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Legal Update

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The President's Message

Dear Colleagues,

It has been a hectic year on many fronts and I am sure all of you are looking forward to the festive season ahead. It is hard to imagine that this year has gone by so quickly.

Stuttgart Meeting

Our 2010 Mid-Year Council Meeting was held over a cool weekend in October in the beautiful city of Stuttgart, Germany. A mid-year meeting in Europe allows us to support and encourage European membership and this year's meeting was held at an enticing and exciting location: the Mercedes-Benz Museum in Stuttgart. The meetings were very enjoyable and productive and we had excellent attendance from many Council members. Besides the proper meetings, we also had an opportunity to tour the museum and admire the museum's fabulous architecture, as well as the striking designs of many legendary Mercedes-Benz cars. Most of us left the museum with bags full of toy cars and other delightful Mercedes-Benz souvenirs!

I am sure all the Council members will join me in thanking Gerhard Wegen, Axel Reeg and the German host committee for their meticulous planning of the Mid-Year Council Meeting and great social events, as well as the use of Gleiss Lutz's impressive offices for our Officers Meetings. We were extremely well looked after by the very helpful and organised staff at Gleiss Lutz and had a wonderful run of their modern and stunning office building. We also had excellent meals and wine at Gleiss Lutz, and our Council night out saw us enjoying even more good food and wine, as well as an engaging dinner talk followed by questions and answers by Judge Prof Dr Ferdinand Kirchhof, Vice-President of the (German) Federal Constitutional Court, Karlsruhe and Professor of Public and Tax Law, Tuebingen Law School.

APEC Collaboration

One of the extremely exciting developments that was reported at this year's Mid-Year Council Meeting is the proposed collaboration with the Asia-Pacific Economic Cooperation (APEC). APEC is a forum for 21 Pacific Rim countries to promote free trade and economic cooperation throughout the Asia-Pacific region. APEC was established in 1989 and its members account for approximately 40% of the world's population, more than half of world's GDP and some 44% of world trade. Annual APEC meetings are attended by heads of government of APEC members. The current APEC chair is from Japan, with its Executive Director from Malaysia; APEC is headquartered in Singapore.

Given the importance of APEC as an organisation, its geographic commonality with the IPBA and its focus on business and trade, the proposed collaboration holds much promise for the IPBA. A draft Friendship Agreement between the two organisations is currently being negotiated. This would be the first time in the history of APEC that it is signing an agreement of this kind with another organisation.

Indeed, as you have seen from the special announcement made in December, collaboration is already underway with respect to the creation of an APEC-accessible databank of IPBA lawyers.

At our Mid-Year Council Meeting in Stuttgart, it was agreed that an Ad-Hoc Committee would be formed for collaboration activities with APEC. This Committee will be chaired by Nobuo Miyake, with Gerald Sumida, Shiro Kuniya and myself as members, and a joint session with both APEC and IPBA representatives is proposed for the Kyoto Conference.

As a follow-up to these discussions at our Mid-Year Council Meeting, in November, Nobuo Miyake, Shiro Kuniya and myself paid a visit to the Japanese Ambassador to APEC, His Excellency, Shigeru Nakamura in Tokyo.

Kyoto Conference

Preparations for our 21st Annual Meeting and Conference from 21–24 April 2011, in Kyoto, continue apace and it is expected that the detailed programme should be available soon. Key speakers for the Kyoto Conference include: His Excellency John Roos, the US Ambassador to Japan; Dr Hiroshi Matsumoto, President of Kyoto University; Dr Shinya Yamanaka, a brilliant Japanese physician and stem cell researcher; and Mr Yasuchika Hasegawa, the President and CEO of Takeda Pharmaceutical Company Ltd. The social programme will include a dinner at the historic and beautiful Ninna-ji Temple which is a UNESCO World Heritage Site. I urge you to register quickly to take advantage of the early bird rate. Online registrations are available at http://www.ipba2011.org/.

Promotional Activities

To promote the Kyoto Conference and the IPBA, a series of visits, seminars and/or receptions are planned in numerous jurisdictions across the world. Please attend and support those that we be held at your home jurisdiction and bring as many IPBA members, as well as potential members to these events.

Scholarship Committee – Silent Auction

A silent auction is being planned at the Kyoto Conference to raise funds for IPBA scholarships. Suggested donations can include the use of IPBA members' vacation homes around the world, bottles of wine, hotel stays, airline and travel packages, restaurant gift certificates, art, collectibles and antiques. This is a wonderful initiative and a very worthy cause and I appeal to you to please to donate generously.

2011

Please have a wonderful new year and I look forward to seeing you in Kyoto, in April 2011, if not before.

Lee Suet Fern
President

The Secretary-General's Message

Dear IPBA Members,

As an international association of business lawyers whose focus is the Asia-Pacific Region, we are keenly sensitive as to how globalisation continues to transform the economies of this region, as well as how economic developments within this region affect, and are affected by, the global economy. In recent decades, the Asia-Pacific region has become the most dynamic in the world. The emergence of China and India, as dominant emerging economies within this region coupled with Brazil and Russia – the so-called BRIC countries – already reveals significant changes in trade and investment patterns that may possibly overshadow traditional trade and investment flows with Europe and North America.

An integral dimension of this transformation is in the manufacturing realm, which today spans ideas, products and services, superseding the traditional production solely of goods. A recent study of global competitiveness[1] concludes that 'this post-industrial manufacturing ecosystem represents a complex and highly integrated globalised value web', which includes 'cutting-edge science and technology, innovation, talent, sustainable design, systems engineering, supply chain excellence and a wide range of smart services, as well as energy efficient, sustainable and low carbon manufacturing'. These forces are 'reshaping the drivers of economic growth, wealth creation, national prosperity and national security'. Among the key drivers of competitiveness are talent-driven innovation emanating from scientific and technological innovation, as well as economic, trade, financial and tax systems, and legal and regulatory systems.

For us, as business lawyers, these recent findings confirm much of what we already know and deal with on a daily basis in our professional work. What is striking, nonetheless, are the breadth and depth of these transformations, how they are intimately linked with business, economic, scientific and technological developments, and the pace at which these changes are occurring, accelerating and permeating in almost all areas of business and social activities. These are factors about which we, as legal professionals, are not often fully aware. Nonetheless, their implications are pervasive and increasingly obvious. Clearly, intellectual property rights, technological transfer arrangements, cross-border investment transactions, enactment and enforcement of business and economic laws, the strengthening of capital markets and securities and investment regimes, environmental and 'green' requirements, labour and immigration regimes, communications and data storage and transmission systems, resulted data privacy matters and more are familiar aspects of our business law practices. However, although the traditional boundaries of legal practice have become increasingly blurred, we are also seeing new areas of legal practice emerging from the transformation of business practices and arrangements, as well as new demands for public policies and legal and regulatory schemes to shape, promote and regulate these new areas of business activities.

Much of what I have described above focuses on 'innovation', and specifically what the global competitiveness study calls 'talent-driven innovation'. Indeed, because of these ongoing transformations, IPBA's Annual Meeting and Conference, to be held in Kyoto/Osaka from 21–24 April 2011, will focus on innovation, including how innovation is affecting companies and firms and where innovation may lead to in the future. The Kyoto Annual Meeting and Conference will also explore how innovation, in general, affects and will affect areas of our business legal practice. The globalisation of legal codes, model laws, best practices and similar efforts at harmonisation of laws, to keep pace with developments in international business and commerce, has already

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1 Deloitte Touche Tohmatsu and The US Council on Competitiveness, *2010 Global Manufacturing Competitiveness Index* (June 2010).

affected national legal systems of virtually all IPBA jurisdictions. These efforts will undoubtedly continue under the auspices of organisations like UNCITRAL, OECD, the UN and its various agencies and functional organisations, but also through APEC, ASEAN and non-governmental organisations such as The World Economic Forum and various global partnerships of governments, businesses and NGOs. All of these will affect not only the substantive practice of business law but will also continue to shape how people live their lives, shape their aspirations and define their opportunities. Moreover, they also underscore the basic need for the rule of law as the foundation on which sustainable economic development and activity can take place and flourish.

In 2010, the IPBA at its Annual Meeting and Conference in Singapore became the first association of lawyers in the Asia-Pacific Region to address issues of climate change and its implications for the practice of law. In the coming year, and following in the same tradition, the IPBA will address innovation and its implications for the practice of law. In this way, the IPBA continues to keep our members abreast of transformations in the law and the practice of law in this region, and what we might be able to foresee in the coming years as a result of changes in our larger societal environments. It also enables us to explore how to promote the rule of law in shaping how these activities should take place. The IPBA's 2011 Annual Meeting and Conference in Kyoto/Osaka promises to be a very significant event and I look forward to seeing you there.

With all best wishes,

Gerald A Sumida
Secretary-General

IPBA Event Calendar

Event	Location	Date
Annual Meeting and Conference		
21st Annual Meeting and Conference	Kyoto/Osaka, Japan	April 21–24, 2011
22nd Annual Meeting and Conference	New Delhi, India	February 29–March 3, 2012
Mid-Year Council Meeting and Regional Conference		
2011 Mid–Year Council Meeting and Regional Conference	Hanoi, Vietnam	September 2–5, 2011
Supporting Events		
(AIJA) International Business and Arbitration: Is India Still Different? *Le business international et l'arbitrage: L'Inde est-elle toujours différente?*	Mumbai, India	December 2–3, 2010
IQPC Identifying & Structuring M&A Deals Southeast Asia 2010	Singapore	December 8–10, 2010
IFLR/IPBA 7th Annual Asia M&A Forum	Hong Kong	March 2–3, 2011
InnoXcell Asia Economic Crime & Legal Exchange Platform	Shanghai, China	March 9–10, 2011

More details can be found on our website:
http://www.ipba.org, or contact the IPBA Secretariat at ipba@ipba.org

INTER-PACIFIC BAR ASSOCIATION

Dear IPBA Member:

The Inter-Pacific Bar Association (IPBA) Scholarship Committee will be holding a Silent Auction fundraising event in April 2011 at the IPBA's Annual Meeting and Conference to be held in Kyoto/Osaka, Japan.

All of the funds raised from this event will be used to support the IPBA Scholarship Committee's work, which is to provide scholarships to young lawyers and lawyers from developing countries to attend the IPBA's Annual Meeting and Conference.

The IPBA Scholarships were initially offered in 1998 to honour the memory of Mr MS Lin of Taipei, who was one of the founders of and a Past President of the IPBA. There are two categories of scholarship:

1. for lawyers from developing countries to provide information and support to lawyers in those countries; and
2. for lawyers under 35 years of age from any jurisdiction to encourage development of those young lawyers in their work.

We are in the process of collecting donations for this event and we request your assistance in making the IPBA Scholarship Committee Silent Auction a success. By donating an item, you will be making a contribution that will help the IPBA Scholarship Committee provide a worthwhile learning opportunity for a young or developing country lawyer who would not otherwise be able to attend the IPBA's Annual Meeting and Conference.

Additionally, you will benefit from exposure of your firm or company's name in materials provided to those who attend the IPBA Annual Conference. Donors will be well publicised and your donation will be on display during the event.

Please consider donating an item to support the continued work of the IPBA Scholarship Committee. Donations will be accepted until 1 April 2011. Please see our website at: http://ipba.org for our donation form under 'Scholarships' and then 'Silent Auction' or you may contact mark@shklovwonglaw.com, to answer any questions regarding participation in the IPBA Scholarship Committee Silent Auction.

Anything and everything is welcome! The monetary value of the item does not have to be great. Please be creative and have fun with your donations. The goal of this project is to support a worthwhile programme and your involvement is important.

Very truly yours,

The IPBA Scholarship Committee

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Vice-Chair

Varya Simpson
Co-Chair

Richard Goldstein
Vice-Chair

The Mid-Year Council Meeting and Conference, Stuttgart, Germany, 16–18 October, 2010

The Mid-Year Council Meeting and Conference was held from 16–18 October in Stuttgart, Germany. Thanks to the organisational expertise of the Host Committee, led by Co-Chairs Prof Dr Gerhard Wegen (JCM, Germany) and Axel Reeg (previous JCM, Germany) and supported by a team of swift and efficient staff at Gleiss Lutz, the weekend's events were a great success.

In addition to the Officer and Council Meetings held at Gleiss Lutz and the Mercedes-Benz Museum, the Conference entitled 'Asian Counterparts in Corporate Transactions – Asian and European Perspectives' was held at the Chamber of Commerce in Stuttgart, with close to 70 delegates in attendance. Social activities included a beautiful meal at the quaint Kern's Pastetchen, with guest speaker Judge Prof Dr Ferdinand Kirchhof's wisdom simultaneously interpreted by the multi-talented Prof Dr Wegen (see the interview with the judge on page 10), and the Speakers' Dinner at the Vinothek am Schlossgarten, in the official conference hotel.

IPBA would like to thank the sponsors for their generous contributions, without which the weekend would not have been possible: Arendt & Medernach; Beiten Burkhardt; Boehmert & Boehmert; CMS Hasche Sigle; Gleiss Lutz; Lustenberger Glaus & Partner; Mannheimer Swartling; Reeg Rechsanwälte; and Studio Legale Macchi de Cellere Gangemi.

The Mercedes-Benz Museum, venue of the Council Meeting, where the Council also enjoyed special tours.

Council Members listening attentively to Judge Prof Dr Ferdinand Kirchhof and Prof Dr Wegen's interpretation.

At the Vinothek am Schlossgarten.

IPBA Secretary-General Gerald A Sumida opening the Conference.

Clas Nyberg, Mannheimer Swartling, Goteborg, and Petter Wirell, Cederquist, Stockholm, answering delegates' questions regarding the Volvo Transaction case study.

The first panel of the Conference presented the Asian Perspective.

The second panel of the Conference presented the European Perspective.

The delegates enjoying networking opportunities over lunch.

Publications Committee Guidelines for Publication of Articles in the IPBA Journal

Please note that the IPBA Publication Committee has moved away from a theme-based publication. Hence, for the next issues, we are pleased to accept articles on interesting legal topics and new legal developments that are happening in your jurisdiction. Please send your article by *22 February 2011* to both **Kojima Hideki** at kojima@kojimalaw.jp and **Caroline Berube** at cberube@hjmasialaw.com. We would be grateful if you could also send a lead paragraph of approximately 50 or 60 words, giving a brief introduction to, or overview of the article's main theme and a photo with the following specifications (File Format: JPG, Resolution: 300dpi and Dimensions: 4cm(w) x 5cm(h)) together with your article).

The requirements for publication of an article in the *IPBA Journal* are as follows:

1. The article has not been previously published in any journal or publication;
2. The article is of good quality both in terms of technical input and topical interest for IPBA members;
3. The article is not written to publicise the expertise, specialisation, or network offices of the writer or the firm at which the writer is based;
4. The article is concise (2500 to 3000 words) and, in any event, does not exceed 3000 words; and
5. The article is written by an IPBA member.

The Honorable Professor Dr Ferdinand Kirchhof, Vice President of the Federal Constitutional Court of Germany

Hideki Kojima

On 16 October 2010, during the 2010 IPBA Mid-Year Conference and Seminar held in Stuttgart, Germany, I was given the opportunity to interview Professor Dr Ferdinand Kirchhof for the *IPBA Journal*. The following is a condensed version of the interview.

Interview by Hideki Kojima*
Kojima Law Offices, Tokyo, Japan

Q: Thank you very much for taking the time out of your busy schedule for this interview. I would like to begin by asking what was your motivation to become a lawyer?

Professor Dr Ferdinand Kirchhof

A: At the end of my college years, I had thought that I would become a veterinarian. However, at some point, I felt that becoming a jurist would be better because such a profession is more comprehensive in terms of the interests of society that are involved. In particular, I had felt that becoming a jurist would allow me to reinforce the relationship between state and society and would also allow me to work with a broad range of human interests.

Q: What are the most important qualities that a good judge should possess?

A: I think that the ability to see the interests behind the law or, in other words, to see the interests of the people behind the case is an important quality. Additionally, I believe that a judge should be objective and refrain from sympathising with any party. I also believe that a good judge should ask, 'What are you doing with your decision?' What I mean by this is that although any given judgment could have a positive juristic effect, it could at the same time be very wrong for society.

Q: In the United States, which is a country with many minority communities, the judiciary includes judges who are from such minority communities. In Germany, is there significant importance placed on ensuring that minority communities are represented in the judiciary?

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A: In the United States, for historical and geographical reasons, I believe that there are many minority communities which significantly influence their representation in the judiciary. On the other hand, in Germany, although we do have minority communities, the issue of whether such minority communities are sufficiently represented in the judiciary is not as significant an issue.

Q: In the United States, there are many female judges, what is the situation in Germany?

A: With regard to the number of female judges, I am aware that we have many in Germany. However, I believe that given the proportion of females to males in society at large, the judiciary should have more female judges. In my position, there is not much that can be done to resolve this problem; we are elected by the parliament. I believe that the power to appoint more female judges rests with the electorate and the choices they make.

Q: Currently in Japan, lawsuits claiming unequal voting rights in the national election have brought the issue of the independence of the judiciary into the spotlight. In Germany, are there any similar issues that have brought the independence of the judiciary into the spotlight?

A: The Federal Constitutional Court has dealt with the issue of unequal voting rights on several occasions and has consistently held that if there is greater than a 25% difference in the voting power of any given election district, the difference should be remedied.

Q: Given Germany's history, I imagine that there are many issues, particularly arising out of the reunification of the former East Germany and West Germany, which must be dealt with by German courts.

A: The current Basic Law in Germany, ie our constitution, makes it clear that democracy and the rule of law is fundamental and provides a solid foundation for the German Republic. In constitutional terms, we have not had any problems since our Bonn Basic Law came into effect, in 1949.

An interesting development is that we now have judges from the former East Germany who were educated during and after the reunification of Germany. I believe that those judges who have been born and raised in the former East Germany, with their unique background, has helped reinforce the relationship between the judiciary of the German Republic and the citizens of the Republic who were born and raised in the former East Germany.

Q: As this interview will be published in the *IPBA Journal*, do you have any specific message for IPBA members?

A: I think that it is important for lawyers to understand that they are an integral part of the judiciary of their respective governments. In this capacity, I think it is important for lawyers to work together with judges to reach the correct decision. Although I think it is possible for lawyers under special conditions to be aggressive at times, such aggressiveness should not be unnecessarily confrontational in nature and should arise from a lawyer's motivation to reach the correct decision. Another issue which I believe is important is for lawyers to be competent in their representation. All too often, I encounter lawyers who do not have a sufficient understanding of the laws related to the issues they are arguing.

Swiss International Cooperation in Tax Matters and Bank Secrecy

Similar to other countries like Austria, Liechtenstein, Luxembourg and Singapore, Switzerland is amending its double taxation conventions to adopt Art 26 of the OECD Model Convention. This article explains how Switzerland is implementing the new rules and what special arrangements are envisaged with respect to major European countries.

Andreas Kolb
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Recently, the scope of Swiss bank secrecy has been the subject of intensive international debate. Swiss bank customer secrecy, however, has not been and will not be abolished. Swiss bank customer secrecy rules are not and never have been absolute. Swiss bank secrecy does not protect an account holder in case of criminal activities, including defrauding the (Swiss or foreign) tax authorities.

In particular, there has been criticism by foreign jurisdictions and the OECD that under present rules and double tax conventions (DTCs), Switzerland has no obligation to provide client account information to foreign authorities in case of simple tax evasion as opposed to tax fraud in the area of direct taxes.

In the light of this recent development, the Swiss government has renegotiated a large number of its DTCs and is still negotiating new ones to the effect that foreign authorities will have the right to claim administrative assistance and information sharing not only in cases of tax fraud and the like, but also in individual, sufficiently substantiated cases concerning foreign taxpayers.

However, Switzerland has not agreed and does not intend to agree to automatic information exchange or information exchange upon a request which is not sufficiently substantiated. This distinguishes Switzerland from many foreign countries where the tax authorities may access customers' bank account details at all times (to some extent even online and without the customer's knowledge) and without specific justification.

Furthermore, people who are residents in Switzerland exclusively for tax purposes need not be concerned about these recent developments because Swiss banks continue to be prohibited from sharing client account information with the Swiss tax authorities even in the case of mere tax evasion of direct taxes.

The Status Quo on the Exchange of Information in Tax Matters

Judicial Assistance

According to the Act on International Criminal Assistance of 20 March 1981 (IMAC), the Treaties on Mutual Assistance in Criminal Matters and the European Convention on Mutual Assistance in Criminal Matters, Switzerland is prepared to exchange bank information if a tax fraud has been committed. Further assistance is granted under the Bilateral II treaties with the European Union (Fraud Agreement and Schengen Agreement). According to these treaties, bank information can also be obtained in cases of tax evasion. However, only information on indirect taxes such as value-added tax can be obtained but not information on direct taxes (ie taxes on income and on capital).

Administrative Assistance

1. DTCs

Under the vast majority of DTCs, bank information cannot be obtained. However, according to Switzerland's DTCs with the United States, Germany, Finland, the United Kingdom, Norway, Austria, Spain, Costa Rica and South Africa, bank information can be obtained if tax fraud or the like has occurred.

2. Treaty on Taxation of Savings

According to the Treaty on Taxation of Savings, bank information can also be obtained in cases of tax fraud or the like, in relation to member states of the European Union. However, the exchange of information is limited to the income which is covered by the treaty, ie interest (it is controversial whether the obligation to exchange bank information also applies to dividend payments and royalties). In a separate Memorandum of Understanding, Switzerland made a commitment to amend its DTCs and exchange information for all taxes mentioned in the DTCs, if tax fraud or the like has occurred.

3. Fraud Agreement

Bank information can also be obtained in case of tax evasion under the fraud agreement with the European Union. However, such information will only be available with regard to indirect taxes (eg value-added tax) and not direct taxes.

Forthcoming Developments in Exchange of Information in Tax Matters

Judicial Assistance

On 29 May 2009, the Swiss Federal Council (SFC) decided to implement enhanced administrative assistance by agreeing to exchange information not only in cases of tax fraud but also in relation to judicial assistance. This decision could lead to an amendment of the treaties on mutual assistance in criminal matters and at a later stage an amendment to the IMAC.

Administrative Assistance

On 13 March 2009, the SFC decided to adopt Art 26 of the OECD Model Agreement in its DTCs. The aim of the SFC to amend at least 12 DTCs by autumn 2009 was achieved. By mid-October 2009, Switzerland had signed 12 DTCs (with Austria, Denmark, the Faroe Islands, Finland, France, Luxembourg, Mexico, Norway, Qatar, the UK and the US) which now include Art 26 of the OECD Model Agreement. A revised agreement with Spain is also considered to have been signed. The existing DTC with Spain contains an automatic most-favoured nation clause which will be activated if Switzerland agrees to a more onerous, far reaching provision with another EU state. This clause was activated by the signing of the DTC with Denmark on 21 August 2009.

Meanwhile, Switzerland has concluded 31 revised and new DTCs which contain an exchange of information clause according to Art 26 of the OECD Model Convention (apart from the above mentioned DTCs: with Canada, Germany, Greece, Hong Kong, India, Ireland, Japan, Kazakhstan, Netherlands, Oman, Poland, Romania, Singapore, Sweden, Slovakia, Taiwan, Turkey, United Arab Emirates, Uruguay. The revised DTCs with Denmark, France and Luxembourg are already in force. The DTCs with Austria, Finland, Mexico, Norway, Qatar, the UK and the US are ready to be ratified.

Once the amendments to each DTC are signed by both parties, it is also necessary for the amendments to be approved, on the Swiss side, by the Swiss parliament. This will take at least three to six months. The parliament will also decide if the amendment should be put to the so-called facultative referendum and if so, then a public vote would be required.

The DTCs with Japan, the Netherlands, Poland and Turkey are expected to be ratified in the summer 2011 while the DTCs with Canada, Germany, Greece, India and Uruguay are to be ratified in autumn 2011.

The amended DTCs provide for the following protective elements:

- The exchange of information will be limited to taxes covered by the DTCs (ie direct taxes). However, some of the new DTCs (eg with France, Germany, Japan and the UK) do not limit exchange of information on taxes covered by the DTC but will extend to other taxes eg value-added tax and inheritance tax.

- The exchange of information will also be granted if the information is requested for a person who is not a resident of the contracting states.
- Generally, only information which concern the period of time following the entry into force of the amended DTCs will be exchanged. Therefore, retroactivity should be, on the whole, avoided. However, it should be mentioned that under some DTCs, information will be granted for earlier time periods. In the new treaty with France, for example, the exchange of information clause will be applied to calendar years and business years as from 2010. Under the new treaty with the US, bank information can be obtained from the date of signature of the agreement, ie 23 September 2009. Under all new treaties, information will only pass the Swiss border if these treaties have entered into force, ie the earliest by the end of 2010.
- The exchange of information will only be granted upon request. It must be noted that the automatic or spontaneous exchange of information has been explicitly excluded.
- The SFC stated that it will not be prepared to exchange information in case of so-called 'fishing expeditions'. Thus, the new DTCs explicitly define what is understood to be a fishing expedition. Therefore, the tax authorities of the requesting state are explicitly obliged to substantiate an information request with the following:

  – Name and address of the tax payer (if possible also other information, such as date of birth, marital status, tax identification number).
  – The time period for which the information is requested.
  – Substantiation as to why the information is 'foreseeably relevant'.
  – Name and address of the information holder (ie the name of the bank). In the new DTC with France, it is also acceptable, if the bank account is identified by other means (eg an IBAN number). It will be of utmost importance how the Swiss Federal Tax Administration interprets these requirements.
  – Description of the information requested.

- The new DTCs also determine that administrative assistance procedures will be respected. This means, from a Swiss point of view, that client data information would be only transmitted to the requesting contracting state if the tax payer has exhausted all administrative procedural rules. For example, it will be possible to appeal against the decision of the Swiss Federal Tax Administration as to whether or not the information sought should be transmitted abroad. Only if this appeal is rejected by the Federal Administrative Court, can information pass the Swiss frontier.
- Another principle which is part of the amended DTC is that of subsidiarity. This means that a request for exchange of information will only be granted once the requesting contracting state has exhausted all regular sources of information available under its own internal taxation procedure.
- From a Swiss point of view, the question of stolen bank data is very sensitive. Last year, a former employee of an HSBC private bank in Geneva stole client data that was handed over

to French authorities. Also, some stolen Swiss bank data that was contained in several CDs purchased by the German authorities were passed on to other countries. Based on such experiences, the Swiss parliament has decided that the SFC must declare to its treaty partners not to exchange information in case of stolen bank data.

Supplementary Agreements

Apart from the revised DTCs which contain Art 26 according to the OECD standard, at the end of October 2010, the Swiss Minister of Finance signed declarations on the initiation of negotiations concerning financial and tax matters with UK and Germany. The ministers of finance reaffirmed the willingness of their countries to further intensify cooperation in financial and tax matters and to strengthen long-term legal security for market participants. By the joint declaration, the ministers agreed to initiate negotiations on the expansion of cross-border cooperation in tax matters and improved market access for banks. Negotiations will be based on the exploratory talks conducted by a joint working group which were held recently. Negotiations expected to commence at the

beginning of 2011 and as soon as the governments have issued their respective mandates. The outcome of the negotiations will then be submitted to parliament. It is expected that similar negotiations will also be conducted with other major European states.

The governments of Switzerland, with the UK and Germany respectively, are confident that the negotiations will lead to a fair and lasting solution in the interests of their states. The parties agree that a new solution would enable distortions in competition, in terms of tax issues, to be avoided. UK and German taxpayers should not be deterred from holding a bank account in Switzerland. In future, however, the possible risk of tax evasion should not impact on the investment decisions of UK and German taxpayers.

During the exploratory talks, Switzerland and the UK and Germany respectively, agreed on a lasting solution that respects the protection of bank client privacy. Consequently, the automatic exchange of information will no longer be an issue in relations between Switzerland and the two states. The solution will apply after the entry into force of the agreement to be negotiated (with no retroactive effect).

The solution, the details of which are to be clarified during the negotiations, covers the following points in particular:

- Regularisation of the past: untaxed existing assets should be regularised.
- Final withholding tax for the future: future investment income should be covered by a withholding tax, the rate of which has yet to be negotiated. The final withholding tax is a tax at source. After it has been paid, the tax obligation towards the country of domicile will have been fulfilled. Extended administrative assistance has been agreed in order to prevent any possibility of circumventing the withholding tax. This envisages that the UK and German authorities can submit a request for administrative assistance that states the name of the client, but not necessarily the name of the bank. The number of requests that can be submitted is limited and must be well-founded. Fishing expeditions are not permissible.
- Further elements: Switzerland and the UK and Germany respectively, intend to tackle the issue of market access for Swiss financial institutions in the UK and in Germany. The package

includes measures to decriminalise banks and their staff.

It is not guaranteed that the envisaged supplementary agreements will pass the Swiss parliament. The success of such negotiations will depend to a large degree on the withholding tax rates which will be levied. If they are too high for the foreign investors, it seems logical that they will withdraw their money and go elsewhere. Apart from Singapore and Hong Kong, German investors could, for example, consider opening an account in Austria which does not levy a comparable withholding tax. However, the extension of the exchange of information clause could encounter serious opposition in the Swiss parliament. The competent commission of the Council of States has already announced that it will refuse the approval of an exchange of information clause which goes beyond Art 26 of the OECD Model Convention.

It is expected that such supplementary agreements will not enter into force before 2012. Thus they could probably be applied in 2013 at the earliest.

Current Status of Amending the DTCs

Since the decision of 13 March 2009 and after having been 'grey-listed' by the OECD, Switzerland has signed 19 DTCs containing an extended administrative assistance clause in accordance with Art 26 of the OECD Model Convention. Consequently, Switzerland has been removed from the 'grey list' of the OECD's Secretariat. Further agreements have been initiated and others will follow in accordance with the OECD Model Convention.

Conclusion

According to the new DTCs, the exchange of information clause will not require a specific type of tax offence. However, exchange of information will only be granted if the requesting state indicates the names and addresses of the tax payer and the information holder (name of the bank), as well as the reason why the information is sought.

It will be possible to appeal against the decision of the Swiss Federal Tax Administration as to whether the information sought will be permitted to be transmitted abroad. It is only when this appeal is rejected by the Federal Administrative Court can information pass the Swiss frontier.

The first amended DTCs (with Denmark, France and Luxembourg) entered into force in 2010. This means that the first requests for exchange of information can be made relating to the period from 2010 with France, and 2011 with Denmark and Luxembourg, and onwards. It is expected that the ratification of other treaties will follow soon.

The supplementary agreements that Switzerland will negotiate at the beginning of 2011 go far beyond the OECD standard and depending on their content, they could provoke substantial restructuring of investors and serious opposition in the Swiss parliament. It is not expected that these agreements will enter into force before 2012 so the earliest application of these agreements will probably be in 2013 at the earliest.

The Aftermath of *Xilinx*: The Arm's Length Standard and Current Cost-Sharing Regulations


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Robert AN Cudd


Michelle Jewett


Edward L Froelich

The Ninth Circuit Court of Appeal's decision in *Xilinx Inc and Subsidiaries v Commissioner* called into question the arm's length standard after the Court withdrew its original opinion and issued a diametrically opposed opinion that resulted in a reassertion of the standard, but it has raised some doubt as to the validity of certain sections of the recently issued cost sharing regulations.

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Calling Long-standing Principles into Question

The case of *Xilinx Inc and Subsidiaries v Commissioner*[1] has had an unusual history and leaves a result that offers both an opportunity for taxpayers and uncertainty as to the current state of the US transfer pricing rules. The basic issue in *Xilinx* is fairly simple: does the 'arm's length' standard apply, meaning that controlled taxpayers cannot be required to adopt pricing that unrelated parties would not. Most tax practitioners would think that the answer to this is 'yes'. That is, most tax practitioners would view the goal of § 482 of the Internal Revenue Code and the Treasury Regulations promulgated thereunder, as placing taxpayers under common control on par with arm's length parties.

There would be good reason to reach such a conclusion, including the basic principle enunciated in the Treasury Regulations promulgated under

§ 482, the language in the US Model Tax Treaty, the language in most US tax treaties, and the transfer pricing guidelines issued by the OECD.[2] In *Xilinx v Commissioner*, the Tax Court did agree with this principle. However, on appeal, the Ninth Circuit initially chose to disregard that the United States Tax Court, as trier of fact, had found that an arm's length party would act as the taxpayer had, and not share certain stock-based employee compensation. In order to reach that conclusion, the Ninth Circuit called into question the arm's length standard, a result not requested by either the Commissioner or the taxpayer. After withdrawal of the original Ninth Circuit opinion, and issuance of a diametrically opposed opinion, what remains is a reassertion of the arm's length standard and some doubt as to the validity of certain portions of the recently issued cost sharing regulations.

The Tax Court and Ninth Circuit Opinions

The Tax Court Opinion

The Tax Court, in *Xilinx v Commissioner*, held that the taxpayer had established that arm's length parties would not share certain stock-based employee compensation. Xilinx provided its US workers with certain stock-based employee compensation, including non-statutory stock options, incentive stock options, and an employee stock purchase plan. When exercised, the non-statutory stock options gave rise to a deduction claimed by Xilinx under § 83(h) of the Internal Revenue Code.[3] Xilinx and its Irish subsidiary had entered into a cost sharing agreement which provided that each party was required to pay a percentage of the research and development costs for jointly-owned technology. The agreement was silent as to whether the cost of employee stock options would be shared. The IRS claimed that the amount deducted with respect to the options should have been shared with the Irish subsidiary, thereby reducing Xilinx's deduction and increasing its taxable income.[4] The taxpayer provided evidence that unrelated parties would not share the cost of such stock-based employee compensation with unrelated parties. The Tax Court held for the taxpayer based on Treasury Regulations § 1.482-1(b)(1), which requires that agreements between related parties reflect how two unrelated parties operating at arm's length would behave. The reliance on the 'arm's length' standard by the Tax Court appears well-reasoned. The transfer pricing regulations provide: "[i]n determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer."[5] The use of 'in every case' leaves no doubt that the arm's length standard is to be viewed as the governing principle of US transfer pricing.

The 27 May 2009 Ninth Circuit Opinion

The Ninth Circuit initially did not agree with the Tax Court. On 27 May 2009, in a 2-1 panel decision, the Ninth Circuit Court of Appeals reversed the Tax Court and remanded on two specific issues.[6] The Ninth Circuit Court held that, under Treasury Regulations in effect during 1997–1999, related companies engaged in a joint venture to develop intangible property must include the value of certain employee stock option compensation in the pool of costs to be shared under a cost sharing agreement, even if companies operating at arm's length would not do so. Judge Noonan dissented from this Ninth Circuit opinion. The majority held that the 'all costs requirement' of the Treasury Regulations § 1.482-7(d)(1) which provides that related companies in a cost-sharing agreement must share all costs in such arrangement was in conflict with Treasury Regulations § 1.482-1(b)(1), which requires that agreements between related parties reflect how two unrelated parties operating at arm's length would behave 'in every case'. The majority relied upon a rule of statutory construction that the specific governs the general and so concluded that the 'all costs requirement' regulations trumped the general arm's length requirement set forth in Treasury Regulations § 1.482-1(b)(1).

As Judge Noonan pointed out in his dissent to the 27 May 2009 Ninth Circuit opinion, the Treasury's Technical Explanation of the 1997 Treaty between the United States and Ireland asserted that Article 9 'incorporates in the Convention the arm's length principle in the US domestic transfer pricing provision, particularly Code section 482'.[7] The formal technical explanation of a treaty offered by the 'Government agencies charged with their negotiation and enforcement is entitled to great weight'.[8]

The 27 May 2009 Ninth Circuit opinion did not appear well-reasoned. In addition to flaws of statutory construction, the Opinion indicated, arguably in *dicta*, that the arm's length standard is not the central unifying principle of transfer pricing. Not only does this run counter to the Regulations promulgated under § 482 and the terms of the US-Ireland Tax Treaties in the years at issue, this runs contrary to the express intention of the Treasury, as set forth in the 1997 USITE and the long-standing effort by the Department of Treasury to establish the arm's length standard as the worldwide principle upon which transfer pricing is based.

The significance of the 27 May 2009 Ninth Circuit opinion is that it had taken a case focused on the issue of the proper sharing of costs between related parties in a cost sharing arrangement and issued an opinion calling into question the use of the arm's length standard, and its significance in transfer pricing and bilateral tax treaties. Looking beyond US domestic tax law, US tax treaties have adopted the 'arm's length' standard. Article IV of 1949 US-Ireland treaty, which was in force for the first two years at issue in *Xilinx*, permits an adjustment if a transaction between related companies reflects 'conditions different from those which would be made with an independent enterprise'. The 1997 US-Ireland tax treaty (which covers the third year at issue) provides in Article 9 that adjustments may be made for conditions that 'differ from those that would be made between independent enterprises'. Treasury, itself, has confirmed that the two treaties reflect the very same arm's length standards. As noted above, the current US Model Treaty, as well as its predecessor, also utilise the arm's length standard.[9]

Finally, the OECD has indicated that:[10]

> "[w]hile recognizing the foregoing considerations, the view of OECD member countries continues to be that the arm's length principle should govern the evaluation of transfer prices among associated enterprises. The arm's length principle is sound in theory since it provides the closest approximation of the workings of the open market in cases where goods and services are transferred between associated enterprises. While it may not always be straightforward to apply in practice, it does generally produce appropriate levels of income between members of MNE groups, acceptable to tax administrations. This reflects the economic realities of the controlled taxpayer's particular facts and circumstances and adopts as a benchmark the normal operation of the market ... A move away from the arm's length principle would abandon the sound theoretical basis described above and threaten the international consensus, thereby substantially increasing the risk of double taxation."

Withdrawal of the 27 May 2009 Ninth Circuit Opinion

Following the 27 May 2009 Ninth Circuit opinion, the taxpayer filed a brief requesting a rehearing. In addition, numerous amicus briefs were filed requesting a rehearing and noting errors in the 27 May Ninth Circuit opinion. On 13 January 2010, the Ninth Circuit issued an order withdrawing the 27 May 2009 Ninth Circuit opinion.[11]

The 22 March 2010 Ninth Circuit Opinion

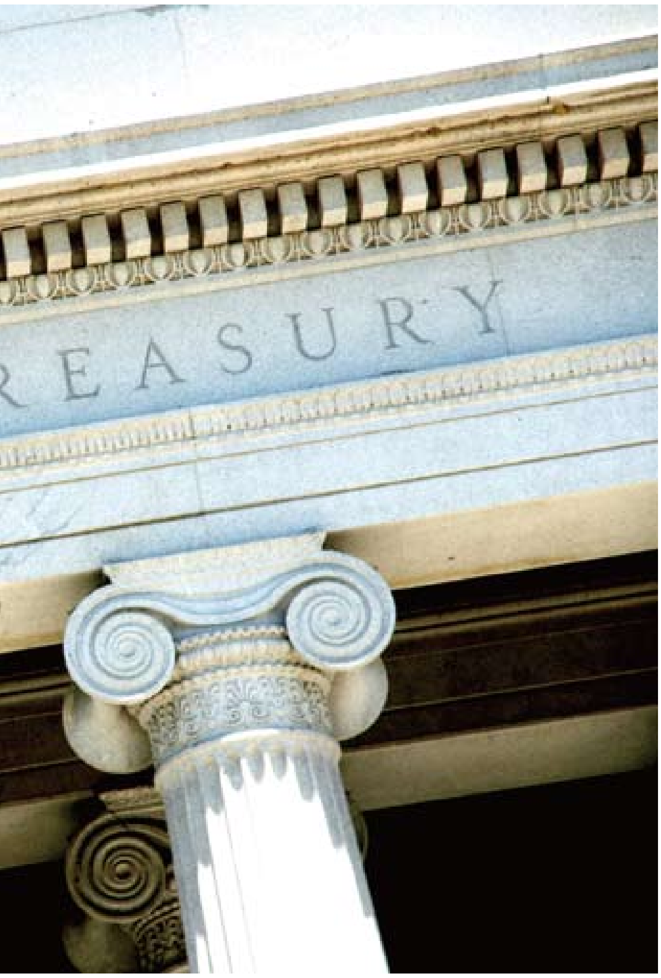
On 22 March 2010 the Ninth Circuit issued an opinion affirming the opinion of the United States Tax Court in *Xilinx Inc v Commissioner*.[12] The 22 March ruling, a 2-1 panel decision written by Judge Noonan, who had written the dissent to the 27 May 2009 Ninth Circuit opinion, relied heavily upon the Treasury Regulations under § 482 and drew support from the US-Ireland Tax Treaty and the Department of Treasury Technical Explanation thereto. Judge Fisher wrote a concurring opinion, while Judge Reinhardt dissented.

The 22 March 2010 Ninth Circuit opinion's analysis is rather brief. The main conclusion is not that there is an irreconcilable conflict between the two regulations, as the 27 May 2009 Ninth Circuit opinion had held, but that their apparent conflict creates an ambiguity regarding what is the standard for determining which costs must be shared in

an intangibles cost-sharing arrangement. This is an interesting manoeuvre around what had been described as a 'winner takes all' conflict between the two pertinent regulations. It allowed the majority to appeal to a reading of the regulations which comports with the purpose of the regulations rather than a mechanical application of the specific versus general rule of construction. The majority reasoned that the purpose of both the regulations and the statute would be undermined by allowing the 'all costs' regulation to trump the arm's length standard. It then supported its view by referencing the enshrinement of the arm's length standard in the US-Ireland Tax Treaty and concluded that the standard of interpretation which applies is the arm's length standard. Though the majority opinion did not specifically state, it suggested that the 'all costs' regulation must be applied so as to allow for the operation of the arm's length principle rather than holding that the all costs regulation is invalid. In effect, the Court applied the arm's length principle to determine which costs should be considered in applying the 'all costs' regulation.

While the 22 March Ninth Circuit opinion addresses regulations no longer in effect, in footnote 4 of the concurring opinion Judge Fisher suggests that the current regulations may not be valid. This footnote provides: "It is an open question whether these flaws have been addressed in the new regulations Treasury issued after the tax years at issue in this case. See 26 CFR § 1.482-7T(a) & (d)(1)(iii) (2009) (stating explicitly that ESOs are costs that must be shared and that the all costs requirement is an arm's length result)."

Both Judge Fisher and Judge Reinhardt appeared unimpressed with the Government's last-hour attempt on brief to harmonise the all costs requirement of the Treasury Regulations § 1.482-7(d)(1) with the arm's length standard. Judge Fisher's note suggests such an attempt may not be possible despite the *ipse dixit* of the Government in the new regulations. This presents a tempting avenue for taxpayers in the Ninth Circuit who wish to challenge the current regulations.



All Good Things are in Footnotes

As noted above, the currently effective cost sharing regulations require that a taxpayer, who is a party to a cost sharing arrangement, share stock-based employee compensation. Revisiting Judge Fisher's footnote, *Xilinx* leaves open the door open for taxpayers whose appeals may lie to the Ninth Circuit to argue that the portion of the current cost-sharing regulations explicitly requiring a sharing of stock-based employee compensation is invalid. Obviously, such an argument would be especially useful for a taxpayer who comes under audit and has not allocated stock-based employee compensation between the parties to a cost sharing arrangement.

The case appears to have also rallied support for the arm's length standard and away from mechanical allocations of costs, income or other items. As the OECD has noted: "[w]hile [the arm's length standard] may not always be straightforward to apply in practice, it does generally produce appropriate levels of income between members of MNE groups, acceptable to tax administrations."[13] Proponents of a unitary apportionment alternative to transfer pricing may argue the simplicity of such a method. But, indeed, even in such a method numerous determinations must be made, including the composition of the unitary group, what income is properly apportioned, and the sourcing of income. The Ninth Circuit opinion in *Xilinx* stands for the proposition that the arm's length principle is the guiding principle of transfer pricing and that a regulation that purports to contradict and override this principle must be harmonised with it or fail to pass muster.

Notes:

[1] *Xilinx Inc and Subsidiaries v Commissioner* 125 TC 37 (2005), *aff'd* 598 F3d 1191 (9th Cir 2009).

[2] Treasury Regulations § 1.482-1(b)(1); United States Model Income Tax Convention of 15 November 2006, Art 9; United States Model Technical Explanation Accompanying the United States Model Income Tax Convention of 15 November 2006; OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2009.

[3] Disqualifying dispositions of incentive stock options would have also given rise to the deduction under Code § 83(h).

[4] The IRS relied on Treasury Regulations Section 1.482-7. The years at issue in *Xilinx* were 1997, 1998, and 1999. On 29 July 2002, the US Department of the Treasury issued proposed regulations regarding the treatment of stock-based employee compensation and require sharing of such costs under cost-sharing arrangements. These regulations were finalised, without change, on 26 August 2003, applicable to stock-based employee compensation provided to employees in taxable years beginning on or after 26 August 2003.

[5] Treasury Regulations § 1.482-1(b)(1).

[6] *Xilinx Inc v Comm'r* 567 F3d 482 (9th Cir 2009).

[7] Slip op 6183 (quoting the Department of Treasury Technical Explanation of the 1997 United States-Ireland Tax Treaty, RIA International Tax Treaty 3095 (1997 USITE)).

[8] *US v Stuart*, 489 US 353, 368 (1989) (addressing the technical explanation to the US-Canada Tax Treaty).

[9] 2006 United States Model Income Tax Convention of 15 November 2006 Art 9; 1996 United States Model Income Tax Convention of 20 September 1996 Art 9.

[10] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2009 ¶¶ 1.13, 1.14.

[11] *Xilinx Inc v Comm'r* 592 F2d 1017 (9th Cir Cal 2010), *withdrawing* 567 F3d 482 (9th Cir 2009).

[12] *Xilinx Inc v Comm'r* 598 F3d 1191 (9th Cir 2009), *aff'g* 125 TC 37 (2005).

[13] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2009 ¶ 1.13.

Insider Trading and the United States Securities Laws

The US Government has sent a clear message that the prosecution of insider trading is a top priority for both the Department of Justice and the Securities and Exchange Commission. With a new weapon in the form of the Sarbanes-Oxley Act, the fight by prosecutors against insider trading has been eased.

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What is 'Insider Trading'?

Insider trading is not a term defined under any of the federal securities laws and can involve both legal and illegal conduct. The legal version is when corporate insiders buy and sell stock in their own companies, and do so within the confines of company policy and applicable law, without breaching any duty owed to the company. The illegal version is the focus of this article.

Although grounded in the Securities Exchange Act of 1934, as amended (the 'Exchange Act'), the term 'insider trading' and its meaning has developed primarily through civil settlements with the Securities and Exchange Commission (SEC) and through judicial case law, both civil and criminal. Two sections of the Exchange Act are relied upon in prosecutions of alleged insider trading: section 10(b), the principal federal securities anti-fraud statutory provision, including rule 10b-5 adopted by the SEC thereunder; and section 14(e), including rule 14e-3 adopted by the SEC thereunder, which specifically prohibits insider trading in the limited context of tender offers. In addition, the Sarbanes-Oxley Act of 2002 (SOX) gave prosecutors a new weapon in fighting insider trading. Section 807[1] of the SOX makes it unlawful to: (1) defraud any person in connection with any security registered under section 12 of the Exchange Act or with respect to which reports are required to be filed under section 15(d) of the Exchange Act; or (2) fraudulently obtain anything of value in connection with the purchase or sale of any such security.

Among other things, rule 10b-5 of the Exchange Act makes unlawful any act, practice or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security. As interpreted over the years by the SEC and the courts, rule 10b-5's provisions have been applied to prevent corporate 'insiders' from trading on non-public or secret information that is 'material', and which is taken from their company in violation of the trust and confidence owed by the insider to the company and its shareholders. This is generally considered to be the 'classic' theory of prohibited insider trading.[2]

Simply stated, insider trading is trading securities while in possession of material non-public information 'in breach of a duty'.

Who is an Insider?

Clearly, the term 'insider' includes officers, directors and employees of the company that issued the securities being traded (the 'Issuer'). Insiders also include those who arguably have a fiduciary relationship with the Issuer, which gives them access to material non-public information, such as bankers, auditors and counsel. These 'temporary insiders' are prohibited from trading on inside information. An 'insider' can also include securities analysts, brokers and shareholders if they come in possession of material non-public information from the company's insiders.

What Constitutes 'Material Non-public Information'?

As to 'materiality', information is material if there is a substantial likelihood that a reasonable investor would consider the information important in making his or her investment decisions. Essentially, material information is news that could reasonably be expected to affect a company's stock price – for better or worse – or the value of other securities issued by a company or other legal entity, such as debt instruments or derivative securities.

Some examples include earnings results (especially if different from the expected) and other financial or operational information, increases or decreases in dividends, acquisitions or dispositions of significant assets, including mergers or joint ventures, major litigation and government investigations or administrative proceedings, significant buy or sell orders by insiders or others who may possess inside information, and the list goes on.

When Does Non-public Information Become Public?

Information becomes public when it has been released by an Issuer or other person or authority and has been sufficiently disseminated broadly to investors in the marketplace, such as a press release being carried or published by *The Wall Street Journal*, Bloomberg Financial, Reuters, etc. Company filings with the SEC and website postings are also recognised means of dissemination of material non-public information.

Securities practitioners once considered, as a general rule of thumb, a period of 48 hours to be an acceptable period for information to become broadly disseminated. Cable news, the internet and internet forums, blogs and other means of electronic communication, including Twitter, can now make material information public in minutes rather than hours.

The 'Misappropriation' Theory

After some legal setbacks in the prosecutions of alleged insider trading, the SEC succeeded in *United States v O'Hagan*[3], in persuading the Supreme Court to extend the boundaries of fiduciary duties under a theory that the person trading 'misappropriated' the material information. This occurs when the person trading on material non-public information 'misappropriated' the information in breach of a duty owed to the source of the information. Following its *O'Hagan* success, the SEC in 2000 adopted rule 10b5-2 under the Exchange Act, which provides a non-exclusive definition of circumstances in which a person trading has a duty of trust or confidence to the Issuer whose securities are being traded.

Under this rule, this duty of trust or confidence exists whenever a person agrees, expressly or implicitly, to maintain information in confidence. However, the recent SEC attempt to prove insider trading against Mark Cuban, a prominent investor and sports team owner, ran into a roadblock in

the federal district court, in the Northern District of Texas, when the court held on 17 July 2009 that liability under the misappropriation theory requires more than breaching an agreement to keep information confidential – it also requires trading in violation of an agreement not to trade on that information.[4] However, on 21 September 2010, the Fifth Circuit Court of Appeals reversed the holding of the lower court and reinstated the SEC's insider trading charges against Cuban, remanding the case to allow the SEC an opportunity to fully develop the factual record through discovery.[5]

The misappropriation theory set forth in rule 10b5-2 also applies whenever the person communicating the material non-public information (the 'tipper') and the person to whom it is communicated (the 'tippee') have such a history or practice of sharing confidences that the recipient knows or reasonably should know that the person providing the information expects the recipient to maintain its confidentiality. Also, and not surprisingly, rule 10b5-2 covers the situation where a person received material non-public information from his or her spouse, parent, child or sibling.

'Tipper' or 'Tippee'

Under either the classical theory first discussed above or under the more recent misappropriation theory, the law holds both the 'tipper' and the 'tippee' equally liable provided the tippee has knowledge, or reasonably should have known, that the tipper was breaching a duty not to disclose the inside information. A tipper does not have to trade or make any profit to incur liability. A tipper can be liable for insider trading even if he or she makes no trade, earns no profit and avoids no losses.

A recent example comes out of the continuing prosecution of prominent hedge fund manager Raj Rajaratnam and others involved with the alleged violations in connection with the Galleon Group. One of the 14 (out of 22 charged) who already have entered a guilty plea is Robert Moffat, a former senior executive at IBM. As reported in the news, Moffat was a tipper who never traded, received no profits, and avoided no losses. Yet he pled guilty to securities fraud and conspiracy in March 2010, and on 13 September 2010 was sentenced to six months in prison and fined US$50,000.

'Pillow talk' can lead to insider trading problems. An ex-Oracle vice president, Christopher Balkenhol, used information obtained from his wife, an assistant to Oracle CEO Larry Ellison, to buy and sell stock in companies that Oracle was planning to purchase. Without admitting any wrongdoing, he settled, returning profits of more than US$97,000 and paying an additional US$100,000 in fines and interest.

Another case involved an Amgen vice-president, who told her husband about positive results with a cancer drug jointly developed with Abgenix and that Amgen might buy that company. She apparently told her husband not to buy the stock, but he did anyway and got caught.

The Martha Stewart case illustrates that inside information need not come from an insider, since it was her broker at Merrill Lynch, Doug Faneuil, who called her with information that ImClone CEO, Sam Waksal, and his family were dumping ImClone stock. Stewart, a successful business woman and prominent media personality, with her own highly rated television program, returned Faneuil's call from her private jet, which was en route to Mexico. At the end of the two-minute call, she instructed him to sell all US$228,000 of her ImClone shares at approximately US$58 per share. When the FDA notified ImClone that its cancer drug application was being denied, ImClone's stock tanked and Stewart ended up in jail.

In addition to potential criminal prosecution, a tipper, although not profiting himself or herself, may still face a civil penalty based on all of the profits made downstream by the tippees. For example, in *SEC v Jones*,[6] a defendant was an insider who tipped his brother about a pending takeover. The brother then tipped others and traded himself. Jones consented to settle the SEC's charges by agreeing to disgorge US$20,000 in trading profits made by the tippees although Jones did not trade himself. He also agreed to pay a civil fine of about US$80,000.

The New Misrepresentation Theory

The SEC last year won a case[7] against a defendant who hacked into a third party's computer system by affirmatively misrepresenting himself in order to gain access to material non-public information, which he then used to trade. The defendant allegedly hacked into a secure server of Thompson Financial Services and gained access to an unreleased earnings report about a public company. The Second Circuit Court of Appeals rejected the defendant's argument that an affirmative duty must exist between the hacker and the source of the information. Instead, the appellate court distinguished the situation where "silence is fraudulent only if there is a duty to disclose,"[8] holding that an affirmative misrepresentation did not require such a duty to exist. This new 'misrepresentation theory', if followed by other courts, could be helpful to the SEC in bringing insider trading cases involving storage of electronic information on computer systems.

Severe Penalties for Insider Trading

Individuals convicted of criminal insider trading can face up to 20 years' imprisonment per violation, criminal forfeiture and fines up to US$5 million or twice the gain from the offence, whichever is greater. In a civil action by the SEC, the penalty could be disgorgement of profits and the greater of US$1 million or three times the amount of the profit gained or loss avoided. Additionally, the SEC can bar the person from serving as an officer or director of a public company.

Civil law suits by investors (contemporaneous traders) can also be brought under section 20A of the Exchange Act against anyone trading while in possession of insider information. However, most private actions are still brought under an implied right of action for violation of rule 10b-5.

In 2009, according to a survey by a prominent international law firm, the SEC filed 35 new insider trading actions and the US Department of Justice (DOJ) brought criminal charges involving insider trading against 31 people. In addition, the DOJ and the SEC have reported that there are numerous open investigations, as has been evidenced by actions brought thus far in 2010.

More than one-third of the cases brought by the SEC, in 2009, involved three or more defendants, and nine of the SEC's cases alleged illegal profits or losses avoided of US$4 million or more. Significantly, eight of the large SEC cases involved an investment professional in some way, and more than half of these eight cases involved hedge funds. George Canellos, the SEC's current Northeast regional director, was reported by Andrew Ross Sorkin of *The New York Times*, in early January 2010, as having cautioned that: "[i]nvestment management, and especially hedge funds, is a big area of emphasis." A report in the 2 December 2009 edition of *The Wall Street Journal* noted that in the prior two months alone, the SEC issued more than three dozen subpoenas to various hedge funds.

In May 2010, according to news reports, Pequot Capital Management and its CEO, Arthur Samberg, agreed to pay nearly US$28 million, consisting of nearly US$18 million in disgorgement of trading profits and interest, and US$10 million in penalties, in order to settle SEC charges of insider trading.

The Galleon Management Case

The Galleon Management criminal prosecution involves allegations of widespread insider trading at several hedge funds, including Galleon Management LP controlled by Raj Rajaratnam, New Castle Funds LLC, Spherix Capital LLC and S2 Capital Management, LP. The DOJ has charged more than 20 individuals in this case and more than half of them have pleaded guilty. The SEC has charged more than 26 defendants in related civil proceedings; both the DOJ and the SEC report that their investigations are ongoing. Cooperating witnesses include: Roomy Kahn; Ali Far and Richard Choo Bang Lee of Spherix Capital; Ali Kumar, formerly a McKinsey director; Gautham Shankar of the Shottenfeld Group; Rajiv Goel, formerly of Intel Capital; and a number of others.

Mark Kurland, a former partner at New Castle Funds, was sentenced on 23 May 2010, to more than two years in prison and forfeiture of US$900,000 in proceeds from the alleged insider trading scheme, becoming the first person to be sentenced in the Galleon related cases. He traded on tips that Danielle Chiesi, a former consultant at New Castle Funds, allegedly received from Robert Moffat, the ex-IBM executive mentioned earlier, and others. Anil Kumar agreed to pay US$2.8 million to settle civil charges filed by the SEC. He admitted passing on confidential information about clients to Raj Rajaratnam and on 7 January 2010, he pleaded guilty to criminal fraud charges and is awaiting sentencing.

Raj Rajaratnam and Danielle Chiesi both entered not guilty pleas in the criminal case and are fighting the SEC civil charges.

Furthermore, wiretaps obtained by federal prosecutors in the Galleon investigation have led to the recent arrest of Don Chu, a consulting-firm executive. This is the first arrest in a new insider trader case which, according to some commentators, may be even larger than the Galleon prosecutions. Chu allegedly provided private information about a company's corporate earnings to a hedge fund.

Tender Offers and Insider Trading

As noted earlier, section 14(e) of the Exchange Act and rule 14e-3 thereunder specifically prohibits insider trading in the limited context of tender offers. Prohibited is the purchase or sale of a security by any person with material information about a tender offer that he or she knows or has reason to know is non-public and which has been acquired directly or indirectly from the tender offerer, the target, or any person acting on their behalf, unless the information and its source have been publicly disclosed, with ample time for market reaction before the trade. Thus, the tender offer provision attaches liability to the person trading even if there is no pre-existing relationship of trust and confidence. In other words, any person and not just insiders can be charged with a violation of section 14(e) and rule 14e-3.

Conclusion

The US Government has sent a clear message that prosecution of insider trading is and will continue to be a top priority for both the DOJ in criminal prosecutions and the SEC in its civil enforcement cases. It is imperative that all businesses which have issued securities that are publicly traded or which are in the financial services business, including brokers, banks and hedge funds, as well as accounting, law and similar service businesses, have and follow established, written and clear policies which prohibit insider trading.

Notes:

1 18 USC § 1348.
2 See *Chiarella v United States*, 445 US 222 (1980). In *Dirks v SEC*, 463 US 646, 653 (1983), the Supreme Court reiterated that insider trading requires 'the existence of a fiduciary relationship'.
3 521 US 642 (1997).
4 634 F Supp 2d 713 (ND Tex 2009).
5 *SEC v Cuban*, 2010 WL3633059, No 09-10996.
6 Civil Action No CV-09-4895 (ND CA filed 15 October 2009).
7 *SEC v Dorozhko*, 574 F 3d 42 (2d Cir 2009).
8 *Id* at 50.

Escrow Arrangements: Innovating Land Sale and Purchase Transactions in Thailand

Apisith John Sutham

Kan Ruksasook

The use of escrow arrangements provide a competitive advantage for relevant parties in the real estate business by ensuring that land sale and purchase transactions are completed smoothly and swiftly.

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The real estate business is one of the most prominent and attractive sectors in Thailand's economy. Considering the geographical areas, Thailand has charming seas, beaches and coastlines in the east and south of the country while natural green forests and mountains lie in the north and north-east region. With the harmony of natural environments, this business attracts real estate developers based in Thailand and from abroad.

Land sale and purchase transactions in the Thai market normally involve two parties, the seller and the purchaser. The main concern of the seller in these transactions is to receive payment, while that of the purchaser's is to take clean title with the transfer of land. Whether or not the transaction will be without problems and efficient depends on the knowledge and trust between the parties, which are a key considerations. This applies to the transactions between a land owner and a developer for securing a location of real estate projects, or between a developer and a customer who wishes to ensure that the project will complete as agreed. The lack of knowledge of the credibility of the other party can also delay the completion of a transaction, as neither party can be sure that the other will duly perform its obligations. In other words, without the intervention of a third party, there may be a risk that one party will default on the agreed transaction.

The Escrow Act

The concept of an escrow arrangement is adopted to mitigate the risk of default by allowing a neutral third party to retain the payment and/or documents or properties, until certain conditions of the transaction are achieved. This allows both parties to the transaction to disentangle themselves from the uncertainty that the other party will not perform their obligations. On 20 February 2008, the Escrow Act BE 2551 (2008) (the 'Act') was published in the Government Gazette of Thailand; the Act became effective on 20 May 2008.

Pursuant to section 3 of the Act, the escrow business means 'a business of acting as an agent to oversee payment of debts of the contractual parties so that it is in accordance with that agreed in the escrow agreement, by operating same as a normal course of business and receiving remunerations or service fees in return'. Section 10 of the Act[1] clearly prescribes that an escrow agent must be a financial institution (ie a commercial bank, a finance company, or a specific purposed bank) or a permitted juristic person; the escrow agent must have the appropriate license from the Ministry of Finance to perform its function.

As per section 5 of the Act,[2] the seller and the purchaser of a land sale and purchase transaction, collectively referred to as the 'contractual parties', may voluntarily appoint a neutral third party to be an escrow agent. Noteworthy is the fact that the escrow agreement must be agreed upon by the contractual parties. If one party declines to enter into an escrow agreement, the other party cannot compel the declining party to do so.

Essentially, the escrow agent functions as the arranger and executor of the escrow agreement, setting out the obligations each party must perform by using an escrow account, which holds the payment to the seller. Through the presence of the escrow agent, transactions can be completed smoothly and swiftly, and the parties do not require comprehensive knowledge of, or trust from each other. The seller can readily transfer the title of the land without reservation and distress, that the purchaser will not make payment, since the payment is held in the escrow account. Similarly, the purchaser can trust that its payment will result in the receipt of the land ownership transfer.

The escrow agreement must be made in writing. The written agreement must contain the stipulated particulars such as: the names of the contractual parties, the date of the agreement, the name of the underlying agreement between the contractual parties, the period or condition of the transfer of land and/or delivery of title deed and payment, the obligations of the contractual parties and the amount of the escrow fee. Upon the contractual parties entering into the escrow agreement, the escrow agent must open an escrow account for the contractual parties and deposit the purchaser's payment into such an account. This process must be done within one day. Upon payment of the deposit, the escrow agent must issue a certificate of depository to the purchaser and also inform the seller of receipt of such deposit.

Pursuant to the Act, the contractual parties will share the cost of the relevant escrow fee, unless agreed otherwise. The escrow agent is prohibited from deducting any amount from the money deposited in the escrow account in payment of service fees. The service fee for an escrow arrangement cannot exceed 0.3% of the money deposited under the escrow account per year.

Land Transfer Prohibition under the Escrow Act

In practice, the land office has prescribed the procedure for the land transfer prohibition under the Act as follows:

Notice of Escrow Arrangement

Where the land to be transferred under the escrow agreement is land having a certificate of rights in such land, eg a title deed or a certificate of use, the escrow agent, by virtue of the Act, must then provide notice to the relevant land official and request the land official to record that the sale of land is subject to an escrow agreement, and no transfer of ownership will be made until the land official is notified by the escrow agent in writing that such transfer is permissible or otherwise.

Inspection of Documents and Record of Land Transfer Prohibition

Upon receipt of notice, the land official will examine the relevant documents with respect to the land under the escrow agreement, as well as the legitimacy of the escrow agent, ie checking escrow business license, escrow agreement, etc. Following that, the land official will then record in the land register particulars on the title deed or the certificate of use thereof that: "It is prohibited to transfer the rights relating to this land in accordance with Section 17 of the Escrow Act BE 2551, except if the land official is informed by the escrow agent in writing. The prohibition hereto is made per the notice of the escrow agent [specify the name] no. [specify number] dated [specify date]."

The prohibition set out above will be recorded on the duplicate copy of the title deed or the certificate of use, which is kept by the land office. In Thailand, the document of title of the land is made in duplicate; the land owner and the land office keeps one copy each.

Completion of Escrow Agreement

In the event that the contractual parties fully perform their obligations as stated in the escrow agreement, the escrow agent will transfer the payment to the seller directly, while the transfer of the land ownership or possession right to the purchaser will be arranged by the escrow agent by notifying the land official to revoke the land transfer prohibition, mentioned earlier, and proceed with recording the land transfer to the purchaser.

Other Registrations to Escrowed Land under the Land Transfer Prohibition

During the term of the escrow agreement, if the land official is requested to proceed with the land registration (which is not the transfer of land ownership or possession right), for instance, lease, mortgage, or other encumbrances, such official must examine the terms and conditions of the escrow agreement before taking any action. In case of doubt whether the land registration may contravene the escrow agreement, the land official must first seek advice from the escrow agent.

Change of Escrow Agent

If the existing escrow agent forfeits its license to operate the escrow business and the escrow agreement has been assigned to another escrow agent as agreed by the contractual parties, the existing escrow agent must inform the land official of such change so that the land official will record it in the land register particulars accordingly.

Cancellation of Escrow Agreement

In the event that the escrow agreement is cancelled for any reason whatsoever, the escrow agent must notify the land official. Upon notice of cancellation, the land official must then revoke the land transfer prohibition and record the revocation in the land register particulars.

Conclusion

The Act provides a clear competitive advantage for relevant parties in real estate businesses, as well as a clear legal basis for escrow arrangements. As a result, it may be worthwhile to consider using an escrow agent as an alternative for boosting the efficiency of transactions and eliminating any uncertainty or risk pertaining to those transactions, during the relationship development phase. One should bear in mind, however, that although this method may be beneficial to customers of real estate projects, real estate developers choosing to utilise an escrow agent will lose control of and the ability to use down payments, which are normally 10-20% of the purchase price.

Notes:

1 Escrow Act BE 2551 (2008) s 10 para 1: The person wishing to obtain the license under s 9 must be a financial institution or other juristic person as prescribed in the Ministerial Regulations.

2 *Ibid*, s 5: In executing any reciprocal contract, the contractual parties may agree to arrange for an escrow agent by executing an escrow contract and comply with the bases prescribed in this Act.

An Invitation to Join the Inter-Pacific Bar Association

INTER-PACIFIC BAR ASSOCIATION

The Inter-Pacific Bar Association (IPBA) is an international association of business and commercial lawyers who reside or have an interest in the Asian and Pacific region. The IPBA has its roots in the region, having been established in April 1991 at an organising conference in Tokyo attended by more than 500 lawyers from throughout Asia and the Pacific. Since then it has grown to over 1400 members from 65 jurisdictions, and it is now the pre-eminent organisation in the region for business and commercial lawyers.

The growth of the IPBA has been spurred by the tremendous growth of the Asian economies. As companies throughout the region become part of the global economy they require additional assistance from lawyers in their home country and from lawyers throughout the region. One goal of the IPBA is to help lawyers stay abreast of developments that affect their clients. Another is to provide an opportunity for business and commercial lawyers throughout the region to network with other lawyers of similar interests and fields of practice.

Supported by major bar associations, law societies and other organisations throughout Asia and the Pacific, the IPBA is playing a significant role in fostering ties among members of the legal profession with an interest in the region.

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The breadth of the IPBA's activities is demonstrated by the number of specialist committees. All of these committees are active and have not only the chairs named, but a significant number of vice-chairs to assist in the planning and implementation of the various committee activities. The highlight of the year for the IPBA is its annual multi-topic four-day conference, usually held in the first week of May each year. Previous annual conferences have been held in Tokyo (twice), Sydney (twice), Taipei, Singapore (twice), San Francisco, Manila, Kuala Lumpur, Auckland, Bangkok, Vancouver, Hong Kong, New Delhi, Seoul, Bali and Beijing attracting as many as 1000 lawyers plus accompanying guests.

The IPBA has organised regional conferences and seminars on subjects such as the Practical Aspects of Intellectual Property Protection in Asia (in five cities in Europe and North America respectively) and Asian Infrastructure Development and Finance (in Singapore). The IPBA has also cooperated with other legal organisations in presenting conferences – for example on Trading in Securities on the Internet, held jointly with the Capital Market Forum.

IPBA members also receive our quarterly IPBA Journal, with the opportunity to write articles for publication. In addition, access to the online membership directory ensures that you can search for and stay connected with other IPBA members throughout the world.

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Membership in the Association is open to all qualified lawyers who are in good standing and who live in, or who are interested in, the Asia-Pacific region.

- Standard Membership ¥23,000
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- Corporate Counsel ¥11,800
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- Young Lawyers (under 30 years old) ¥6,000

Annual dues cover the period of one calendar year starting from 1 January and ending on 31 December. Those who join the Association before 31 August will be registered as a member for the current year. Those who join the Association after 1 September will be registered as a member for the rest of the current year and for the following year.

Membership renewals will be accepted until 31 March.

Selection of membership category is entirely up to each individual. If the membership category is not specified in the registration form, standard annual dues will be charged by the Secretariat.

There will be no refund of dues for cancellation of all membership categories during the effective term, nor will other persons be allowed to take over the membership for the remaining period.

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Any corporation may become a Corporate Associate of the IPBA by submitting an application form accompanied by payment of the annual subscription of (¥50,000) for the current year.

The name of the Corporate Associate shall be listed in the membership directory.

A Corporate Associate may designate one employee ('Associate Member'), who may take part in any Annual Conference, committee or other programmes with the same rights and privileges as a Member, except that the Associate Member has no voting rights at Annual or Special Meetings, and may not assume the position of Council Member or Chairperson of a Committee.

A Corporate Associate may have any number of its employees attend any activities of the Association at the member rates.

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The following restrictions shall apply to payments. Your cooperation is appreciated in meeting the following conditions.

1. Payment by credit card and bank wire transfer are accepted.
2. Please make sure that related bank charges are paid by the remitter, in addition to the dues.

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See overleaf for membership registration form

IPBA SECRETARIAT

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