ARIZONA CORPORATION COMMISSION

SECURITIES DIVISION
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October 17, 1997

Chris R. Youtz, Esq.
Sirianni & Youtz
1700 Westlake Center
1601 Fifth Avenue
Seattle, Washington 98101-1625

RE: No Action Request of Forex Investment Services Corporation and Eastern Vanguard
44-1801(22)

Dear Mr. Youtz:

The Securities Division has reviewed your "no-action" request dated August 23, 1996. The Division is denying your request.

Based upon the information set forth in your request, it appears that the investment opportunity described in your request falls within the definition of a "commodity investment contract." See A.R.S. §44-1801(6); see also A.R.S. §44-1801(3). Under the Arizona Securities Act, a commodity investment contract is a security. See §44-1801(23). Accordingly, the described transaction would need to comport with Arizona's securities laws.

Very truly yours,

Michael G. Burton, Sr.
Director of Securities

LAW OFFICES OF
SIRIANNI & YOUTZ

August 23, 1996

ARIZONA CORPORATION COMMISSION
Securities Division
234 North Central Avenue
Phoenix, Arizona 85004
Attention: Leslie Block, Associate General Counsel

RE: *No Action Letter*

Dear Ms. Block:

INTRODUCTION

On behalf of Forex Investment Services Corp. ("FISC") and Eastern Vanguard Forex, Ltd. ("Eastern Vanguard"), we request confirmation that the Securities Division will not recommend enforcement action for violation of the Securities Act of Arizona (the "Act") in connection with the sale of contracts for foreign currency, as described below, on the grounds that the sale of such contracts do not constitute the sale of a "security" under the Act and may be offered in the State of Arizona without regard to the registration and other requirements of the Act. A check in the amount of $200 is enclosed in payment of the required fee.

Eastern Vanguard is an international company that specializes in transactions involving spot market sales of foreign currency (often referred to as "forex") for the customers of various businesses world-wide. Eastern Vanguard handles transactions for businesses located in the Philippines, Singapore, Mexico, India, and the United States.

The forex market exists because of the changing value of the U. S. dollar compared to foreign currencies. Businesses and individuals buy forex contracts to protect themselves from losses that can result from changing currency values, and for investment or speculation. For example, a company doing business with Japan may buy forex contracts for Yen to insure that its profit is not lost due to currency fluctuations. A person buying a contract (taking a "long position") for Swiss francs believes that the U. S. dollar will weaken against that currency. If a person takes a "sell position" (also called a "short position") for a contract of Swiss francs, that person anticipates that the U. S. dollar will gain against that foreign currency. Unlike transactions involving futures, there is no defined date for delivery of the currency, and the contract can be closed at any time either by paying the full amount due and accepting delivery of the currency or by closing with an offsetting transaction where

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spot transaction is executed that reverses the prior long or short position in the foreign currency. See *Bank Brussels Lambert, S.A., v. Intermetals Corporation*, 779 F. Supp. 741, 743 (S.D.N.Y. 1991).

FISC'S PROPOSED BUSINESS

FISC will provide support services, which will include the maintenance of the on-site computer links to the interbank market. FISC will solicit customers who will place orders with Eastern Vanguard. Eastern Vanguard will execute orders placed by these customers.

FISC intends to obtain customers for Eastern Vanguard through three channels. First, FISC intends to offer its services to brokerage firms that want to include a spot forex component in their customers' portfolios. FISC would have no direct contact with the brokerage firms' customers, but would simply provide information to the brokerage firm and receive and forward orders to Eastern Vanguard.

Second, FISC intends to establish a telemarketing group that will solicit customers, including businesses and individuals. In the initial telephone call, a marketing representative will briefly describe the forex market and offer to send written information regarding forex to the potential customer. After written materials have been sent, the marketing representative may follow up with an additional telephone call to determine whether the person is interested in purchasing forex. If the person is interested, an appointment is made for that person to meet with a FISC representative. The marketing representatives are not permitted to solicit money or conclude agreements with potential customers over the telephone.

The potential customer will then meet with a representative of FISC either at FISC's offices or at the customer's home or business. A customer may not open an account to purchase forex without personally meeting with a representative. The representative will obtain financial information regarding the potential customer, and will review the account contract and risk disclosure documents with the potential customer.

Once the customer decides to open an account, the customer must execute the customer agreement and a risk disclosure form, which is used to describe the risks of purchasing forex contracts.

A customer must make a minimum deposit of $10,000 to open an account. The customer may purchase and sell forex contracts by calling, writing, or faxing FISC, who will arrange to have the orders executed with Eastern Vanguard. Typically, customers give discretionary trading authority to a professional trader. FISC intends to retain a professional forex trader who has had a minimum of three years of forex trading through a bank, dealer, or other institution.

This trader will be assisted by assistant traders. Each customer, of course, has the right to make trades in his or her own account. Also, customers may grant discretionary authority to traders or advisers of their own choosing, who have no relationship to FISC.

Regardless of who initiates the trade, a fixed commission is charged on all trades, as described in the written materials provided to the customers. Confirmations and statements showing the status of the account are sent directly to the customer.

The third source for customers will be solicitations directly by the traders. The traders may, if they choose, solicit customers directly, but FISC anticipates that this will be a limited source of customers. If a trader solicits a customer, the same procedures must be followed for opening an account, including an in-person interview with the potential customer.

Since sales of off-exchange forex contracts are not regulated, as discussed below, there is no specific net worth required for an individual or a business to purchase forex contracts. As a matter of business judgment, however, FISC has concluded that it will not accept customers who have a liquid net worth of less than $100,000. This requirement may be waived with respect to certain start up businesses that wish to purchase forex contracts for hedging or investment, but is not expected to be waived with respect to personal purchases by individuals.

DISCUSSION OF APPLICABLE LAW

The sale of forex contracts do not take place on exchanges, but rather through "an informal network of banks and currency dealers," such as Eastern Vanguard. *CFTC v. Frankwell Bullion Ltd.*, 904 F. Supp. 1072, 1075 (N.D.Cal. 1995). The market values for the various currencies are described through computer services which provide instantaneous details of currency transactions around the world, including TeleRate (a service of Dow Jones) and Reuters.

The informal forex market plays an important role in world commerce, and both the Treasury Department and Congress have acted to ensure that sale of contracts occurs with as little regulation as possible. For example, exclusive regulation of commodities futures lies with the Commodities Futures Trading Commission under the Commodities Exchange Act ("CEA"). When Congress amended the CEA in 1974, it was intended that the CFTC would have exclusive jurisdiction over transactions in commodities transactions. See, *SEC v. American Commodity Exchange*, 546 F. 2d 1361 (10th Cir. 1976). The 1974 amendments to the Act, however, specifically exclude from regulation "transactions in foreign currency . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade." 7 U. S. C. § 2. Accordingly, "[a]ll transactions in which foreign currency is the actual subject matter of an off-exchange contract for future delivery are exempt from the CEA," including transactions involving the general public. *Salomon Forex*, 795 F. Supp. at 776, 774-75. *Accord, Intermetals Corp.*, 779 F. Supp. at 748. *Accord, Frankwell Bullion*, 904 F. Supp. at 1075.

Congress excluded these transactions from regulation because of its agreement with the Treasury Department's concern, among other things, that additional regulation could have "an adverse impact on the usefulness and efficiency of foreign exchange markets for traders and investors." *Salomon Forex*, 795 F. Supp. at 772, *quoting* letter dated July 30, 1974, from the General Counsel of the Treasury to the Chairman of the Senate Committee on Agriculture and Forestry, U. S. Code Cong. & Admin. News 1974 at 5843.

Further, it is clear that transactions involving forex and other commodities are not securities. *E.g., Berman v. Dean Witter & Co., Inc.*, 353 F. Supp. 669, 670-71 (C.D.Cal. 1973) (futures contracts for Japanese yen did not constitute "securities" under federal securities laws). Further, the fact that a customer may give discretion to a another person to trade in the customer's account does not convert the transaction into the sale of a security. The Ninth Circuit has firmly held that discretionary commodities accounts are not securities. *Lopez v. Dean Witter Reynolds, Inc.*, 805 F.2d 880 (9th Cir. 1986); *Meyer v. Thomas & McKinnon Auchincloss Kohlmeyer, Inc.*, 686 F.2d 818 (9th Cir. 1982); *Mordaunt v. Incomco*, 686 F.2d 815 (9th Cir. 1982), *cert. denied*, 469 U.S. 1115; *Brodt v. Bache & Company*, 595 F.2d 459 (9th Cir. 1978).

The plaintiffs in these cases argued that the individual commodity accounts constituted "investment contracts" that were "securities" under the federal securities acts. The Court of Appeals in each case disagreed. In *Brodt v. Bache &*

Company, Inc., 595 F.2d 459 (9th Cir. 1979), the plaintiffs invested in a discretionary commodities account. The trial court granted summary judgment for the defendant, concluding that transactions in discretionary commodities accounts were not "securities."

The Court of Appeals examined whether the trades in the accounts were under an "investment contract" constituting a security. The court applied the now-classic definition of an investment contract set forth in *SEC v. Howey Company*, 328 U.S. 293, 301 (1946), that there be "an [1] investment of money in a [2] common enterprise with [3] profits to come solely from the efforts of others." The court in *Brodt* focused on the second of those requirements and found that discretionary commodity accounts are not "common enterprises" for the purpose of finding a security:

> This court has defined "common enterprise" as one in which the "fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties.
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> * * *
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> [I]n the instant case, the investor's return while specifically determined by the commodities market, is also clearly affected by the expertise of the person doing the trading. . . . [T]he success or failure of Bache as a brokerage house [however] does not correlate with individual investor profit or loss. On the contrary, Bache could reap large commissions for itself and be characterized as successful, while the individual accounts could be wiped out. Here, strong efforts by Bache will not guarantee a return, nor will Bache's success necessarily mean a corresponding success for Brodt. Weak efforts or failure by Bache would deprive Brodt of potential gains but will not necessarily mean that he will suffer severe losses. Thus, since there is no direct correlation on either the success or failure side, we hold that there is no common enterprise between Bache and Brodt.

595 F.2d at 460-461.

In *Mordaunt v. Incomco*, 686 F.2d 815 (9th Cir. 1982), the Ninth Circuit reversed a judgment finding that federal and state securities laws had been violated by a commodities dealer. The Court of Appeals noted that the plaintiffs were entitled to prevail only if the discretionary commodities trading accounts they opened with the dealer were "investment contracts" and therefore "securities" within the meaning of 15 U.S.C. § 77(b). The plaintiffs argued that vertical commonality existed because the success or failure of the investments collectively depended on promoter expertise. The court noted that this contention was considered and rejected in *Brodt*. "Under *Brodt*, there is no common enterprise unless there is some direct relation between the success or failure of the promoter and that of his investors. In this case, as in *Brodt*, such direct relation is lacking and concluded that no security was present. 686 F.2d at 817.

In *Svets v. Osborn Precious Metals Company, Inc.*, 1992 CCH Fed. Sec. L. Rptr. ¶ 96,877 (N.D. Cal. 1992), the defendant contacted prospective investors by telephone and persuaded them to make "a highly leveraged investment in a contract for purchase of precious metal, usually platinum, gold or silver." One of the defendants arranged for bank financing to support the loans necessary to purchase the precious metals. The investments were presented as low risk, safe, passive and highly profitable, when in fact they were inherently risky.

In examining the definition of "investment contract" as set forth in *SEC v. Howey Company*, the court there concluded that the second prong (the "common enterprise" requirement) was not met under the holding in *Brodt*. The court noted that plaintiff alleged that, in fact, the defendants could reap huge commissions while the plaintiffs could be "wiped out."

The court also held that the plaintiffs failed to satisfy the third prong of *Howey*—that profits be expected solely from the efforts of the promoter of the third party. The court found that the profits depended on the fluctuation of the market, not the managerial efforts of the defendants. Accordingly, neither the second nor third prongs of the three-part *Howey* test were met and no security was found. The court dismissed the securities claim, noting that even if there were misrepresentations, the "federal securities laws do not reach every such scheme."

Here, as well, there is no direct relationship between the success or failure of Eastern Vanguard or FISC and the success or failure of their customers. Eastern Vanguard is entitled to a flat commission for every trade placed with it whether the

customer makes money or not. Further, whether the customer makes or loses money depends on the fluctuation of the international currency market, not on Eastern Vanguard's or FISC's management skills. Thus, the proposed transactions do not constitute the sale of securities under the Securities Act of Arizona, and we request issuance of the no-action letter.

Please call me if you wish to discuss this further or need more information. Thank you for considering this request.

Very truly yours,

SIRIANNI & YOUTZ

Chris R. Youtz