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# THE EXTRATERRITORIAL REGULATION OF FOREIGN BUSINESS UNDER THE U.S. SECURITIES LAWS

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*The United States securities laws, if applied expansively, can have a great impact on securities transactions both in the United States and abroad. In this Article, the authors examine the extraterritorial application of the U.S. securities law. Most of the judicial activity in this area has been concerned with the application of the antifraud provisions of the securities laws to the regulation of the affairs of foreign individuals and businesses. In order to combat fraudulent foreign securities transactions the courts have developed very broad tests for subject matter jurisdiction. After introducing basic principles of international law, the authors analyze this extraterritorial application of the 1934 Act antifraud provisions. They then examine the application of other provisions of the securities laws to foreign transactions and argue that the broad tests developed under the antifraud provisions should not be extended to these other areas of securities regulation. The authors caution against broadly imposing U.S. regulatory provisions upon the internal operations of a foreign business already subject to the regulatory authority of its domiciliary country.*

## I. INTRODUCTION

With increasing frequency foreigners are becoming concerned with the extraterritorial application of the United States securities laws.<sup>1</sup> The American case law on this subject is focused on the application of the antifraud provisions of section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act").<sup>2</sup> In these cases the courts have developed two tests for subject matter

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The authors would like to dedicate this Article to J. Nelson Young, who recently became Professor Emeritus at the University of Illinois and who is now Professor of Law at the University of North Carolina at Chapel Hill. Professor Young taught law to Mr. Hacker when the latter was a student at Illinois. Professor Young also has been a colleague there with Professor Rotunda, with whom he coauthored CONSTITUTIONAL LAW, one of the West hornbook series.

The authors would like to thank Dean Peter Hay and Professor Francis Boyle of the University of Illinois for reading the manuscript and offering many helpful suggestions, and Clarence Krantz and Steven Stevens for their research assistance.

1. See, e.g., B. RIDER & H. FRENCH, THE REGULATION OF INSIDER TRADING 426 (1979), reviewed in Painter, Book Review, 80 COLUM. L. REV. 664 (1980); Loss, *Extraterritoriality in the Federal Securities Code*, 20 HARV. INT'L L.J. 305 (1979).

2. 15 U.S.C. § 78j(b) (1976). The provision states that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or

jurisdiction over the conduct of foreign persons. The first test is based on conduct within the United States; the second is based on effects within the United States of conduct occurring principally abroad. While some of the cases have involved aspects of both the conduct test and the effects test, the line of cases makes it clear that a court may, under proper circumstances, support subject matter jurisdiction based either on a pure conduct test or on a pure effects test.

In this Article we analyze the line of cases arising under section 10(b), and conclude that the two alternative tests developed by the courts reflect the likely intent of Congress with respect to the extra-territorial application of the federal securities laws to isolated transactions, such as fraudulent misrepresentations, that have some contact with the United States. On the other hand, we argue that the broad tests for extraterritorial application of the antifraud provisions should not apply equally to other provisions of the federal securities laws, such as the proxy rules<sup>3</sup> or the short-swing trading provisions of section 16(b).<sup>4</sup> Such a course of action would result in American securities laws regulating the ongoing, internal affairs of a foreign business.

In making this argument we first consider the extraterritorial application of the broker-dealer regulations to a foreign broker-dealer. Section 30(b) of the 1934 Act<sup>5</sup> exempts from regulation under that Act any broker-dealer that conducts its business outside the jurisdiction of the United States. In section 30(b) Congress appears to have drawn a distinction between regulations that would apply to the ongoing business affairs of a foreign broker-dealer, and provisions such as section 10(b) that apply to isolated transactions that might have an impact on the United States. In contrast to jurisdiction under section 10(b), jurisdiction under the 1934 Act over a foreign broker-dealer is based on a test that requires both essential acts within the United States *and* foreseeable effects from the conduct in question on protected United States interests.

We next turn to the extraterritorial application of section 16(b) to the insiders of a foreign corporation. Although the section 30(b) exemption would not be available for most foreign corporations that have a class of securities registered under section 12 of the 1934 Act,<sup>6</sup> the policy underlying section 30(b) should be equally applicable to the extraterritorial application of *broad*

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instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3. *Id.* § 78n; 17 C.F.R. § 240.14 (1980).

4. 15 U.S.C. § 78p(b) (1976).

5. *Id.* § 78dd(b). This section provides that:

The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.

6. *Id.* § 78l.

*regulatory provisions* such as section 16(b). Congress should be found to have intended to extend subject matter jurisdiction under the 1934 Act to regulate the ongoing, internal affairs of a foreign company only when the activities in question involve essential acts within the United States and have a foreseeable effect on United States persons or on the United States securities markets. Thus, even when conduct within the United States, standing alone, may be sufficient to support personal jurisdiction over a foreign company or its officers, directors, and principal stockholders, subject matter jurisdiction under the 1934 Act to regulate the ongoing, internal affairs of such a foreign company should require, apart from conduct, a foreseeable impact on protected United States interests.

## II. GENERAL PRINCIPLES OF EXTRATERRITORIAL APPLICATION OF DOMESTIC LAW

### A. *Subject Matter Jurisdiction*

Customary international law recognizes that domestic law has extraterritorial application only in limited circumstances. While it is difficult to summarize all of the intricacies involved, one should be aware of some of the basic principles governing a state's assertion of its jurisdiction in civil and criminal cases.

International law generally recognizes the territorial principle that a state has subject matter jurisdiction in civil cases over anything located in its territory or over the conduct of any person, including an alien, that occurs within the state's territory.<sup>7</sup> In addition, conduct abroad that produces requisite effects within the state is also considered within the subject matter jurisdiction of the state. The extraterritorial conduct and the effect must be constituent elements of the activity prescribed, and the effect of the activity must be both substantial and a direct and foreseeable or intended result of the conduct.<sup>8</sup> It

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7. *E.g.*, RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 (1965) [hereinafter cited as REST. FOR. REL.]. Section 17 provides that:

A state has jurisdiction to prescribe a rule of law

(a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and

(b) relating to a thing located, or a status or other interest localized, in its territory.

For the various recognized definitions of "territory," see *id.* §§ 11-16.

8. *See, e.g.*, *United States v. Aluminum Co.*, 148 F.2d 416, 443-44 (2d Cir. 1945); *The King v. Oliphant*, [1905] 2 K.B. 67; REST. FOR. REL., *supra* note 7, § 18, which provides:

A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if either

(a) the conduct and its effect are generally recognized as constituent elements of a crime or tort under the law of states that have reasonably developed legal systems, or

(b)(i) the conduct and its effect are constituent elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems.

For a discussion of the question of intent, see Akehurst, *Jurisdiction in International Law*, 46 BRIT. Y.B. INT'L L. 145, 155 (1975). *See generally* Rosenthal & Flowe, *A New Approach to U.S. Enforce-*

is generally accepted that jurisdiction based upon the effects of activities abroad includes within its provisions laws aimed at preventing conduct abroad that would have internal effects.

International law also recognizes a state's jurisdiction over the conduct of its nationals, wherever it may occur.<sup>9</sup> Assuming a genuine link between the national subject and the state, an individual is considered to have the nationality of the state that confers it upon him,<sup>10</sup> while a private legal entity has the nationality of the state in which it is created.<sup>11</sup> The United States usually does not rely upon this nationality principle to establish jurisdiction, although several exceptions have been made in tax,<sup>12</sup> trademark infringement, and anti-trust cases.<sup>13</sup> It is generally recognized that, unless otherwise indicated, United States statutory law applies only to conduct that occurs within the country or that produces the requisite effect within the country.<sup>14</sup>

The most widely recognized principles of international jurisdiction over criminal activities are based upon internal conduct or effects that are constituent elements of the prescribed offense. These territorial bases of criminal ju-

*ment of Antitrust Laws Against Foreign Cartels*, 6 N.C.J. INT'L L. & COM. REG. 81 (1980); Oliver, *Extraterritorial Application of United States Legislation against Restrictive or Unfair Trade Practices*, 51 AM. J. INT'L L. 380 (1957).

9. REST. FOR. REL., *supra* note 7, § 30:

(1) A state has jurisdiction to prescribe a rule of law

(a) attaching legal consequences to conduct of a national of the state wherever the conduct occurs or

(b) as to the status of a national or as to an interest of a national, wherever the thing or other subject-matter to which the interest relates is located.

(2) A state does not have jurisdiction to prescribe a rule of law attaching legal consequences to conduct of an alien outside its territory merely on the ground that the conduct affects one of its nationals.

10. *Id.* § 26 provides that "[a]n individual has the nationality of a state that confers it upon him provided there exists a genuine link between the state and the individual." See *Nottebohm Case*, [1955] I.C.J. 4 (*Liechtenstein v. Guatemala*).

11. "A corporation or other private legal entity has the nationality of the state which creates it." REST. FOR. REL., *supra* note 7, § 27. See note 86 *infra*.

12. See *Blackmer v. United States*, 284 U.S. 421 (1932). See generally RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 129, Reporter's Note (1971).

13. Compare *Steele v. Bulova Watch Co.*, 344 U.S. 280 (1952), with *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951) and *Vanity Fair Mills, Inc. v. T. Eaton Co.*, 234 F.2d 633 (2d Cir. 1956). See generally K. BREWSTER, *ANTITRUST AND AMERICAN BUSINESS ABROAD* (1958); W. FUGATE, *FOREIGN COMMERCE AND THE ANTITRUST LAWS* (2d ed. 1973); Note, *Extraterritorial Application of the Antitrust Laws*, 69 HARV. L. REV. 1452 (1956).

14. REST. FOR. REL., *supra* note 7, § 38. An example of a statute clearly indicating extraterritorial application is 28 U.S.C. § 1783 (1976) (subpoena of person in foreign country).

The RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES, *supra* note 7, asserts that a state may not extend its jurisdiction to "prescribe a rule of law attaching legal consequences to the conduct of an alien outside its territory merely on the ground that the conduct affects one of its nationals." *Id.* § 30(2) & Illustration 5. Not all nations recognize this limitation. France goes far beyond § 30 in article 14 of the French Civil Code, providing that it has jurisdiction over aliens domiciled within France or abroad who have incurred civil liability to a French national, regardless of his location. Article 14 does not require that the cause of action be connected with France. This assertion of jurisdiction has been highly criticized, but the French justify it upon a claim of the necessity of providing the high quality of French justice to national subjects, and upon the lack of a French provision establishing quasi in rem jurisdiction. Furthermore, article 15 authorizes French jurisdiction over a French national for obligations contracted by him in a foreign country, whether or not the other party is French. See generally H. STEINER & D. VAGTS, *TRANSNATIONAL LEGAL PROBLEMS* 751-52 (2d ed. 1976).

risdiction closely parallel the territorial bases of civil jurisdiction. Some countries, however, have expanded the accepted rule and claim jurisdiction over activities that produce internal effects that are not a constituent element of the crime involved.<sup>15</sup>

The nationality principle establishes criminal jurisdiction of a state over acts of its nationals abroad. International law does not require that the act be criminal under the *lex loci*.<sup>16</sup> As with civil jurisdiction based upon nationality, the United States and other common-law nations have been reluctant to exercise such extraterritorial powers. Instead, these countries tend to extend the territorial concept of criminal jurisdiction to achieve the desired result.

International law also recognizes a protective principle, allowing a state to exercise jurisdiction over any conduct occurring outside of its territory that threatens its security, such as counterfeiting of the state's currency.<sup>17</sup> Furthermore, under the universality principle any state—because of the common interest in all states—has jurisdiction to try certain crimes, such as piracy.<sup>18</sup> Related to the universality principle is the passive personality principle, stating that jurisdiction exists over aliens for criminal acts committed against nationals abroad. The *Restatement of Foreign Relations Law* expressly rejects this principle,<sup>19</sup> as do many states.<sup>20</sup>

15. Akehurst, *supra* note 8, at 153. See generally H. STEINER & D. VAGTS, *supra* note 14, at 854-931.

16. Akehurst, *supra* note 8, at 156. Some states, however, including France and Turkey, require that the act be criminal under the *lex loci*, that the crimes be serious, or that prosecution be requested by either the injured party or his government. *Id.* See generally M. WESER, CONVENTION COMMUNAUTAIRE SUR LA COMPÉTENCE JUDICIAIRE ET L'EXÉCUTION DES DÉCISIONS 99-111 (1975); Weser, *Bases of Judicial Jurisdiction in the Common Market Countries*, 10 AM. J. COMP. L. (1961).

17. REST. FOR REL., *supra* note 7, § 33:

(1) A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct outside its territory that threatens its security as a state or the operation of its governmental functions, provided the conduct is generally recognized as a crime under the law of states that have reasonably developed legal systems.

(2) Conduct referred to in Subsection (1) includes in particular the counterfeiting of the state's seals and currency, and the falsification of its official documents.

Common-law countries such as the United States and the United Kingdom usually do not exercise such jurisdiction. Thus, within the United States it is a crime to counterfeit foreign currency, 18 U.S.C. § 482 (1976), but no American law forbids counterfeiting U.S. currency abroad. REST. FOR. REL., *supra* note 7, at 93.

18. REST. FOR. REL., *supra* note 7, § 34. See also *id.*, Reporter's Note, at 97:

In addition to the slave trade, traffic in women for prostitution, traffic in narcotic drugs, and war crimes have been the subject of similar universal condemnation. However, with the possible exception of war crimes . . . universal interest in the suppression of slavery and these other crimes has not as yet been carried to the point of recognizing, either in customary law or in international agreements, the principle of universal jurisdiction that obtains in the instance of piracy.

19. *Id.*, Comment, at 88. See *id.* § 30(2), quoted in notes 8 & 9 *supra*.

20. *But cf.* The S.S. Lotus, [1927] P.C.I.J., Ser. A, No. 10 (a state is free to exercise jurisdiction as long as there is not an established norm of international law to the contrary).

Nations that subscribe to this theory could present an argument that it would apply to fraud of the type delineated in § 10(b) of the Securities Exchange Act of 1934. The act of fraud requires misrepresentation with the intent to deceive. To this extent, scienter becomes a necessary element of the crime, and the parallel to criminal law is obvious. See *IIT v. Cornfeld*, 619 F.2d 909, 921 (2d Cir. 1980).

As is readily seen, the United States in many instances does not exercise its jurisdictional power to the fullest extent allowed by customary international law. The general rule in the United States is that subject matter jurisdiction can be asserted over the extraterritorial activities of a foreign person when (1) conduct has occurred within the United States,<sup>21</sup> or (2) conduct has occurred abroad that caused a substantial and foreseeable or intended effect within the United States.<sup>22</sup>

Although the United States has the power to apply its laws to the extraterritorial activities of foreign persons under either of these principles, the first question before a United States court with respect to any particular statute is whether Congress in fact intended the provisions of the statute to be applied to the activities of foreign persons to the fullest extent allowed by international law.<sup>23</sup> The courts in the United States have considered the extraterritorial application of the 1934 Act<sup>24</sup> primarily in actions arising under section 10(b)<sup>25</sup> and rule 10b-5<sup>26</sup> of that Act, which prohibit any person from using the means and instrumentalities of United States interstate commerce to effect fraudulent transactions in securities. The courts generally have held that Congress intended the antifraud provisions of the 1934 Act to apply extraterritorially only when there has been some conduct occurring within the United States or some significant impact on United States investors or on the United States securities markets.<sup>27</sup> A mere incidental use of the means and instrumentalities of

21. See REST. FOR. REL., *supra* note 7, § 17.

22. See *id.* §§ 18, 38. See also *Strassheim v. Daily*, 221 U.S. 281, 285 (1911). The Foreign Sovereign Immunities Act of 1976 generally supersedes these rules of jurisdiction for foreign states and their agents or instrumentalities. 28 U.S.C. §§ 1330, 1332, 1441, 1602-1611 (1976). See *New England Merchants Nat'l Bank v. Iran Power Generation & Transmission Co.*, 495 F. Supp. 73 (S.D.N.Y. 1980) (Iranian assets litigation). See generally *Delaume, Long-Arm Jurisdiction Under the Foreign Sovereign Immunities Act*, 74 AM. J. INT'L L. 640 (1980).

If the relevant acts of foreigners take place outside of the territory of the United States, mere effects in the United States are insufficient to confer jurisdiction. The effects must be "substantial" and either be intended or "occur 'as a direct and foreseeable result' of that particular conduct." *Id.* at 646. See also *Akehurst, supra* note 8, at 155.

23. See *United States v. Aluminum Co.*, 148 F.2d 416, 443 (2d Cir. 1945). See also *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1980).

24. 15 U.S.C. § 78 (1976).

25. *Id.* § 78j(b).

26. 17 C.F.R. § 240.10b-5 (1980):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in 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.

27. *But see* *Thos. P. Gonzalez Corp. v. Consejo Nacional de Produccion de Costa Rica*, 614 F.2d 1247 (9th Cir. 1980); *East Europe Domestic Int'l Sales Corp. v. Terra*, 467 F. Supp. 383 (S.D.N.Y. 1979); *Carey v. National Oil Corp.*, 453 F. Supp. 1097 (S.D.N.Y. 1978), *aff'd*, 592 F.2d 673 (2d Cir. 1979).

United States commerce, however, will not support subject matter jurisdiction over an allegedly fraudulent extraterritorial transaction.

### 1. Extraterritorial Application of the Antifraud Provisions of the 1934 Act

Although subject matter jurisdiction in section 10(b) and rule 10b-5 actions depends on congressional intent, there is, unfortunately, little in the 1934 Act to guide the courts. Consequently, the courts have developed two basic tests to determine whether jurisdiction exists. If a transaction satisfies either an "effects" test or a "conduct" test, subject matter jurisdiction will be found. This section will trace the development and application of these tests as they have been applied to rule 10b-5 actions.

In *Schoenbaum v. Firstbrook*<sup>28</sup> plaintiffs alleged that an issue of stock in Canada to insiders of a Canadian company at an unfairly low price adversely affected the value and the price of the company's shares listed on the American Stock Exchange, some of which were held by resident U.S. citizens including the plaintiff. In holding that the court had subject matter jurisdiction over the violations alleged to have taken place outside the United States, the Second Circuit defined the extraterritorial reach of the 1934 Act: "We believe that Congress intended the Exchange Act to have extraterritorial application *in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities.*"<sup>29</sup>

While the *Schoenbaum* court found jurisdiction over an extraterritorial transaction in foreign securities because it affected the domestic securities market, several years later the same circuit in *Investment Properties International, Ltd. v. IOS, Ltd.*<sup>30</sup> rephrased the test:

[A]lthough the behavior of a defendant, including its connection to the United States and to the domestic securities market and exchanges, is relevant in deciding whether an extraterritorial transaction comes within the jurisdiction of the Act, the main consideration appears to be: *does the transaction have some significant impact [1] on the domestic securities market or [2] on domestic investors[?]*<sup>31</sup>

In *Leasco Data Processing Equipment Corp. v. Maxwell*<sup>32</sup> the Second Circuit developed a test applicable to an extraterritorial transaction in foreign securities traded exclusively in foreign markets. In *Leasco* a series of alleged misrepresentations about an English corporation were made in the United States to officers of a publicly held U.S. corporation that was being induced to purchase the British corporation's stock. Even though other misrepresenta-

28. 405 F.2d 200, *modified on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969). See generally Becker, *Extraterritorial Dimensions of the Securities Exchange Act*, 2 N.Y.U.J. INT'L L. & POL. 233 (1969).

29. 405 F.2d at 206 (emphasis added).

30. [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,011 (S.D.N.Y.), *aff'd mem.*, No. 71-1415 (2d Cir. 1971).

31. *Id.* at 90,735 (emphasis added).

32. 468 F.2d 1326 (2d Cir. 1972).



tions were made in England and the purchase of the shares was effected there, the court concluded that "if Congress had thought about the point, it would . . . have wished to protect an American investor if a foreigner comes to the United States and fraudulently induces him to purchase foreign securities abroad. . . ." <sup>33</sup>

The *Leasco* court noted that "[w]hen no fraud has been practiced in this country and the purchase or sale has not been made here, we would be hard pressed to find justification for going beyond *Schoenbaum*." <sup>34</sup> On the facts in *Leasco*, however, the issue did not arise. Because *Leasco* involved both significant conduct within the United States (misrepresentations in U.S. territory) and a direct impact on U.S. investors, the court was not required to decide whether one or both facts—conduct and effects—would be enough to support subject matter jurisdiction.

In *Bersch v. Drexel Firestone, Inc.* <sup>35</sup> the Second Circuit clarified the extent to which significant domestic conduct is a necessary element for jurisdiction when there is a direct impact on U.S. investors. *Bersch* was a class action brought on behalf of persons who had purchased common stock in Investors Overseas Services ("IOS"), a Canadian corporation, in a public offering abroad pursuant to an allegedly misleading prospectus. The plaintiff class included U.S. citizens who were resident both in the United States and abroad and foreigners resident abroad. The plaintiffs alleged that IOS, with the assistance of U.S. accountants and underwriters, planned the offering and partially drafted the prospectus within the United States.

The court concluded that the activities that occurred in the United States would not of themselves confer subject matter jurisdiction for the foreign plaintiffs because the activities were "merely preparatory" to the actual fraud, which was committed by placing the allegedly false prospectus in the purchaser's hands. <sup>36</sup> The court found, however, that the dispatch of misleading statements from abroad to residents in the United States to induce them to purchase foreign securities abroad would support jurisdiction for these residents. With respect to the U.S. citizens resident abroad, the court concluded that "[w]hile merely preparatory activities in the United States are not enough to trigger application of the securities laws for injury to foreigners located abroad, they are sufficient when the injury is to Americans so resident." <sup>37</sup>

Thus, in *Bersch* the court formulated the most comprehensive test to date

33. *Id.* at 1337.

34. *Id.* at 1334.

35. 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

36. *Id.* at 992. The court rejected plaintiff's argument that jurisdiction could be based on the adverse economic impact of the collapse of IOS on the domestic securities markets and on domestic investors, stating:

[T]here is subject matter jurisdiction of fraudulent acts relating to securities which are committed abroad only when these result in injury to purchasers or sellers of those securities in whom the United States has an interest, not where acts simply have an adverse effect on the American economy or American investors generally.

*Id.* at 989 (footnotes omitted).

37. *Id.* at 992.

of the application of the antifraud provisions of the 1934 Act to extraterritorial transactions in foreign securities:

We have thus concluded that the anti-fraud provisions of the federal securities laws:

(1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and

(2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but

(3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses.<sup>38</sup>

In a companion case, *IIT v. Vencap, Ltd.*,<sup>39</sup> decided the same day as *Bersch*, the Second Circuit determined, at least with respect to a U.S. defendant, that perpetration of the fraudulent acts themselves within the United States would confer jurisdiction. The court stated that it did not believe that "Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners."<sup>40</sup> The court further emphasized, however, that jurisdiction could not be based on mere preparatory activities within the United States.

The Second Circuit, in essence, has developed criteria for finding subject matter jurisdiction based on either conduct or effect in the United States, although it did not explicitly use those labels. Under the jurisdictional test in *Bersch*, a foreigner could be subject to jurisdiction under section 10(b) and rule 10b-5 if any of the investment information or materials regarding foreign securities that it transmits to U.S. citizens resident in the United States are materially misleading even though such Americans may purchase or sell the securities abroad relying on the information or materials. Similarly, in *Des Brisay v. Goldfield Corp.*<sup>41</sup> the Ninth Circuit found jurisdiction over acts that were substantially foreign in origin when they resulted in a direct adverse effect on domestic securities markets. An adverse effect on U.S. securities markets apparently will support jurisdiction regardless of whether the securities in question were those of a U.S. citizen or a foreign issuer.<sup>42</sup>

A foreigner, however, would not be subject to jurisdiction under section 10(b) and rule 10b-5 for merely transmitting allegedly misleading advisory

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38. *Id.* at 993.

39. 519 F.2d 1001 (2d Cir. 1975).

40. *Id.* at 1017. See also *SEC v. Kasser*, 548 F.2d 109 (3d Cir.), cert. denied, 431 U.S. 938 (1977), in which the court permitted the SEC to sue to enjoin allegedly fraudulent actions committed in the United States by a U.S. and a Canadian corporation against another Canadian corporation, even though the foreign corporation was the sole victim of the fraud and there were no noticeable effects of the fraud in the United States.

41. 549 F.2d 133 (9th Cir. 1977).

42. *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1336 (8th Cir. 1972).

information or materials regarding foreign securities to U.S. citizens resident abroad or to foreigners as no acts of material importance by such foreigner occurring in the United States would have significantly contributed to any injury of such persons.<sup>43</sup> If the advisory materials were prepared in the United States, though, that would be sufficient to give the court subject matter jurisdiction to the extent that the materials were sent to U.S. citizens resident abroad.<sup>44</sup> The simple act of preparing the materials in the United States, however, seemingly would not support jurisdiction over foreigners who delivered the materials abroad to other foreigners, the preparation of such materials being "merely preparatory" to the actual fraud, which occurred when the materials were delivered abroad.

The line of cases from *Schoenbaum* to *Bersch* thus indicates two primary concerns when a court is asked to give the federal securities laws extraterritorial effect. The first, articulated by *Schoenbaum*, is that the fraud must have some "effect" in the United States.<sup>45</sup> The second concern focuses on the fraudulent actions themselves. For foreign sales to U.S. citizens resident abroad or foreigners resident abroad, the *Bersch* test asks whether acts of material importance occurring in the United States contributed to, or directly caused, the alleged losses.<sup>46</sup>

*Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*<sup>47</sup> explicitly recognized that subject matter jurisdiction can be based purely on a conduct test.<sup>48</sup> In *Continental Grain*, an Australian corporation, Continental, purchased stock in another Australian corporation, Pacific Seeds, Ltd., from three vendors. The vendors were a third Australian corporation, a California corporation, and a California resident. The vendors did not inform the purchaser that a third-party supplier intended to reclaim valuable seedstock it had sold to Pacific Seeds if the corporation were sold. The vendors used the mails and telephone system in the United States to discuss the proposed purchase of the corporation and the problems concerning the seedstock, and decided not to

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43. One's potential exposure to an action by a U.S. resident for damages under rule 10b-5 has been reduced significantly by the recent decision in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), in which the United States Supreme Court held that the defendant's alleged negligence was insufficient to maintain a cause of action because rule 10b-5 required some showing of "scienter"—that is, intent to deceive, manipulate, or defraud. *But see* Hacker & Rotunda, *The Reliance on Counsel Defense in Securities Cases: Damage Actions v. Injunctive Actions*, 1 CORP. L. REV. 159 (1978).

Apart from the federal antifraud provisions, however, a negligent transmittal of allegedly misleading advisory material to a U.S. resident by a foreigner or its agents might give rise to an action in tort under state common law. *See* A. CONARD, CORPORATIONS IN PERSPECTIVE 36-39 (1976). Many states also have adopted statutory law governing securities transactions that might be applicable to such foreigners if they or their agents transmitted allegedly misleading advisory material to persons within the state. As we discuss in the next section, a state court might be able to exercise personal jurisdiction over such a foreigner pursuant to a state "long-arm" statute for an alleged violation of state common law or statutory law.

44. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

45. 405 F.2d at 206. *See* notes 28-29 and accompanying text *supra*.

46. 519 F.2d at 993.

47. 592 F.2d 409 (8th Cir. 1979).

48. *Id.* at 417.

inform the purchaser of the supplier's intentions. The contract for sale was executed in California but, apparently for tax reasons, was closed in Australia.

The court first noted that there was no measurable effect of the fraud in the United States. The sole victim of the fraudulent nondisclosure was a foreign corporation, and the securities sold were not traded on any American exchange. Therefore, the transaction had no measurable effect on the domestic securities market and had, at best, only a minimal effect in the United States.<sup>49</sup>

The Eighth Circuit, however, found the conduct occurring in the United States sufficient to establish subject matter jurisdiction:

[W]e examine the relationship between defendants' conduct in the United States and the alleged fraudulent scheme, specifically whether defendants' conduct in the United States was significant with respect to the alleged violation and whether it furthered the fraudulent scheme. The conduct in the United States cannot be "merely preparatory" and must be material, that is, "directly cause the losses."<sup>50</sup>

Applied to the defendants before the court, the Eighth Circuit found that letters and telephone calls were necessary to further the fraudulent scheme and constituted organization and completion of the fraud. Facilities of U.S. commerce were used to transmit the vendor's representatives between Australia and California. Furthermore, two of the vendors were a U.S. corporation and a U.S. resident.<sup>51</sup> Even though the ultimate effect was in Australia, the court held that the conduct in the United States was significant and constituted a fraud completed in the United States.<sup>52</sup> The court conceded that its finding of subject matter jurisdiction was based on policy considerations.<sup>53</sup> Congress explicitly provided that the federal securities laws should apply to foreign commerce to prevent the United States from becoming a base for fraudulent securities schemes.<sup>54</sup> In addition, such jurisdiction may encourage enforcement of antifraud laws internationally as well as maintain a high standard of conduct in securities transactions.<sup>55</sup> These policy considerations militated in favor of subject matter jurisdiction, even if the fraud had no effect in the United States.

The policy of not permitting the United States to become a haven for fraudulent securities transactions was also present in *SEC v. Kasser*,<sup>56</sup> in

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49. *Id.* at 415. Continental was owned by a U.S. corporation and, because of the accounting system used, the loss from the transaction would be reflected on the U.S. corporation's financial statements. The court specifically held that this effect was too remote and insubstantial to confer subject matter jurisdiction on the court. *Id.* at 417.

50. *Id.* at 420 (citations omitted).

51. *Id.* The court held, however, that the nationality of the corporation and the individual had "no independent significance for jurisdictional purposes." *Id.* at 417.

52. *Id.* at 420.

53. *Id.* at 421.

54. *Id.* See 15 U.S.C. § 77b (1976).

55. 592 F.2d at 421.

56. 548 F.2d 109 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977).

which the Third Circuit held that subject matter jurisdiction will exist if there is conduct in the United States that directly causes the fraud. In *Kasser* the sole victim of the fraud was a Canadian corporation. There was no measurable effect of the fraud in the United States. The court found, however, that conduct occurred in the United States that directly caused the victim's losses.<sup>57</sup> "We are reluctant to conclude that Congress intended to allow the United States to become a 'Barbary Coast,' as it were, harboring international securities pirates."<sup>58</sup>

These various jurisdictional principles were recently applied in *IIT v. Cornfeld*.<sup>59</sup> In *Cornfeld* the district court dismissed the complaint of the liquidators of a Luxembourg corporation against alleged U.S. and foreign defrauders and against U.S. accounting and brokerage firms that aided and abetted the fraud by certifying false financial statements and underwriting securities offerings with knowledge of the fraud. The court rejected the claim that subject matter jurisdiction existed just because a fraction of one percent of the fund holders in the investment trust were Americans.<sup>60</sup> Nor would a vague claim of a damaged ability of the United States to attract foreign investment support jurisdiction.<sup>61</sup>

Turning to a "conduct" test the court determined that, although the investment trust purchased substantial amounts of U.S. securities, this was insufficient to confer subject matter jurisdiction. To uphold jurisdiction on this ground would mean that a "foreign shareholder in any foreign corporation could bring a derivative action in this country to challenge the conduct of the foreign directors who effected the purchases."<sup>62</sup> The court further characterized the conduct of the U.S. accounting and underwriting firms, if true, as merely preparatory to the primary deception practiced on the fundholders. The essence of the complaint was that foreign directors of the investment trust looted the corporation. "Since virtually all the fundholders were foreign nationals residing in foreign countries, the deception . . . *must* have occurred outside of the United States."<sup>63</sup> The court concluded that the application of rule 10b-5 to the foreign directors would be a "totally unprecedented and unauthorized expansion of the reach" of that rule.<sup>64</sup>

The Second Circuit, however, disagreed.<sup>65</sup> Although it agreed with the district court's conclusion that the transactions' effects within the United States were insufficient to support subject matter jurisdiction,<sup>66</sup> the court, nevertheless, found the conduct within the United States a sufficient basis for jurisdic-

57. *Id.* at 115.

58. *Id.* at 116.

59. 462 F. Supp. 209 (S.D.N.Y. 1978), *modified*, 619 F.2d 909 (2d Cir. 1980).

60. *Id.* at 223 n.33.

61. *Id.*

62. *Id.* at 225. See note 86 *infra*.

63. 462 F. Supp. at 224 (emphasis in original).

64. *Id.* at 226.

65. *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980).

66. *Id.* at 917. See text accompanying notes 60-61 *supra*.

tion.<sup>67</sup> The court disagreed with the district court's characterization of the transactions. It found that several U.S. defendants were more intimately involved in the perpetration of fraud than was determined by the district court.<sup>68</sup> The court also placed greater emphasis on the trust's purchase of U.S. securities. It noted that "the American nationality of the issuer [and] the consummation of the transaction in the United States" both "pointed strongly toward applying the antifraud provisions of [the] securities laws."<sup>69</sup> The transaction was sufficient to support subject matter jurisdiction even though "the purchaser was a foreigner and the orders were transmitted from abroad."<sup>70</sup> The court rejected the idea that "foreigners engaging in security purchases in the United States are not entitled to the protection of . . . [U.S.] securities laws."<sup>71</sup>

The court went on to find subject matter jurisdiction with respect to the trust's purchases of debentures from a foreign subsidiary of a U.S. company.<sup>72</sup> The court viewed the debentures in substance as U.S. securities rather than as foreign securities.<sup>73</sup> The court distinguished *Bersch* on the ground that in this case U.S. securities were involved, a majority of the offerings occurred in the United States, U.S. underwriters were heavily involved, and much of the work was done in the United States.<sup>74</sup> Thus, the court concluded that

while many of the acts in the United States . . . were similar to those in *Bersch*, the relativity is entirely different because of the lack here of the foreign activity so dominant in *Bersch* . . . . Determination whether American activities "directly" caused losses to foreigners depends not only on how much was done in the United States but also on how much (here how little) was done abroad.<sup>75</sup>

Though a court may find subject matter jurisdiction under section 10(b) and rule 10b-5 based either upon acts of fraud that occurred in the United States or on a foreseeable effect in the United States of fraudulent conduct abroad, these two tests do not confer unlimited subject matter jurisdiction on the federal courts. The limits of subject matter jurisdiction are illustrated in the recent case of *Fidenas AG v. Compagnie Internationale Pour L'Informatique*

67. 619 F.2d at 917-18.

68. *Id.*

69. *Id.* at 918.

70. *Id.*

71. *Id.*

72. *Id.* at 919-21.

73. *Id.* at 919.

74. *Id.* at 919-20.

75. *Id.* at 920-21 (footnote omitted). The defendants also argued that the assertion of subject matter jurisdiction would "affront" Luxembourg. *Id.* at 921. The court disposed of this argument by noting:

The problem of conflict between our laws and that of a foreign government is much less when the issue is the enforcement of the anti-fraud sections of the securities laws than with such provisions as those requiring registration of persons or securities. The primary interest of Luxembourg is in the righting of a wrong done to an entity created by it. If our anti-fraud laws are stricter than Luxembourg's, that country will surely not be offended by their application. If they are weaker . . . the [plaintiffs] made their choice

. . . .

*Id.* This same theme is stressed throughout this Article.

*CII Honeywell Bull S.A.*<sup>76</sup> Three foreign dealers in commercial paper brought a section 10(b) action against other foreign corporations and individuals who allegedly issued fraudulent promissory notes. All transactions and fraudulent conduct occurred outside of the United States, and all the plaintiffs were foreign. Although some of the fraudulent notes were sold to Americans, the court found that this would not support jurisdiction when those U.S. purchasers were not parties to the suit.<sup>77</sup> The plaintiffs also charged that a United States parent corporation of one of the foreign defendants knew of the cover-up phase of the alleged fraud. The court, however, characterized this conduct, even if true, as at most secondary or ancillary conduct.<sup>78</sup> The court characterized the actions as "predominantly foreign" and therefore found no subject matter jurisdiction.<sup>79</sup> Thus, *Fidenas* indicates the limits of a "conduct" test. When all parties to an action are foreigners resident abroad, and there is no measurable effect in the United States, a court must find conduct in the United States that directly causes the losses before it can maintain subject matter jurisdiction.

## 2. Extraterritorial Application of Broker-Dealer Regulations Under Section 30(b)

Apart from the jurisdictional principles developed by the courts for application to the antifraud provisions of section 10(b), Congress specifically addressed the extraterritorial jurisdiction of the 1934 Act in section 30(b), which provides:

The provisions of this Chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.<sup>80</sup>

The SEC has not adopted any rules or regulations under section 30(b).

There are two basic conditions to the applicability of the section 30(b) exemption: that the exempt person "transact a business in securities" and that he do so "without the jurisdiction of the United States."

### (a) *Business In Securities*

The Court of Appeals for the Second Circuit in *Schoenbaum v. Firstbrook*<sup>81</sup> examined the applicability of section 30(b) and found that "while section 30(b) was intended to exempt persons conducting a business in securities

76. 606 F.2d 5 (2d Cir. 1979).

77. The court declined to rule on whether jurisdiction could be maintained if a U.S. purchaser brought the action. *Id.* at 8 n.4.

78. *Id.* at 8 (citing opinion of the trial court).

79. *Id.* at 10.

80. 15 U.S.C. § 78dd(b) (1976).

81. 405 F.2d 200, modified on other grounds, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 906 (1969). See text accompanying notes 28-29 *supra*.

through foreign securities markets from the provisions of the Act, it does not preclude extraterritorial application of the Exchange Act to persons who engage in isolated foreign transactions."<sup>82</sup> The court thus made it clear that a person must conduct a literal "business in securities" in order to come within the section 30(b) exemption. The court reasoned that Congress enacted section 30(b) to allow persons to conduct a business in securities outside the United States "without complying with the burdensome reporting requirement of the Act and without being subject to its regulatory provisions."<sup>83</sup> The exemption is not available for persons engaging in isolated transactions, as for instance nonbrokers and nondealers who make misrepresentations in violation of section 10(b) in inducing the purchase or sale of securities.<sup>84</sup>

The position taken by the court in *Schoenbaum* represents a reasonable policy distinction designed to promote the principle of comity among nations. Absent compelling circumstances, section 30(b) leaves the regulation of the internal business operations of foreign securities businesses to the authorities of the host countries, but reserves to the competence of U.S. courts adjudication of disputes over isolated events having some contact with the United States.

The courts have interpreted the section 30(b) exemption to be "limited in its application so as to exempt from the 1934 Act only brokers, dealers and banks" when they transact business outside the United States.<sup>85</sup> Thus, the exemption is not available to exempt from regulation under the 1934 Act the internal business operations of other types of foreign businesses. As will be discussed in the next section, however, the logic underlying the section 30(b) exemption seems equally applicable to other types of foreign businesses. Principles of international comity suggest that the internal business operations of foreign business in general, as distinct from isolated events that impact on the United States, should be left to the regulatory authorities of the domiciliary nation unless regulation under United States law is essential for the protection of legitimate United States interests.<sup>86</sup>

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82. 405 F.2d at 207. See also *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 526 n.21 (8th Cir. 1973).

83. 405 F.2d at 207.

84. *Finch v. Marathon Sec. Corp.*, 316 F. Supp. 1345 (S.D.N.Y. 1970). The rules and regulations promulgated by the SEC must provide expressly for their extraterritorial effect if § 30(b) is not to apply, and the purpose of such rules must be to prevent evasion of the Act. H.R. REP. NO. 792, 73d Cong., 2d Sess. 23 (1934); H.R. REP. NO. 1383, 73d Cong., 2d Sess. 28 (1934). The Commission has not promulgated any rules under § 30(b).

85. *Travis v. Anthes Imperial Ltd.*, 331 F. Supp. 797, 801 (E.D. Mo. 1971) (interpreting the phrase "business of securities").

86. See the decision of the International Court of Justice, *Barcelona Traction, Light & Power Co.* [1970] I.C.J. 3. The issue before the court was whether Belgium could exercise a right of diplomatic protection on behalf of shareholders of Belgian nationality in a corporation organized under the laws of Canada and having its primary place of business in Spain. The court held that Belgium did not have the capacity to assert a claim on behalf of Belgian shareholders of a Canadian corporation against the Spanish Government for alleged abuse of its bankruptcy jurisdiction and powers. The court stressed that unless Belgium had another independent and valid ground for jurisdiction, "the general rule of international law authorizes the national state of the company alone to make a claim." *Id.* ¶ 88. The court also expressed reservations that "competing diplo-



(b) *Without the Jurisdiction of the United States*

The Ninth Circuit, in *SEC v. United Financial Group, Inc.*,<sup>87</sup> held that "jurisdiction" as employed in section 30(b) is not defined as "territorial limits," and apparently decided that it was intended to mean subject matter jurisdiction.<sup>88</sup> The courts that have construed section 30(b) generally have followed the rule that a transaction will be deemed to have occurred within the jurisdiction of the United States only if *both* some necessary and substantial element of the transaction occurred within the United States *and* the transaction had a foreseeable effect on U.S. investors or the domestic securities markets.<sup>89</sup>

In *Kook v. Crang*,<sup>90</sup> for example, a Canadian brokerage firm extended credit to a United States resident in an amount allegedly in excess of that permitted by section 7(c) of the 1934 Act. The court, however, held that the transaction did not have sufficient contacts with the United States to defeat the section 30(b) exemption:

All the essentials of these transactions occurred without the United States. Stock of a Canadian corporation was purchased on the Toronto Exchange by a Canadian brokerage house. The orders were placed and payment received in Canada. Credit was extended and the stocks were held as collateral in Canada. Confirmation and all margin calls emanated from Canada. Whatever choice of law theory might be applied, these were Canadian transactions, and the use of the mails and telephone within the United States does not change the locale.<sup>91</sup>

Nor was the otherwise foreign transaction deprived of the exemption because the defendant maintained an office in the United States: "Certainly, the mere presence of defendant as a broker or dealer [registered under the 1934 Act] would not, without more, make its foreign transactions subject to the Act."<sup>92</sup>

In *Roth v. Fund of Funds, Ltd.*,<sup>93</sup> the defendant, a Canadian corporation based in Switzerland, was held not to be entitled to the section 30(b) exemption for purchases and sales of securities of a U.S. corporation within six months in violation of section 16(b). The Second Circuit noted that "the Fund

matic claims . . . could create an atmosphere of confusion and insecurity in international economic relations." *Id.* ¶ 96.

87. 474 F.2d 354 (9th Cir. 1973).

88. *Id.* at 357-58. *Accord*, *Bersch v. Drexel Firestone, Inc.*, [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,889, at 97,027 (S.D.N.Y. 1974). The Second Circuit panel, in affirming in part and reversing in part, did not reach this issue. 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

89. *See* text accompanying notes 90-94 *infra*.

90. 182 F. Supp. 388 (S.D.N.Y. 1960).

91. *Id.* at 390. Similarly, in *Sinva, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 48 F.R.D. 385 (S.D.N.Y. 1969), the court held that the commodity futures transactions in question were within the § 30(b) exemption because they "were between foreigners, were made in France or in Italy and were executed on the London Exchange." *Id.* at 386.

92. 182 F. Supp. at 391. *See* *UFITEC, S.A. v. Carter*, [1976-1977] FED. SEC. L. REP. (CCH) ¶ 95,874 (Cal. Ct. App. 1977).

93. 405 F.2d 421 (2d Cir. 1968), *cert. denied*, 394 U.S. 975 (1969).

bought and sold the securities in question on the New York Stock Exchange, utilizing New York City stock brokers to execute its orders to buy and sell, and made payment for the purchases through a New York bank."<sup>94</sup> Consequently, the court found that, as the transaction occurred within the United States and had a direct effect on the domestic securities markets, it could not come within the exemptive language "insofar as he transacts a business in securities without the jurisdiction of the United States."

In contrast to the expanded test governing subject matter jurisdiction under the antifraud provisions of section 10(b), which allows jurisdiction on the basis of either pure effects or pure conduct,<sup>95</sup> the section 30(b) test of extraterritorial jurisdiction requires a finding of both necessary and substantial conduct within the United States and a foreseeable effect on U.S. investors or securities markets.<sup>96</sup> The congressional purpose underlying section 30(b), as well as principles of international comity, argue against applying the expanded test for jurisdiction developed under section 10(b) to impose regulation under the 1934 Act upon the internal business operations of a foreign business that is subject to the regulatory authority of its host nation. Thus, a foreign broker-dealer should be exempt under section 30(b) from registration under the 1934 Act and from the extensive regulation of its ongoing business operations entailed by such registration, unless it conducts a necessary and substantial part of its business within the United States and its business has a foreseeable effect on United States persons or on the United States securities markets.

To illustrate, consider a foreign broker-dealer whose business involves the following contacts with the United States. Our hypothetical foreign broker-dealer maintains an arrangement with a registered U.S. broker-dealer for the execution and clearance of transactions in U.S. securities on behalf of the foreign broker-dealer's customers who are foreign persons; the foreign broker-dealer maintains custodian accounts in U.S. banks in connection with the transactions in U.S. securities; the foreign broker-dealer provides investment advisory materials and recommendations regarding foreign securities to U.S. broker-dealers; members of the foreign broker-dealer travel to the United States to discuss the U.S. broker-dealer's investment in foreign securities as a means of soliciting brokerage business; and the foreign broker-dealer mails information regarding specific foreign securities to U.S. investors pursuant to their unsolicited requests for the information.

Section 15(a)(1) of the 1934 Act<sup>97</sup> requires that all investment bro-

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94. *Id.* at 422. See *Sinva, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 48 F.R.D. 385 (S.D.N.Y. 1969), discussed in note 91 *supra*. See also *United States v. Weisscredit Banca Commercial E D'Investimenti*, 325 F. Supp. 1384 (S.D.N.Y. 1971); *In re IOS, Ltd.*, [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,637 (SEC Administrative Proceedings, March 14, 1972).

95. See text accompanying notes 14-55 *supra*.

96. See text accompanying notes 64-68 *supra*.

97. 15 U.S.C. § 78o(a)(1) (1976):

It shall be unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer which is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities

kers<sup>98</sup> or dealers,<sup>99</sup> with certain exceptions not relevant here, who "make use of the mails or of any means or instrumentalities of interstate commerce to effect any transaction in, or to induce the purchase or sale of, . . . any security otherwise than on a national securities exchange" must register with the SEC. Unlike an attempt to effect or induce a transaction, a mere incidental use of the means or instrumentalities of U.S. interstate commerce in connection with a foreign broker-dealer's conduct of a wholly extraterritorial brokerage business would not provide a basis for subject matter jurisdiction under section 15(a)(1).<sup>100</sup> Given our hypothetical set of facts the question is whether the foreign broker-dealer's additional contacts with the United States represent its engagement in the "business" of a broker-dealer within the jurisdiction of the United States so that the section 30(b) exemption is unavailable and the registration requirements of section 15(a)(1) are applicable. Under a jurisdictional test that would require both essential conduct within the United States and a foreseeable effect on U.S. investors or U.S. securities markets, none of the activities of this hypothetical foreign broker-dealer should result in a finding of subject matter jurisdiction under section 15(a)(1).

(i) Providing Investment Advisory Materials and Advice to  
U.S. Broker-Dealers

The solicitation of securities business has been viewed as an essential element of conducting business as a broker-dealer.<sup>101</sup> A foreign broker-dealer that provides investment advisory materials and advice regarding foreign securities to American broker-dealers obviously does so as a means of soliciting brokerage business in foreign securities. Thus, it might be argued that the foreign broker-dealer's conduct of business within the United States, standing alone, should be sufficient under a pure conduct test to assert subject matter jurisdiction and require registration under section 15(a)(1).

This conclusion may well be the wrong result because the foreign broker-dealer's conduct in providing materials and advice to U.S. broker-dealers would not have a foreseeable effect on U.S. investors or on the U.S. securities

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exchange) to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered in accordance with subsection (b) of this section.

98. A broker is defined in § 3(a)(4) of the 1934 Act to include "any person engaged in the business of effecting transactions in securities for the account of others . . ." *Id.* § 78c(a)(4).

99. A dealer is defined in § 3(a)(5) of the 1934 Act as any person who, in the regular course of business, purchases and sells securities for his own account. *Id.* § 78c(a)(5).

100. The court in *SEC v. United Financial Group, Inc.*, 474 F.2d 354, 357 (9th Cir. 1973), suggested that a mere incidental use of the means and instrumentalities of U.S. interstate commerce, without more, was an insufficient basis for subject matter jurisdiction under the antifraud provisions.

101. See *In re F.W. Horne & Co.*, 38 S.E.C. 104, 108 (1957); see also *SEC v. Myers*, 285 F. Supp. 743 (D. Md. 1968) (case brought under the Investment Advisers Act of 1940 §§ 201-221, 15 U.S.C. §§ 80b-1 to -21 (1976), in which the court held that solicitation of clients, whether or not successful, is an integral part of the business of an investment adviser).

markets. The SEC staff, in two "no-action" letters,<sup>102</sup> has taken the position that investment advice transmitted from abroad to U.S. public investors constitutes a use of the means and instrumentalities of U.S. interstate commerce<sup>103</sup> "to induce" the purchase or sale of a security within the meaning of section 15(a)(1). Therefore, under the SEC position a foreign broker-dealer that transmits such investment advice must register under section 15(b),<sup>104</sup> pursuant to the registration requirements of section 15(a)(1). The transmittal of such advisory materials and advice to U.S. broker-dealers, however, contemplates that the U.S. broker-dealers will use the materials and advice to solicit brokerage business from their U.S. customers. Because the solicitation of brokerage business from the public by U.S. broker-dealers is already subject to regulation by U.S. law,<sup>105</sup> the transmittal of advisory materials and advice by a foreign broker-dealer to U.S. broker-dealers, standing alone, should not be viewed as having a foreseeable effect on U.S. investors or on the U.S. securities markets. Any effect on protected U.S. interests would arise only from the U.S. broker-dealers transmitting the materials and advice to U.S. investors, conduct that is clearly subject to regulation under U.S. law. Without some clear effect on protected U.S. interests, there seems to be little reason to subject the internal business operations of a foreign broker-dealer already regulated by the domiciliary nation to overlapping and possibly conflicting regulation under U.S. law.

(ii) Unsolicited Requests for Advice Regarding Foreign Securities  
From U.S. Persons

As mentioned above, a foreign broker-dealer may be subject to registration pursuant to section 15(a)(1) if it sends advisory materials regarding specific foreign securities to investors resident in the United States. In a "no-action" letter to Hoare & Govett, Ltd.,<sup>106</sup> the SEC staff stated that such advice to U.S. investors will trigger the registration requirements notwithstanding the generality of the advice. The staff warned:

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102. SEC "No-Action" Letters to Hoare & Co. Govett, Ltd. (avail. Oct. 28, 1973) and to Wood, Mackenzie & Co. (avail. Sept. 23, 1974). A "no-action" letter is informal, interpretative legal advice by the SEC staff in which it indicates that, on the basis of certain facts stated in a letter or other communication, "the staff would not recommend that the Commission take any enforcement action." 17 C.F.R. § 200.81(a) (1980). The procedure to receive no action and interpretative letters is outlined in 36 Fed. Reg. 2600 (1971). A "no-action" letter does not operate to bind third parties. See 27 Fed. Reg. 1316, 1317 (1962). The SEC also has argued that a "no-action" letter does not even bar the Commission staff from later instituting an enforcement action against the recipient of a "no-action" letter. Brief for SEC, Abbett, Sommer & Co. v. SEC, [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 92,813 (D.C. Cir. 1970), cert. denied, 401 U.S. 974 (1971), cited in 3 H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW § 1.11, at 1-50.3 (1976); Hacker & Rotunda, *The SEC's Ectoplasmic Theory of an Issuer as Applied to Educational and Charitable Institutions, Bank Trustees, and Other Exempt Issuers*, 65 CAL. L. REV. 1181, 1202 n.106 (1977).

103. The term "interstate commerce" is defined in § 3(a)(17) of the Act, 15 U.S.C. § 78c(a)(17) (1976), to include "trade, commerce, transportation, or communication . . . between any foreign country and any State . . ."

104. *Id.* § 78o(b).

105. *Id.* § 78o(a)(1) & (2).

106. SEC "No-Action Letter" to Hoare & Govett, Ltd. (avail. Oct. 28, 1973).

The fact that the nature of the advice or solicitation is general—that is, that Hoare would not recommend specific securities, but might only mention the name of a foreign broker or dealer and indicate that foreign securities may be purchased through that foreign firm—does not appear to suggest a different result.<sup>107</sup>

The SEC staff letter suggested that the publishing of generalized information in the United States about a foreign broker-dealer and the sending of advice regarding specific foreign securities to U.S. investors upon their unsolicited request for the information might subject a foreign broker-dealer to the registration provisions of section 15(a)(1). This suggestion of the staff seems to rely on a pure conduct test for jurisdiction. By contrast, if the proper jurisdictional test for provisions such as section 15(a)(1)—provisions that impose regulations on internal business operations rather than provisions like section 10(b) relating to the prevention of fraud—requires both conduct within the United States and a foreseeable effect on U.S. investors or securities markets, then section 30(b) should exempt from registration under section 15(a)(1) a foreign broker-dealer who does no more than publish generalized information about itself in the United States and send advisory information about specific foreign securities to U.S. persons pursuant to their unsolicited request for the information. The foreign broker-dealer's conduct does not appear to have a sufficient effect on protected U.S. interests. A U.S. person who encounters generalized information about a foreign broker-dealer and who, on his or her own initiative, requests from the foreign broker-dealer advisory information about specific foreign securities has no reason to believe that the foreign broker-dealer is engaged in business in the United States and is thereby subject to regulation under U.S. law. By acting on his or her own initiative to solicit specific recommendations from a foreign broker-dealer, a U.S. person assumes the risk that the business affairs of the broker-dealer will be governed by foreign law. There should be no reason, therefore, for the United States to seek to interfere with a foreign sovereign's regulation of the internal business of its domiciliary company to protect any legitimate U.S. interests.<sup>108</sup>

(iii) The Maintenance of Clearing Arrangements With  
U.S. Broker-Dealers

A foreign broker-dealer should not become subject to jurisdiction under section 15(a)(1) just because it maintains certain custodian accounts with U.S. banks in connection with transactions in U.S. securities effected for its foreign customers through U.S. broker-dealers. These transactions have no significant impact on U.S. investors because they are effected solely on behalf of the foreign customers. Nor is there a significant impact on U.S. securities markets from the transactions as they are effected on the U.S. markets solely through regulated U.S. broker-dealers.

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107. *Id.*

108. *See* note 86 *supra*.

The SEC staff in one "no-action" letter<sup>109</sup> appeared to confirm this view, at least with respect to the foreign customers of the foreign broker-dealer. In the letter the staff agreed to take "no-action" to require registration of Sun Hung Kai Securities, Ltd. ("SHK"), a foreign broker-dealer, if SHK used Bear Stearns, a registered U.S. broker-dealer firm, to execute and clear transactions in U.S. securities for SHK's customers on a fully disclosed basis and if SHK maintained custodian accounts in U.S. banks in connection with the transactions. The staff emphasized, however, that Bear Stearns would not open any accounts for any SHK customers who were indicated to be U.S. residents or U.S. citizens abroad. This restriction is reasonable because a foreign broker-dealer's maintenance of accounts of U.S. persons for the purpose of effecting transactions in U.S. securities on U.S. markets through clearance arrangements with a U.S. broker would appear to have a sufficient effect on protected U.S. interests to justify regulation under U.S. law.

### 3. Extraterritorial Application of Section 16(b) of the 1934 Act

The tests developed by the courts for the extraterritorial application of the antifraud provisions of section 10(b) should not apply equally to all of the other provisions of the 1934 Act. The question of the extraterritorial application of any particular provision of the Act is basically one of congressional intent.<sup>110</sup> In adopting section 30(b) of the 1934 Act, Congress appears to have drawn a distinction between isolated events, such as misrepresentations by a foreign person, to which the U.S. antifraud provisions would apply, and U.S. regulation of the internal business operations of a foreign business that is subject to the regulatory jurisdiction of its host nation.<sup>111</sup> In the latter case, principles of international comity argue that U.S. law should avoid interfering in a foreign nation's regulation of the internal affairs of its domiciliary business organizations, unless there is a clear need to impose U.S. regulation in order to protect legitimate U.S. interests.<sup>112</sup> Under section 30(b) the courts, when dealing with regulations under the 1934 Act that would apply to the internal business operations of a foreign broker-dealer, have applied a jurisdictional test that requires both essential conduct within the United States and a foreseeable effect on U.S. persons or on the U.S. securities markets.<sup>113</sup> Although section 30(b) applies only to broker-dealers and banks,<sup>114</sup> the jurisdictional test developed under section 30(b) also reflects Congress' intent regarding the extraterritorial application of those provisions under the 1934 Act that would regulate the internal operations of foreign businesses, as distinct from provisions such as section 10(b), which would apply to isolated misrepresentations by a foreign person that had some contact with the United States.

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109. SEC "No-Action Letter" to Bear, Stearns & Co. (avail. Feb. 6, 1976).

110. See *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206, *modified on other grounds*, 405 F.2d 125 (2d Cir. 1968) (en banc), *cert. denied*. 395 U.S. 906 (1969).

111. *Id.* at 207.

112. See note 86 *supra*.

113. See text accompanying note 88 *supra*.

114. See text accompanying note 85 *supra*.

Section 16(b) of the 1934 Act,<sup>115</sup> when applied extraterritorially, imposes U.S. regulation on the internal affairs of a foreign business. Section 16(b) was enacted to discourage the unfair use of information in short-term trading by beneficial owners of more than ten percent of a class of equity security registered pursuant to section 12 of the 1934 Act<sup>116</sup> and by officers and directors of the issuer of such a security ("statutory insiders"). The section provides that profits realized by statutory insiders from the purchase and sale, or sale and purchase, of any equity security of the issuer, within a period of less than six months, inure to, and are recoverable by, and on behalf of, the issuer. The section applies automatically to any short-swing transactions, regardless of whether the insider in fact used inside information when effecting the transactions.<sup>117</sup>

Section 16(b) imposes automatic liability on the insider regardless of actual injury because the section is designed to assure outside investors who may wish to trade in the securities that "insiders" of the issuer who may have access to information regarding the issuer's short-term prospects will not have an advantage when trading in the market. In contrast to the antifraud provisions of section 10(b) of the 1934 Act,<sup>118</sup> it is not the purpose of section 16(b) to impose liability for damages suffered by the plaintiff-issuer or its outside stockholders resulting from an insider's unfair use of inside information. Nor is it the purpose of section 16(b) to impose liability for any unfair adverse effect on the market price of an issuer's securities resulting from the insider's short-swing transactions. Rather, when applied extraterritorially section 16(b) imposes regulation on the *internal affairs* of foreign companies that seek access to the U.S. securities markets by imposing absolute liability on their officers, directors, and principal stockholders for short-swing profits regardless of fault.<sup>119</sup>

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115. 15 U.S.C. § 78p(b) (1976):

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

116. *Id.* § 78l. See Hacker & Rotunda, *Short-Swing Profits, Section 16(b), and Nonstatutory Insiders*, 3 CORP. L. REV. 252 (1980).

117. *Cf.* Hazen, *The New Pragmatism under Section 16(b) of the Securities Exchange Act*, 54 N.C.L. REV. 1 (1975) (discussing the pragmatic trend away from an objective application of § 16(b)).

118. 15 U.S.C. § 78j(b) (1976).

119. See Hetherington, *Insider Trading and the Logic of the Law*, 1967 WIS. L. REV. 720.

Section 16(b) applies only to the officers, directors, and principal stockholders of any issuer that registers a class of its equity securities under section 12 of the 1934 Act. When such an issuer is a foreign company subject to regulation by its host nation, however, Congress arguably would not intend to impose regulation pursuant to section 16(b) unless the short-swing transactions by the insiders of the foreign company would have a foreseeable effect on U.S. persons or on the U.S. securities markets. This conclusion seems particularly true because a number of foreign countries have considered, and rejected, imposing regulations similar to section 16(b) on their domiciliary companies.<sup>120</sup>

In *Wagman v. Astle*<sup>121</sup> the lack of any foreseeable effect on protected U.S. interests led the court, in an action arising under section 16(b), to find it lacked personal jurisdiction over the insiders of a foreign corporation. *Wagman* involved an action to recover short-swing profits realized by three Canadians (officers of a Canadian corporation), who were trading in equity securities of the corporation on Canadian exchanges and in private sales in Canada. The Canadian corporation was listed on the American Stock Exchange and registered pursuant to section 12 of the 1934 Act. Defendants filed ownership reports with the SEC, as required by section 16(a), which stated defendants' changes in beneficial ownership of the securities. Defendants, however, did not do business in the United States, nor did they do any acts in the United States connected with effecting the transactions giving rise to the cause of action. Hence, jurisdiction over defendants could only be invoked if defendant's acts in Canada caused effects in the United States sufficient to make the exercise of such jurisdiction reasonable. Because the purpose of section 16(b) was not to impose liability for actual damage suffered by a private plaintiff as a result of short-swing transactions nor to protect investors from any adverse effects of such short-swing transactions on the price of securities trading in the market, the court concluded that the short-swing transactions effected by the Canadians in Canada did not have sufficient impact on any protected U.S. interests to sustain personal jurisdiction over defendants.

While the court in *Wagman* did not have to reach the question of subject matter jurisdiction, our analysis suggests that subject matter jurisdiction under section 16(b) similarly was not meant to extend to the short-swing transactions involved in *Wagman* because the transactions had no foreseeable effect on either specific U.S. persons or on the U.S. securities markets. The short-swing transactions had no foreseeable effect on any specific U.S. persons because only the foreign corporation, or its shareholders derivatively, could seek recovery under section 16(b). Even if a U.S. person were a shareholder of the foreign corporation, the purpose of section 16(b) is not to impose liability for any damage done to that shareholder. Rather, section 16(b) imposes absolute liability on corporate insiders regardless of fault in order to promote investor confidence in the integrity of the securities markets.

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120. Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn in Order to Kill the Rats,"* 52 CORNELL L.Q. 69, 70-71 (1966).

121. 380 F. Supp. 497 (S.D.N.Y. 1974).



The foreign transactions in *Wagman* likewise had no foreseeable impact on the U.S. securities markets. Assuming that securities are traded both abroad and on a U.S. exchange, one might argue that there is an indirect effect on U.S. securities markets from short-swing transactions effected abroad because U.S. investors might have less confidence in the U.S. market for a foreign corporation's securities if they feel that an insider of the corporation could have an advantage over them by trading in the corporation's securities abroad. In *Roth v. Fund of Funds, Ltd.*<sup>122</sup> such an effect was held sufficient to sustain jurisdiction under section 16(b) when short-swing transactions were carried out by foreigners on the U.S. securities markets.<sup>123</sup> When the transactions are carried out by foreigners abroad, however, the cases arising under section 10(b) suggest that the necessary impact on the U.S. markets must be far more direct, resulting in a foreseeable "diminution in the value" or price of the security traded in the U.S. securities market.<sup>124</sup> At best, any arguably adverse effect on investor confidence in the U.S. markets for a foreign corporation's securities, resulting from a foreign statutory insider's short-swing transactions effected abroad, would involve only the type of broad effect on the U.S. economy or U.S. investors in general that *Bersch* held to be insufficient to support subject matter jurisdiction over substantially extraterritorial transactions.<sup>125</sup>

## B. Jurisdiction Over the Person

### 1. Service Outside the United States

As *Wagman*<sup>126</sup> illustrates, apart from subject matter jurisdiction under the 1934 Act, a federal court must also have personal jurisdiction over the defendant. Due process limits a court's power to exercise jurisdiction over a corporate or individual defendant to those cases in which the defendant has at least "minimum contacts"<sup>127</sup> with the forum state. The minimum contacts test ensures that "the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" <sup>128</sup> Factors weighed in determining if the defendant has the minimum contacts required for personal jurisdiction include the quantity and quality of any business done in the state by the defendant, whether the contacts the defendant has have been initiated by the defendant,<sup>129</sup> and the foreseeability that an act performed by the defendant

122. 405 F.2d 421 (2d Cir. 1968) (per curiam), cert. denied, 394 U.S. 975 (1969). See Note, *Jurisdiction—Extra-Territorial Application of United States Securities Laws*, 10 COLUM. J. TRANS-NAT'L L. 150 (1971).

123. 405 F.2d at 422. See text accompanying notes 93-94 *supra*.

124. See *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 528 (8th Cir. 1973); *Schoenbaum v. Firstbrook*, 405 F.2d 200, 208-09, modified on other grounds, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 906 (1969).

125. See *Des Brisay v. Goldfield Corp.*, 549 F.2d 133, 136 n.4 (9th Cir. 1977); text accompanying notes 35-38 *supra*.

126. 380 F. Supp. 497 (S.D.N.Y. 1974).

127. *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

128. *Id.* at 316 (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940)). See also *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980); *Oswalt v. Scripto, Inc.*, 616 F.2d 191 (5th Cir. 1980).

129. See *Hanson v. Denckla*, 357 U.S. 235 (1958) (jurisdiction denied because defendant's

outside the state will have repercussions within the state.<sup>130</sup> If a court seeks to exercise personal jurisdiction over a defendant for an act not arising out of defendant's contacts with the state the defendant's contacts with the forum must be "sufficiently substantial and of such a nature as to permit" the state to force the defendant to litigate the claim in the forum.<sup>131</sup>

Section 27 of the 1934 Act authorizes the court to assert personal jurisdiction to enforce any liability under the Act by service of process "wherever the defendant may be found." In *Leasco Data Processing Equipment Corp. v. Maxwell*<sup>132</sup> the Second Circuit held that Congress intended application of section 27 to be limited only by the constraints of due process.<sup>133</sup> Thus, extraterritorial service of process may be had whenever the defendant has the requisite contacts with the state.<sup>134</sup>

The court in *Wagman*<sup>135</sup> suggested that a court is less restrained in exercising personal jurisdiction over a foreign defendant than it is in claiming subject matter jurisdiction.<sup>136</sup> The court apparently concluded that Congress had placed restrictions upon subject matter jurisdiction in addition to those imposed by due process, whereas personal jurisdiction only faces constitutional limitations. For example, when dealing with U.S. regulation of the internal affairs of a foreign business Congress probably did not intend to extend subject matter jurisdiction to the limits of due process.

In determining if a foreign defendant possesses the minimum contacts with the state necessary to subject it to personal jurisdiction it is important to distinguish between jurisdiction over acts arising out of defendant's contacts with the state, and jurisdiction over defendant for a suit unrelated to defendant's activities within the state. In the first situation personal jurisdiction will be supported by a single act by defendant within the forum state. For example, if there has been a rule 10b-5<sup>137</sup> violation by a foreign person in the United States, there will be both subject matter jurisdiction and jurisdiction over the defendant for that fraud. A U.S. court is able, then, to assert personal jurisdiction over the hypothetical foreign broker-dealer, discussed earlier in this Article,<sup>138</sup> based solely on its conduct within the United States. By contrast Congress, arguably, did not intend U.S. broker-dealer regulations to apply to such conduct by a foreign broker-dealer. Therefore, although a court

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contacts with forum state were due to decedent moving to that state after becoming defendant's customer). See also *Kulko v. Superior Ct.*, 436 U.S. 84 (1978).

130. Foreseeability alone is not a sufficient basis for jurisdiction. See 6 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1067 (Supp. 1980).

131. *Perkins v. Benguet Consol. Mining Co.*, 342 U.S. 437, 447 (1952).

132. 468 F.2d 1326 (2d Cir. 1972).

133. *Id.* at 1340.

134. See also *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446, 459 (S.D.N.Y. 1974), *modified*, 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

135. 380 F. Supp. 497 (S.D.N.Y. 1974).

136. *Id.* at 501-02.

137. 17 C.F.R. § 240.10b-5 (1980).

138. See text accompanying notes 96-97 *supra*.

might assert personal jurisdiction over such a foreign broker-dealer, the court probably would not have subject matter jurisdiction over the conduct.

If jurisdiction is sought to adjudicate a defendant's liability for an act not arising out of any contacts defendant has with the forum state, however, the contacts must be substantial. In determining if defendant's contacts are substantial enough to make it reasonable to extend jurisdiction in this situation courts appear to consider two factors: the nature and quality of the activities in the forum state and the dollar volume of business done there.<sup>139</sup> When these factors establish that defendant's business within the state forms an "integral part of. . . [its] over-all operation," personal jurisdiction will be sustained.<sup>140</sup>

Finally, personal jurisdiction arises when acts outside the state have an effect within the state.<sup>141</sup> This basis for jurisdiction will apply when the effect in the United States involves either an adverse impact on identifiable U.S. investors,<sup>142</sup> or on the U.S. securities markets.<sup>143</sup> The Second Circuit, however, has held that this basis for asserting personal jurisdiction must be applied with caution in an international context, and that at a minimum the effect within the state must occur "as a direct and foreseeable result of the conduct outside the territory."<sup>144</sup>

*Wagman v. Astle*<sup>145</sup> is the leading case considering the application of this basis for jurisdiction in the context of an action to recover section 16(b) short-swing profits for transactions effected by foreign defendants abroad. In *Wagman* the effect in the United States of such transactions was held to be too remote to sustain personal jurisdiction.<sup>146</sup> The Supreme Court's recent decision in *World-Wide Volkswagen Corp. v. Woodson*<sup>147</sup> has further clarified the degree to which conduct occurring outside the forum state must have a direct impact on the forum in order to sustain personal jurisdiction over a foreign defendant. In *World-Wide Volkswagen*, the Court held that Oklahoma could not constitutionally exercise personal jurisdiction over a New York retail automobile dealer merely because it was foreseeable that a New York resident and purchaser may move to or drive through another state. The court found that foreseeability alone is not enough. Consistent with due process, the forum state can only assert personal jurisdiction if the corporation's delivery of its product to the foreign state "is not simply an isolated occurrence, but arises

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139. *E.g.*, *Walsh v. National Seating Co.*, 411 F. Supp. 564, 573 (D. Mass. 1976).

140. *Stockwell v. Page Aircraft Maintenance, Inc.*, 212 F. Supp. 102, 105 (M.D. Ala. 1962).

141. *See generally* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 37 (1971).

142. *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446, 460-61 (S.D.N.Y. 1974), *modified*, 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

143. *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 529 (8th Cir. 1973).

144. *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1341 (2d Cir. 1972) (quoting *REST. FOR REL.*, *supra* note 7, § 18).

145. 380 F. Supp. 497 (S.D.N.Y. 1974).

146. *Id.* at 499.

147. 444 U.S. 286 (1980). *See also* *Oswalt v. Scripto, Inc.*, 616 F.2d 191 (5th Cir. 1980); *Green v. Advance Ross Elecs. Corp.*, 87 Ill. App. 3d 279, 408 N.E.2d 1007 (1980). *See generally* *Louis, The Grasp of Long Arm Jurisdiction Finally Exceeds its Reach: A Comment on World-Wide Volkswagen Corp. v. Woodson and Rush v. Savchuk*, 58 N.C.L. REV. 407 (1980).

from the efforts of the manufacturer or distributor to serve, directly or indirectly, the market for its product" in the forum state.<sup>148</sup> The forum state cannot assert personal jurisdiction unless the corporation delivers its product "with the expectation that they will be purchased by consumers in the forum State."<sup>149</sup>

## 2. Service Within the United States

Service of process on an individual officer of a foreign company who is visiting the United States would not constitute valid service on the foreign corporation unless the individual were the company's designated agent for service of process in the United States.<sup>150</sup> Assuming that the officer is not the company's agent for service of process, service on that officer would be sufficient to subject the foreign corporation to suit only if it is "doing business" in the United States such that a court may assert personal jurisdiction over it.<sup>151</sup> In such a case, however, a U.S. court presumably would uphold direct extraterritorial service of process on the foreign corporation.<sup>152</sup>

Even if the foreign officer is a designated agent for service of process, it is unclear whether a brief visit in the United States would of itself constitute a sufficient basis for the assertion of personal jurisdiction over either the corporation or the corporate official. In the past some courts have upheld assertions of in personam jurisdiction based solely on the transient presence of a defendant within the state. For instance, in *Grace v. MacArthur*,<sup>153</sup> the Federal District Court for the Eastern District of Arkansas upheld an assertion of in personam jurisdiction based on defendant's presence in the airspace over the state at the time of service of process.<sup>154</sup> *Grace* and other similar cases, however, can no longer be considered to be valid precedent for the assertion of jurisdiction based merely on presence within the state in light of the recent Supreme Court decision in *Shaffer v. Heitner*.<sup>155</sup> The *Shaffer* Court held that all assertions of jurisdiction must meet the *International Shoe* standard.<sup>156</sup> The prime factor in determining whether to allow the assertion of jurisdiction

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148. 444 U.S. at 297.

149. *Id.* at 298.

150. *E.g.*, *Vogel v. Tenneco Oil Co.*, 276 F. Supp. 1008, 1012 (D.D.C. 1967).

151. *E.g.*, *S.M. Stein Enterprises v. Irish Int'l Airlines*, 236 F. Supp. 71, 72 (E.D. Pa. 1964).

152. See text accompanying notes 137-40 *supra*.

153. 170 F. Supp. 442 (E.D. Ark. 1959).

154. *Id.* at 448.

155. 433 U.S. 186 (1977). For an excellent analysis of *Shaffer* and its implications, see Hay, *The Interrelation of Jurisdiction and Choice-of-Law in United States Conflicts Law*, 28 INT'L & COMP. L.Q. 161 (1979).

156. 433 U.S. at 212. The Court spoke in the context of a state court's exercise of jurisdiction. The same test, however, should apply to a federal court's assertion of in personam jurisdiction over foreigners. The relationship of the United States to noncitizens outside of its territory is analogous to the relationship of the individual states to nonresidents of the state seeking to assert jurisdiction. If a state's assertion of extraterritorial jurisdiction over a nonresident violates the due process clause of the fourteenth amendment, the federal court's assertion of extraterritorial jurisdiction over a noncitizen should also violate the fifth amendment. The Supreme Court has long interpreted the due process restraint of both clauses identically. J. NOWAK, R. ROTUNDA & J. YOUNG, *CONSTITUTIONAL LAW* 19, 383 (1978).

is not the presence of the defendant within the state, but rather "the relationship among the defendant, the forum, and the litigation."<sup>157</sup> The Court rejected "mechanical or quantitative evaluations of the defendant's activities in the forum" and looked to "the quality and nature of the activity in relation to the fair and orderly administration of the laws."<sup>158</sup>

Although *Shaffer* dealt with an attempted assertion of quasi in rem jurisdiction, its requirement that all assertions of jurisdiction meet the *International Shoe* standard makes its rationale applicable to any attempt to assert jurisdiction. In the context of an attempt to assert personal jurisdiction over a foreign corporate official or his corporation solely on the basis of his fortuitous presence within the United States, it would seem that the *International Shoe* standard of "fair play and substantial justice" would seldom be met. The fortuitous presence of the corporate officer in the United States because of, for example, an airline stopover at a U.S. airport does not affect the relationship between the defendant foreign corporation, the forum, and the litigation. Therefore, service on an agent making a transient appearance in the United States that is unrelated to the cause of action should not result in personal jurisdiction over a foreign business entity when, in the absence of the agent's fortuitous presence, due process strictures would prohibit the assertion of personal jurisdiction.

Similarly, although foreigners and foreign corporations frequently own property in the United States, it does not appear that quasi in rem jurisdiction should be asserted by a U.S. court to attach such property if the cause of action is unrelated to the property.<sup>159</sup> Under the *Shaffer* rationale, whenever it would appear unlikely that a court could sustain personal jurisdiction over a foreign officer or his corporation, it would be equally unlikely that a court could seek to attach the corporation's property located in the United States.<sup>160</sup>

### III. CONCLUSION

In seeking to determine the extraterritorial reach of U.S. securities laws, a foreigner finds few guideposts. The SEC has virtually abdicated its rule-making power under the 1934 Act,<sup>161</sup> and Congress has shown no interest in moving into the vacuum.<sup>162</sup> The small number of cases in this area have focused

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157. 433 U.S. at 204.

158. *Id.*

159. *But see* *Feder v. Turkish Airlines*, 441 F. Supp. 1273 (S.D.N.Y. 1977); *Louis*, *supra* note 147, at 420 n.97.

160. If process were served on a foreign individual while he was in the United States so as to validly support personal jurisdiction over him, a U.S. court could then seek to attach that individual's assets in the United States in satisfaction of any personal liability imposed upon him.

It should be noted that the *Shaffer* Court left open the question whether the presence of defendant's property in a state would be sufficient basis for jurisdiction when no other forum is available to the plaintiff. 433 U.S. at 211 n.37.

161. 15 U.S.C. § 78dd(b) (1976). *See* Loss, *supra* note 1, at 307.

162. The proposed FEDERAL SECURITIES CODE (A.L.L., Proposed Official Draft, Mar. 15, 1978), however, has a section dealing with the problem. *See id.* § 1905. *See also* Loss, *supra* note 1. Congress has not enacted the proposed Code. As described by Professor Loss, the reporter for this project, "the draft does not attempt to anticipate more than the more common and repetitive

on the reach of the antifraud provisions of the securities laws.<sup>163</sup> We have argued that the long arm of U.S. jurisdiction in the antifraud area should not be used to support by way of analogy a similar reach for those portions of our securities laws that are aimed at regulating the internal affairs of corporations. As a matter of policy, Congress should not be deemed to have intended to extend subject matter jurisdiction in these areas unless not only essential acts are performed within the United States but also such conduct leads to a substantial and foreseeable or intended impact on protected U.S. interests.<sup>164</sup>

Foreign corporations should not be subjected to our intricate securities rules, possibly conflicting with the law of the corporation's own domicile, unless important U.S. interests are at stake. A comparison of *Bremen v. Zapata Off-Shore Oil Co.*<sup>165</sup> with *Scherk v. Alberto-Culver Co.*<sup>166</sup> well illustrates this

factual configurations. It thus allows ample room—particularly in ascertaining ‘the limits of international law’—for what Thurman Arnold used to call ‘the sporting theory of justice.’” *Id.* at 308.

A study of the proposed § 1905 is beyond the scope of this Article. Compare Karmel, *Application of the Federal Securities Code*, 7 CONN. L. REV. 669 (1975), with Curtis, *The Extraterritorial Application of the Federal Securities Code: A Further Analysis*, 9 CONN. L. REV. 67 (1976).

163. See generally B. RIDER & H. FRENCH, *supra* note 1, at 426-31.

164. The exercise of self-restraint by U.S. courts in asserting extraterritorial jurisdiction will also enhance the chances that foreign courts will recognize our judgments in those cases in which we do assert it. For example, such jurisdictional self-restraint may help avoid a situation such as the one that currently exists in the antitrust area. See generally Rosenthal & Flowe, *supra* note 8. The efforts by the United States over the years to extend the extraterritorial reach of its antitrust laws—see, e.g., *United States v. Watchmakers of Switzerland Information Center, Inc.*, [1963] Trade Cas. ¶ 70,600 (S.D.N.Y. 1962), *modified*, [1965] Trade Cas. ¶ 71,352 (S.D.N.Y. 1965); compare *United States v. Imperial Chemical Indus., Ltd.*, 100 F. Supp. 504 (S.D.N.Y. 1951), *decree entered*, 105 F. Supp. 215 (S.D.N.Y. 1952), with *British Nylon Spinners, Ltd. v. Imperial Chemical Indus., Ltd.*, [1952] 2 All. E.R. 780 (Ct. App.), [1954] 3 All. E.R. 88 (Ch.)—has led to countermeasures by other countries. See, e.g., Owles, *The Protection of Trading Interests Bill*, [1980] 4 LLOYD'S MAR. & COM. L.Q. 55 (discussing the British Protection of Trading Interests Bill). This bill's full title is “A Bill to provide protection from requirements, prohibitions and judgments imposed or given under the laws of countries outside the United Kingdom and affecting the trading or other interests of persons in the United Kingdom.” *Id.* at 56.

The British bill was in response to the decision of *Westinghouse Elec. Corp. v. Rio Algom Ltd.* (*In re Uranium Antitrust Litigation*), 617 F.2d 1248 (7th Cir. 1980), which upheld the exercise of subject matter jurisdiction in an antitrust action against various foreign and domestic uranium producers.

Australia and other countries are also considering similar retaliatory action:

Australia is preparing legislation along the line of the UK Protection of Trading Interests Act.

The Australian government is considering legislation which would enable it to seize the Australian assets of the U.S.-based Westinghouse Electric . . . . Such an action would be in retaliation for seizure of assets owned by Australian companies within the U.S.A., should Westinghouse win its \$1,000 million action against 29 U.S. and foreign uranium producers, . . . for allegedly operating a cartel outside the U.S.A. between 1973 and 1975.

The Australian legislative move follows the adoption of measures banning the recognition and enforcement of foreign judgments in antitrust proceedings. These were enacted in Australia in March 1979 at about the same time that the Protection of Trading Interests Act was passed by Parliament in the U.K. Similar legislation was proposed by the Canadian government in July 1979, and is likely to be approved by its parliament later this year. The law will replace temporary statutory measures adopted to protect Canadian enterprises against demands for evidence in the Westinghouse uranium case.

New Zealand passed similar measures in July 1979, and the 41 member states of the British Commonwealth were invited to adopt protective legislation in May, 1979.

Financial Times, European Law Letter 7 (Sept. 1980).

165. 407 U.S. 1 (1972).

166. 417 U.S. 506 (1974).

latter point.

In *Bremen* the Supreme Court upheld the validity of a provision in an international towage contract that provided that any dispute arising out of the contract would be heard before the London Court of Justice. The contract also contained two clauses purporting to exculpate the petitioner from liability for damages to the towed barges. The respondent brought suit in admiralty in the U.S. courts alleging negligent towage and breach of contract. The lower courts found the forum selection clause unenforceable, treating it as against public policy because it was an agreement in advance of a controversy for the purpose of ousting the jurisdiction of the courts. The Supreme Court disagreed, even though it conceded that forum-selection clauses are traditionally disfavored by U.S. courts. The Court reasoned that the

expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts. . . . We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts.<sup>167</sup>

The Court went on to hold the forum selection clause valid even though the English courts would likely enforce the exculpatory clauses and the U.S. courts might find such a clause to be against public policy.

*Bremen* involved a contract provision negotiated by fully competent and sophisticated businessmen in an arms length transaction. The effect of this agreement was that one party gave up the preexisting right to turn to the jurisdiction of U.S. courts and accepted the exculpatory clauses. Any public policy against forum-selection or exculpatory clauses is primarily for the benefit of the parties, who in turn ought to be able to waive this protection in circumstances such as those in *Bremen*. It is, however, a different matter if parties can contract out of a regulatory law, like rule 10b-5, because the purpose of that rule is to protect investors in general, not merely the parties. Yet in *Scherk* the Court allowed this more far-reaching escape of the reach of U.S. law. In *Scherk*, the Court enforced an arbitration clause in an international sales contract between a U.S. corporation and a German citizen. The agreement provided that arbitration would be before the International Chamber of Commerce in Paris and that Illinois law should govern. The district court, nonetheless, sought to exercise jurisdiction claiming that Scherk's fraudulent representations concerning certain trademark rights violated section 10(b) and rule 10b-5. The lower court relied on section 14 of the 1933 Act, which prohibits "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter. . . ." <sup>168</sup>

Relying on section 14, the Supreme Court had previously declined to en-

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167. 407 U.S. at 9.

168. 15 U.S.C. § 77n (1976).

force such arbitration clauses, finding them against public policy.<sup>169</sup> The Court in *Scherk*, nevertheless distinguished these earlier cases because the sales contract involved in *Scherk* "was a truly international agreement."<sup>170</sup> Unlike a case in which it is clear that U.S. law applies, the international character of the contract created uncertainty over the applicable law. It was because of this uncertainty that the parties bargained for and stipulated to the applicability of Illinois law, with any controversies or claims arising out of the agreement to be referred to arbitration before the International Chamber of Commerce in Paris. Given the importance of international commerce and trade, the U.S. courts should respect such arbitration clauses:

[U]ncertainty will almost inevitably exist with respect to any contract touching two or more countries, each with its own substantive laws and conflict-of-laws rules. A contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is, therefore, an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction. Furthermore, such a provision obviates any danger that a dispute under the agreement might be submitted to a forum hostile to the interests of one of the parties or unfamiliar with the problem area involved.

A parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate these purposes, but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages.<sup>171</sup>

If, in some circumstances, the importance of foreign trade is sufficient to counteract the policies behind section 14 of the 1933 Act and section 10(b) of the 1934 Act, then, a fortiori, foreign corporations should not be subjected to intricate U.S. securities rules regulating the internal affairs of corporations unless important U.S. interests are at stake. The difficulty of securing valid personal jurisdiction in such circumstances underscores this conclusion, for it is unlikely that Congress would have engaged in a fruitless exercise of attempting to assert subject matter jurisdiction in cases in which it is very likely that no valid personal jurisdiction could be obtained.<sup>172</sup>

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169. *E.g.*, *Wilko v. Swan*, 346 U.S. 427 (1953). Because of the provisions of § 14 of the 1933 Act, the *Wilko* Court refused to recognize the applicability of the United States Arbitration Act, 9 U.S.C. § 1 (1976), which had placed arbitration agreements on the same footing as other contracts. The *Scherk* Court, however, found the Arbitration Act applicable, distinguishing *Wilko* because the international contract in *Scherk* was not constrained by § 14. 417 U.S. at 514-20. See text accompanying note 171 *infra*.

170. 417 U.S. at 515.

171. *Id.* at 516-17.

172. The difficulty of securing proper venue in 1934 Act cases in many situations outside of the antifraud provisions also supports this conclusion.

Under § 27 of the 1934 Act, 15 U.S.C. § 78aa (1976), venue may be laid in any district where the defendant is found, is an inhabitant, transacts business, or where any act or transaction constituting the violation or the liability-creating action occurred. The Second Circuit has held, for example, that venue in an action under § 16(b) is proper in the district where the securities exchange is located, although the order to buy or sell may have been given elsewhere, if the purchase and the sale giving rise to liability were executed on the exchange. *Gratz v. Cloughton*, 187 F.2d 46, 49 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951). Moreover, venue is present for the entire § 16(b)



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claim if any of the transactions giving rise to liability occurred within the district even though not all of them did. *Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954). Thus, if any short-swing transactions were executed in the United States, venue would lie for the entire § 16(b) claim in any district where the transactions were executed. On the other hand, if none of the transactions were executed in the United States or otherwise involved any contact with the United States, venue would be appropriately set only where the defendant is found or transacts business. If the foreign corporation maintains no employees or agents in the United States, it would not be found in the United States even though it may have property there. *United Indus. Corp. v. Nuclear Corp.*, 237 F. Supp. 971, 976 (D. Del. 1964). An individual traveling in the United States might, of course, be "found" for both venue and service of process purposes.

To determine where a corporation "transacts business," it has been held that "[t]he quantum of business which must be transacted in a district to permit the laying of venue therein is less than the 'doing business' necessary to warrant a finding that the defendant is present or is to be found, in the district for jurisdictional purposes." *SEC v. Wimer*, 75 F. Supp. 955, 962 (W.D. Pa. 1948). Nevertheless, the activities within the district must constitute "a substantial part of a defendant's ordinary business [and] be continuous, and at least of some duration," and the burden is on the plaintiff to support venue. *United Indus. Corp. v. Nuclear Corp.*, 237 F. Supp. 971, 978-79 (D. Del. 1964).