Financial Law Board
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Interim Note Concerning Application of Finance-related Laws and Regulations to Cross-border Activity, Particularly Issues under the Securities and Exchange Law

1. Issues to Be Addressed

It is generally agreed that Japanese laws should govern issues that do not involve international elements and can be resolved entirely within Japan. It is not self-evident, however, to what extent Japanese laws should govern issues that include international elements. This issue has been frequently discussed as a matter of "conflict of laws" in case that the issue is related to private laws and regulations (for which legislation exists in the form of the Law Governing the Application of Laws (HÔREI), etc.), or as a matter of "territorial jurisdiction under criminal law" in case that the issue is related to criminal law (for which statutory provisions exist in the General Provisions of the Penal Code). Nevertheless, similar issues exist with respect to laws and regulations other than private and criminal law.

Although in some cases it is possible to use a straightforward application of conflict of laws or the theory of territorial jurisdiction under criminal law to demarcate the scope of international application of finance-related laws and regulations, in many cases this is not possible. There are, for example, many laws and regulations which cannot be interpreted as private or as criminal, such as market regulations (particularly the Securities and Exchange Law (SEL)) and "industry laws" which govern enterprises in various industries. Consequently, the scope of international application of finance-related laws and regulations requires its own study, including the question of whether it is possible to apply conflict of laws or the theory of territorial jurisdiction under criminal law.

Traditionally, this topic has been discussed primarily as a matter of "extraterritoriality," particularly in connection with laws and regulations such as the SEL[1]. However, there are many areas which have yet to be clarified, since most finance-related laws and regulations including the SEL do not have statutory provisions which stipulate the scope of international application, and there is little in the way of academic commentary or cases which address these issues. It is undeniable that this lack of clarity concerning the territorial jurisdiction of the laws and regulations has in some cases impeded transactions since participants in financial transactions and markets are forced to act on the assumption that the most unfavorable interpretation will be applied.

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*In preparing this interim note, we received invaluable comments from Professor Hitoshi Saeki of the Faculty of Law at Tokyo University, but the content and opinions expressed herein are entirely those of the Financial Law Board.

[1] *Shôken No Kokusai Torhihiki Ẃo Meguru Hôteki Mondai –Ikigai Tekiyô Wo Chûshin Toshite* (Legal Issues Involving International Transactions of Securities. A Focus on Extraterritoriality), 102 SHÔKEN KENKYÛ (1992) was published as a collection of articles making a broad study of extraterritoriality in the fields such as the SEL.

The present interim note considers the scope of international application with a focus on the SEL and laws and regulations that are closely related to the SEL such as the Law Concerning Foreign Securities Firms, as being the most typical finance-related laws and regulations[2]. This interim note is organized as follows : Section 2 presents the basic concepts involving the scope of international application of the SEL; Section 3 presents a study of specific cases in connection with several important regulations and systems within the SEL by type of regulation, and then suggests the implications that can be drawn from the study of the specific cases; Section 4 discusses transactions over the Internet, which present somewhat unique issues; and finally Section 5 states topics that should be addressed in the future.

Issues of international application of laws and regulations include that of the authority of an administrative agency to enforce domestic law through physical actions such as arrest, investigation or compulsory search (administrative authority), as well as that of the authority of a judicial agency to define the scope of jurisdiction and to apply domestic laws thereby judging specific cases and to proceed civil enforcement (judicial authority)[3]. The present interim note, however, does not address these issues of administrative or judicial authority, but instead focuses on studying the type of cases to which Japanese law, particularly the SEL, would apply (meaning issues of legislative authority).[4,5]

2. Basic Concepts

(1) Scope of Application of the SEL: "Principle of Territoriality" and "Principle of Effect"

Although there is no specific provision on the scope of application of the SEL,[6] the standard interpretation is that application of the law is demarcated by the "principle of territoriality".[7] The "principle of territoriality" is understood as being "the concept that, in

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[2] As subsequently stated, the SEL contains various clauses which have a differing nature, but the present interim note mainly considers the territorial jurisdiction of the SEL as an administrative law. The territorial jurisdiction of the penal regulations in the SEL is governed by Article 1 of the Penal Code (through Article 8 thereof), while the provisions concerning civil (private) law in the SEL (such as the special provisions concerning civil liability arising from a false statement in a securities report or prospectus) are in principle governed by the choice of law rules prescribed by the Law Governing the Application of Laws.

[3] See SÔJI YAMAMOTO, KOKUSAI HÔ (SHINPAN) (International Law (New Edition)), at 232ff (1994).

[4] While the issues involving the extent of international application of laws and regulations and administrative or judicial enforcement are interrelated, they are normally considered separately. See Yamamoto, *supra* note 3, at 232. See also Masato Dôgauchi, *Hôtekiyô Kankei Riron Ni Okeru Ikigai Tekiyô No Ichiduke–Hôtekiyô Kankei Riron Josetsu* (Position of Extraterritoriality in Legal Theory on the Application of Laws: Introduction to the Theories Related to Application of Laws), in KOKUSAI TORIHIKI TO HÔ (International Transactions and Law) at 226-227 (1988).

[5] Nevertheless it is not possible to avoid the limits to enforcement that occur in international cases. And when considering the scope of application of the SEL as a matter of legislative authority, there arises an issue whether the practical extent of enforceability should be taken into consideration in demarcating the scope of application of the SEL. See also *infra* note 15.

[6] However, Article 194-2 of the SEL provides that "matters necessary in connection with application of this Law to trading of securities in foreign securities market or to intermediation, brokering or agency of consignment of foreign market securities futures, such as technical reading in the case of the application of this Law to these transactions in foreign securities market, shall be determined by a cabinet order." This Article is interpreted as envisioning that there may be cases in which the SEL will extraterritorially apply to transactions in foreign securities market. See CHÛKAI SHÔKEN TORIHIKI HÔ (Annotated Securities and Exchange Law) at 1350 (Hideki Kanda ed., 1997). Article 36 of the SEL Enforcement Order is provided pursuant to this Article.

[7] Kanda, *supra* note 6, at 1352. See also Misao Tatsuta, *Kokusaiteki Na Shôkentorihiki No Hôteki Kisei* (Legal Regulation of International Securities Transactions) in SHÔHÔ / KEIZAI HÔ NO SHOMONDAI (Various Issues in Commercial and Economic Law), at 536ff (1994).

principle, a law applies only within the territory over which the sovereign can extend its control,"[8] but there is no unified understanding on the application of laws that the principle can lead.[9]

The "principle of effect" (or the "theory of effect") is also cited in connection with the scope of application of laws. This idea holds that, if an act has an effect within a territory of a country (such as the effect of insider trading on domestic investors), then the laws of the country will apply on that basis. While the "principle of effect" can be understood as being a concept that stands in opposition to the "principle of territoriality", it is also possible to consider the "principle of effect" to be "a type of" or "a variation on" the "principle of territoriality" (i.e., principle of objective territoriality).[10]

(2) Limits to the "Principle of Territoriality" and Possibility of Applying the "Principle of Effect"

From the standpoint of the arguments based on the traditional "principle of territoriality", there is little opposition to applying the provisions of the SEL to the "acts" (excluding any results or effects of said acts) set forth in the SEL, as long as those acts are committed within Japan. The "acts" involved are defined specifically in each provision as acts such as "soliciting" or "trading." As with the interpretation of the territorial jurisdiction of the Penal Code mentioned above, there is not much opposition to the position that the SEL may apply if any portion of the "acts" is committed in Japan. According to the standpoint of the "principle of territoriality", the straightforward interpretation would be that the SEL would not apply to the cases in which the acts were not committed within Japan, either in their entirety or in part, and there was only an effect in Japan (thus the SEL as a domestic law would not apply to cases of this nature).

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[8] Takao Sawaki, *Shôken Torihiki Hô No Ikigai Tekiyô* (Extraterritoriality of the Securities and Exchange Law), 50 SHÔKEN KENKYÛ (1976) at 83.

[9] The "principle of territoriality" includes principle of objective territoriality and that of subjective territoriality. The former is the idea that if the results of an act occur within a territory of a country, the laws of the country will apply. In turn the latter is the idea that even if the results of an act occur outside the territory, the laws of the country will apply as long as the act was committed within that territory. The term "principle of territoriality" as used in this interim note is not synonymous with the term as used in the Penal Code. Article 1 of the Penal Code provides that "this Code shall apply to every person who committed a crime within Japan," and this article is understood as a clear statement of the principle of territoriality under the Penal Code. This Article also applies to penal sanctions within laws other than the Penal Code (see Article 8 of the Penal Code). This Article is interpreted as meaning that if "the location where any portion of the facts that constitute the required elements exists" is within Japan, Japan's Penal Code will apply on the basis that Japan is the site of the crime (theory of universality). In specific, it is understood that "the place of the crime would be any of the following: the place of commission of the act that constitutes the required elements, the place in which the result occurred that constitutes the required elements, or the place of indirect effect in the course of cause and effect between the act(s) and result(s). See Kuniji Shibahara, *Kokusai Hanzai To Keihô* (International Crime and Criminal Law) 5 GENDAI KEIHÔ KÔZA (Lectures on Modern Criminal Law) (1982) at 321-323.

[10] Regarding the concepts of the principle of objective territoriality, that of subjective territoriality and that of effect, see Yamamoto, *supra* note 2, at 234-5. See also Akira Kotera, *Kokusaihô To Ikigai Tekiyô–Kokka Kankatsuken Ni Kansuru Kokusai Saibansho No Hyôka Wo Tegakari Ni Shite* (International Law and Extraterritoriality–Observing the Assessment By International Courts of National Jurisdiction), in KOKUSAI SHÔ TORIHIKI NI TOMONAU HÔTEKI SHOMONDAI (2) (Various Legal Problems in International Commercial Transactions No. 2) (1993) at 129-130.

However, with the growth of cross-border transactions, and the significant progress of the globalization of financial markets that has already taken place, there is a concern that the purposes of the laws might not be fulfilled if domestic laws are applied only to acts that are committed within Japan. Especially, legal interests such as "price-formation mechanism in the markets" which the SEL seeks to protect is comparatively easy to undermine without committing an act within Japan (for example, the price of securities that are globally traded can be manipulated without committing an act within Japan), in comparison with legal interests in life or health of an individual, or property interests in tangible objects.[11] From this perspective, there would be significant importance in studying whether the SEL can be applied in cases that would have an effect[12] on Japan (meaning the cases in which there is a probability or possibility of infringement of the legal interests that the SEL seeks to protect), to the extent necessary to achieve the purposes of the SEL such as efficient distribution of resources and protection of investors through the price-formation mechanism in the markets.[13]

(3) Approaches in Connection with Applying the "Principle of Effect"

Provided that, as discussed above, the "principle of effect" is justifiable in connection with the international application of the SEL, there are two approaches in adopting the principle. The first approach is to maintain the "principle of territoriality" but to expand the scope of application by adding the "principle of effect" when it is not otherwise possible to fulfill the purposes of the SEL, while the second approach is to use the "principle of effect" as the basis for applying the SEL, but to narrow the scope of application in cases where its broad application causes problems . In this interim note we have mainly focused our study on the first approach since it seems that adjusting the scope of application from the "principle of territoriality" is more suited to accommodating traditional approach.[14]

When taking the approach of adjusting the scope of application of the SEL pursuant to the "principle of effect" from the "principle of territoriality," a variety of factors must be taken into consideration to demarcate the scope of application of the SEL under the "principle of effect". These factors include the purpose of the regulation, type and importance of the legal interest to be protected, and the extent to which the act in question infringes the legal interest involved. Further, considering the social cost of enforcing actual

[11] With respect to this issue, see the report by the International Organization of Securities Commissions (IOSCO) discussed in 4. below.

[12] The term "effect" here does not necessarily mean a "result" as prescribed as a legal requirement in some clauses, but rather should be understood as a concept indicating an infringement or danger of infringement of legal interests that are protected by the SEL.

[13] In December 2001 the United Kingdom put into effect the Financial Services and Markets Act 2000. Article 21.3 of this Act, among the clauses concerning financial marketing activities, provides that an act of financial promotion using information from abroad is subject to the regulation if the activity "is capable of having an effect" on the United Kingdom. See Kenji Kawamura, *Eikoku Kinyû Sâbisu Oyobi Shijô Hôan No Gaiyô To Kinji No Tenkai* (Summary and Recent Developments in Financial Services and Markets Bill of the United Kingdom), 446 KOKUSAI SHÔJI HÔMU (August 1999) at 897.

[14] In general, under this approach, taking the "principle of effect" into consideration will expand the territorial jurisdiction of the SEL as normally demarcated by the "principle of territoriality, " but in some cases it is possible that the scope of application will be reduced. See note 19 in connection with "Specific Case Study (1) " in 3 below.

regulations in an effective manner (both to the regulator and the persons being regulated) as well as accordance with regulations by other relevant countries (or jurisdictions), the conclusion that the SEL can only be applied when the effect on Japan exceeds a certain level would be also possible. In this case, the judgment of whether the effect on Japan exceeds a certain level would be based on such factors as the extent of the effect on the price-formation mechanism in the markets, the number and the character of domestic investors affected (such as whether they are professional investors), the scope of the securities traded (such as whether they are listed securities), and whether the act was "intended" for domestic investors. However, it is a difficult issue which factors and to what extent should be taken into account in any type of regulation, and a uniform decision is not always possible as shown in the case examples studied in 3. below.[15] Further, it is possible that interpretations of the current law will be divided as a result of the work of demarcating the scope of application of particular clauses of the SEL in consideration of the above factors, particularly from the perspective of the "principle of effect." Thus, in principle, it would be necessary to resolve the issue by legislation.

(4) Approaches Categorized by Types of Regulations

When studying the issues concerning the scope of application of the SEL based on the first approach stated in (3) above, it will be useful to present an analysis on the basis of classifying the various clauses in the SEL into several regulatory categories. For this purpose, we divided these clauses into (i) supervisory rules for the purpose of selecting and supervising the businesses, such as the registration requirement of securities business ("business regulations"), and (ii) market rules regarding the acts of participants of transactions on the market ("market regulations"). We further classified (ii) into (ii-i) rules concerning the regulation of transactions themselves ("trading regulations"), and (ii-ii) rules imposed in relation to, or in connection with, certain transactions or situations, such as disclosure requirements ("incidental regulations").[16,17] And as follows we will attempt to organize the scope of application of regulations by each regulatory category (business regulations, trading regulations or incidental regulations) and will make a brief study of specific cases. The concepts stated in this study indicate several perspectives which appear to be possible as an interpretation of existing law.

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[15] In addition to the factors discussed in the text, it is probably also necessary to study whether the practical possibility of enforcement of penalties in connection with a violation of the relevant clause of the SEL should be taken into consideration (see note 5 above). Moreover, as discussed in 2(3), when another country (or jurisdiction) regulates the same act, particularly when the conceptual underpinnings, content and method, etc., of the regulation differ, there arises an issue what type of consideration should be given to achieving harmonization between these jurisdictions.

[16] The June 1998 Discussion Report of the Conference Concerning the New Trend of Finance (*Atarashii Kinyû No Nagare Ni Kansuru Condankai (Ronten Seiri)*) classified the rules under financial law into "trading rules" (rules to clarify the rights and obligations between parties), "market rules" (general rules applicable to all participants in transactions, and "business rules" (rules covering activities, etc., by businesses in the industry). Some of the provisions of the SEL are "trading rules" (such as clauses concerning civil liability) but relatively many of the clauses can be understood as "market rules" or "business rules. "

[17] The clauses of the SEL are not restricted to those classified as such. There are also various types of clauses including those related to the establishment and regulation of securities-related associations such as securities exchanges, securities dealers associations, and investors protection funds, those related to investigation procedures by the Securities and Exchange Surveillance Commission into criminal activity, and those related to cooperation with the securities regulators in other countries.

3. Analysis by Type of Regulation

(1) Business Regulations

The business regulations consist of the registration requirement for securities companies (additional permission from competent minister is required for some of the business activities of securities companies), and a set of regulations involving administrative supervision of securities companies. The SEL requires, as a business regulation, any persons who engage in securities business to register with the Prime Minister (Article 28).[18] Besides the SEL prescribes stringent regulations on securities companies that have registered, including restrictions on their scope of business, imposition of a requirement to submit various reports and filings, restrictions on methods of transactions, regulation of capital adequacy, and a requirement to be subject to inspections and reporting requests.

In general, regulation of businesses under a "business law" uses a means of regulation by which a person who engage in certain "acts" as a business is requested to obtain a license or a permit from, or register with, the administrative authority. The registration requirement of securities companies under the SEL provides that engaging any of the acts set forth in Article 2(8) thereof (i.e. trading of securities, or intermediating, brokering or acting as an agent of trading of securities, etc.) as a business constitutes "securities business" and requires any person to engage in "securities business" to be registered.

This presents an issue whether only acts performed in Japan may come under the meaning of "securities business" when it is performed as a business, or whether under certain circumstances acts performed outside of Japan may come under the meaning of "securities business." Here, as "acts performed outside of Japan," two types are possible; acts performed outside of Japan but through a business place in Japan, and acts performed through a foreign branch but directed towards domestic investors.

[Specific Case Study 1]

A business which has a business place in Japan receives an order from a customer in the United States, and purchase T-Bills for the customer in a securities market in the United States, or acts as an intermediary to have the order executed with another customer in the United States. If certain communications or other acts in connection with the intermediation are performed in Japan, it is possible that the SEL would apply under the "principle of territoriality" on the grounds that the acts are engaged in Japan, and said

[18] This registration is in practice handled by the Director General of the Local Finance Bureau having jurisdiction (Article 194-6(1) and (3) of the SEL, as well as Article 42 of the SEL Enforcement Regulations). Permission from the authorities is additionally required in order to engage in certain business activities such as securities OTC derivative trading or brokering thereof (Article 29(1) of the SEL). Registration of a securities company under the SEL is based on the assumption that the company is a Japanese stock corporation, and foreign companies which intend to engage in the securities business in Japan through their branches in Japan are required to register pursuant to Article 3(1) of the Law Concerning Foreign Securities Firms (or in the case of certain business activities obtain additional permission pursuant to Article 7(1) thereof).

business would be required to register to engage in the securities business under the SEL. It is likely that from a substantive basis as well, as long as these acts are performed through a business place in Japan, a reasonable basis for regulating the business under the SEL will be found to exist from the standpoint of ensuring the fairness of securities transactions in Japan. Even if the ultimate objective of the registration requirement of securities businesses under the SEL is to protect domestic investors, ensuring of fairness and smoothness of transactions in the securities markets, as systemic protections (in a broad sense of the term), is also the objective of the requirement. Thus, as long as acts are performed by a business through a business place in Japan, there would be a certain justification for requiring said business to comply with the registration requirement, on the basis that it engages in the "securities business" in Japan.[19]

[Specific Case Study 2]

A person engages in acts in connection with securities trading which target domestic investors through a business place outside of Japan. In the determination of whether registration is required under Article 3(1) of the Law Concerning Foreign Securities Firms in the event that said acts are performed as a business (and for which purpose the person will be required to establish a branch in Japan),[20] it is possible, from the perspective of protecting investors, to take the position that Japanese law (which in this case would be the Law Concerning Foreign Securities Firms) should in principle apply to acts which seek to target domestic investors beyond a certain level, even if the acts themselves take place outside of Japan, on the grounds that this type of acts may infringe the legal interests of Japan. This issue is also discussed in 4. below since application of laws and regulations is a particular issue in Internet trading, which has recently experienced extremely rapid growth.

(2) Trading Regulations

The various regulations under the SEL include insider trading regulations, the prohibition of market manipulation and other regulations, which directly regulate unfair trading and similar acts.

[19] In addition to the reasons stated in the text, it is possible to take the position that, from a policy perspective, the regulations under the SEL should apply to cross-border transactions, by taking it into account that there may be cases in which it is not necessarily clear whether the interests of investors in Japan are involved, that from the average domestic investors the scope of activity of said "business" may not be transparent, and that a "business" which has facilities for engaging in such activities can easily conduct activities in connection with transactions with domestic investors as customers as the counter-party of the transactions. Nevertheless, it is also possible to take the position that registration under the SEL is not required, on the basis of emphasizing that cases such as the hypothetical example do not constitute a direct infringement of a legal interest which the SEL is designed to protect. When taking the latter position, there may be a dispute whether this narrowing of the scope of application is a result of applying the "principle of effect" or should be understood as a restriction or restraint that is inherent in the "principle of territoriality."

[20] The Law Concerning Foreign Securities Firms does allow a "foreign securities business" outside of Japan to conduct certain of the "acts of securities trading" directed towards persons in Japan "from abroad" without registration pursuant to the law, if directed persons in Japan are certain financial institutions, etc. or if there is no solicitation (proviso to Article 3(2) of the Law Concerning Foreign Securities Firms, and Article 2 of the Enforcement Order thereof). A "foreign securities firm" must establish a branch in Japan and register itself if it engages in the "securities business" in Japan beyond such scope, but the border is not necessarily clear.

These regulations are more concerned with protecting the legal interests in fair trading and the mechanism of fair price formation in the markets in which securities are traded rather than protecting the interests of particular investors. From this perspective, there is good reason to take the position that the SEL can be applied to the extent necessary to achieve these purposes, as long as the trading has a certain effect on Japan, even if the "acts" are not performed in Japan.[21]

[Specific Case Study 3 (Market Manipulation)]

i. If a person engages in spreading rumors or collusive trading in connection with stocks of a Japanese company that is listed on a securities exchange in Japan (assuming that the securities exchange is the main securities exchange of said stock), and if the purpose of these acts is to manipulate the price in the exchange in Japan, then even if the acts themselves are performed outside of Japan, it seems to be possible to apply the regulations of market manipulation under the SEL without requiring any other particular conditions, on the grounds that the acts are aimed to the Japanese securities market and that the "effect" of the acts presents the danger of damage to the legal interest of the fairness of securities markets in Japan. Although in many cases it would be difficult to apply the penal clauses set forth in the SEL since the principle of territoriality pursuant to Article 1 of the Penal Code would apply, there is room for applying Article 160 of the SEL in connection with liability for damages, and in this sense there would be significance in applying the SEL.[22]

ii. A different scenario would be that a foreign company is listed on a securities exchange in Japan but has its main securities exchange in its home country. In this case, it is likely that the direct impact of the market manipulation on Japanese markets will be slight if the act is committed in a foreign country and if the transaction volume in the securities exchange in Japan is smaller than that in the main exchange in the home country. Thus, it is possible to take the position that the SEL should apply in particular circumstances that would cause a certain level of damage to fairness of securities transaction in securities markets in Japan, such as when at least a certain percentage of shareholders of the foreign company are in Japan, or when the transaction volume in the securities exchange is more than a certain amount.

[21] In the United States, there are many case precedents concerning private claims for damages pursuant to the Securities Exchange Act of 1934 on the basis of illegal acts such as insider trading, a false statement in a document such as a prospectus or fraudulent trading. Both the "effect test" and the "conduct test" are used as grounds for these claims. For an introduction to these case presidents in the United States see Tatsuta, *supra* note 7, at 501ff.

[22] The SEL contains clauses which set forth more than one sanction (including civil, criminal and administrative sanctions) for the same violation of a prohibition. An example of this is that market manipulation will incur both criminal and civil responsibility. In principle, in this event as well, it is likely that the proper course will be to demarcate the scope of application of the law for each sanction (see *supra* note 2). Consequently, if for example a securities company performs an act outside of Japan which constitutes a violation to a clause which penal sanction applies, there may be cases in which it is possible to cancel the registration of that company for the securities business on the grounds that it has "violated a law or regulation" as provided by Article 56(1)(iii) of the SEL even though the company does not incur penal sanction because of the restriction of Penal Code Article 1 and Article 8.

Nevertheless it is possible to take a position that the SEL should apply regardless of the factors such as the number of shareholders in Japan or the transaction volume in the securities exchange in Japan, since there is a danger of infringement of legal interest as long as the act has an impact on transactions in securities markets in Japan. In other words, if the securities exchange in the home country is the main securities exchange and transaction volume in the securities exchange in Japan is small enough, in many cases the price in the main securities exchange would have a significant impact on the price in the securities exchange in Japan, and consequently it is expected that the impact of the market manipulation in the home country would indirectly extend to the securities markets in Japan. This position also seems to have good reason, when it is considered that if the trading regulations under the SEL do not apply to many foreign stocks because their main securities exchanges are not securities exchanges in Japan, then this presents the danger of undermining the credibility of securities markets of foreign stocks in Japan, as well as the credibility of fairness of all transactions in these securities markets.

Further, the acts in question would in many cases be subject to regulation of the home country. In this case, since there is little need for double regulation under the SEL, and attempts to adjust for differences in the regulations of both countries would likely raise difficult issues, the position could be taken that there should be restraint in applying the SEL to acts which are regulated in the country (other than Japan) in which the main securities exchange is located. Even with respect to this issue, however, it is also possible to take the position that laws and regulations of Japan should apply independently, irrespective of whether those of the other country apply.

[Specific Case Study 4 (Trading Reports by Major Shareholders, etc., and Duty of Major Shareholders, etc., to Return Profits from Short Swing Trades)]

The requirement for trading reports by officers and major shareholders, etc., of a listed company, and the obligation of these parties to return profits from short swing trading (Article 163 and Article 164 of the SEL) are a part of the regulations against insider trading. These regulations seek to prevent unfair trading by insiders, irrespective of whether the insider information is used, by automatically imposing an obligation to report and to return profits from short wing trading on related persons to the company.

i. Consider the scenario of a domestic company which is listed on a securities exchange in Japan, and has an officer or a major shareholder who is domiciled in a foreign country. If the officer or the major shareholder trades the stocks of the company outside of Japan, then the obligation to file a trading report would be imposed on the officer or the major shareholder, since the main securities exchange is in Japan and thus there would be a strong demand to protect the legal interests in connection with the securities markets. In this event, issues of rights and obligations under the private laws would occur between the company and the officer or the major shareholder in connection with the obligation to return profits from short swing transactions (see Article 164(9) of the SEL in connection with calculating the amount of profits to be returned), and it is possible that there would be issues of consistency

with rules under conflict of laws. Nevertheless, from the perspective of integrity of the regulations, the conclusion would probably be that there is good reason to interpret these provisions as applying in the same manner.[23]

ii. In contrast to the above, consider the scenario of a foreign company which is listed on a securities exchange in Japan but whose main securities exchange is in the home country, and has an officer or a major shareholder who is domiciled in the foreign country. If the officer or the shareholder trades the stocks of the company outside of Japan, for the same reasons as discussed in the case example for market manipulation (3ii above), it is possible to take the position that the SEL should apply only under certain circumstances such as where trading in the securities exchange in Japan exceeds a certain volume. But it is also possible to take the position that the SEL should apply irrespective of such circumstances, as long as there is the danger of a infringement of a legal interest in Japan. At the very least, applying the provisions of the SEL to officers of a foreign company which actively lists its stocks on a securities exchange in Japan should not cause any surprise to the officers, and complying with the regulation by the SEL would not be excessively cumbersome.[24]

There is also room to consider whether the SEL should be restrained in application in connection with acts that are subject to a similar regulation under the law of the foreign country.

(3) Incidental Regulations

Incidental regulations under the SEL include the requirement of disclosure of information at the time of issuing securities (issue disclosure), continuous disclosure (distribution disclosure), the requirement of disclosure of large holdings, and disclosure in connection with public tender offers.

These regulations each differ somewhat in their intent, but their basic objective is to provide the information necessary for the purpose of protecting investors in connection with securities trading. When considering the scope of application of these regulations, it would be appropriate that the obligation of disclosure, etc., is imposed

[23] As stated in the preceding footnote, in some cases the SEL has a layered combination of several sanctions for a single prohibition, or applies several provisions all together in an attempt to achieve the purposes of regulation. It has been stated that in these situations special consideration which differs from the above principle may be necessary, but this likely requires a consideration which complies with the purpose of each provision. For example Kazunori Ishiguro, *Shôken Torihikihô No Kokusaiteki Tekiyô Ni Kansuru Shomondai –Josetsuteki Oboegaki Toshite* (Various Issues in Connection With International Application of the Securities and Exchange Law–An Introductory Memorandum), 102 SHÔKEN KENKYÛ (1992) at 1ff, which states that it was envisioned that the aspects of civil and administrative regulations would function as "one set" in connection with the return of short term swing trading by officers and major shareholders (Article 164 (formerly Article 189) of the SEL), and the problem will be resolved if this is considered as an absolute mandatory legal provision of the country of forum (i.e., Japan) as a whole.

[24] With respect to this issue an inquiry with the Financial Services Agency (Financial Markets Division, Planning and Coordination Bureau) was made. The response was that if a nonresident (or a foreign corporation) who is a director or a major shareholder of a foreign company trades the stocks of the company that is listed on an exchange in Japan, the person is not required to file a trading report because Japanese law would not apply.

within a reasonable range as long as it is useful in light of the purposes of disclosure. And this should not be restricted to the cases that acts to be disclosed are performed in Japan.

[Specific Case Study 5 (Reports of Large Holdings)]

A large holding report is for the purpose of disclosing information in connection with changes in the control of a listed company, as well as information in connection with supply and demand in the securities markets.

i. It would be appropriate to require a report on acquisition of stocks in a Japanese company that is listed on a securities exchange in Japan, even if the transaction that was the cause of the acquisition took place in a foreign country or the acquiring person is located outside of Japan, since there is a strong need for the information in order to achieve the purposes of the regulation.

ii. Consider a scenario in which a person in a foreign country acquires stocks of a foreign company that is listed on a securities exchange in Japan but whose main securities exchange is in the home country of the foreign company, and the acquisition by the person in a foreign country takes place outside of Japan. From the perspective of the level of necessity and usefulness of disclosure in the case that the securities market in Japan is a subordinate securities market (meaning that it is not the main securities market), it would be possible to impose a obligation to report only if certain circumstances apply, such as that a certain percentage of shareholders in the foreign company are domiciled in Japan, or if the trading volume in the securities exchange in Japan exceeds a certain amount.[25]

[Specific Case Study 6 (Public Tender Offers)]

The regulations concerning public tender offers (tender offers, or take-over-bids, by a person other than the issuer) in general set forth terms that include the method and disclosure of off-market trading of securities. These regulations are for the purpose of achieving fairness of securities transactions by requiring compliance with these terms, and particularly to achieve transparency of the formation of prices in securities markets.

i. Consider a scenario of a Japanese company which is listed on a securities exchange in Japan, for which a tender offer outside of the securities market takes place exclusively in a foreign country. One possible interpretation would be to stress the purposes of the regulation and to apply the SEL to all tender offers in the foreign country. In other words, under such interpretation taking of procedures such as the filing of a public tender offer registration statement pursuant to the SEL is required, even if the tender offer takes place exclusively (or mainly) outside of Japan.

[25] Current application of the regulation requiring large holding reports does not impose an obligation to report if a person outside of Japan acquires stocks of a foreign country through a transaction that takes place outside of Japan, but in all other cases a reporting requirement is held to exist. See 5% RÛ-RU NO JITSUMU TO Q&A (Practice, Questions and Answers Concerning the 5% Rule) at 109-110 (5% Rûru Jitsumu Kenkyukai (Study Group on Practical Implementation of the 5% Rule) ed. 1991).

It is also possible to take a contrasting position that the procedures for a public tender offer under the SEL will be required only if the number of the stocks or the shareholders in the foreign country exceeds a certain level (such as a certain percentage of total stocks issued and outstanding or total shareholders), on the grounds that the impact on the securities markets in Japan is expected at least a certain scale. In this case, there is also room for consideration whether application of the SEL should be waived if the tender offer is made in accordance with procedures of the country in which the tender offer is made which are similar to those applied to a public tender offer under the SEL (for reasons such as that the stocks of the company are also listed on the country), since taking these procedures would to some extent satisfy the purposes which the SEL seeks to achieve.

ii. A further scenario is that a tender offer of a foreign company that is listed on a securities exchange in Japan but whose main securities exchange is in the home country takes place outside of the securities market in the country. In this case, there is room for consideration whether it is appropriate to require the procedures of public tender offer in Japan as well, only if the number of stocks or shareholders in Japan or the trading volume in Japan exceeds a certain level.

4. Internet Trading

Applying the traditional "principle of territoriality" to Internet trading presents a difficult issue of how to evaluate the location of the "acts" in question. Examples would include cases in which email messages are sent from a foreign country to Japan, as well as cases in which a website that can be viewed from Japan is hosted on equipment outside of Japan.

With respect to this issue the International Organization of Securities Commissions (IOSCO) stated as follows in its report on "Securities Activity on the Internet" which it released in September 1998:

> *If an issuer's or financial service provider's offer or sales activities over the Internet occur within a regulator's jurisdiction, or if the issuer's or financial service provider's offshore activities, in fact, have a significant effect upon residents or markets in the regulator's jurisdiction, a regulator may impose its regulatory requirements (e.g., licensing and registration requirements) on such activities.*

Based on this report the Financial Services Agency published an administrative guideline in December 1999 [26] which stated that "acts by a foreign securities firm such as presenting . . . advertisements or offering information in connection with securities transactions. . . on a website, etc.,

[26] Paragraph 4-4. "Cross Border Transactions by Foreign Securities Firms Using Internet, etc." of Section 1. *Concerning Supervision of Securities Companies, Etc.*, in *Cautions Concerning the Supervision, Etc., of Securities Companies, Investment Trust Management Companies, and Investment Corporations, Etc., as Well as Securities Investment Advisory Businesses, Etc.*, of the Administrative Guidelines in Connection With the Law Concerning Foreign Securities Firms (Article 3), the Enforcement Order of the Law Concerning Foreign Securities Firms (Article 2) and the Order of the Cabinet Office in Connection With Foreign Securities Firms (Article 7).

in principle constitute *soliciting.*" This provision involves the obligation of foreign securities firms to register under Article 3 of the Law Concerning Foreign Securities Firms, which is related to the regulation of "businesses regulation" under the Law.

It is not impossible to interpret an advertisement or offering of information by a website as being an act in Japan (regardless of where the server is actually located) from the traditional perspective of the "principle of territoriality" concerning the application of the SEL.[27] Given this understanding it is also possible to understand that the guideline regards representations on a website as "acts performed in Japan" and attempts to apply Japanese law (in this case the Law Concerning Foreign Securities Firms) from the perspective of protecting investors, while maintaining the traditional conceptual framework that the SEL only applies to acts that take place in Japan.[28]

However, taking the position that acts through website which can be accessed from anywhere in the world is in principle an act of soliciting, etc., in Japan (where the people who view the website are domiciled) seems deviate to some extent from the traditional approach that the SEL will apply only to acts performed in Japan. From this perspective it appears possible to understand that under the guideline statements on the Internet are not held to be solicitation, etc. in Japan (or that under the guideline the location of the "act" does not matter), and that the guideline is based on the position that Japanese law would apply if an act committed outside of Japan had at least a certain impact in Japan.[29]

5. Future Issues

As stated in the results of the study discussed above, even if the "principle of territoriality" is taken as the core concept when applying the SEL and other finance-related laws and regulations to cross-border transactions, there are cases in which a broad application of Japanese law is necessary on the basis of the infringement of a legal interest that these laws and regulations are intended to protect. It is also possible, however, that interpretation concerning the scope of application will be divided, and various difficult issues may be raised. For this reason it would be desirable to enact legislation in order to address important issues that include, to a certain extent, legislative policy decisions. With respect to matters involving application of law that are comparatively administrative, it would also be possible for an administrative agency to present standards for interpretation in a guideline or similar form, and it would be appropriate in this event for the specific standards to be as objective as possible. One example is that certain clauses of the SEL would apply only if certain standards are met, such as the

[27] In connection with the scope of application of the crime of private lottery under the Penal Code, there is a position that "in case of direct marketing of private lottery, since a part of the selling takes place in Japan, the direct marketing constitutes a domestic crime" (See Tsuguo Kameyama, *Kokugai Han –Gaikoku No Takarakuji* (Offshore Crime–Lotteries of Other Countries) HANREI TIMES 443 (1981) at 40ff). Nevertheless it will probably be necessary to take into account the differences between direct marketing by mail and Internet transactions (such as that mail is sent to a specific person and the addressees can be specified by the sender, while it is difficult to restrict access to representations made on a website to persons in specific countries).

[28] The guideline also states that as long as reasonable steps are taken so that the website does not lead to acts of securities trading with investors in Japan (such as an explicit disclaimers), the website would not constitute solicitation of domestic investors, because it would be an advertisement mainly directed to persons in foreign countries. Consequently, the guideline does not mean that Japanese law will be applied to all websites viewable from Japan.

[29] The guiding principle of the scope of application of the law is presented in the form of an administrative guideline by the Financial Services Agency only about Internet transactions. This is base on somewhat unique circumstances that the Japanese government has put into effect matters which were agreed between governments as stated in the IOSCO report. Nevertheless, the position presented here suggests the future direction of the scope of application of the SEL to cross-border transactions.

number of stocks or shareholders in Japan or the transaction volume in securities exchanges in Japan. In this event it would also be beneficial to set rules which explicitly provide objective standards, such as quantitative guidelines, as guidelines for the behavior of related parties (i.e., so-called *safe harbor rules*). The administrative guideline in connection with Internet transactions referred to in 4. above, also has the characteristics of rules of this type.

It is also desirable, in the course of practical procedures for applying a rule, that a no-action letter system plays its significant role sufficiently in connection with laws and regulations related to finance generally. Under the system, if the interpretation or application of laws, regulations or administrative rules under a law or a regulation are not clear in particular cases, the administrative agency would on request state its interpretation, and would not impose sanctions if the parties acted accordingly.[30]

In consideration of the future progress of globalization of financial transactions and markets, there is likely to be a growing need for harmonization with the way of extraterritorial application of jurisdictions other than Japan, as well as for harmonization among countries in connection with the regulations themselves. A broad-based study by international institutions such as IOSCO is desired in connection with these issues. At the same time, in Japan the necessity must be broadly recognized for the legislative steps and the enactment of rules in connection with interpretation and application of laws and regulations by administrative agency as discussed above, and the effort must be made to achieve these goals.

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[30] Pursuant to the Cabinet Resolution of March 27, 2001 (Concerning Introduction of Pre-confirmation Procedures for Application of Laws and Regulations by Administrative Institutions), the Financial Services Agency has implemented the pre-confirmation procedures for application of laws and regulations in connection with certain laws and regulations from July 16, 2001 (commonly known as the *no-action letter* system), which was followed thereafter by many administrative agencies. Moreover, procedures for submitting opinions concerning the enactment or amendment of laws, regulations and systems (commonly known as *public comment procedures*) have been implemented by administrative agencies pursuant to the Cabinet Resolution of March 23, 1999 (Procedures for Submitting Opinions Concerning the Enactment or Abolishment of Regulations; amended in part on December 26, 2000). In the course of these proceedings, responses and some interpretations have been stated by administrative agencies to opinions and questions presented by the private sector. And this has, in substance, had a function of having administrative agencies inform the general public of their interpretations of the laws and regulations over which they have jurisdiction.