is acquired by the bidder, the remaining shareholders that did not tender can compel the bidder to buy their shares on the same terms which they previously refused.<sup>56</sup>

### *E. Observations on Conflicts*

As the foregoing demonstrates, there are numerous conflicts between the takeover regulations of the United States, the United Kingdom, Germany, and Australia. These conflicts are deeply rooted not only in the legal systems of these countries, but in their systems of corporate finance and capital formation. The conflicts involve not only mechanical and technical requirements such as the circumstances under which a tender offer can or must be made, how long an offer must be kept open and withdrawal rights, but also informational requirements concerning whether or not certain disclosures are mandatory. Fairness provisions, such as whether and when some investors may receive preferential treatment, and the availability of takeover defenses also differ. If the tender offer regulations of more countries were to be detailed, further conflicts would appear.

## III. A COMPARISON OF BANS AGAINST TRADING ON INSIDE INFORMATION

### *A. Relationship Between Disclosure and Insider Trading Prohibitions*

An important means of enforcing mandatory disclosure requirements is to prohibit trading by persons who are in possession of material undisclosed information about an issuer or its securities. Information

---

52. See National Takeovers Code, *supra* note 49, § 16(2); Hambrook, *supra* note 49, § 10.11(5).

53. See Hambrook, *supra* note 49, § 10.11(6).

54. See *id.* § 10.11(5).

55. See National Takeovers Code, *supra* note 49, §§ 42(1), (2); Hambrook, *supra* note 49, § 10.11(10).

56. See National Takeovers Code, *supra* note 49, § 43(3); Hambrook, *supra* note 49, § 10.11(11).

about an upcoming tender offer is market information, rather than classic inside information, which is non-public information about events or circumstances related to a company's assets or earning power, known only to corporate management and its confidants, and reasonably expected to materially affect the market price of the company's stock.<sup>57</sup> Further, a bidder or potential bidder does not have a fiduciary relationship to the shareholders of a target company requiring it to keep information about the bid confidential. Nevertheless, where such information is utilized for trading prior to a public announcement of a tender offer, target company shareholders are deprived of the benefits of the Williams Act in the United States or similar statutory or non-statutory regulatory regimes in other countries. Further, the bidder is disadvantaged by purchases that drive up the price of the target company's common stock.

Accordingly, bans against trading on non-public information about upcoming tender offers were developed by case law and SEC rules in the United States. In Europe, a general directive on insider trading promulgated by the EU<sup>58</sup> included some prohibitions regarding tender offers. So do Australian statutes on insider trading. Indeed, there is greater international harmonization regarding prohibitions against trading on insider information about tender offers than there is with regard to requirements placed on a bidder in a tender offer. Nevertheless, disparities exist both in the substantive law and in law enforcement.

### *B. The United States*

Rule 14e-3, adopted by the SEC in 1980, promotes the disclosure obligations of the Williams Act by setting forth an obligation to disclose information about an upcoming tender offer or abstain from trading upon any person other than a bidder or prospective bidder who is in possession of material information relating to a tender offer "which information he knows or has reason to know is non-public and which he knows or has reason to know has been acquired directly or indirectly from (1) The offering person, (2) [the target], or (3) Any officer, director, partner or employee or any other person acting on behalf of the offering person."<sup>59</sup> It is noteworthy that this disclose or abstain obligation is

---

57. See *Securities and Exch. Comm'n v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

58. See Council Directive 89/592 of 13 November 1989 Coordinating Regulations on Insider Dealing, 1989 O.J. (L. 334) 30, available in LEXIS, Intlaw Library, ECLaw File [hereinafter EU Insider Trading Directive].

59. 17 C.F.R. § 240.14c-3 (1997).

imposed whether information about a bid emanates from the offeror or target.

Rule 14e-3 was adopted by the SEC soon after the decision of the United States Supreme Court limiting the scope of insider trading violations under Rule 10b-5 in *Chiarella v. United States*.<sup>60</sup> This case involved a printer who learned about upcoming tender offers to purchase stock in target companies. The Court held that silence in connection with a purchase or sale may operate as a fraud only if liability is premised on a duty to disclose arising from a relationship of trust and confidence, and not merely one's ability to utilize information because of his position in the marketplace. Although the defendant's conduct may have been reprehensible, the Supreme Court pointed out that not every instance of financial unfairness violates Rule 10b-5. In a dissenting opinion, Chief Justice Berger set forth the view that anyone who misappropriates material non-public information in breach of an employment, fiduciary, or similar duty to anyone and then trades on or tips that information to his own advantage violates Rule 10b-5.<sup>61</sup>

The SEC release adopting Rule 14e-3 justified the rule on the grounds that trading by persons in possession of material, non-public information relating to a tender offer results in unfair disparities in market information and market disruption because security holders who purchase from or sell to such persons are effectively denied the disclosure and the substantive provisions of the Williams Act. If furnished with information about the tender offer, however, they could make an informed investment decision.<sup>62</sup> No breach of a fiduciary duty need be demonstrated. In addition, Rule 14e-3 was clearly intended to enforce the disclosure provisions of the Exchange Act relating to tender offers.

Because Rule 14e-3 avoids some important elements required in a Rule 10b-5 action, in particular, the need to prove breach of a fiduciary duty and the need to prove scienter, there were persistent questions concerning its validity. These questions were first addressed by the Second Circuit in the case of *United States v. Chestman*.<sup>63</sup> Judge Meskill, writing for the majority, upheld the defendant's conviction and the SEC's authority to promulgate Rule 14e-3 on two grounds. First, the statutory power to define and prescribe means reasonably designed to prevent fraudulent acts and practices allows the SEC to define fraud in

---

60. 445 U.S. 222 (1980).

61. *See id.* at 243, 245.

62. *See* Tender Offers, Exchange Act Release No. 34-17120, 45 Fed. Reg. 60,410 (1980).

63. 947 F.2d 551 (2d Cir. 1991) (en banc).

ways that go beyond the common law.<sup>64</sup> Second, the power to prevent fraud in the tender offer context necessarily encompasses the power to proscribe conduct outside the purview of common law or SEC-defined fraud.<sup>65</sup>

In *United States v. O'Hagan*<sup>66</sup> the United States Supreme Court likewise held that, by giving the SEC the authority to regulate nondeceptive activities as a reasonably designed means of preventing manipulative acts under § 14(e) of the Exchange Act, the "Commission may prohibit acts, not themselves fraudulent under the common law or § 10(b) if the prohibition is 'reasonably designed to prevent [fraudulent acts and practices].'"<sup>67</sup> Further, under either a definitional or preventive analysis, the Court gave the SEC rule-making deference regarding Rule 14e-3.<sup>68</sup>

*O'Hagan* leaves blurred some of the contours of the tort of trading on undisclosed tender offer information. In particular, it is unclear whether mere "possession" of inside information is sufficient because the Court described the wrong as trading "on the basis" of inside information.<sup>69</sup> Additionally, the Court deliberately left open the question of whether "warehousing" violates Rule 14e-3.<sup>70</sup>

Insider trading can be sanctioned by the SEC like any other violation of Rules 10b-5 or 14e-3, in an injunctive action or agency disciplinary proceedings.<sup>71</sup> Also, criminal cases can be instituted by the United States Department of Justice.<sup>72</sup> In addition, in 1984 Congress gave the SEC the authority to seek up to three times the profits made or losses avoided as a civil penalty against insider traders, over and above any other remedies otherwise available.<sup>73</sup> Then, in 1988 Congress further increased the sanctions for insider trading, creating a private right of action on behalf of contemporaneous traders,<sup>74</sup> inserting a new bounty provision for informers on insider trading,<sup>75</sup> increasing criminal fines,<sup>76</sup>

---

64. *See id.* at 561.

65. *See id.*

66. 117 S. Ct. 2199 (1997).

67. *Id.* at 2217 (quoting 15 U.S.C. § 78n(e) (1994)).

68. *See id.* at 2218 n.19.

69. *Id.* at 2219.

70. *Id.* at 2217 n.17; *see also infra* note 238 and accompanying text.

71. *See* 15 U.S.C. §§ 78u(d)(1), (d)(3), 78u-2, 78u-3 (1994).

72. *See id.* § 78u(d)(1).

73. *See id.* § 78u-1(a)(3); *see also* Donald C. Langevoort, *The Insider Trading Sanctions Act of 1984 and Its Effect on Existing Law*, 37 VAND. L. REV. 1273, 1280-81 (1984).

74. *See* 15 U.S.C. § 78t-1(a).

75. *See id.* § 78u-1(e).

76. *See id.* § 78ff(a).

and giving the SEC greater authority to investigate international securities law violations.<sup>77</sup>

### C. The EU Insider Trading Directive

The European Economic Community, now the EU, Insider Trading Directive was adopted in November 1989 as part of the 1992 single-market program.<sup>78</sup> Its purpose was to harmonize insider trading laws throughout the EU.<sup>79</sup> Prior to the EU Insider Trading Directive, the laws in Europe concerning insider trading were not uniform.<sup>80</sup> The EU Insider Trading Directive was required to be implemented by national law by June 1, 1992. Unlike U.S. law, the EU Insider Trading Directive defines "inside information" to mean "information which has not been made public of a precise nature relating to one or several issuers of transferable securities or to one or several transferable securities, which, if it were made public, would be likely to have a significant effect on the price of the transferable security or securities in question."<sup>81</sup>

The EU Insider Trading Directive's definition divides individuals who possess non-public information into "primary" and "secondary" insiders. A "primary" insider is any person who "by virtue of his membership of the administrative, management or supervisory bodies of the issuer, by virtue of his holding in the capital of the issuer, or because he has access to such information by virtue of the exercise of his employment, profession or duties, possesses inside information."<sup>82</sup> A primary insider is prohibited from "taking advantage of that information with full knowledge of the facts by acquiring or disposing of for his own account or for the account of a third party, either directly or indirectly, transferable securities of the issuer or issuers to which that information relates."<sup>83</sup> In addition, primary insiders must refrain from acting as

---

77. See *id.* §78b(1).

78. See *supra* note 58 and accompanying text. The Single European Act of 1986, 1987 O.J. (L 169), art. 13, set a goal of achieving complete regulatory harmony and economic unity by December 31, 1992. See Manning G. Warren III, *The Regulation of Insider Trading in the European Community*, 48 WASH. & LEE L. REV. 1037, 1037 n.2 (1991).

79. See Amy E. Stutz, Note, *A New Look at the European Economic Community Directive on Insider Trading*, 23 VAND. J. TRANSNAT'L L. 135, 155-61 (1990).

80. France was the first European country to ban insider trading and it did so in 1967. See *id.* at 164-65. When the EU Insider Trading Directive was passed, insider trading was a criminal offense in the United Kingdom, see *id.*, but not violative of any statute in Germany. See Ursula C. Pfeil, Comment, *Finanzplatz Deutschland: Germany Enacts Insider Trading Legislation*, 11 AM. U. J. INT'L L. & POL'Y 137, 137 (1996).

81. EU Insider Trading Directive, *supra* note 58, art. 1, § 1.

82. *Id.* art. 2, § 1.

83. *Id.*

tippers, as they are prohibited from disclosing inside information to any third party unless such disclosure is made in the normal course of the exercise of the tipper's employment, profession, or duties. They are also prohibited from "recommending or procuring a third party, on the basis of that inside information, to acquire or dispose of transferable securities admitted to trading on its securities markets."<sup>84</sup> The EU Insider Trading Directive then extends its mandate to "secondary insiders" or, "any person other than [a primary insider] who with full knowledge of the facts possesses inside information, the direct or indirect source of which could not be other than a [primary insider]."<sup>85</sup>

In summary, primary insiders are prohibited from either trading or tipping, and secondary insiders are prohibited from trading, but are not subject to the anti-tipping provisions. The gap in the legislation as it applies to tipping by secondary insiders may reflect the impracticality of detecting and prosecuting remote tipping of non-public information.<sup>86</sup> It is clear, that unlike the U.S. insider trading laws, determination of illegal trading is not based on breach of a fiduciary duty, but rather, possession of non-public information.

The EU Insider Trading Directive attempts to balance the need to provide a clear, predictable rule and the fear of over-regulating trading that does not present problems common in the use of non-public information. The definitions of primary and secondary insiders reflect an attempt to balance the need for competent insider trading enforcement against the risk of establishing too broad a prohibition.<sup>87</sup> The EU Insider Trading Directive lays out broad guidelines, but stricter laws may be enforced by Member States.<sup>88</sup> In addition, although the prohibition of insider trading is prescribed for all Member States of the EU, the penalties are to be determined by each Member State. The Directive states that the penalties must be "sufficient to promote compliance with the measures."<sup>89</sup>

---

84. *Id.* art. 3.

85. *Id.* art. 4.

86. See Thomas Lee Hazen, *Defining Illegal Insider Trading—Lessons from the European Community Directive on Insider Trading*, LAW & CONTEMP. PROBS., Autumn 1992, at 231, 236.

87. See *id.*

88. See EU Insider Trading Directive, *supra* note 58, art. 6. The Directive states, in part, that "[e]ach Member State may adopt provisions more stringent than those laid down by this Directive or additional provisions, provided that such provisions are applied generally." *Id.*

89. *Id.* art. 13.



*D. The United Kingdom*

Prior to 1980, self-regulatory prohibitions against insider trading in the United Kingdom were poorly enforced.<sup>90</sup> Then the Companies Act of 1980 provided that it was a criminal offense to buy or sell on the London Stock Exchange on the basis of unpublished specific information likely to materially affect the market price of the stock if the defendant knew the information was price sensitive.<sup>91</sup> The 1980 Act was superseded by the Company Securities Act of 1985,<sup>92</sup> and then by the Criminal Justice Act of 1993 (CJA), which was adopted to bring the United Kingdom into compliance with the EU Insider Trading Directive.<sup>93</sup> In addition, the Panel on Takeovers and Mergers has rules dealing specifically with insider trading in the context of a takeover attempt, but sanctions are limited and the Panel most often uses informal leverage to force disgorgement.<sup>94</sup>

The CJA replaced offenses in the 1985 Act with three new offenses: "dealing while in possession of inside information; encouraging another to deal in such circumstances; and disclosing information other than in the proper performance of one's employment of professional duties."<sup>95</sup> Inside information is information that is relevant, specific or precise, has not been made public, and is price sensitive.<sup>96</sup> Information that a company has decided to make a bid for a target is "specific" but not "precise," in the absence of information about the price at which the bid is to be made.<sup>97</sup>

One of the ways in which the CJA broadened the law is that an insider does not have to have a connection with the issuer of the securities in relation to which the insider has inside information.<sup>98</sup> Rather, an insider is someone who knows he has inside information and also knows that he has obtained it either: through being a director, employee, or shareholder of an issuer of securities; or through having

---

90. See JACQUELINE A.C. SUTER, *THE REGULATION OF INSIDER DEALING IN BRITAIN* 3 (1989).

91. See HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *3E SECURITIES AND FEDERAL CORPORATE LAW* § 15.08(6)(b) (1997).

92. See *id.* It was then amended by the Financial Services Act of 1986.

93. See Mark Stamp & Carson Welsh, *United Kingdom*, in *INTERNATIONAL INSIDER DEALING* 91, 92 (Mark Stamp & Carson Welsh eds., 1996).

94. See *id.* at 122. The London Stock Exchange monitors trading in securities listed on the exchange and investigates apparent cases of insider trading. See *id.* at 118. Because the sanctions by the Exchange may only be imposed against its members, its enforcement reach is significantly restricted. See *id.* at 121-22.

95. Criminal Justice Act, 1993, § 52 (4th ed. Halsbury's Statutes of England and Wales 1991) (Eng.); see also Stamp & Welsh, *supra* note 93, at 92.

96. See Criminal Justice Act, 1993, §§ 56, 60(4).

97. Stamp & Welsh, *supra* note 93, at 97.

98. See *id.* at 101.

access to the information by virtue of his employment, office, or profession; or by having it directly or indirectly from such person.

The wide scope of the CJA makes defenses to insider trading important. One defense is that there was no profit or avoidance of a loss as a result of the dealing and that, therefore, the information was not price sensitive.<sup>99</sup> An individual may also show that at the time of the dealing he believed on reasonable grounds that the information had been, or alternatively (in the case of encouragement of dealing) would be disclosed widely so that those dealing on the other side would have an equivalence of information.<sup>100</sup> An individual also may show he would have traded even if he had not had the information.<sup>101</sup> Finally, it is a defense for the accused to show that, at the time, he did not expect any person, because of the disclosure, to deal in securities on a regulated market or in the capacity of or in reliance upon a professional intermediary.<sup>102</sup> Market makers and other security industry professionals have special defenses. An individual is not guilty of the dealing or encouraging offense if he proves on the balance of probabilities that he acted in good faith in the course of either his business as a market maker, or his employment in the business of a market maker.<sup>103</sup> Further, an individual may show that the information he had as an insider was market information and that it was reasonable for someone in his position to have acted as he did.<sup>104</sup>

Insider trading is a criminal offense, punishable by fines and a possible maximum prison sentence of seven years.<sup>105</sup> When the CJA was in the process of being drafted, the chairman of the London Stock Exchange and others called for the introduction of civil penalties for insider dealing and the establishment of an enforcement agency to monitor compliance with the law. However, these calls were rejected by the government.<sup>106</sup>

### *E. Germany*

On August 1, 1994, Germany took a step toward aggressively competing in the international financial arena when it finally outlawed

---

99. See Criminal Justice Act, 1993, § 53; Stamp & Welsh, *supra* note 93, at 110.

100. See *id.* at 111.

101. See *id.* at 112.

102. See *id.* at 112-13.

103. See *id.* at 113.

104. See *id.* at 114.

105. See *id.* at 116.

106. See *id.* at 92.

insider trading.<sup>107</sup> The insider trading regulations are part of a larger, comprehensive program to develop a fairer and more attractive investment environment in the German marketplace. The newly created Federal Supervisory Authority for Securities Trading (FSA), is somewhat similar to the SEC. It is a federal agency under the Federal Ministry of Finance. In spite of pressure from within Germany and from the world's leading financial markets, Germany remained the last major financial market to adopt insider trading legislation. Indeed, Germany was two years late in complying with the EU Insider Trading Directive.<sup>108</sup> Instead, Germany had relied on a voluntary code of conduct which was wholly ineffective.<sup>109</sup>

The German Securities Trading Act applies to insider securities which, generally, are those securities listed on the official or a regulated market in Germany, traded over the counter in Germany, or listed on an exchange in another EU Member State. The law applies to both "primary insiders"<sup>110</sup> and "secondary insiders."<sup>111</sup> Primary insiders are

---

107. The law, known as the Securities Trading Act, is divided into 7 sections: (1) States the scope of application and definition of key terms; (2) Establishes a federal supervisory authority for securities trading and its duties, obligations and powers; (3) Sets forth the scope of insider trading, defines insiders, prohibits insider trading, requires the disclosure of material information. This part implements the insider trading prohibitions including the requirements of the EU Insider Trading Directive. The first section of Part 3, § 12 defines "insider securities," a critical definition because the insider trading prohibition applies only to information relating to "insider securities" or to issuers of "insider securities"; (4) Establishes notification and publication obligations upon changes in the voting participation in listed companies (to 5%, was formerly 25%) and with respect to potentially material information; (5) Establishes rules of conduct for investment services firms (including brokers); (6) Prescribes criminal penalties and administrative fines; (7) Sets forth transitional provisions relating to the disclosure requirements in Part 4. The author has utilized the English translation of the Securities Trading Act by Marlene Van Dyke and Chistoy von Dryarder of Cleary, Gottlieb, Steen & Hamilton. Their translation is printed along with explanations in a booklet distributed by the Deutsche Börse AG, and entitled INSIDER TRADING AND AD HOC DISCLOSURE PURSUANT TO THE GERMAN SECURITIES TRADING ACT 30-56 (1994) (copy on file with the *University of Cincinnati Law Review*).

108. The EU Insider Trading Directive required Member States to adopt insider trading laws by June 1992. See Stephen J. Leacock, *In Search of a Giant Leap: Curtailing Insider Trading in International Securities Markets By the Reform of Insider Trading Laws Under European Union Council Directive 89/592*, 3 TULSA J. COMP. & INT'L L. 51, 55 (1995). When Germany had not responded, the European Commission instituted infringement proceedings in October of 1992. The insider law was finally passed on July 8, 1994. See *id.* at 62-63.

109. The Insider Trading Guidelines were first published in 1970 and revised in 1976 and again in 1988. See *id.* at 61. The Guidelines amounted to no more than a moral code to which people could voluntarily bind themselves by contract. See *id.* at 66-67. The sole remedy was disgorgement of trading profits, unless a party refused to disgorge, in which case a suit for breach of contract was available. See *id.* The Guidelines created a Board of Inquiry, but without a filed complaint, there was generally no Board power to investigate. See *id.* Further, because the compliance system usually required corporations to bring actions against their own management, complaints were rarely filed. See *id.* Finally, resources were limited to the point that the Board lacked effectiveness. See *id.* at 61, 65-67; see also Pfeil, *supra* note 80, at 141.

110. INSIDER TRADING PROHIBITIONS AND AD HOC DISCLOSURE PURSUANT TO THE GERMAN SECURITIES TRADING ACT, *supra* note 107, § 13(1), at 40.

111. *Id.* § 14(2), at 40.

those who have access to and knowledge of insider information through a position in management or as a shareholder of an issuer, or one who "participat[es] in the capital of an issuer," or through "profession or activities or duties." Secondary insiders are simply those with knowledge of inside information.

The statute also defines "inside information" as "a non-public fact that relates to one or more issuers of Insider Securities or to Insider Securities if such fact, should it become publicly known, could materially influence the price of the Insider Securities."<sup>112</sup> Therefore, the information need not be material, but must only be *capable* of considerably influencing the value of an insider security *if it were* publicized. A specific exemption designed to protect securities analysts is an evaluation based exclusively on public information; even if it could influence the price of the security, it is excepted from the definition of inside information.<sup>113</sup> Prohibited insider transactions are set forth.<sup>114</sup> First, insiders may not take advantage of their knowledge of insider information. Second, insiders are prohibited from providing insider information to others without authorization. Third, insiders cannot use inside information to recommend that a third party buy or sell insider securities.

A three-tiered enforcement structure is established with most of the power lying with the FSA.<sup>115</sup> Issuers must disclose all potentially market-moving information to the investing public via exchange newspapers and electronic information systems.<sup>116</sup> The FSA has the power to demand documents and enter business premises to ensure compliance. Further, if information is not forthcoming as required, the exchanges may halt trading until information is disseminated. Clearly, the purpose of this section is to significantly reduce inside information, and subsequently reduce trading on that information. There are stringent criminal sanctions for insider trading of imprisonment of up to

---

112. *Id.* § 13(1), at 40.

113. *See id.* § 13(2), at 40.

114. *See id.* § 14(1), at 40.

115. *See id.* Pt. 2, §§ 3-11, at 33-38. Power also resides at the Lander or state and exchange levels. All credit institutions with headquarters in Germany, their foreign branch offices, and other market participants must disclose their securities and derivative transactions (as defined in the law) on a daily basis. The Federal Supervisory Authority for Securities Trading (FSA) is responsible for verifying whether the disclosure requirements have been met. If the FSA suspects insider trading activity, it may proceed further with an investigation. *See id.* § 9(1), at 36. Two common motivations for a heightened investigation are: (1) to ascertain specific individuals involved in the suspected trading activity, and (2) to address inquiries of issuers of securities. Penalties may be assessed for intentional or negligent failure to comply with reporting requirements, and for failure to comply with the FSA's requests for additional information. Once a suspicion is confirmed, the matter is turned over to a state attorney's office for prosecution.

116. *See id.* § 15, at 40-41.

five years, which are harsher than those of other states in the European Union and harsher than the penalties for other white collar crimes. Further, the Treasury may seek disgorgement of profits derived from illegal insider trading. Whether any private right of action on behalf of contemporaneous traders is available is a subject of debate.<sup>117</sup>

#### *F. Australia*

Australia has regulated insider trading since the early 1970s. Few cases were brought by prosecutors, however, and these cases did not result in convictions.<sup>118</sup> Critics blamed this on Australia's complex statutory scheme and judicial reluctance to enforce the statute. The first effort to improve the insider trading laws resulted in more detailed legislation which was adapted in 1980. However, a 1988 survey of market participants concluded that "the incidence of insider trading in Australia ranges between Not uncommon and Widespread."<sup>119</sup>

In 1989, the Attorney General, responding to concerns that widespread insider trading was making foreign investors reluctant to enter the Australian market and was discouraging small investors from investing in securities, requested that the House of Representatives Standing Committee on Legal and Constitutional Affairs (known as the Griffiths Committee) study the extent of insider trading and other forms of market manipulation in Australia. The Griffiths Committee Report then set forth a basis for 1991 amendments to Australian law concerning insider trading.<sup>120</sup> The new law, among other things, increased the penalties for insider trading and expanded the definition of insider.

Under the old law, the Securities Industry Act (SIA), a person could not deal in the securities of a corporation if the person was connected with the corporation (or had been connected with the corporation during the six months preceding the contemplated transaction) and, by virtue of the connection, was in possession of materially price-sensitive information that was not generally available. The insider trading sections of the SIA were recodified and broadened by dropping the limitation on insiders to those connected with the issuer.<sup>121</sup> Currently, the Corporate Law defines an insider as "(a) a person [who] possesses

---

117. See Harmut Krause, *The German Securities Trading Act (1994): A Ban on Insider Trading and an Issuer's Affirmative Duty to Disclose Material Nonpublic Information*, 30 INT'L LAW. 555, 576-77 (1996).

118. See R. TOMASIC ET AL., *CORPORATION LAW, PRINCIPLES, POLICY AND PROCESS* § 12.24 (2d ed. 1992).

119. Roman Tomasic & Brendan Pentony, *Insider Trading*, LEGAL SERV. BULL., Feb. 1989, at 3, 4.

120. See Marie McDonald, *Australia*, in INTERNATIONAL INSIDER DEALING, *supra* note 93, at 439-40.

121. See *id.* at 442.

information that is not generally available but, if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of securities of a body corporate; (b) the person knows or ought reasonably to know that: i) the information is not generally available; and ii) if it were generally available, it might have a material effect on the price or value of those securities."<sup>122</sup> An insider thus defined is then prohibited from dealing in securities or procuring another person to deal in securities.<sup>123</sup>

A "body corporate" will be deemed to possess information that is known by an officer of the corporation if the officer came into possession of the information in the course of his official duties.<sup>124</sup> The statute further provides that a body corporate is presumed to be aware of information that an officer of the corporation knows, or ought to reasonably to know, because of his position as an officer of the corporation.<sup>125</sup> Corporations are permitted to participate in securities transactions if they employ "Chinese Wall" procedures.<sup>126</sup>

A person with price-sensitive information may not deal in securities if: (1) he has obtained that information, directly or indirectly, from a person whom he knows or ought reasonably to have known, is precluded from dealing in those securities; and (2) if, when the information was obtained, the tippee was associated with the insider, or had an arrangement with the insider for the communication of the information, so that the tippee could deal in the securities alone or with the insider. The law also contains an anti-tipping provision which focuses on the tipper. An insider is prohibited from directly or indirectly communicating price-sensitive, nonpublic information concerning a company's securities to another person if the insider knows or should know that the other person would be likely to engage in securities transactions or to procure a third person to buy or sell securities on his behalf.<sup>127</sup> Effectively, the knowledge requirement has the greatest impact when it comes to prosecuting tippers and the scienter requirement allows some to escape sanctions.

A person accused of insider trading may avoid liability by establishing that the information received was broadly disseminated.<sup>128</sup> Along the same lines, the defendant trader may escape liability by showing that the

---

122. The Corporations Law, § 1002G(1) (Austl.), *The Corporations Law* (last modified Feb. 17, 1998) <<http://scaleplus.law.gov.au/html/histact/2/1056/top.htm>> [hereinafter Corporations Law].

123. *See id.* § 1002G(2).

124. *Id.* § 1002E(a).

125. *See id.* § 1002E(b).

126. *Id.* § 1002M.

127. *See id.* § 1002G(3).

128. *See id.* § 1000T(2)(a).

contra trader knew or ought reasonably to have known of the price-sensitive information before entering into the trade.<sup>129</sup> A licensed securities dealer, which could not otherwise trade in certain securities by virtue of possessing inside information, could trade if acting as an agent and on specific instructions from a customer with whom the dealer is not associated and has not given advice in respect to the specific securities.<sup>130</sup>

There are steep criminal penalties for insider trading intended to send a clear signal to the market that insider trading will not be tolerated.<sup>131</sup> Corporations may be fined for an amount not exceeding Au\$1,000,000.<sup>132</sup> Individuals may be fined for an amount not exceeding Au\$200,000 and/or may be sentenced to five years imprisonment.<sup>133</sup> Civil remedies against natural persons or corporations also are available. The other party to a transaction, who did not possess the inside information, is entitled to compensation for any loss sustained by reason of the difference in price between the price at which the transaction took place and where the transaction would have occurred had the information been known.<sup>134</sup> In addition, the issuer is entitled to any profit accruing from the insider trades.<sup>135</sup> However, an insider who sells prior to the announcement cannot be liable to both the party to a transaction and the issuer on the same transaction, because avoiding a loss does not constitute a "profit."<sup>136</sup>

### G. A Comparison of the Law

#### 1. General

European and Australian insider trading prohibitions are modeled to some extent on U.S. law. However, in the United States, the law of insider trading has been developed on a case-by-case basis and, in the case of Rule 10b-5 violations, requires proof of a breach of a fiduciary duty by the trader. However, U.S. law is dynamic and constantly changing. In the United Kingdom, Germany, and Australia, the law is

---

129. *See id.* § 1000T(2)(b).

130. *See id.* § 1000S. The statute appears to create an exemption for investment banks so that they can assist clients in establishing a position in the case of a tender offer. However, that use appears to be undermined if the exception may not be used where a broker or investment bank has given advice on the specific securities.

131. *See McDonald, supra* note 120, at 457.

132. The maximum fine for corporations under the old law was Au\$50,000.

133. The maximum fine for individuals under the old law was Au\$20,000.

134. *See Corporations Law, supra* note 122, §§ 1005, 1013.

135. *See id.*

136. *Id.* § 130(1)(d).

statutory and frozen until changed by superseding legislation. The same fact pattern should produce the same result but could produce different coverage in each jurisdiction.

In addition, in a transnational insider trading scheme, there is the potential that tortfeasors will violate the laws of several different jurisdictions. If each jurisdiction applies its law extraterritorially, there could not only be a clash of culpability standards, but also a multiplicity of sanctions. In the United States and Australia there is civil liability for insider trading violations, whereas in the United Kingdom, sanctions are either criminal or self-regulatory and contemporaneous traders have no claim for damages. In Germany, there is criminal liability for insider trading as well as a disgorgement remedy enforced administratively and whether civil damage actions exist is unclear.

## 2. United States

One way to compare various insider trading laws is to apply the laws to a common fact pattern and analyze the outcomes under various laws. *United States v. O'Hagan*<sup>137</sup> provides a good fact pattern because it was recently decided by the United States Supreme Court and, thus, reflects the current state of U.S. insider trading law. Further, the case raises issues about how far-removed from the primary information source a trader can be and still fall into the category of an "insider." The liability of classic insiders who tip or use inside information is almost universally accepted in countries that choose to ban insider trading, but the liability of remote tippees remains an issue in the United States, even after *O'Hagan*. *O'Hagan* involved trading in securities of a target company by an attorney for the bidder who obtained information about the upcoming bid from partners at the bidder's law firm.

The United States Supreme Court validated the "misappropriation theory" under which liability for insider trading attaches, regardless of whether the trader owed a fiduciary duty to the shareholders of the corporation whose shares are traded, so long as there is a breach of trust and confidence. The defendant in *O'Hagan* had no duty to the target whose shares were purchased. Moreover, he was not working on the takeover deal. Nevertheless, the Court found that *O'Hagan's* trading on information in breach of duties owed to his law firm and its client was sufficient for an inside trading conviction under Rule 106-5 as well as Rule 14e-3. However, the Court cast doubt on the use of these rules

---

137. 117 S. Ct. 2199 (1997). For further discussion of this case, see *supra* text accompanying notes 66-70.



to prohibit "warehousing"—that is, the practice by a bidder of suggesting to other traders that they purchased shares in a prospective target.<sup>138</sup>

*O'Hagan* fits into a line of misappropriation cases holding that a trader may not use non-public information in breach of a duty of trust and confidence owed to an employer and its customers or clients.<sup>139</sup> The sufficiency of more tenuous relationships has not been addressed by the Supreme Court. For example, in *United States v. Willis*,<sup>140</sup> a psychiatrist whose patient was the wife of a corporate executive received and traded on information regarding a business transaction.<sup>141</sup> The defendant argued that he was not alleged to have "breached a duty to a 'market participant or any participant in the corporate world.'"<sup>142</sup> However, the court found that, as a doctor, the defendant had an obligation to maintain patient confidences, and when he used the information gained through the doctor-patient relationship, he breached a duty of trust and confidence. Therefore, he misappropriated inside information.

An even more tenuous tipper-tippee relationship was involved in *United States v. Chestman*<sup>143</sup> where the defendant was a stockbroker who had as a client the husband of an heir to a large supermarket chain.<sup>144</sup> When the chain was to be sold, the stockbroker learned of the transaction from his client, who learned of it from his wife, who learned of it from her mother, who learned of it from her brother, the president of the chain (the client's wife's uncle). The court recognized that the broker was a tippee, and as such, could not be convicted unless his client breached a duty owed to the source of the information based on a fiduciary or similar relationship of trust and confidence and, in addition, that the broker knew that the client had done so.<sup>145</sup> The court found that under Rule 10b-5 the broker did not breach a fiduciary duty to his uncle-in-law, the source of the inside information.<sup>146</sup> However, the defendant's conviction was upheld under Rule 14e-3.<sup>147</sup>

---

138. *Id.* at 2217 n.17.

139. *See, e.g.,* *Carpenter v. United States*, 484 U.S. 19 (1987) (columnist's duty to his newspaper); *Securities and Exch. Comm'n v. Matcra* 745 F.2d 197 (2d Cir. 1984) (employee's duty to his employer and its clients); *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981) (investment banker's duty to his firm).

140. 737 F. Supp. 269 (S.D.N.Y. 1990).

141. *See id.* at 271.

142. *Id.* at 274.

143. 947 F.2d 551 (2d Cir. 1991) (en banc). For further discussion of this case see *supra* text accompanying notes 63-65.

144. *See id.* at 555.

145. *See id.* at 564.

146. *See id.* at 570.

147. *See supra* text accompanying notes 64-65.

### 3. United Kingdom

In the United Kingdom, status attaches to a person who comes into possession of information, obtained by virtue of his employment, office, or profession and as long as the information is relevant, specific or precise, non-public, and price sensitive.<sup>148</sup> The attorney-defendant in *O'Hagan* clearly would fall into the category of a culpable trader. What would be a more interesting question would be whether market players who warehouse securities in anticipation of a bid would be culpable. The defenses available for professionals who come into possession of market information and act reasonably for a person in such a position suggests that warehousing in the United Kingdom could be lawful.<sup>149</sup> The doctor-patient in *Willis* probably would be a culpable trader because he obtained information in the course of his professional duties and he knew that the information emanated from an inside source.<sup>150</sup> Similarly, although none of the chain of family tippers in *Chestman* probably would be culpable because they did not obtain information "by virtue" of their employment or profession, the stockbroker-defendant did and probably would be culpable.<sup>151</sup>

### 4. Germany

In Germany, it is unclear whether the attorney-defendant in *O'Hagan* would be considered an "insider" under the definition which includes "any person who by virtue of the designated purpose of his or her profession or activities or duties has knowledge of insider information."<sup>152</sup> A chance acquisition of inside information by a professional, not in the course of his duties might not be considered "by virtue of" a designated purpose.<sup>153</sup> The defendant in *O'Hagan* could have argued that, although working for the law firm of the acquirer, he was not individually assigned to the takeover project, and he did not

---

148. See Criminal Justice Act, 1993, §§ 56, 57, 60(4) (4th ed. Halsbury's Statutes of England and Wales 1991) (Eng.).

149. See Matthew White, *The implications for securities regulation of new insider dealing provisions in the Criminal Justice Act 1993*, 16 COMPANY LAW 163, 166 (1995).

150. See Stamp & Welsh, *supra* note 93, at 101-03.

151. *Id.*

152. INSIDER TRADING PROHIBITIONS AND AD HOC DISCLOSURE PURSUANT TO THE GERMAN SECURITIES TRADING ACT, *supra* note 107, § 13(1)(3), at 40.

153. Tony Hickinbotham & Christoph Vaupel, *Germany, in INTERNATIONAL INSIDER DEALING, supra* note 93, at 129, 136.

have the requisite contractual relationship with the bidder and thus did not violate the terms of the statute.

On the other hand, the defendants in *Willis* and *Chestman* both learned of inside information by virtue of the designated purpose of their professions, activities, or duties. While a narrow reading of the German law could require a professional to be linked directly to the source of inside information, as is a lawyer, investment banker, or accountant for an issuer or bidder, the relationship of the secondary insider does not have to be with the issuer of securities. An employee of an advisor or contractor advising a bidder can be an insider in relation to the securities of the target company.<sup>154</sup>

### 5. Australia

Under Australian law, once a person (individual or body corporate) comes into possession of inside information that person knows or has reason to know is material and non-public, that person is deemed to be an insider.<sup>155</sup> Thus, once it is established that a person has non-public information, an examination of his position, title, role, or specific duties is unnecessary. Therefore, not only would the defendant in *O'Hagan* have been an insider in Australia, but so would the family members of traditional insiders in *Willis* and *Chestman* who received information, as well as the psychiatrist and stock-broker defendants who traded on the information.<sup>156</sup>

The Australian Corporations Law defines inside information as that "not generally available but, if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of securities . . . ."<sup>157</sup> The Code further defines information as a matter relating to "intentions" and "likely intentions" of a person.<sup>158</sup> The assessment of materiality under Australian insider trading law must also consider whether "a reasonable person would be taken to expect information to have a material effect on the price or value of securities of a body corporate if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether or not to subscribe for, buy or sell the first

---

154. *See id.*

155. *See* McDonald, *supra* note 120, at 443.

156. *See* *Ampolex Ltd. v. Perpetual Trustee Co. Ltd.*, BC 9601889, 1996 NSW LEXIS 2827, at \*26 (Supreme Court of New South Wales, May 23, 1996).

157. Corporations Law, *supra* note 122, § 1002G(1)(a).

158. *Id.* § 1002A(1).

mentioned securities."<sup>159</sup> The court in *Ampolex Ltd. v. Perpetual Trustee Co., Ltd.*, one of the few Australian insider trading cases, summarized the materiality issue as being one where the judge must ask whether such a reasonable person would expect the intention or likely intention of the acquirer to take over the target to materially affect the value of the target's equity securities. Under the facts of *Willis, Chestman*, and *O'Hagan* this definition of information would be satisfied (because a reasonable person would expect the takeover, when announced, to materially affect the price of the options and stock) and that information was not generally available.

#### IV. CONFLICTS AND EXTRATERRITORIALITY

##### A. *The Conduct and Effects Test*

Although a statute ordinarily is "intended to be confined in its operation and effect to the territorial limits over which the lawmaker has general and legitimate powers,"<sup>160</sup> the federal securities laws, at the urging of the SEC, have long been given extraterritorial effect. In antifraud cases, the SEC generally has advocated the broadest possible coverage in order to protect U. S. investors and U. S. markets, but has been somewhat less aggressive with respect to securities or broker-dealer registration requirements. Tender offer regulation has presented unique problems, which the SEC has had under consideration for some time.

Congress contemplated that the federal securities laws would be applied to transnational securities transactions. The term "interstate commerce" as defined in both the Securities Act of 1933 (Securities Act) and the Exchange Act includes transportation or communication among the states and between any state and any foreign country.<sup>161</sup> Section 30(b) of the Exchange Act exempts from that Act's provisions or any regulation thereunder "any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe."<sup>162</sup> The interests of international law and comity might have been best served by giving the phrase "without the jurisdiction of the United States" a territorial interpretation.

---

159. *Ampolex*, 1996 NSW LEXIS 2827 at \*26-27 (analyzing § 1002C).

160. *American Banana Co. v. United Fruit Co.*, 213 U.S. 347, 357 (1909); *accord* *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949).

161. 15 U.S.C. §§ 77(b)(7), 78c(a)(17) (1994).

162. *Id.* § 78dd(b). The Securities and Exchange Commission (SEC) has never passed any rules to implement this section.

However, the SEC and the courts gave the Exchange Act extraterritorial effect, interpreting "jurisdiction" as a legal rather than a geographical concept.<sup>163</sup>

The 1968 Second Circuit decision of *Schoenbaum v. Firstbrook*<sup>164</sup> was a landmark opinion explicating the law on the extraterritorial application of the Exchange Act. This was a derivative action brought by an American shareholder of a Canadian corporation, Banff Oil Ltd. (Banff), whose shares were listed and traded on the American Stock Exchange. The complaint alleged that Banff sold treasury shares at a deflated price to two foreign companies.<sup>165</sup> The plaintiff's theory of the case was that Banff was defrauded by its directors and controlling stockholder who combined to force it to sell treasury stock at the prevailing market price when they knew this price was artificially low.<sup>166</sup> The defendants argued that the court was without subject matter jurisdiction because the entire transaction occurred in Canada between foreign corporations.<sup>167</sup> The Second Circuit rejected that argument stating that "[w]e believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities."<sup>168</sup>

Subsequently, the courts developed an alternative rationale for applying the securities laws extraterritorially—the conduct test. Utilizing this test, the courts applied the antifraud provisions of the securities laws to losses from sales of securities to Americans residing in the United States, to Americans residing abroad if acts of material importance in the United States contributed to the losses, and even to foreigners outside the United States if acts within the United States directly caused their losses.<sup>169</sup> More recently, in *Itoba Ltd. v. Lep Group*

---

163. See *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446, 453-55 (S.D.N.Y. 1974), *rev'd in part*, 519 F.2d 974 (2d Cir. 1975).

164. 405 F.2d 200 (2d Cir. 1968).

165. See *id.* at 205.

166. See *id.* at 210.

167. See *id.* at 204, 206.

168. *Id.* at 206. More recently, the "silence" of Congress on the issue of extraterritoriality has been noted. *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir. 1991).

169. See, e.g., *Robinson v. TCI/U.S. West Communications, Inc.*, 117 F.3d 900, 906 (5th Cir. 1997); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 33 (D.C. Cir. 1987); *Bersch v. Drexel Firestone, Inc.* 519 F.2d 974, 993 (2d Cir. 1975); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972). Some circuits require a lesser quantum of conduct—that the domestic conduct be significant to the fraud, rather than a direct cause of it. See, e.g., *Securities and Exch. Comm'n v. Kasser*, 548 F.2d 109 (3d Cir. 1977); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 420-21 (8th Cir. 1979); *Butte Mining PLC v. Smith*, 76 F.3d 287, 290-91 (9th Cir. 1996).

PLC,<sup>170</sup> the subsidiary of a Bermuda-based holding company listed on the New York Stock Exchange sued Lep Group PLC (Lep), a London based holding company, with NASDAQ listed American depository receipts, for omissions in its Form 20-F filed with the SEC. Based on these omissions and similar fraudulent information in Lep's United Kingdom annual reports, the plaintiff purchased shares of Lep on the London Stock Exchange which resulted in a write-off of \$522 million. Further, an individual defendant who was a U.S. director of Lep sold shares through his U.S. broker which were sold to plaintiff on the London Stock Exchange. The court held there was subject matter jurisdiction under a combination of the "conduct" and "effect" tests.

Aggressive extraterritorial application of the Williams Act occurred in *Consolidated Gold Fields PLC v. Minorco S.A.*<sup>171</sup> This case arose out of a hotly contested tender offer by Minorco, S.A. for Consolidated Gold Fields PLC (Gold Fields). Minorco was a Luxembourg corporation controlled by South Africans who had a 29.9% stake in Gold Fields. Minorco tendered for the 70.1% of Gold Fields stock with a market value of approximately \$120 million, which was owned by U.S. investors; over half of these shares were held indirectly through nominee accounts in the United Kingdom. The Minorco offer was not mailed into the United States, but it was mailed to British nominees for U.S. shareholders. Minorco stated that it would accept tenders from U.S. residents as long as the acceptance form was sent to Minorco from outside the United States. Gold Fields sued Minorco under the antitrust laws and also under the federal securities laws, alleging that Minorco made false and misleading statements concerning the extent to which it was controlled by South African corporations and individuals.

The Second Circuit held that the district court should have found subject matter jurisdiction. Minorco knew that the British nominees were required by law to forward the tender offer documents to shareholders in the United States and this "effect" was a direct and foreseeable result of the conduct outside the territory of the United States. Because American shareholders were allegedly defrauded, there was subject matter jurisdiction.<sup>172</sup>

The SEC as amicus curiae argued in support of subject matter jurisdiction over the fraud claims, but urged the court to abstain, for reasons of international comity, from enjoining the tender offer worldwide pending corrective disclosure.<sup>173</sup> The court declined to do so,

---

170. 54 F.3d 118 (2d Cir. 1995), cert. denied sub nom. Berkley v. Itoba Ltd., 516 U.S. 1044 (1996).

171. 871 F.2d 252 (2d Cir.), modified, 890 F.2d 569 (2d Cir. 1989).

172. See id. at 262-63.

173. See *Consolidated Gold Fields*, 890 F.2d at 569.

but rather remanded the case to the district court to determine whether an appropriate remedy, consistent with comity principles, could be fashioned.<sup>174</sup> The stand taken by the Second Circuit in *Gold Fields* in support of its vision of U.S. interests was very aggressive in that Minorco arguably was acting contrary to British law in instituting a lawsuit in the United States and the lawsuit defeated the tender offer.<sup>175</sup>

### B. *The Third Restatement*

The claims of comity in defeating subject matter jurisdiction in a securities law case were given some consideration in the Third Restatement of Foreign Relations Law (Third Restatement).<sup>176</sup> In general, the Third Restatement set forth limits on the exercise of jurisdiction premised on a balancing test, labeled "reasonableness," derived from antitrust cases.<sup>177</sup> This test places great weight on comity

174. See *Consolidated Gold Fields*, 871 F.2d at 263.

175. See Jeremy G. Epstein, *Takeover Panel Regains Control in B.A.T. Ruling*, N.Y.L.J., Dec. 4, 1989, at 41. The City Code enjoins target companies from taking action to frustrate a bid. See *supra* note 44 and accompanying text.

176. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (1987).

177. *Id.* § 403. Section 403 of the Restatement provides:

#### Limitations on Jurisdiction to Prescribe

(1) Even when one of the bases for jurisdiction under § 402 is present, a state may not exercise jurisdiction to prescribe law with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable.

(2) Whether exercise of jurisdiction over a person or activity is unreasonable is determined by evaluating all relevant factors, including, where appropriate:

- (a) the link of the activity to the territory of the regulating state, *i.e.*, the extent to which the activity takes place within the territory, or has substantial, direct, and foreseeable effect upon or in the territory;
- (b) the connections, such as nationality, residence, or economic activity, between the regulating state and the person principally responsible for the activity to be regulated, or between that state and those whom the regulation is designed to protect;
- (c) the character of the activity to be regulated, the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted;
- (d) the existence of justified expectations that might be protected or hurt by the regulation;
- (e) the importance of the regulation to the international political, legal, or economic system;
- (f) the extent to which the regulation is consistent with the traditions of the international system;
- (g) the extent to which another state may have an interest in regulating the activity; and
- (h) the likelihood of conflict with regulation by another state.

(3) When it would not be unreasonable for each of two states to exercise jurisdiction

and the need to accommodate interests of foreign states. Although under the balancing test the conduct and effects tests can be considered, other relevant factors could have reversed the outcome of the case. These other factors include: justified expectations of the parties, the extent to which U.S. regulation is consistent with the traditions of the international system, the extent to which another state may have an interest in regulating the activity, and the likelihood of conflict with regulation by other states.<sup>178</sup>

The SEC strongly objected to the balancing test and urged that relevant provisions of the Federal Securities Code be used as a straightforward restatement of current law and practice.<sup>179</sup> The Federal Securities Code provided for securities law coverage of purchases, sales, offers, proxy solicitations, tender offers, and investment advisory activity occurring within the United States, although initiated outside the United States, or initiated within the United States for consummation abroad. Further, the Code provided for greater coverage for the antifraud provisions than for regulatory provisions.<sup>180</sup> In order to accommodate the SEC, the American Law Institute authored a special provision of the Third Restatement to deal with securities law cases.<sup>181</sup> This provision

---

over a person or activity, but the prescriptions by the two states are in conflict, each state has an obligation to evaluate its own as well as the other state's interest in exercising jurisdiction, in light of all the relevant factors, Subsection (2); a state should defer to the other state if that state's interest is clearly greater.

178. See *id.* § 403(2)(d), (f)-(h).

179. See REPORT OF THE STAFF OF THE U.S. SECURITIES AND EXCHANGE COMMISSION, INTERNATIONALIZATION OF THE SECURITIES MARKETS, VII-21 to VII-23 (July 27, 1987); see also Daniel L. Goelzer et al., *The Draft Revised Restatement: A Critique from a Securities Regulation Perspective*, 19 INT'L LAW. 431, 472-75 (1985).

180. See AMERICAN LAW INSTITUTE, FEDERAL SECURITIES CODE § 1905 (1980).

181. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 416. Section 416 provides:

**Jurisdiction to Regulate Activities Related to Securities**

- (1) The United States may generally exercise jurisdiction to prescribe with respect to
  - (a)(i) any transaction in securities carried out in the United States to which a national or resident of the United States is a party, or
  - (ii) any offer to enter into a securities transaction, made in the United States by or to a national or resident of the United States;
- (b) any transaction in securities
  - (i) carried out, or intended to be carried out, on an organized securities market in the United States, or
  - (ii) carried out, or intended to be carried out, predominantly in the United States, although not on an organized securities market;
- (c) conduct, regardless of where it occurs, significantly related to a transaction described in Subsection (1)(b), if the conduct has, or is intended to have, a substantial effect in the United States;
- (d) conduct occurring predominantly in the United States that is related to a transaction in securities, even if the transaction takes place outside the



permits a court to assume jurisdiction based on conduct or effects. Further, the rationale for an extraterritorial application of the law can be either to protect U.S. markets or investors, activity in the United States, or participation in the activity by a U.S. national or resident.

### C. *The Tender Offer Arena*

The filing and disclosure requirements of the Williams Act generally apply to the securities of issuers which are subject to the continuous disclosure obligations of the Exchange Act. If a foreign issuer has applied for an exemption from the Exchange Act registration provisions, the filing and disclosure provisions generally do not apply.<sup>182</sup> If the tender offer is not a cash offer but an exchange offer, the registration provisions of the Securities Act may apply.<sup>183</sup> Moreover, the antifraud provisions of the Williams Act apply to all tender offers, whether or not the issuer is a reporting company.<sup>184</sup> Further, the SEC has taken the position that the tender offer provisions of the Williams Act are extraterritorial in scope.<sup>185</sup>

As a result of this policy position, foreign offerors routinely exclude U.S. investors from their takeover bids if this will enable them to avoid compliance with the filing and disclosure requirements of the Williams

United States; or

- (e) investment advice or solicitation of proxies or of consents with respect to securities, carried out predominantly in the United States.
- (2) Whether the United States may exercise jurisdiction to prescribe with respect to transactions or conduct other than those addressed in Subsection (1) depends on whether such exercise of jurisdiction is reasonable in the light of § 403, in particular
  - (a) whether the transaction or conduct has, or can reasonably be expected to have, a substantial effect on a securities market in the United States for securities of the same issuer or on holdings in such securities by United States nationals or residents;
  - (b) whether representations are made or negotiations are conducted in the United States;
  - (c) whether the party sought to be subjected to the jurisdiction of the United States is a United States national or resident, or the persons sought to be protected are United States nationals or residents.

182. See *Goldsmith Not Required to Comply with U.S. Securities Laws in B.A.T. Takeover*, 21 SEC. REG. & L. REPT. (BNA) 1389, 1399 (1989).

183. See *Problematic Practices Under Regulation S*, Securities Act Release No. 33-7190, 60 Fed. Reg. 35,663 (1995); *Offshore Offers and Sales*, Securities Act Release No. 33-6863, 55 Fed. Reg. 18,306 (1990). A discussion of the Securities registration provisions applicable to foreign issuers is beyond the scope of this article.

184. See *Concept Release on Multinational Tender and Exchange Offers*, Securities Act Release No. 33-6866 n.2, 55 Fed. Reg. 23751 (1990) [hereinafter *Concept Release*].

185. See *id.*

Act and possibly the other provisions of the Exchange Act as well.<sup>186</sup> Despite *Gold Fields*, the courts have permitted foreign bidders for foreign targets to escape from the Williams Act even if the target has U.S. shareholders where they are excluded from the offer. In *John Labatt Ltd. v. Onex Corp., LBT*,<sup>187</sup> the court held that where "a tender offer is totally foreign and neither solicits nor will accept tenders by U.S. shareholders, it is not a tender offer directed to U.S. shareholders and the threshold jurisdictional requirement of Section 14(e) [of the Exchange Act] is not met."<sup>188</sup> It should be noted that Australian investors are similarly excluded from foreign tender offers.<sup>189</sup>

Where foreign bidders are unable to escape from provisions of the Williams Act that conflict with provisions of other regulatory schemes such as the U. K. City Code, the SEC has been willing to grant exemptions from the Williams Act under certain circumstances for certain types of problems.<sup>190</sup> In addition, in 1991, the SEC proposed exemptive rules and registration procedures, based on a mutual recognition philosophy, to facilitate the inclusion of U.S. investors in offers for a foreign target's securities.<sup>191</sup> Such exemptions would not turn on the nationality of the bidder.<sup>192</sup> The Release proposed that if U.S. security holders owned less than ten percent of the class of securities subject to the offer, the bid would be exempted from the filing and dissemination requirements, and the rules regarding proration, minimum offer period, and withdrawal rights would be suspended so long as there was an English language translation of any tender offer materials and U.S. investors were treated at least as favorably as foreign holders.<sup>193</sup>

When the Multijurisdictional Disclosure System (MJDS) was adopted with Canada, mutual recognition of tender offers was included.<sup>194</sup> Pursuant to the MJDS, third-party and issuer tender offers to all holders of any class of securities of a Canadian issuer of which U.S. shareholders are less than forty percent of the class may proceed in accordance with all relevant Canadian federal, provincial, and territorial rules and

---

186. See Greene et al., *supra* note 33, at 825-27, 833-34.

187. 890 F. Supp. 235 (S.D.N.Y. 1995).

188. *Id.* at 245.

189. See Greene et al., *supra* note 33, at 825-26.

190. See Concept Release, *supra* note 184, at 23,753; see, e.g., PacifiCorp Offer for The Energy Group PLC, SEC No-Action Letter, 1997 SEC No-Act. LEXIS 724 (June 25, 1997).

191. See International Tender and Exchange Offers, Exchange Act Release No. 34-29275, 56 Fed. Reg. 27,582 (1991).

192. See *id.* at 27,585.

193. See *id.*

194. See Multijurisdictional Disclosure and Modification to the Current Registration and Reporting System for Canadian Issuers, Exchange Act Release No. 34-29354, 56 Fed. Reg. 30,036 (1991).

regulations instead of complying with the Williams Act.<sup>195</sup> However, securities laws antifraud provisions continue to apply.<sup>196</sup>

The intervening years have created further conflicts between the United States and other jurisdictions, as tender offers have become more widespread and additional countries have developed tender offer regulations. In 1991, the SEC detailed the conflicts between the U.K. City Code and the Williams Act and proposed exemptive provisions and a "mutual recognition of documents" regime to accommodate bidders.<sup>197</sup> Yet, the SEC has taken no further action to implement any exemptions from the Williams Act for foreign issuers or any regime of mutual recognition beyond the MJDS despite the disadvantage this works for U.S. investors.

#### *D. Insider Trading*

The SEC has been very aggressive in giving the Exchange Act extraterritorial reach in insider trading cases. As stated above, the SEC has taken the position that the tender offer provisions, and particularly the antifraud rules, of the Williams Act are extraterritorial in scope. In insider trading cases, the SEC has utilized the injunctive process to exert leverage on foreign financial institutions through fines and asset seizures to force them to give up the names of suspected insider traders.<sup>198</sup>

In one case, Fred C. Lee, a Taiwanese businessman, accumulated nineteen million dollars in profits from trading on inside information provided by a former analyst for Morgan Stanley & Company. Some of the profits were deposited in a Hong Kong branch of Standard Chartered, which also had branches in the United States. The district court ordered disgorgement and a penalty and froze the assets.<sup>199</sup> Lee then requested a court in Hong Kong to rule that this order had no effect. The SEC responded by requesting sequestration from the Hong Kong branch, which was granted. Standard Chartered then appealed to the Second Circuit, arguing that the order violated its due process rights and infringed upon Hong Kong's sovereignty. The Second Circuit never had the opportunity to decide the matter, however,

---

195. *See id.* at 30,047.

196. *See id.* at 30,072.

197. *Id.* at 30,069-82.

198. *See, e.g.,* Securities and Exch. Comm'n v. Unifund SAL, 910 F.2d 1028 (2d Cir. 1990); Securities and Exch. Comm'n v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981).

199. *See* Securities and Exch. Comm'n v. Wang, 699 F. Supp. 44, 46 (S.D.N.Y. 1988).

because the Morgan Stanley analyst pled guilty in a criminal case and Lee settled an SEC injunctive action for \$25.1 million.<sup>200</sup>

The SEC's aggressive posture in insider trading cases has been criticized as infringing upon the jurisdiction of other countries.<sup>201</sup> Yet, the SEC has largely been successful not only in its insider trading investigations (by breaking through foreign bank secrecy laws in many high profile cases and negotiating memoranda of understanding with various foreign regulators and the EU for the exchange of information in enforcement cases), but also in persuading other countries that insider trading should be banned. To at least some extent, it is because of SEC pressure and pressure from U.S. institutional investors that various jurisdictions, such as Germany, which previously ignored insider trading, decided to outlaw it. Given this success in imposing a U.S. standard on other countries, it is unlikely that the SEC will back off from its claims of extraterritoriality.

#### *E. A Comparative Analysis*

The other jurisdictions analyzed in this Article have different approaches to the problem of extraterritorial coverage of their insider trading laws. Because tender offer regulation in the United Kingdom and Germany and to some extent in Australia, is self-regulatory, the analysis here of extraterritorial coverage will be limited to insider trading law. In this connection, it is important to remember that in the United Kingdom insider trading is a criminal violation and civil damage actions are unavailable. In Australia, and perhaps in Germany, insider trading is both a criminal and civil offense.

In the United Kingdom, individuals are not guilty of the offense of dealing on insider information unless either: they were within the United Kingdom at the time they were alleged to have done any act constituting or forming part of the alleged dealing; or the dealing was alleged to have occurred on a U.K. regulated market. Further, individuals are not guilty of encouraging or disclosing insider information unless they were either within the United Kingdom when they were alleged to have disclosed the information or encouraged the

---

200. See Securities and Exch. Comm'n v. Wang, 44 S.E.C. 377; Litigation Release No. 12191, SEC Docket (Aug. 2, 1989).

201. See, e.g., Lawrence Collins, *Problems of Enforcement in the Multinational Securities Market: A United Kingdom Perspective*, 9 U. PA. J. INT'L BUS. L. 487, 505-506 (1987); Arthur R. Pinto, *The Internationalization of the Hostile Takeover Market: Its Implications for Choice of Law on Corporate and Securities Law*, 16 BROOK. J. INT'L L. 55, 60 (1990).

dealing, or the recipient of the information was within the United Kingdom when the information or encouragement was transmitted.<sup>202</sup>

In Germany, the territorial scope of the criminal sanctions is governed by the Penal Guide.<sup>203</sup> Criminal sanctions for insider trading apply to: (1) violations committed within Germany; (2) violations committed abroad against a German victim, provided that the act constitutes a criminal offence at the place where committed; and (3) violations committed in a foreign country if the act constitutes a criminal offense in that country, if committed by a German citizen or by a foreigner who is found in Germany and not extradited.<sup>204</sup>

The insider trading laws of Australia apply to "[a]cts within Australia in relation to securities of any body corporate, whether formed or carrying on business in Australia or not," and to "[a]cts outside Australia in relation to securities of a body corporate that is formed or carries on business in Australia."<sup>205</sup>

As can be seen, the individual defendant in *Itoba* described above,<sup>206</sup> who resided in Connecticut but on the basis of inside information sold stock over the London Stock Exchange, violated the criminal insider trading provisions of U.K. law as well as the antifraud provisions of the U.S. securities laws. If such sale had been to a German victim, German insider trading laws could also have been violated, even if the sale had been in London. Under Australian law, however, the acts would either have had to have been done in Australia, or the securities involved would have had to have been issued by an Australian corporation.

As an increasing number of jurisdictions pass and enforce insider trading laws, multiple criminal prosecutions become possible. Cooperation among securities regulators will hopefully eliminate duplicate prosecutions. Further conflict can be envisioned, however, if a greater number of jurisdictions enact civil liability provisions for insider trading.

One of the interesting questions such a situation would present is whether U.S. courts might then dismiss cases on the type of grounds set forth in the Third Restatement.<sup>207</sup> In recent cases involving actions by Names in Lloyd's of London insurance syndicates, dismissal turned to some extent on the issue of whether plaintiffs in securities class actions who had agreed to have U.K. law apply to their contracts would have

---

202. See Criminal Justice Act, 1993, § 62 (4th ed. Halsbury's Statutes of England and Wales 1991) (Eng.).

203. See *Hickinbotham & Vaupel*, *supra* note 153, at 140.

204. See *id.* at 140-41.

205. McDonald, *supra* note 120, at 450.

206. See *supra* text accompanying note 170.

207. See *supra* notes 176-81 and accompanying text.

recourse in the United Kingdom.<sup>208</sup> If insider trading violations do not give rise to civil penalties, it is difficult to argue there are equivalent actions abroad. But if civil penalties are available, a defendant could attempt to dismiss a case, on appropriate facts, on the grounds that a plaintiff should bring suit in another country.

## V. MECHANISMS FOR RESOLVING REGULATORY CONFLICTS

### A. Academic Theories

Actual and potential conflicts between U.S. law and the laws of other jurisdictions have sparked a wide range of academic theories concerning methods for resolving such conflicts. Professor Merritt B. Fox has suggested that the SEC limit its jurisdiction to U.S. issuers and allow foreign regulators to control foreign issuers.<sup>209</sup> According to Professor Fox, the costs and benefits of disclosure are borne by issuers, and financial economics does not justify the customary rationales for forcing issuers to disclose more information—fairer markets, lessening investment risk, or efficient allocation of resources.<sup>210</sup> Professor Fox therefore argues that the traditional SEC goal of investor protection and its more recently articulated goal of market protection are both misguided and U.S. practice should change so that the SEC imposes its disclosure regime only on U.S. issuers regardless of where transactions in the issuer's shares occur or the nationality of buyers.<sup>211</sup> This argument is made for securities offerings but presumably would extend to the Williams Act because Professor Fox has also argued that, even in insider trading cases, the only relevant jurisdictional hook should be the issuer's nationality.<sup>212</sup>

Professor Jill E. Fisch has argued that the SEC's extraterritorial reach with respect to tender offers is an affront to the sovereignty of other nations and Congress should amend the Williams Act to restrict it to U.S. issuers.<sup>213</sup> Professor Fisch would define "U.S. issuers" fairly broadly, however, and include not only securities issued by a U.S.

---

208. See, e.g., *Richards v. Lloyd's of London*, [current] Fed. Sec. L. Rep. (CCH) ¶ 90, 134 (February 3, 1998) (en banc); *Bonny v. Society of Lloyds*, 3 F.3d 156 (7th Cir. 1993); *Roby v. Corporation of Lloyds*, 996 F.2d 1353 (2d Cir. 1993).

209. See Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom?*, 95 MICH. L. REV. 2498 (1997).

210. See *id.* at 2532-50.

211. See *id.* at 2608-09.

212. See Merritt B. Fox, *Insider Trading in a Globalizing Market: Who Should Regulate What?* 5 LAW & CONTEMP. PROBS., Autumn 1992, at 263.

213. See Fisch, *supra* note 3, at 525.

corporation, but also securities listed on a national securities exchange and securities registered with the SEC pursuant to § 12(g) of the Exchange Act.<sup>214</sup> Her proposal, therefore, is not as radical as that of Professor Fox, but would only limit jurisdiction in antifraud cases to the jurisdiction the SEC now exercises with respect to the filing and disclosure requirements of the Williams Act.

Edward F. Greene and other practitioners have urged the SEC to move to a regime of mutual recognition.<sup>215</sup> Under a mutual recognition regime, disclosure documents prepared in accordance with an issuer's home jurisdiction are accepted without change by securities regulators in other jurisdictions. As I have previously argued, however, mutual recognition is only feasible politically if it is based on a fair degree of harmonization.<sup>216</sup> Along these lines, Professor Steven R. Salbu has advocated harmonization through statutes.<sup>217</sup> Professor James D. Cox has taken issue with the proposition that harmonization is a desirable goal, and advocates inter-market regulatory competition.<sup>218</sup> He argues that there are benefits to such competition not only in the area of disclosure policy, but also where abuse of managerial opportunism is involved, such as insider trading.<sup>219</sup> While Professor Cox recognizes the value of SEC accommodation to foreign laws, he also recognizes the practical and philosophical limits of such accommodation.<sup>220</sup> He therefore urges the SEC to engage in deregulation so that U.S. disclosure standards will be competitive internationally.<sup>221</sup>

In my view, while each of the foregoing theories is logically argued, the problem with all of them is that the U.S. policy setter, the SEC, perceives its mandate as investor protection and protection of U.S. securities markets. Further, the SEC has successfully persuaded the courts that it has jurisdiction to police foreign issuers that tap the U.S. capital markets and foreign transactions that are planned or executed in part in the United States. The SEC has been happy to participate in

---

214. *Id.*

215. See generally Greene et al., *supra* note 33; see also Edward F. Greene et al., *Hegemony or Deference. U.S. Disclosure Requirements in the International Capital Markets*, 50 BUS. LAW. 413 (1995); Pinto, *supra* note 201 at 76.

216. See Roberta S. Karmel, Discussion Paper, *National Treatment, Harmonization and Mutual Recognition*. International Bar Association, Capital Markets Forum (1993) (on file with the *University of Cincinnati Law Review*).

217. See Steven R. Salbu, *Regulation of Insider Trading in a Global Marketplace: A Uniform Statutory Approach* 66 TUL. L. REV. 837, 838 (1992).

218. See James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition* LAW & CONTEMP. PROBS., Autumn 1992, at 157, 158-64.

219. See *id.* at 165-69.

220. See *id.* at 177-82.

221. See *id.* at 185.

harmonization projects that it believes will not lower U.S. standards, but rather raise international standards to U.S. levels.<sup>222</sup> Also, the SEC has put considerable resources into cooperation agreements with foreign regulators providing for assistance in the prosecution of insider traders.<sup>223</sup>

Despite ongoing globalization of the markets and the challenges of Internet communications and trading, it is unlikely that the SEC will accede to the pleas of those who advocate reduced regulatory jurisdiction or mutual recognition in situations where U.S. investors have a stake or U.S. securities markets will be adversely affected. On the other hand, where relaxed jurisdiction might be in the interests of U.S. investors or markets, the SEC is more likely to be sympathetic. It is probable, therefore, that the SEC will eventually exempt tender offers for foreign securities that have a minority U.S. ownership component from the Williams Act so that U.S. investors can be cashed out. But even in this area, exemption from the antifraud provisions is highly unlikely.

A regime in which U.S. law applies to tender offers for the securities of target companies that have a significant trading market in the United States is not as wrong headed as commentators have suggested. When a foreign issuer enters the U.S. disclosure system voluntarily in order to list on a U.S. stock exchange or raise capital, it becomes subject to the Williams Act and investors expect to be protected by the U.S. securities laws. With regard to disclosure requirements imposed on a bidder or the obligation to refrain from trading on the basis of inside information, there is no insurmountable problem posed by requiring compliance with U.S. law. On the other hand, where disclosure regimes are comparable for tender offer documents, the mutual recognition solution adopted with respect to Canada is a viable solution and is preferable to requiring a bidder to comply with multiple disclosure requirements. Tender offer disclosure requirements in the United States and the United Kingdom, for example, are reasonably similar so mutual recognition could simplify U.S.-U.K. takeovers.<sup>224</sup>

The imposition of U.S. law becomes more problematic when conflicting mechanical requirements for the conduct of a tender offer makes it impossible for a bidder to comply with two or more regimes.

---

222. See Brian J. Lane, *The Current Regulatory Perspective on International Offerings—Recent Developments and Contemplated Initiatives*, in INTERNATIONAL SECURITIES MARKETS 1, 21-22 (Beller & Mann eds., 1997).

223. There is an excellent summary of transnational enforcement efforts in insider trading cases and the Memoranda of Understanding negotiated by the SEC to assist in the investigation and prosecution of such cases in WILLIAM K.S. WANG AND MARC. I. STEINBERG, INSIDER TRADING §§ 14.4 (1996).

224. See Greene et al., *supra* note 33, at 852-53.



In such a situation, it would seem reasonable and fair to apply the law of the target's country. Giving deference to the law of the bidder's country would not be good policy because a bidder could organize a corporation as the acquirer in a friendly jurisdiction. When U.S. investors buy a foreign issuer's securities, they are buying into a foreign corporate governance system. Also, the availability of takeover defenses is generally regarded as a question of internal corporate affairs and deference should be given to the target's home country with respect to such issues.

### *B. The Thirteenth Directive*

The Treaty of Rome mandated at least some harmonization of the company laws of the Member States of the EU in order to achieve the objective of freedom of establishment of companies throughout the EU.<sup>225</sup> In the 1985 White Paper, the Commission for the EU emphasized the need for facilitating cross-border cooperation as a means of achieving a single European market.<sup>226</sup> Initially, the draft of the Thirteenth Directive on Company Law was concerned with the equal treatment of the various parties involved in takeovers and the transparency of corporate takeovers while a takeover bid was in progress.<sup>227</sup> There was a provision for a mandatory bid once a threshold position of one-third of the voting shares were acquired. Also, controlling target-company shareholders would have been required to act in the interests of all shareholders by not frustrating the bid.

At that time, and even today, takeover bids in Europe were not as common as in the United States, except for the United Kingdom. Further, the system of takeover regulation varied considerably.<sup>228</sup> In some countries, such as the United Kingdom, capital formation depended upon equity capital so there was a constant monitoring of management performance, protection of minority shareholders, and efficient resource allocation. On the continent, as exemplified by Germany, management was given a long-term mandate, its first duty was to the business, and then to the employees and the company's bankers. Further, there was stable and knowledgeable ownership of

---

225. See TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Mar. 25, 1957, art. 54(3)(g).

226. See *supra* text accompanying note 78.

227. Proposal for a Thirteenth Council Directive on Company Law Concerning Takeover and Other General Bids, 1989 O.J. (C64) 8.

228. See Ingrid Depser, *Amended EC Proposal for a 13th Council Directive on Company Law Concerning Takeover and other General Bids*, INT'L BUS. LAW., Nov. 1991, at 483, 484.

business with close ties to banks.<sup>229</sup> Given this difference, the British regarded takeovers as the ultimate discipline over bad management, whereas the Germans considered hostile bids as inimical to three ingredients of their post-war success—management's ability to take the long-term view, harmonious labor relations, and the disciplinary function of German banks. Accordingly, German law countenanced numerous barriers to hostile takeovers.<sup>230</sup> Because the Germans and other continentals believed that the Thirteenth Directive adopted the pro-takeover underpinnings of the U.K. system, they opposed it. The British also opposed it because they did not wish to see their self-regulatory system replaced by a statutory system.

However, the European Commission believed that there was a need to facilitate the restructuring of European companies to meet international competition, so an amended version of the Thirteenth Directive was put forth.<sup>231</sup> By this time, takeover activity had increased to some extent and the need for shareholder protection had become more apparent.<sup>232</sup> The amended Thirteenth Directive required each Member State to designate a supervisory authority to put the Directive into effect, a requirement that previously had been included in the EU Insider Trading Directive. The supervisory authorities were then given the mandate to assure, among other things, that holders of securities in the target company would be treated equally; target company shareholders would have time and information to reach an informed decision on the bid and the target company board would not frustrate the bid.<sup>233</sup> Mandatory bid provisions and mandated disclosure in offering documents also were specified. However, there was provision for mutual recognition.<sup>234</sup>

The amended Thirteenth Directive fared no better in achieving acceptance and a consensus in favor of adopting it than the original proposed directive. In 1997 a new and streamlined proposal for a takeover directive was put forward by the European Commission.<sup>235</sup> This proposal takes into account the subsidiarity principle and leaves Member States some latitude in deciding how to achieve the goals of the

---

229. *See id.*

230. *See id.*

231. 89/C 240/09, Sept. 14, 1990.

232. *See* Lois Moore, *The EC's Proposed Takeover Directives*, N.Y.L.J., May 28, 1991, at 1. Takeover activity has continued to increase. *See Merger Monday*, *ECONOMIST*, Oct. 18, 1997, at 61.

233. *See* Amended Commission Proposal for a Thirteenth Council Directive on Company Law Concerning Takeover and Other General Bids, art. 6(a), 1989 O.J. (L395) 2, 6.

234. *See id.* art. 6(3).

235. *See* 97/C 378/11, Dec. 13, 1997.

directive. The Directive would apply to securities traded on a regulated market of a company governed by the law of an EU Member State.

Nevertheless, the general principles of the Thirteenth Directive that would have to be followed in national law are unchanged. They are that holders of securities in target companies who are in the same position must be treated equally, the addressees of a bid must have sufficient time and information to enable them to reach a properly informed decision, the board of an offeree company must act in the interests of the company as a whole, false markets must not be created in the securities of companies involved in a bid, and target companies must not be hindered in the conduct of their business beyond a reasonable time. Further, national rules would have to be established for a decision to bid to be made public once the supervisory authority and target company are notified and the bidder would be required to draft a disclosure document and submit it to the supervisory authority. The Directive recognizes that prompt announcement of an intention to launch a takeover bid reduces opportunities for insider trading. The target company board would be prohibited from taking action to affect the success of the bid after receiving notification of the bid and they would have to publish a report giving reasoned views on the bid. Rules would have to be published on withdrawal or nullity of bids, revision of bids, treatment of competing bids, and disclosure of the outcome. Whether mandatory bids would be required at any point would be left to the laws of the Member States.

The twice amended Directive remains an anathema to the British who fear that, despite the recognition of the Takeover Panel as a proper supervisory authority, it would change the workings of the Panel by tangling its operations in endless legal challenges.<sup>236</sup> The prospects for adoption of the Directive are therefore murky.

### *C. Harmonization of Insider Trading Bans*

As I have argued elsewhere at length, prohibitions against trading on inside information should be viewed as ancillary to the primary securities law goal of disclosure and such bans are necessary to enforce disclosure obligations.<sup>237</sup> In the case of laws and regulations to suppress information about forthcoming tender offers, the prohibition against trading on undisclosed information accomplishes two objectives. It

---

236. See *Euro-takeovers*, FIN. TIMES, Jan. 14, 1997, at 17.

237. See Roberta S. Karmel, *Outsider Trading on Confidential Information—A Breach In Search of a Duty*, 20 CARDOZO L. REV. (forthcoming 1998).

assures that shareholders of target companies will enjoy the protections of the Williams Act (or a comparable regulatory regime in other countries) and it fosters the objective of takeovers as a shareholder tool in disciplining management by protecting the bidder. If trading on information about a forthcoming bid is permitted by anyone other than the bidder, the price of the target company's securities will increase and the bidder will have to make an offer at a higher price.<sup>238</sup>

It would seem logical, therefore, that adoption and enforcement of insider trading bans in tender offer situations would follow from legislation like the Williams Act protecting shareholders of a target company. Further, harmonization of insider trading laws would seem to follow from harmonization of laws on public company disclosure and the conduct of tender offers. In fact, however, the contrary has been true. It has been easier for countries to agree on harmonized prohibitions against trading on inside information than on the harmonization of disclosure standards and tender offer legislation. As described above, the European Union was able to adopt a directive outlawing insider trading but has not yet been able to adopt a directive regulating takeovers. Further, the SEC has been able to negotiate memoranda of understanding with numerous jurisdictions in an effort to combat insider trading worldwide. In addition, the Council of Europe in 1990 adopted a Convention on Insider Trading, condemning it and committing signatories to a regime of mutual assistance in combating it.<sup>239</sup>

Is there any explanation for the consensus on insider trading in light of the impasse on takeover legislation? One commentator has suggested that there are three principal factors which have motivated countries to crack down on insider trading—competition between markets to attract foreign investors, international enforcement efforts spearheaded by the SEC, and advances in technology facilitating regulatory surveillance.<sup>240</sup> The facts of insider trading cases are scandalous and hard to defend. The United States, the United Kingdom, and Australia all strengthened their insider trading prohibitions in recent years in the wake of insider trading scandals and the perception that existing law enforcement mechanisms were not successful.<sup>241</sup> The justification for insider trading

---

238. Probably in recognition of this rarely articulated premise behind Rule 14c-3, the Supreme Court in *O'Hagan* reserved judgment on whether "warehousing," that is, purchasing of target company stock by confederates of the bidder, is insider trading. 117 S. Ct. 2199, 2217 n.17 (1997).

239. 29 I.L.M. 309 (1990).

240. See Harvey L. Pitt & David B. Hardison, *Games Without Frontiers: Trends in the International Response to Insider Trading*, LAW & CONTEMP. PROBS., AUTUMN 1992, at 199, 201-07.

241. See Larry R. Lavoie, *The Insider Trading and Securities Fraud Enforcement Act of 1988*, 22 SEC. & COMMODITIES REG. (Standard & Poor's) 1, 1 (Jan. 11, 1989); White, *supra* note 149, at 164; TOMASIC ET AL., *supra* note 118, § 12.25, at 845-46.

laws generally has been rather vague language concerning the integrity of the securities markets and investor protection.<sup>242</sup> Although the German banking industry was strongly opposed to insider trading legislation, it was backed into a corner by scandals involving Deutsche Bank and then a member of the supervisory board of Daimler Benz.<sup>243</sup> It is interesting that in Germany, insider trading laws have been used as a lever to compel better corporate disclosure. A publication by the Frankfurt Stock Exchange points out that the legal elements of insider information are broader than those of information that is subject to a disclosure obligation, but the timely publication of price-sensitive information helps to prevent the abuse of inside information.<sup>244</sup>

Regulation that fosters takeovers, however, impinges upon powerful business interests—a country's corporate leaders. Public choice theory would suggest that there would need to be countervailing powerful interests for the interests of shareholders to supplant the interests of corporate managements.<sup>245</sup> In the case of takeovers, investment bankers, their advisors, and institutional investors benefit from regulations that threaten corporate managers. Therefore it is not surprising that the SEC, whose primary constituents are on Wall Street, rather than on Main Street, favors tender offers as a corporate governance mechanism, whereas German regulators, whose constituents are universal banks, do not favor takeovers as a check on corporate managers.<sup>246</sup> As long as countries have different systems of corporate finance it is unlikely that they will be able to harmonize takeover laws. Further, even if insider trading on confidential information about upcoming tender offers is banned as a result of a general ban against trading on inside information, it is unlikely that enforcement of such a ban will be as vigorous in countries that do not foster a market for corporate control as in countries that do.

---

242. See *O'Hagan*, 117 S. Ct. at 2210 (1997); White, *supra* note 149, at 163; Justin Mannolini, *Insider Trading—The Need for Conceptual Clarity*, 14 COMPANY & SEC. L.J. 151, 155 (1996).

243. See Leacock, *supra* note 108, at 63-64.

244. See INSIDER TRADING PROHIBITIONS AND AD HOC DISCLOSURE PURSUANT TO THE GERMAN SECURITIES TRADING ACT, *supra* note 107, at 9, 13.

245. Public choice theory suggests that regulations will tend to favor (subsidize) relatively small and well-organized groups that have a high per capita stake in the regulations, at the expense of relatively large poorly organized groups with a lower per capita stake in the program. In the case of the SEC, approximately 10,000 corporations prepare disclosure documents that support financial analysts, portfolio managers, and other securities market professionals. See SUSAN M. PHILLIPS & J. RICHARD ZECHER, *THE SEC AND THE PUBLIC INTEREST* 21-23 (1981).

246. Similarly, state laws in the United States are sympathetic to corporate managers who wish to resist hostile takeovers. See *supra* text accompanying notes 19-24.

## VI. CONCLUSION

This Article has generally outlined takeover regulation and prohibitions against trading on inside information concerning tender offers in four countries that have different legal systems and different systems of corporate finance. Competition for capital in a globalizing economy is exerting a harmonizing influence on the laws pertaining to takeovers, but such harmonization is far from complete. Insider trading laws are more compatible than laws regulating the conduct of takeovers and the disclosure of information by bidders.

In the absence of harmonization, the SEC can be expected to continue to vigorously enforce its insider trading prohibitions, even if this involves the extraterritorial application of U.S. law. Because insider trading is essentially tortious conduct, at this juncture of the development of international securities regulation, it is reasonable to apply traditional comity and choice of law concepts that cover torts generally. Policy regulating takeovers is a more complex matter. Even where the target company is foreign and is listed on a U.S. exchange or NASDAQ, U.S. investors and markets are not necessarily aided by the imposition of the Williams Act on bids because U.S. investors are deprived of the ability to tender shares. This is also the case in Australia. Regulators might therefore be advised to rely upon mutual recognition in such situations, at least where the percentage of domestic investors is relatively minor. Furthermore, because takeover regulation involves corporate governance at least as much as investor protection, according comity to the law of the target issuer's country of incorporation with regard to takeover defenses is sound policy.

