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## The Extraterritorial Reach of the United States Securities Laws Towards Initial Public Offerings Conducted Over the Internet

Paul Hamilton

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# THE EXTRATERRITORIAL REACH OF THE UNITED STATES SECURITIES LAWS TOWARDS INITIAL PUBLIC OFFERINGS CONDUCTED OVER THE INTERNET

## I. INTRODUCTION

The United States securities laws were originally enacted in 1933<sup>1</sup> and 1934<sup>2</sup> to preserve and protect domestic markets.<sup>3</sup> The Securities Act of 1933 ("1933 Act") requires the filing of certain information at the time a security is issued.<sup>4</sup> The Securities Exchange Act of 1934 ("1934 Act") supplements the 1933 Act by requiring the registration of those, and other traded securities, and the periodic dissemination of information regarding these securities and their issuers.<sup>5</sup> In addition to these requirements, the

1 See Securities Act of 1933, 15 U.S.C. § 77a (1983).

2 See Securities Exchange Act of 1934, 15 U.S.C. § 78a (1983).

3 See H.R. REP. NO. 73-1383, at 1 (1934) (stating purpose of legislation was to protect investors); S. REP. NO. 73-47, at 1 (1933) (explaining purpose of Securities Act was to protect buyer); THOMAS LEE HAZEN, TREATISES ON THE LAW OF SECURITIES REGULATION § 1.2, at 7 (3d ed. 1995) (indicating that widespread speculation and fraud premised securities laws); Michael P. Coakley & Mary A. Bedikian, *De-mystifying Securities ADR: Reform and Resurgence after McMahon*, 76 MICH. B.J. 176, 178 (1997) (noting central goal behind Securities Acts of 1933 and 1934 was to protect investors); see also *Wilko v. Swan*, 346 U.S. 427, 430-31 (1953) (indicating Securities Act of 1933 was designed to protect investors); *overruled by Rodriguez de Quijas v. Shearson/ Am. Express, Inc.*, 490 U.S. 477 (1989); Harold A. Malkin, *Extraterritorial Application of United States Commodity and Securities Laws to Market Transactions in an Age of Intercontinental Trading Links*, 7 NW. J. INT'L L. & BUS. 351, 376 (1985) (protecting domestic investors from fraud is principle aim behind Securities Act of 1934); Joel Seligmen, *The Quiet Revolution: Securities Arbitration Confronts the Hard Questions*, 33 HOUS. L. REV. 327, 339 (1996) (stating purpose of Securities Act of 1933 was to protect investors).

4 See Securities Act of 1933, 15 U.S.C. § 77aa (1983). Schedule A requires specific information regarding the issuer, including the issuers name, principal place of business, the state or sovereign under which it is organized, and names and addresses of its directors, officers, and partners. *Id.*; see also Richard L. Epling & Terence W. Thompson, *Securities Disclosure in Bankruptcy*, 39 BUS. LAW. 855, 866 (1984). The Securities Act of 1933 also requires the filing of a 'record statement' containing information about the security in order to help inform investors. *Id.*; Michael McDonough, Comment, *Death in One Act: The Case for Company Registration*, 24 PEPP. L. REV. 563, 566 (1997). In addition to disclosing certain information, the Securities Act of 1933 prohibits fraud in connection with the distribution of those securities. *Id.*

5 See S. REP. NO. 73-1455, at 151 (1934). Information at the time the security is is-

1934 Act created the Securities and Exchange Commission ("SEC") which is designed to enforce the provisions of both Acts.<sup>6</sup> The goal of the 1933 and 1934 Acts is to protect American investors by requiring the registration of securities and public disclosure of information.<sup>7</sup> Although the scope of the United States anti-fraud provisions have been given a fairly limited international interpretation, the potentially expansive international reach of the antifraud provisions is problematic in terms of comity and manageable enforcement.<sup>8</sup>

A recent technological advance, compounding the unsettled expanse of the securities laws, is the Internet.<sup>9</sup> The Internet is a

sued is required to be filed by the Securities Exchange Act of 1934. *Id.* The Act also requires that there be an effective registration of any security before any member, broker, or dealer may effect a transaction on a national securities exchange with respect to such security. *Id.*; H.R. REP. NO. 88-1418, at 8 (1964). The general objective of the Securities Exchange Act of 1934 is to protect the public and investors against malpractice in the securities and financial markets by providing for the disclosure of information concerning securities listed on exchanges and for the regulation of trading securities and exchanges in over-the-counter markets. *Id.* The objective of the Securities Act of 1933 relates to truthful disclosure of information about new securities offerings. *Id.*

6 See S. REP. NO. 73-1455, at 331 (1934). The SEC has complete jurisdiction over the distribution of securities as well as all transactions in securities. *Id.*; H.R. REP. NO. 99-181, at 14 (1985). Section 14(B) of the Securities Exchange Act of 1934 grants the SEC authority to regulate broker-dealers of securities. *Id.*; H. R. REP. NO. 73-1838, at § 4(a). This section contains the precise words creating the SEC. *Id.*; see also SEC v. Kaplan, 397 F. Supp. 564, 567 (E.D.N.Y. 1975). The United States Congress created the Securities and Exchange Commission in order to have an independent regulatory body to enforce the Securities Act of 1933 and the Securities Exchange Act of 1934. *Id.*

7 See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976). The Securities Act of 1933 was designed to provide investors with full disclosure of material information concerning public offerings of securities, to protect investors against fraud and, to promote the ethical standards of honesty and fair dealing. *Id.*; SEC v. Southwest Coal & Energy Co., 624 F.2d 1312, 1318 (5th Cir. 1980). The federal securities laws were enacted to serve two separate goals, promoting and requiring sufficient disclosure of information to allow those in securities markets to make intelligent investment decisions, and controlling fraud and manipulation in the trading of securities. *Id.*; U.S. v. Carmen, 577 F.2d 556, 564 (9th Cir. 1978). The desire to compel full and fair disclosure in the issuance of securities so that investors will be adequately protected was the primary purpose of the Securities Act. *Id.*

8 See HAZEN, *supra* note 3, § 14.2, at 59 (indicating primary concern for domestic registration requirements within United States).

9 See Carolyn C. Wong, *Superhighway Swindles and On-Line Con Games*, OPEN COMPUTING, Feb. 1995, at 24 (explaining what Internet is as well as its effects on current securities laws); see also Alan J. Berkeley & John J. McDonald, *Some Background and Observations on Corporate Websites and the Federal Securities Laws*, in SECURITIES LAW FOR NONSECURITIES LAWYERS 1997, at 307, 322 (ALI-ABA Course of Study No. SC20, 1997) (noting Internet has led to major changes in federal securities laws); Thomas C. Newkirk et. al., *Recent S.E.C. Enforcement Cases*, in ADVANCED SECURITIES LAW WORKSHOP, at 429, 547 (PLI Corp. L. and Practice Course Handbook Series No. 1005, 1997) (indicating that Internet presents challenges to SEC's Enforcement Program in many areas, including offers and sales of securities over Internet, possible manipulation of securities prices through communications over news groups and various bulletin board services; 'spamming' over Internet—tactics by which investment promoters use electronic

vast expanse of information available to anyone with a modem and a computer.<sup>10</sup> There are an estimated forty million Internet users in the United States and Canada alone.<sup>11</sup> Through the Internet's World Wide Web ("Web"), investors have access to useful and sophisticated financial information previously unavailable.<sup>12</sup>

The Internet's enormous breadth and scope has seriously impacted the securities market, particularly the policies of the SEC.<sup>13</sup> For example, the SEC has approved the use of the Internet to access stock quotes and financial newsletters<sup>14</sup> as well as to access Internet bulletin boards where secondary securities market trading occurs.<sup>15</sup> The most significant impact, however,

mail to send unsolicited and misleading sales pitches to large numbers of potential investors; and foreign financial service providers using Internet to offer services to United States investors).

<sup>10</sup> See Guy Alvarez, *Using the Internet to Enhance the Practice of Law*, in WHAT THE SMALL OFFICE PRACTITIONER MUST KNOW ABOUT LEGAL RESOURCES AND CLIENT DEVELOPMENT ON THE INTERNET, at 7, 9 (PLI Corp. L. and Practice Course Handbook Series No. 1003, 1997) (describing Internet and its uses); Michael R. Arkfield, *To Intranet or Not to Intranet - That is the Question*, 33 JUNE ARIZ. ATT'Y 13, 13 (1997) (discussing tremendous growth of Internet along with its uses); Wong, *supra* note 9, at 24 (discussing use of Internet).

<sup>11</sup> See Alexander C. Gavis, *The Offering and Distribution of Securities in Cyberspace: A Review of Regulatory and Industry Initiatives*, 52 BUS. LAW. 317, 320 (1996) (describing increasing numbers of individuals using Internet); Robert A. Robertson, *Personal Investing in Cyberspace and the Federal Securities Laws*, 23 SEC. REG. L.J. 347, 349 (1996) (predicting estimated numbers of estimated Internet users by 1997); see also Victoria A. Cundiff, *Trade Secrets and the Internet: A Practical Perspective*, 14 NO. 8 COMPUTER LAW. 6, 6 (1997) (stating estimated 75 million people can access Internet worldwide with tens of millions of people in United States accessing it routinely).

<sup>12</sup> See Mary Cornaby, *Blue Sky in Deep Cyberspace: New Internet Research Resources For State Securities Law Practice*, 52 BUS. LAW. 379, 383 (1996) (discussing that Internet provides researchers with current and useful information instantly).

<sup>13</sup> See Boris Feldman & David Priebe, *Federal Securities Law and the Internet*, in FIRST ANNUAL INTERNET LAW INSTITUTE, at 435, 439 (PLI Patents, Copyrights, Trademarks, and Literary Property Course Handbook Series No. 482, 1997) (indicating that SEC gave qualified approval to brewing company to operate Internet trading mechanisms); Richard L. Field, *Survey of the Year's Developments in Electronic Cash Law and the Laws Affecting Electronic Banking in the United States*, 46 AM. U. L. REV. 967, 1013 (1997) (exemplifying convergence of Internet and securities markets when California company selling energy saving solar panels online seeks SEC approval); Stephen G. Martin, *The Convergence of Securities Law and the Internet*, 71 FLA. B.J. 46, 47 (1997) (indicating SEC approval for certain private offerings).

<sup>14</sup> Joseph F. Cella III & John Reed Stark, *SEC Enforcement and the Internet: Meeting the Challenge of the Next Millennium*, 52 BUS. LAW. 815, 816 (1997) (identifying current uses of Internet, including obtaining stock quotes and securities news); Mark A. Schiller, *An Internet Primer For Lawyers*, 68 WIS. LAW. 14, 16 (1995) (stating availability of stock quotes and mutual fund reports on Internet).

<sup>15</sup> See Real Goods Trading Corp., SEC No-Action Letter, [Current Binder] Fed. Sec. L. Rep. (CCH) Para. 77,131 at 77,226 (June 24, 1996). The SEC allowed an Internet bulletin board to be used to post the names, addresses, and telephone numbers of buyers and sellers of Real Goods Trading Corporation's stock along with relevant securities information. *Id.*; see also Recent Agency Action, *Securities Law—SEC Allows Internet-Based Trading of Securities—Real Goods Trading Corp.*, SEC No-Action Letter, 110

has been upon the SEC's approval of Initial Public Offerings ("IPO's") on the Internet.<sup>16</sup>

An IPO is the first time a company issues securities, usually common stock, to the public and is useful in raising capital.<sup>17</sup> The traditional IPO usually requires an investment bank to underwrite the offering and attract buyers.<sup>18</sup> For these services, investment banks charge a fee, starting from six to ten percent and going as high as forty percent, of the expected offering.<sup>19</sup> These high fees can cause tremendous financial loss to those companies with an unsuccessful offering.<sup>20</sup> The Internet, however, provides a more attractive medium for IPO's because it allows issuers to avoid investment bank fees while attracting the attention of a large number of potential investors.<sup>21</sup>

HARV. L. REV. 959, 959 (1997). The SEC's No-Action Letter has encouraged securities trading over Internet. *Id.*

16 See Spring Street Brewing Co., SEC No-Action Letter, [Current Binder] Fed. Sec. L. Rep. (CCH) Para. 77,201, at 77,001 (Apr. 17, 1996). In its No-Action Letter, the SEC approved the use of the Internet for IPO's under the Regulation A securities exemption. *Id.*; see also Christine K. McGlosson, *Who Needs Wall Street? The Dilemma of Regulating Securities Trading in Cyberspace*, 5 COMM. CONCEPTS 305, 309 (1997) (noting Internet is currently becoming widely used for IPO's); Lawrence E. Mitchell, *Beyond the Law and Economics Style: Advancing Corporate Law in an Era of Downsizing and Corporate Reengineering*, 84 CAL. L. REV. 1693, 1705 n.50 (1996) (book review) (arguing that many small companies will follow Spring Street Brewing Co.'s model for website trading). See, e.g., Kenneth W. Brakebill, Note, *The Application of Securities Laws in Cyberspace: Jurisdictional and Regulatory Problems Posed by Internet Securities Transactions*, 18 HASTINGS COMM. & ENT. L.J. 901, 905 (1996) (stating that Spring Street Brewing Company pioneered first IPO online and illustrated how Internet IPO can be made).

17 See Jared Silverman, *Cyberspace Offerings Raise Complex Compliance Issues*, N.J. L. J., Dec. 25, 1995, at 10 (noting IPO's over Internet are valuable for capital formation since large numbers of individuals can be notified inexpensively); see also Bruce E. Crocker, *The Initial Public Offering Process*, in HOW TO PREPARE AN INITIAL PUBLIC OFFERING, at 385, 387 (PLI Corp. L. and Practice Course Handbook Series No. 955, 1996) (describing usefulness of initial public offerings for companies). See generally Jonathan A. Koff & Michael C. Lee, *The Initial Public Offering Process*, in UNDERSTANDING THE SECURITIES LAWS, at 109, 113-16 (PLI Corp. L. and Practice Course Handbook Series No. 1012, 1997) (examining initial public offerings).

18 See McGlosson, *supra* note 16, at 306 (explaining problems that arise with traditional IPO's); Laird H. Simons III, *Considerations in Selecting the Managing Underwriter(s) for an Initial Public Offering*, in HOW TO PREPARE AN INITIAL PUBLIC OFFERING, at 23, 23 (PLI Corp. L. and Practice Course Handbook Series No. 1008, 1997) (describing underwriting process); Larry W. Sonsini et. al., *The Roles of the Parties in Preparing the Registration Statement*, in POSTGRADUATE COURSE IN FEDERAL SECURITIES LAW 1997, at 123, 128 (ALI-ABA Course of Study No. SC09, 1997) (discussing public offerings and underwriting process).

19 See McGlosson, *supra* note 16, at 306 (discussing investment banking); see also Sonsini, *supra* note 18, at 138 (discussing public offerings).

20 *Id.* (addressing disadvantages of hiring outside underwriters).

21 See Richard Raysman & Peter Brown, *Securities Offerings Over the Internet*, N.Y. L.J., June 10, 1997, at 1. Before the Internet, it was possible to make an IPO without an underwriter but it was difficult to reach a large number of investors without institutional support. *Id.* The Internet now allows IPO's, without institutional support, to reach a

The use of the Internet for IPO's implicates the United States securities laws because the Internet is a non-paper-based medium of communication<sup>22</sup> that transcends all national borders.<sup>23</sup> It has been asserted that many of the current securities laws are not suited to deal effectively with this kind of new technology because such laws do not consider trading markets other than those which use paper-based forms of communication.<sup>24</sup> In addition, it is unclear which country's laws govern online IPO's and purchases involving individuals from different countries.<sup>25</sup>

Section 5<sup>26</sup> of the 1933 Act<sup>27</sup> requires persons offering securities for sale within the jurisdiction of the United States to comply with the Act's registration requirements.<sup>28</sup> The antifraud

global audience of potential investors. *Id.*; see also Donald Langevoort, *Information Technology and the Structure of Securities Regulation*, 98 HARV. L. REV. 747, 773-74 (1985). The evolving technology, particularly the Internet, has a tremendous effect on the investment banking community. *Id.*

<sup>22</sup> See Use of Electronic Media for Delivery Purposes, Securities Act Release No. 7234, [1995-1996 Transfer Binder] Fed. Sec. L. Rep. (CCH) Para. 85,702 at 87,112 (Oct. 6, 1995). The problems posed by non-paper based communications, however, have been addressed by the SEC Release. *Id.* In the Release, the SEC stated that information delivered by electronic means would satisfy the federal securities laws if it results in the delivery to the intended recipients "of substantially equivalent information as these recipients would have had if the information were delivered to them in paper form." *Id.* The Release also stated that notice of delivery, access to electronic documents, and evidence of delivery are three factors considered in determining whether the electronic communication complies with federal securities laws. *Id.* Finally, the Release said that paper versions of the communication must be available if either the system fails or the investor requests a paper document. *Id.*; see also Raysman & Brown, *supra* note 21, at 1. The use of electronic media is now permissible and is in compliance with the federal securities laws. *Id.*

<sup>23</sup> See Brakebill, *supra* note 16, at 910 (referring to jurisdictional problems posed by system which casts information over all nations borders); Bradford P. Weirick, *With the Internet Craze Reaching the Public-Offering Markets, State, Federal and Foreign Regulators are Scrambling to Catch up with Technological Advances*, NAT'L L.J., May 6, 1996, at B5 (discussing Internet's ability to cross jurisdictional boundaries); see also Langevoort, *supra* note 21, at 762-63 (stating that "communications technology renders spatial distances and geographic boundaries relatively insignificant in securities transactions").

<sup>24</sup> See Martin, *supra* note 13, at 48 (indicating inherent limits in Securities Acts as they were written); see also Bevis Longstreth, *The SEC After Fifty Years: An Assessment of its Past and Future*, 83 COLUM. L. REV. 1593, 1610 (1983) (discussing that improvements in technology will pose challenges to SEC to ensure investor protection).

<sup>25</sup> See Martin, *supra* note 13, at 48 (discussing territorial problems with Securities Acts); Mark Rappel, *Extraterritorial Application of Securities Laws Between the United States and Canada*, 24 GONZ. L. REV. 391, 392 (1988/89) (discussing that decision of jurisdiction to apply its law outside its boundaries is delicate).

<sup>26</sup> Securities Act of 1933 § 5, 15 U.S.C. § 77a (1988).

<sup>27</sup> 15 U.S.C. §§ 77a et seq. (1988).

<sup>28</sup> See *id.* Section 5(c) of the 1933 Act makes it unlawful to "use any means or instruments of transportation or communication in interstate commerce" to offer to buy or sell securities without registering them with the SEC. *Id.*; see also HAZEN, *supra* note 3, at 87. Some exceptions to the registration requirements do apply, however, for securities transactions involving dealers, unsolicited broker transactions, non-public offerings for

provisions<sup>29</sup> of the 1934 Act<sup>30</sup> have been interpreted broadly by United States courts, extending subject matter jurisdiction to transactions taking place outside the United States when substantial fraud is found to have occurred in the United States.<sup>31</sup> Thus, when combined with the international nature of the Internet, United States securities laws could potentially apply overseas, expanding far beyond the traditional territorial jurisdiction of the United States.<sup>32</sup>

This Note addresses the reach of United States jurisdiction over securities offered through the Internet. Part I of this Note analyzes current Circuit Court interpretations of the antifraud provisions of the securities laws and the Regulation S exemption from registration for foreign issuers. In this context, the problem of conflicts with national laws and the idea of international comity will also be examined. Part II of this Note explores the current resolutions of jurisdictional issues over the Internet being developed domestically by both the individual states through

issuers, and small issuings under five million dollars. *Id.*; C. Steven Bradford, *Transaction Exemptions in the Securities Act of 1933: An Economic Analysis*, 45 EMORY L.J. 591, 598-610 (1996). Where the author describes the registration requirements of the federal securities laws. *Id.*

<sup>29</sup> See Securities Exchange Act of 1934 15 U.S.C. §78j(b) (1988). The Act clearly states that it is unlawful to use manipulative and deceptive devices in contravention of the SEC rules. *Id.*; Employment of Manipulative and Deceptive Devices 17 C.F.R. § 240.10b-5 (1988). Rule 10b-5 is the enforcement arm of the prohibition on manipulative and deceptive devices set forth in the 1934 Act. *Id.* Rule 10b-5 prohibits employing any devices used to defraud, to make untrue statements or omissions, or to engage in any act that would defraud investors. *Id.*

<sup>30</sup> See Securities Exchange Act of 1934, 15 U.S.C. §§ 78a – 78kk (1983). The Act was instituted in order to exert greater control over the securities market. *Id.*

<sup>31</sup> See *Robinson v. TCI/US West Comm., Inc.*, 117 F.3d 900, 905 (5th Cir. 1997) (stating that suits under antifraud provisions of securities laws will be heard when substantial acts in furtherance of fraud were committed within United States); *SEC v. Kasser*, 548 F.2d 109, 114 (3d Cir. 1977) (concluding that federal securities laws do grant jurisdiction, in international securities cases, where at least some activity designed to further fraudulent schemes occurs within United States); see also Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927, 933 (1994) (indicating that broad reach of federal antifraud provisions is decided by courts on case by case basis).

<sup>32</sup> See Testy, *supra* note 31, at 932-33 (discussing extraterritorial reach of federal securities laws); see also Ian C. Ballon, *The Law of the Internet: Developing A Framework For Making New Law*, in FIRST ANNUAL INTERNET LAW INSTITUTE, at 9, 25 (PLI Patents, Copyrights, Trademarks, and Literary Prop. Course Handbook Series No. 482, 1997) (discussing ramifications of Internet's wide reach); Robert W. Helm, *Creating, Managing & Distributing Offshore Investment Products: A Legal Perspective*, in NUTS AND BOLTS OF FINANCIAL PRODUCTS, at 431, 505 (PLI Corp. L. and Practice Course Handbook Series No. 975, 1997) (indicating that federal jurisdictional issues arise when Internet is used to offer securities).

their "Blue Sky" laws,<sup>33</sup> and by the federal government with the passage of the National Securities Markets Improvement Act of 1996 ("NSMIA").<sup>34</sup> Finally, this Note proposes restrictions on the broad reach of United States securities laws in the interest of both fairness and international comity. This Note concludes that foreign issuers of securities over the Internet, who do not intend to sell securities within the United States and who clearly so state in their offer, should be exempt from the federal securities acts and the registration requirements therein.

## II. THE SCOPE OF THE UNITED STATES SECURITIES LAWS

As relevant to this Note, the United States securities laws embodied in the Securities Act of 1933<sup>35</sup> and the Securities Exchange Act of 1934,<sup>36</sup> were first developed in the interest of protecting the investor.<sup>37</sup> The laws seek to protect United States investors from fraud by prohibiting trading based on material non-public information<sup>38</sup> and by requiring individuals involved in securities transactions in the United States to comply with the registration requirements set forth therein.<sup>39</sup> The regula-

<sup>33</sup> See Gavis, *supra* note 11, at 353 (1996) (noting that states securities laws are called "Blue Sky" laws); Thomas H. McCormick & Jennifer W. Lewis, *Use of the Internet By Private Issuers*, in REGULATION D OFFERINGS AND PRIVATE PLACEMENTS 1997, at 547, 555-56 (ALI-ABA Course of Study No. SB65, 1997) (discussing problems that "Blue Sky" requirements pose to issuers of securities over Internet); see also Joseph McLaughlin, 'Booting' the Federal Securities Laws Into the 21st Century, 11 NO. 7 INSIGHTS 21, 24 (1997) (discussing limitations "Blue Sky" laws place on underwriters issuing securities via Web sites).

<sup>34</sup> National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, §101, 110 Stat. 3416, 3417 (1996).

<sup>35</sup> Securities Act of 1933, 15 U.S.C. §§ 77a - 77aa (1983).

<sup>36</sup> 15 U.S.C. §§ 78a - 78kk (1983).

<sup>37</sup> See *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 522 (8th Cir. 1973) (stating purpose of antifraud provisions is to "protect investors from deceptive schemes"); *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206 (2d Cir. 1968) (stating that antifraud provisions are for "protection of investors"); see also *Associated Sec. Corp. v. SEC*, 293 F.2d 738, 740 (10th Cir. 1961) (stating that purpose of securities laws is to "protect investors"); *Straley v. Universal Uranium & Milling Corp.*, 289 F.2d 370, 372 (9th Cir. 1961) (stating that Congress' intentions in enacting Securities Act of 1933 was to protect innocent purchasers of securities, and that provisions of it must be interpreted in light of that intent and purpose).

<sup>38</sup> See Paul G. Mohoney, *Article: Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623, 623 (1992) (discussing how issuers will reduce information available to public to avoid fraud liability); Lynn L. White, *Recent Development: Securities Regulations—The Disclosure or Abstain Rule—Tipee Liability*, 51 TENN. L. REV. 359, 362 (1984) (indicating securities laws require disclosure of material non-public information or to abstain from trading).

<sup>39</sup> See *Travis*, 473 F.2d at 522 (discussing goal of protection of investor); see also Gerald S. Backman, *Report of the Securities and Exchange Commission Advisory Com-*

tions originally focused on the effects of domestic securities transactions within the United States.<sup>40</sup> Since their inception, however, these acts have gained international reach through broad judicial interpretation.<sup>41</sup> When this broad interpretation is extended to the realm of the Internet, the statutes have the potential of becoming overly expansive, possibly infringing on the securities laws of other countries.<sup>42</sup> Consequently, the two foremost issues that surface are: (1) the reach of the antifraud provisions of the Securities Exchange Act of 1934 over the Internet, and (2) the Internet's effect on Regulation S of the Securities Act of 1933 and its exemption of "Off-Shore Transactions" from the Act's registration requirements.

### A. The Antifraud Provisions of the Securities Exchange Act of 1934

The antifraud provisions of the Securities Acts are set forth in section 10(b)<sup>43</sup> of the 1934 Act and implemented through Rule

*mittee on the Capital Formation and Regulatory Processes, in PRIVATE PLACEMENTS, at 149, 283 (PLI Corp. L. and Practice Course Handbook Series No. 983, 1997) (discussing that goal of disclosure is to deter fraud); Harvey Bines & Steve Thel, Investment Management Arrangements and the Federal Securities Laws, 58 OHIO ST. L.J. 459, 460-61 (1997) (examining registration requirements set forth by federal securities laws).*

<sup>40</sup> See Jill E. Fisch, *Imprudent Power: Reconsidering United States Regulation of Foreign Tender Offers*, 87 NW. U. L. REV. 523, 547-48 (1993) (stating that when federal securities laws were drafted Congress was primarily concerned with domestic markets); Testy, *supra* note 31, at 928 (expressing domestic effect of securities laws when initially enacted); Gregory K. Matson, Note & Comment, *Restricting the Jurisdiction of American Courts Over Transnational Securities Fraud*, 79 GEO. L.J. 141, 153 (1990) (indicating that 1934 Act was intended to have domestic purpose).

<sup>41</sup> See John C. Maguire, *Regulatory Conflicts: International Tender and Exchange Offers in the 1990s*, 19 PEPP. L. REV. 939, 965 (1992) (discussing Second Circuit's broad treatment of securities antifraud provisions); Louise Corso, Note, *Section 10(b) and Transnational Securities Fraud: A Legislative Proposal to Establish A Standard for Extraterritorial Subject Matter Jurisdiction*, 23 GEO. WASH. J. INT'L L. & ECON. 573, 584 (1989) (discussing one circuit court's characterization of securities antifraud provisions as broad); see also Matson, *supra* note 40, at 161 (indicating that courts rarely question antifraud provision's extensive reach and interpretation by other courts).

<sup>42</sup> See Testy, *supra* note 31, at 928 (discussing reach of securities regulations in global marketplace); see also Brakebill, *supra* note 16, at 910 (discussing problems concerning jurisdiction over transactions in cyberspace).

<sup>43</sup> Securities Exchange Act of 1934 §10(b), 15 U.S.C. Section 78j(b) (1988). This section reads:

Section 10. 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-

(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

10b-5.<sup>44</sup> Both provisions, entitled "Manipulative and Deceptive Devices," focus primarily on preventing the defrauding of investors.<sup>45</sup> While the impetus behind the statutes is apparent, the 1934 Act's extraterritorial reach is less apparent, and had thus required judicial interpretation.<sup>46</sup> To determine the scope of the 1934 Act, courts have developed two different tests.<sup>47</sup> One test determines whether United States securities laws enable courts to claim subject matter jurisdiction based upon the situs of the conduct, regarding the sale of securities.<sup>48</sup> The other test de-

public interest or for the protection of investors.

*Id.*

44 Securities Exchange Act of 1934, 17 C.F.R. §240.10b-5n (1988). This rule reads: Rule 10b-5. Employment of Manipulative and Deceptive Devices.

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,

(1) to employ any devise, scheme, or artifice to defraud,

(2) 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 light of the circumstances under which they were made, not misleading, or

(3) 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.

*Id.*

45 See Brakebill, *supra* note 16, at 910 (setting forth investor protection sections of Securities Exchange Act of 1934); Paul Lansing & Cris Alan Schoon, *Rule 10b-5 and the Personal Benefit Requirement: Dirks v. Securities And Exchange Comm.*, 11 WM. MITCHELL L. REV. 1, 1 (1985) (indicating that protection of investors is at core of Rule 10b-5 and §10(b)).

46 See Joseph P. Garland & Brian P. Murray, *Subject Matter Jurisdiction Under the Federal Securities Laws: the State of Affairs After Itoba*, 20 MD. J. INT'L L. & TRADE 235, 246 (1996) (stating that courts are left with defining which acts will confer subject matter jurisdiction); Charles Vaughn Baltic, Note, *The Next Step in Insider Trading Regulation: International Cooperative Efforts in the Global Securities Market*, 23 LAW & POL'Y INT'L BUS. 167, 181 (1991/1992) (indicating that development of law concerning 10b-5 antifraud provision has been left to courts to develop on case by case basis without any guidance from Congress).

47 See *Robinson v. TCI/US West Communications Inc.*, 117 F.3d 900, 905 (5th Cir. 1997) (discussing two basic tests for determining subject matter jurisdiction under Securities Exchange Act of 1934); *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 121 (2d Cir. 1995) (describing that two jurisdictional tests have emerged in interpreting Securities Exchange Act of 1934); see also Stephen J. Choi & Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market*, 65 FORDHAM L. REV. 1855, 1885 (1997) (explaining how courts are left to grapple with and apply issues of extraterritoriality); Testy, *supra* note 31, at 928 (indicating development of two different tests in determining jurisdiction).

48 See *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326, 1337 (2d Cir. 1972) (upholding jurisdiction when substantial misrepresentations were made in United States); see also *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 425 (9th Cir. 1983) (upholding jurisdiction where some of alleged fraudulent conduct took place in United States); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 420 (8th Cir. 1979) (upholding jurisdiction where conduct in United States was "significant with respect to the alleged violation").

termines whether subject matter jurisdiction exists based solely on the effects of the transaction on American investors or securities markets regardless of where the transaction actually took place.<sup>49</sup>

### 1. The Conduct Test

The conduct test is a territorial rule that bases jurisdiction on the location of the events.<sup>50</sup> The test focuses on the nature of the conduct within the United States as it relates to the alleged fraud under the federal securities laws.<sup>51</sup> The test is premised on the concept that the world can be divided into distinct legal regimes, such as between the territorial United States and foreign territories.<sup>52</sup>

The conduct test was first developed by the Second Circuit in *Leasco Data Processing Equipment Corp. v. Maxwell*.<sup>53</sup> The court held that conduct within the territorial United States was sufficient to confer jurisdiction on federal courts in federal securities cases.<sup>54</sup> Subsequent Second Circuit cases have limited this test by conferring subject matter jurisdiction only when the "defendant's activities in the United States [are] more than

<sup>49</sup> See *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206 (2d Cir. 1968) (concluding that Securities Exchange Act protects domestic securities market from effects of fraudulent foreign transaction in American securities), *rev'd with respect to holding on merits*, 405 F.2d 215, 217 (2d Cir. 1968) (en banc), *cert. denied sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969); see also *Des Brisay v. Goldfield Corp.*, 549 F.2d 133, 135-36 (9th Cir. 1977) (upholding jurisdiction where effect of foreign transaction adversely affected domestic securities markets); *Butte Mining PLC v. Smith*, 876 F. Supp. 1153, 1162-63 (D. Mont. 1995), *aff'd*, 76 F.3d 287 (9th Cir. 1996) (describing "effects test").

<sup>50</sup> See *Choi & Guzman*, *supra* note 47, at 1885 (describing jurisdiction based on conduct as territorial rule); see also Gary B. Born, *A Reappraisal of the Extraterritorial Reach of United States Law*, 24 L. & POLY INT'L BUS. 1, 47 (1992) (stating that jurisdiction in conduct test is based on whether conduct occurred within United States); Harvey L. Pitt et. al., *Problems of Enforcement in the Multinational Securities Market*, 9 U. PA. J. INT'L BUS. L. 375, 393-94 (1987) (stating that conduct test permits exercising jurisdiction over actions conducted within each state's territory).

<sup>51</sup> See *MCG, Inc. v. Great Western Energy Corp.*, 896 F.2d 170, 174 (5th Cir. 1990) (discussing conduct test as it applies to acts or omissions within United States); *Pismenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1045 (2d Cir. 1983) (describing conduct test under antifraud provisions of federal securities laws); Philip R. Wolf, *International Securities Fraud: Extraterritorial Subject Matter Jurisdiction*, 8 N.Y. INT'L L. REV. 1, 6 (1995) (describing conduct test); see also *Brakebill*, *supra* note 16, at 912 (describing conduct test).

<sup>52</sup> See *Choi & Guzman*, *supra* note 47, at 1885-86 (describing basing jurisdiction as territorial rule).

<sup>53</sup> 468 F.2d 1326, 1337 (2d Cir. 1972) (upholding jurisdiction when substantial misrepresentations were made in United States).

<sup>54</sup> *Id.* at 1334 (indicating that significant conduct can confer jurisdiction).

'merely preparatory' to a securities fraud conducted elsewhere,"<sup>55</sup> and where the "activities or culpable failures to act within the United States 'directly cause[d]' the claimed injuries."<sup>56</sup> In *Bersch v. Drexel Firestone, Inc.*,<sup>57</sup> the antifraud provisions of the securities laws were more broadly construed and held applicable by the Second Circuit so long as an American resident incurred the loss from the sale of securities, regardless of whether the acts or failure to act occurred in the United States.<sup>58</sup> The *Bersch* court distinguished itself from other holdings by concluding that "merely preparatory" acts performed abroad may be sufficient to confer jurisdiction so long as Americans are injured.<sup>59</sup> Currently, the *Bersch* court's approach has been embraced by two other circuits who have adopted this restrictive conduct test.<sup>60</sup> In contrast, three other circuit courts have taken an even broader approach, holding that jurisdiction exists when merely some activity furthering a fraudulent scheme occurs within this country.<sup>61</sup>

<sup>55</sup> See *Itoba Ltd. v. LEP Group PLC*, 54 F.3d 118, 122 (2nd Cir. 1995), *cert. denied sub nom.*, *Bersch v. Arthur Anderson & Co.*, 423 U.S. 1018 (1975)) (upholding jurisdiction where allegedly false and misleading filings were made with SEC (quoting *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 987 (2nd Cir.1975))).

<sup>56</sup> See *Itoba Ltd.*, 54 F.3d at 122 (enunciating requirement that fraud 'directly caused' injuries (quoting *Alfadda v. Fenn*, 935 F.2d 475, 478 (2nd Cir. 1991))).

<sup>57</sup> 519 F.2d 974, 981 (2d Cir. 1975). The *Bersch* case dealt with claims by American investors, who were seeking to impose United States securities laws on foreign defendants. *Id.* They alleged to have been defrauded by a Canadian corporation and its officers for failure to reveal material facts in its prospectus. *Id.* On appeal, the Second Circuit reversed and imposed United States securities laws upon the defendants. *Id.*

<sup>58</sup> See *Bersch*, 519 F.2d at 993. The court also held that the antifraud provisions of the federal securities laws would apply to losses from sales of securities to American residents abroad if acts of material importance in the United States significantly contributed to the injury, but did not apply to losses from sales of securities to foreigners outside the United States unless acts within the United States directly caused such losses. *Id.* See generally *Robinson v. TCI/West Communications Inc.*, 117 F.3d 900, 906 (5th Cir. 1997) (adopting Second Circuit test expressly); *Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27, 31-33 (D.C. Cir. 1987) (stating that court was adopting Second Circuit's test).

<sup>59</sup> See *Bersch*, 519 F.2d, at 992 (granting jurisdiction when at least preparatory fraudulent acts occurred and Americans were injured).

<sup>60</sup> See *Robinson*, 117 F.3d at 906 (adopting Second Circuit test); *Zoelsch*, 824 F.2d at 31-33 (adopting Second Circuit test)

<sup>61</sup> See *SEC v. Kasser*, 548 F.2d 109, 114 (3d Cir. 1977) (holding that test is whether "at least some activity designed to further a fraudulent scheme occurs within this country"); see also *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 425 (9th Cir. 1983) (upholding jurisdiction where at least some of alleged fraudulent conduct took place in United States); *Continental Grain (Australia) Pty., Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 421 (8th Cir. 1979) (finding jurisdiction where defendants conduct in United States was in furtherance of fraudulent scheme); *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 524 (8th Cir. 1973) (holding that jurisdiction "attaches whenever there has been significant conduct with respect to alleged violations in the United States"). *But see Wolf*, *supra* note

When utilizing the conduct test, as evidenced by the differing circuits, the United States securities laws appear to be applicable to issues of securities over the Internet because the Internet, by its very nature, blurs territorial lines and thereby makes it extremely difficult to determine where an online transaction "occurs."<sup>62</sup> For example, the situs of an Internet sales transaction is often believed to be cyberspace, rather than a physical location.<sup>63</sup> This spurs uncertainty about the application of conventional jurisdictional rules, since courts are left to determine where the conduct occurs.<sup>64</sup>

Since conduct relating to IPO's on the Internet arguably falls within the varying circuit court standards, an American investor defrauded by an international online IPO can seek relief under United States securities laws.<sup>65</sup> The conduct of defrauding the investor may be deemed to have taken place in the United States because the investor had contacts on the Internet.<sup>66</sup> Jurisdic-

51, at 13 (discussing problems with conduct test as it applies extraterritorially).

<sup>62</sup> See *State Regulators Wrestle With Internet Issues*, INVESTOR DEALERS' DIG., Oct. 21, 1996, at 8 (discussing lack of boundaries on Internet enables information to be available to all computer users throughout world); Robin Forman Pollack, Comment, *Creating the Standards of a Global Community: Regulating Pornography on the Internet— An International Concern*, 10 TEMP. INT'L & COMP. L.J. 467, 470 (1996) (indicating that remote log-on features of Internet allow users in one geographical location to access and control devices in another); see also Brakebill, *supra* note 16, at 923 (describing problems of determining where act "occurs" online).

<sup>63</sup> See R. Scot Grierson, *State Taxation of the Information Superhighway: A Proposal for Taxation of Information Services*, 16 LOY. L.A. ENT. L.J. 603, 639 (1996) (indicating widespread belief in business communities that Internet sales occur in cyberspace); Edward A. Morse, *State Taxation of Internet Commerce: Something New Under the Sun?*, 30 CREIGHTON L. REV. 1113, 1115 (1997) (discussing problems facing taxation authorities in context of Internet sales); see also Brakebill, *supra* note 16, at 922 (explaining "uniqueness" of Internet securities transactions).

<sup>64</sup> See Diana J. P. Mackenzie, *Commerce on the Net: Surfing Through Cyberspace Without Getting Wet*, 14 J. MARSHALL J. COMPUTER & INFO. L. 247, 247 (1996) (expressing view that law in cyberspace poses many challenges because it is inherently different than existing notions of business transactions); Richard S. Zembek, *Jurisdiction and the Internet: Fundamental Fairness in the Networked World of Cyberspace*, 6 ALB. L.J. SCI. & TECH. 339, 355 (1996) (stating that courts have to examine nature of cyber-transaction to determine if jurisdiction exists); see also Brakebill, *supra* note 16, at 924 (discussing role of courts in determining Internet jurisdiction);

<sup>65</sup> See Martha L. Cochran, *Sweeping Reform: Litigating and Bespeaking Caution Under the New Securities Laws*, in APPENDICES, at 31 (PLI Corp. L. and Practice Course handbook Series No. 924, 1996) (indicating that SEC "safe harbors" provide no protection for IPO's that have violated federal securities laws); Herbert S. Wacker, *Developments In Securities Law Disclosure*, in ADVANCED SECURITIES LAW WORKSHOP, at 7, 108 (PLI Corp. L. and Practice Course Handbook Series No. 1005, 1997) (stating that class action suits have been brought against IPO's for fraud).

<sup>66</sup> See Gavis, *supra* note 11, at 355 (discussing Pennsylvania's view that Internet messages to sell securities within Pennsylvania are deemed to have occurred within Pennsylvania).

tional questions arise, however, under the conduct test when those Internet participants involved in the transaction come from many different nations.<sup>67</sup> The conduct test is also problematic in its failure to proffer sufficient guidance for determining which acts are "merely preparatory," and therefore, escape one circuit's interpretation of the securities and laws reach, and which acts are central to the transaction, thereby conferring subject matter jurisdiction.<sup>68</sup>

## 2. The Effects Test

The effects test premises United States subject matter jurisdiction on the effect of the securities transaction on United States capital markets.<sup>69</sup> As seen in *Schoenbaum v. Firstbrook*,<sup>70</sup> foreign defendants involved in foreign transactions can be regulated by the 1934 Act's antifraud provisions if the conduct causes significant adverse effects to United States markets or investors.<sup>71</sup> While the Second Circuit in *Schoenbaum* found that a listing on a United States stock exchange is an important element in determining effects, such a listing is not determinative.<sup>72</sup> The court held that there was jurisdiction over the

<sup>67</sup> See Choi & Guzman, *supra* note 47, at 1887 (explaining problems in conduct test when there are many participants of different nationalities); Pollack, *supra* note 62, at 470 (examining problems posed by many participants located in different nations on laws governing Internet). See generally SEC Working Group Ponders Internet Issues, FINANCIAL NET NEWS, May 5, 1997, available in 1997 WL 12170910, at \*2 (discussing impact of Internet on securities markets).

<sup>68</sup> See Choi & Guzman, *supra* note 47, at 1887 (discussing problems with determining importance of acts in transaction); Edward A. Fallone, *Section 10(b) and the Vagaries of Federal Common Law: The Merits of Codifying the Private Cause of Action Under a Structuralist Approach*, 1997 U. ILL. L. REV. 71, 123 (1997) (stating how conduct is problematic given statute's vagueness).

<sup>69</sup> See Dennis R. Dumas, *United States Antifraud Jurisdiction Over Transnational Securities Transactions: Merger of the Conduct and Effects Tests*, 16 U. PA. J. INT'L BUS. L. 721, 721 (1995) (indicating effects test considers jurisdiction based on effects within United States); see also Fisch, *supra* note 40, at 523 (stating how effects test looks towards influence on United States markets).

<sup>70</sup> 405 F.2d 200, 206 (2d Cir.1968), *rev'd with respect to holding on merits*, 405 F.2d 215, 217 (2d Cir. 1968) (en banc), *cert. denied sub nom.*, Manley v. Schoenbaum, 395 U.S. 906 (1969) (concluding that Securities Exchange Act protects domestic securities market from effects of fraudulent foreign transactions in American securities).

<sup>71</sup> *Id.* at 208. Specifically, the *Schoenbaum* court stated that United States courts will have jurisdiction over violations of the federal securities laws for transactions that take place outside of the United States in instances where, at least, the transactions involve stock registered and listed on a national securities exchange and the transactions are detrimental to the interests of the American investor. *Id.*

<sup>72</sup> *Id.* at 206. The Second Circuit enunciated that Congress intended the Securities Acts to have "an extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic

fraudulent acts outside the United States when, at a minimum, the transactions involve stock registered and listed on a national securities exchange, and the acts are detrimental to the interests of American investors.<sup>73</sup>

Additionally, courts have held even more broadly that the extraterritorial reach of the federal securities laws extend to fraud claims involving foreign transactions and defendants when the fraud substantially affects the United States.<sup>74</sup> It has been noted, however, that the increasing globalization of the business community has made it difficult to find an event in one nation's market that does not affect another nation's market.<sup>75</sup> As the world marketplace becomes increasingly interconnected, the effects test inevitably expands the extraterritoriality of United States securities laws.<sup>76</sup>

When jurisdiction is conferred on the United States to hear a case under either the conduct test or the effects test, it has become increasingly more clear that the foreign company will be subject to the registration requirements of the federal securities

securities market from the effects of improper foreign transactions in American securities." *Id.*

<sup>73</sup> *Id.* at 208 (holding that subject matter jurisdiction exists in instances where not only do transactions involve stock registered and listed on a national securities exchange but such transactions are adverse to American investors' interests); see also *Tamari v. Bach & Co. (Lebanon) S.A.L.*, 547 F. Supp. 309, 313 (N.D. Ill. 1982), *aff'd*, 730 F.2d 1103 (7th Cir. 1984) (stating that harm to domestic exchanges can be presumed because fraud implicates integrity of American markets).

<sup>74</sup> See *Butte Mining PLC v. Smith*, 876 F. Supp. 1153, 1162-63 (D. Mont. 1995), *aff'd*, 76 F.3d 287 (9th Cir. 1996) (describing "effects test"); *Consolidated Gold Fields PLC v. Minorco S.A.*, 871 F.2d 252, 262 (2d Cir.1989), *modified by* 890 F.2d 569 (2d Cir.1989) (allowing application of federal securities laws to predominantly overseas transaction involving small fraction of American investors); *Des Brisay v. Goldfield Corp.*, 549 F.2d 133, 136 (9th Cir. 1977) (applying federal securities laws in foreign takeover involving improper use of American securities that were listed on national exchange and adversely affected American securities market); *SEC v. Capital Growth Co., S.A. (Costa Rica)*, 391 F. Supp. 593, 596-97 (S.D.N.Y. 1974) (upholding jurisdiction where there was extraterritorial conduct which had harmful impact upon United States investors).

<sup>75</sup> See Edward F. Green et. al., *Toward a Cohesive International Approach to Cross-Border Takeover Regulation*, 51 U. MIAMI L. REV. 823, 828 (1997) (describing increase of cross-border investment activity); Jeffrey Hoffman, *Regulation S*, in UNDERSTANDING THE SECURITIES LAWS, at 377, 379 (PLI Corp. L. and Practice Course Handbook Series No. 956, 1996) (discussing globalization of capital markets). See e.g., John Crudele, *Japan's Market Pains Felt Here*, ST. LOUIS POST-DISPATCH, Dec. 6, 1993, at 8 (commenting that failing Japanese stock market is not beneficial to United States markets).

<sup>76</sup> See Jean-Pierre R. Bourton, Jr., *United States Regulation of Foreign Takeovers*, 70 TUL. L. REV. 1609, 1628 (1996) (describing effect of globalization of marketplace on securities laws); Michael V. Hurley, *International Debt and Equity Markets: U.S. Participation in the Globalization Trend*, 8 EMORY INT'L L. REV. 701, 703 (1994) (discussing globalization of securities markets); Testy, *supra* note 31, at 936 (hypothesizing on expanding reach of federal securities laws under effects test).

laws.<sup>77</sup> Traditionally, a securities offering that solicits investors by mail, provides them with the choice not to participate in certain jurisdictions by not mailing or offering securities there.<sup>78</sup> A securities offering over the Internet, however, has no such limitations because it can be accessed anywhere in the world.<sup>79</sup> As a result, a foreign company with an Internet offering that does not anticipate participation in certain jurisdictions may unwittingly be in violation of the strict registration requirements of the 1933 Act and be subject to further penalties.<sup>80</sup> Consequently, the antifraud provisions of the 1934 Act seemingly extend themselves over the Internet to hold a non-United States entity offering or trading in securities to United States securities laws.<sup>81</sup>

### *B. Regulation S of the Securities Act of 1933*

The SEC adopted Regulation S<sup>82</sup> in 1988 in an effort to limit the securities acts from being imposed on offshore transac-

<sup>77</sup> See HAZEN, *supra* note 3, at 65 (indicating that selling foreign securities in United States implicates registration requirements since it creates risk to American investors); see also Brakebill, *supra* note 16, at 913 (stating that jurisdiction under either conduct or effects tests can hold individuals to registration requirements of federal securities laws unless exemption exists).

<sup>78</sup> See McGlosson, *supra* note 16, at 309 (explaining that under normal circumstances issuers cannot send solicitations to residents of states where offering is not registered); see also *Corporate Finance*, in THE SEC SPEAKS IN 1996, at 7, 41 (PLI Corp. L. and Practice Course Handbook Series No. 925, 1996) (indicating that securities offerings are solicited through mail).

<sup>79</sup> See McGlosson, *supra* note 16, at 309 (describing easy access of Internet offerings); see also Martin, *supra* note 13, at 48 (indicating online information reaches everywhere since Internet has no geographical limits); Bradford P. Weirick, *Securities Law*, NAT'L L.J., May 6, 1996, at B5 (indicating breadth of securities offerings over Internet).

<sup>80</sup> See Weirick, *supra* note 79, at B5 (explaining potential to access Internet from virtually anywhere); see also Constance E. Bagley & John Arledge, *SEC Could Ease Offering of Securities Via the Web*, NAT'L L. J. Jan. 13, 1997, at 3 (discussing implications of online IPO's on national scale and describing how offeror is automatically subject to all fifty states registration requirements); Raysman & Brown, *Securities Over the Internet*, N.Y.L.J., Jun. 10, 1997, at 1 (indicating that online IPO's must be conducted in adherence to state and federal securities laws).

<sup>81</sup> See Sidney G. Wigfall, *Subject Matter Jurisdiction In Transnational Securities Fraud Cases: The Second Circuits Extraterritorial Application of the 1934 Securities Exchange Act and Congressional Intent*, 5 TOURO INT'L L. REV. 233, 244 (1994) (indicating Congressional intent to subject foreign and international securities to extraterritorial jurisdiction of federal securities laws antifraud provisions).

<sup>82</sup> Securities Act Release No. 33-6779, [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84, 242 (June 10, 1988). See *Offshore Offers and Sales*, Securities Act Release No. 33-6863 [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,524 at 80661 (Apr. 24, 1990) (enacting Regulation S); see also Regulation S—Rules Governing Offers and Sales Made Outside the United States Without Registration Under the Securities Act of 1933, 17 C.F.R. §§ 230.901-904 (1995) (enunciating rules and activities proscribed by Regulation S).

tions.<sup>83</sup> The regulation offers an exemption from the securities registration requirements to purely non-United States transactions.<sup>84</sup> This exemption is accomplished by creating two "safe harbor" rules: One for offshore offerings by issuers,<sup>85</sup> and the other for offshore resale transactions.<sup>86</sup> To qualify for Regulation S, two conditions must be met.<sup>87</sup> First, the offer must be made in an "offshore transaction,"<sup>88</sup> which requires that offers cannot be made to a resident in the United States.<sup>89</sup> Second, no "directed selling efforts"<sup>90</sup> in connection with the offer, can be made in the United States.<sup>91</sup>

An IPO on the Internet may potentially violate both of the conditions imposed by Regulation S.<sup>92</sup> A violation may occur due

<sup>83</sup> See HAZEN, *supra* note 3, at 72 (discussing purpose of Regulation S); see also Choi & Guzman, *supra* note 47, at 210 (indicating Regulation S was adopted to deal with offshore transactions).

<sup>84</sup> See Regulation S Rules, 17 C.F.R. §230.901 (1997) (offering an exemption from registration for securities transactions without United States); see also Choi & Guzman, *supra* note 47, at 210 (noting Rule 901 exempts issues made outside United States from federal registration requirements); Julie L. Kaplan, Comment, "Pushing the Envelope" of the Regulation S Safe Harbors, 44 AM. U. L. REV. 2495 (discussing registration exemption for foreign securities offerings).

<sup>85</sup> See Regulation S Rules, 17 C.F.R. § 230.903 (1997) (listing requirements necessary to qualify for offshore safe harbor); see also Choi & Guzman, *supra* note 47, at 210 (explaining "safe harbor" rule for foreign offerings); Kaplan, *supra* note 84, at 2518 (discussing extent of foreign exemption).

<sup>86</sup> See Regulation S Rules, 17 C.F.R. § 230.904 (1997) (listing requirements to meet offshore resale safe harbor); see also Choi & Guzman, *supra* note 47, at 210 (discussing requirements necessary to be deemed an offshore resale transaction); Kaplan, *supra* note 84, at 2518 (examining "safe harbor" provision for securities resold without United States jurisdiction).

<sup>87</sup> See Jeffrey B. Tevis, *Asset-Backed Securities: Secondary Market Implications of SEC Rule 144A and Regulation S*, 23 PAC. L.J. 135, 189 (1991). The availability of the safe harbor is conditioned upon the existence of "offshore transactions" and the absence of "directed selling efforts." *Id.*; see also Stephen H. Cooper, *Rule 144A and Regulation S Under the Securities Act of 1933*, in INSTITUTIONAL INVESTORS: PASSIVE FIDUCIARIES TO ACTIVIST OWNERS, at 353, 360 (PLI Corp. L. and Practice Course Handbook Series No. 704, 1990). Regulation S allows offshore offers and sales to be outside the reach of federal securities laws provided certain conditions are met. *Id.*

<sup>88</sup> See HAZEN, *supra* note 3, at 309 n.6 (explaining definition of offshore transaction as one not made to someone in United States and either purchaser is outside United States when buy order is originated, or transaction is executed on foreign securities exchange); see also Regulation S Rules, 17 C.F.R. §§ 230.903(a)-230.904(a) (1993) (referring to sales and resales).

<sup>89</sup> See Regulation S Rules, 17 C.F.R. § 230.902(i)(1)(i) (1993); see also Choi & Guzman, *supra* note 47, at 211 (discussing requirements to qualify for Regulation S).

<sup>90</sup> See Testy, *supra* note 31, at 945-46 (explaining that directed selling efforts are activities that could reasonably be expected, or are intended, to condition market with respect to securities being offered in reliance upon Regulation S); see also Choi & Guzman, *supra* note 47, at 211-12 (discussing requirements to qualify for Regulation S exemption).

<sup>91</sup> See Regulation S Rules, 17 C.F.R. §§ 230.903(b)-230.904(b) (1994) (referring to sales and resales exemptions for securities outside United States).

<sup>92</sup> See Robert W. Helm, *Creating, Managing and Distributing Offshore Investment*

to the fact that an IPO on the Internet is considered an offer as well as a directed selling effort to anyone who can access the particular website.<sup>93</sup> Although there are certain specific forms of advertising<sup>94</sup> which are excluded from being deemed "directed selling efforts," a parallel exclusion for Internet offerings is not enumerated.<sup>95</sup>

One problem with online offerings is that they do not occur exclusively offshore, rather they occur anywhere their message is received.<sup>96</sup> The location where the message is received and downloaded impacts the determination over which nation's laws

*Products: A Legal Perspective*, in NUTS AND BOLTS OF FINANCIAL PRODUCTS, at 431, 505 (PLI Corp. L. and Practice Course Handbook Series No. 975, 1997). It has yet to be determined if a person in the United States accessing the sales material of an offshore fund over the Internet constitutes an "offer" under the 1933 Act. *Id.*

<sup>93</sup> See McLaughlin, *supra* note 33, at 21 (indicating current concern over offshore offerings on Internet being considered "directed selling efforts" under Regulation S); Julie B. Strickland & Shandra D. Wedlock, *Information Practices: the Nits & Grits Versus the Net: Differing Disclosure Standards for "Retail" Versus "Professional" Investors*, in 29<sup>TH</sup> ANNUAL INSTITUTE ON SECURITIES REGULATION, at 939, 947 (PLI Corp. L. and Practice Course Handbook Series No. 1022, 1997) (discussing importance of not selling securities to public at large, but rather to certain qualified investors in accordance with federal securities regulations).

<sup>94</sup> See Daniel Dunson, *New U.S. Securities Rules for the 1990s*, in 22<sup>ND</sup> ANNUAL INSTITUTE ON SECURITIES REGULATION, at 59, 123 (PLI Corp. L. and Practice Course Handbook Series No. 712, 1990) (explaining that "tombstone advertisements" must include restrictive language in required form containing no more information than permitted by Regulation S); Linda C. Quinn & Ottilie L. Jarmel, *Publicity Considerations for Corporate Issuers: Getting the Message Across Under the Federal Securities Laws*, in 29<sup>TH</sup> ANNUAL INSTITUTE ON SECURITIES REGULATION, at 797, 806 (PLI Corp. L. and Practice Course Handbook Series No. 1022, 1997) (indicating SEC exemption for "tombstone advertisements" requires that they include only specific information, such as; issuer's name, price of securities being sold, and title of securities being sold); Harold S. Bloomenthal, *The SEC and Internationalization of Capital Markets: Herein of Regulation S and Rule 144A—Part II*, 19 DENV. J. INT'L L. & POL'Y 343, 354 (1991) (noting existence of exemption for "tombstone advertisements" if less than twenty percent of publications circulation is in United States).

<sup>95</sup> See Regulation S Rules, 17 C.F.R. §§ 230.902(b)(2), 230.902(b)(4) (1993). In order to qualify for the exemption advertisements must state that "the securities have not been registered under the Act and may not be offered or sold in the United States." *Id.*

<sup>96</sup> See Jonathan Reed Stark, *SEC Enforcement: Meeting The Challenges of the Next Millenium*, in SECURITIES ENFORCEMENT INSTITUTE: A PRACTICAL GUIDE TO INVESTIGATION, SETTLEMENT & LITIGATION, at 419, 435 (PLI Corp. L. and Practice Course Handbook Series No. 1007, 1997). The main problem is that online communication links go across all geographical lines. *Id.*; see also Gavis, *supra* note 11, at 373-74. It has been asserted that when a market participant offers securities online, the audience is located more widely than just in the jurisdiction where the offeror may be registered to sell the securities. *Id.* Cf. Alexander Gigante, *Ice Patch on the Information Superhighway: Foreign Liability for Domestically Created Content*, 14 CARDOZO ARTS & ENT. L.J. 523, 547 (1996). In the context of the right of privacy, it has been asserted that Internet online services and gateway providers "could be held liable for allowing their systems to be used to transmit into France materials found to invade a complainant's privacy under French Law." *Id.*

will apply.<sup>97</sup> Thus, an Internet securities offering has the potential to violate the "offshore transaction" condition of the Regulation S safe harbor because the offering may be deemed to occur in the United States, if the particular website was accessed domestically.<sup>98</sup>

An offer to sell securities online is essentially an advertisement to the world<sup>99</sup> that is not subject to the ordinary territorial limitations evinced through use of the mail.<sup>100</sup> A posted site on the Internet is accessible by any person in any jurisdiction.<sup>101</sup> An online offering, therefore, constitutes "direct selling efforts" within the United States.<sup>102</sup> As a consequence, the Regulation S safe harbor will be violated and the offering will be subject to federal securities laws and regulations.<sup>103</sup> Furthermore, the intention of the company to be subject to the federal securities laws is immaterial.<sup>104</sup> Thus, it follows that once an offering is made over the Internet, that foreign company is subject to

97 See Jonathan I. Edelstein, Note, *Anonymity and International Law Enforcement in Cyberspace*, 7 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 231, 286 (1996) (indicating that messages on Internet will be subject to national law both before being sent on Internet and after it is received).

98 See Josh Futterman, Note, *Evasion and Flowback in the Regulation S Era: Strengthening U.S. Investor Protection While Promoting U.S. Corporate Offshore Offerings*, 18 FORDHAM INT'L L.J. 806, 838-39 (1995). The SEC interprets non-compliance with specific safe harbor provisions as resulting in a forfeiture of the safe harbor if a member of the issuing group violates the offering restrictions or engages in directed selling efforts in the United States. *Id.* Cf. Richard H. Rowe, *An Overview of Certain Registration Provisions, Exemptions & Developments in the Legal Regime Under the Securities Law Governing Capital Formation*, in NUTS AND BOLTS OF FINANCIAL PRODUCTS, at 7, 123 (PLI Corp. L. and Practice Course Handbook Series No. 975, 1997). Currently, in the context of Internet securities offerings, the states have asserted jurisdiction over such offers and twenty-two states have granted exemptions. *Id.* The SEC has not yet adopted a formal approach to Regulation S transactions and the Internet. *Id.*

99 See Gerard R. Boyce & Sarah Hewitt, *Proxy Season in an Electronic Environment*, N.Y. L.J., May 8, 1997, at 1 (stating that Internet sites allow increased availability to securities information).

100 See Gerald R. Boyce, *Offering and Trading Securities on the Internet*, N.Y. L.J., May 9, 1996, at 1 (recognizing differences between ways of offering securities on Internet versus traditional ways of making such offerings).

101 See Wong, *supra* note 9, at 24 (discussing Internet's ability to cross many jurisdictions simultaneously); see also Weirick, *supra* note 79, at B5 (discussing breadth of Internet).

102 See Rowe, *supra* note 98, at 123 (indicating many states have asserted jurisdiction over Internet offerings); see also Futterman, *supra* note 98, at 838-39 (discussing extent of consequences from non-compliance with Regulation S, including elimination of its "safe harbor").

103 See McLaughlin, *supra* note 33, at 21 (indicating concern that federal securities laws will apply to Internet offerings).

104 See Choi & Guzman, *supra* note 47, at 210-212 (indicating that issuer's intent is of no concern).

United States securities laws.<sup>105</sup>

### C. Conflicts With Other Nations Laws

The application of federal securities laws to IPO's on the Internet<sup>106</sup> raises issues of comity and questions of how far the international reach of United States laws should be extended.<sup>107</sup> The sparse legislative history addressing the extraterritorial scope of the securities laws is indicative of the fact that Congress did not foresee the expansive internationalization of securities markets when it passed the securities acts.<sup>108</sup> Recently, the SEC issued a concept release, posing questions on the regulation of exchanges, and suggesting that one option would be to have sole reliance on a foreign market regulation.<sup>109</sup> This approach would be similar to the multijurisdictional disclosure system<sup>110</sup> that the SEC adopted with Canada in the early 1990's.<sup>111</sup> The inherent problem in this approach to regulation, however, is that it is limited because it necessitates comparable securities laws in

<sup>105</sup> See Edelstein, *supra* note 97, at 286 (explaining that federal securities laws could apply to Internet offerings both before and after offer is sent). See generally Boyce & Hewitt, *supra* note 99, at 1 (discussing ramifications of merger of Internet and securities offerings).

<sup>106</sup> See Bradford P. Weirick, *Regulatory Hurdles May Impede IPO's on the Web*, NAT'L L.J., May 6, 1996, at B6 (discussing breadth of federal securities laws to foreign offerings over Internet).

<sup>107</sup> See Testy, *supra* note 31, at 929 (examining problems of international comity when offerings are made over Internet).

<sup>108</sup> See John W. Hamlin, Comment, *Exporting U.S. Law: Transnational Securities Fraud and Section 10(B) of the Securities Exchange Act of 1934*, 3 CONN. J. INT'L L. 373, 383 (1988) (indicating that Congress expressed few views on extraterritorial reach of Securities Acts when writing them).

<sup>109</sup> See Regulation of Exchanges, SEC Concept Release No. 34-38672, available in 1997 WL 276278. Under one approach, the SEC could simply rely on the enforcement of the securities laws and regulators in the foreign markets that the Internet offerings reach. *Id.* This approach, however, would only work if those foreign markets have laws and regulations substantially similar to the United States. *Id.* Furthermore, under this approach, the SEC could decide which of those foreign markets it believes are subject to comparable regulation. *Id.*

<sup>110</sup> See HAZEN, *supra* note 3, at 73. One possible solution to the jurisdictional dilemmas is the multijurisdictional disclosure system ("MJDS"). *Id.* The SEC adopted the MJDS as a way of facilitating registration and reporting requirements for qualifying Canadian securities issuers. *Id.* The impetus behind the MJDS was to ease the differences in securities laws by providing exemptions with participating nations. *Id.* The SEC intended to make similar arrangements with other nations, however, there were problems implementing the MJDS with countries whose securities laws varied greatly from United States securities laws. *Id.* Therefore, the possibility of utilizing a MJDS on a larger scale to correct the registration problems posed by securities offerings over the Internet is overcome by the same problem of international incompatibility. *Id.*

<sup>111</sup> See *id.* (indicating commencement date of MJDS).

participating countries.<sup>112</sup>

The *Restatement (Third) of the Foreign Relations Law* of the United States advocates less comity and indicates that federal securities laws have a broad extraterritorial reach in securities transactions.<sup>113</sup> The reach, however, is premised on conduct occurring in the United States.<sup>114</sup> In the context of the Internet, where the online transaction can be deemed to occur in the United States, thereby conferring federal jurisdiction, the law is substantially less clear.<sup>115</sup>

Another problem with the foreign market regulation approach is that the goals and interests of the United States securities laws may differ from those of other nations.<sup>116</sup> In contrast to the position taken by the *Restatement (Third)*, the SEC supports the view that investors should be allowed to choose the jurisdictional law to which they wish to be subject.<sup>117</sup> The SEC also advocates that requiring foreign markets to register under the 1934 Act could cause a conflict of laws and recognizes that United States securities laws should attempt to minimize conflicts with foreign markets.<sup>118</sup> Imposing United States laws on jurisdictions with different legal philosophies may be unjust since those who do not intend to offer securities on a global scale have no expectation of punishment as a result of their actions.<sup>119</sup>

<sup>112</sup> See *id.* (pointing towards inherent flaw in securities system based upon comparable securities laws and regulations).

<sup>113</sup> See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 416(1)(d) (1986). The Restatement states that the United States has jurisdiction with respect to "conduct occurring predominantly in the United States, that is related to a transaction in securities, even if the transaction takes place outside the United States." *Id.*

<sup>114</sup> See *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 987 (2d Cir. 1975) (upholding jurisdiction in securities fraud cases where conduct occurs within United States).

<sup>115</sup> See *Choi & Guzman, supra* note 47, at 1885 (explaining broad reach of federal securities laws when conduct occurs in United States).

<sup>116</sup> See *Testy, supra* note 31, at 956 (discussing problems of conflicting national laws on marketplace).

<sup>117</sup> See *Thorn EMI PLC, SEC No-Action Letter, available in* 1992 WL 56547, at \*6. The SEC has stated that "[a]s investors choose their markets, they choose the laws and regulations applicable in such markets." *Id.* (quoting Securities Act Release No. 33-6863 (April 24, 1990) 55 Fed. Reg. 18306).

<sup>118</sup> See *Regulation of Exchanges, SEC Concept Release No. 34-38672, available in* 1997 WL276278, at \*155. When posed with the possibility of requiring foreign markets to register under the United States securities laws, the SEC also foresaw problems that could occur such as the possibility that SEC requirements could conflict with the regulations that the foreign markets are already subject resulting in duplicative and expensive legal obligations. *Id.* In light of these problems, the SEC sought to minimize conflict with obligations imposed by the foreign country's primary regulators. *Id.*

<sup>119</sup> *Id.* (expressing SEC's view that principles of comity and reasonable expectations

### III. CONFINING THE BROAD REACH OF THE UNITED STATES SECURITIES LAWS WHEN APPLIED TO SECURITIES OFFERINGS OVER THE INTERNET

In the interests of comity, the SEC should provide an exemption from compliance with federal securities laws for foreign online securities offerings due to the problematic breadth of the United States securities laws when applied to the Internet.<sup>120</sup> When an United States interest is not involved, the United States should refrain from extending its securities laws abroad.<sup>121</sup>

The United States is confronting the problems presented by securities offerings over the Internet in two ways.<sup>122</sup> On the state level, several states have granted exemptions to online offerings that do not intend to offer securities in those states.<sup>123</sup>

of participants in global markets justify reliance on foreign jurisdictions laws to define requirements for transactions effected offshore); Fisch, *supra* note 40, at 523 (stating that imposition of United States regulations in cross border transactions has offended sovereignty of other countries which have reacted by passing retaliatory legislation of their own). See, e.g., Rachele Kauffman, *Secrecy and Blocking Laws: A Growing Problem as the Internationalization of Securities Markets Continues*, 18 VAND. J. TRANSNAT'L L. 809, 809 (1985) (discussing effects of Bank Secrecy Act on international securities transactions).

<sup>120</sup> See McGlosson, *supra* note 16, at 317 (arguing that possible exemption of IPO's from state securities regulations may solve problems of domestic regulation of IPO's); Weirick, *supra* note 106, at B6 (urging exemptions from state securities laws to IPO's that are not being directed toward that particular state for solicitation); see also David Feldman, *Electronic Delivery of Disclosure*, in 15TH ANNUAL FEDERAL SECURITIES INSTITUTE, at 427, 440-41 (ALI-ABA Course of Study No. SB69, 1997) (illustrating exemptions in other states with respect to registration for securities offers communicated through internet). See, e.g., Ronald M. Loeb, David J. Richter, *Electronic Offerings: Securities Law in the Age of the Internet*, in ADVANCED SECURITIES LAW WORKSHOP, 319, 319 (PLI Corp. L. and Practice Course Handbook Series No. 953, 1996) (describing effects of electronic offering of Spring Street Brewing Co.'s initial stock offering).

<sup>121</sup> See McCormick & Lewis, *supra* note 33, at 547, 556. For example, one instance of regulatory self-control is Pennsylvania's exemption, from its state securities registration requirements, for securities offerings made on the Internet that specially state they do not desire to sell securities in Pennsylvania. *Id.*

<sup>122</sup> See Martin, *supra* note 13, at 46 (explaining effects of securities offerings on Internet).

<sup>123</sup> See Raysman & Brown, *supra* note 21, at 1 (*quoting* Blue Sky Reports (CCH) Vol. 2A P42,586):

An offer for sale or purchase of a security or commodity within the meaning of New York General Business Law (GBL) Article 23-A will not be deemed to be made within [the State of New York] merely because an offer made on or through the Internet. . . originating outside [the State of New York] where (a) the offer indicates, directly or indirectly, that the offer is not being made to residents of the State of New York; (b) the offer is not specifically directed to any person in the State of New York by, or on behalf of, the offeror; and (c) no sales or purchases of the security or commodity are made in the State of New York as a result of the Offer until such time as all registration requirements pursuant to Article 23-A are fulfilled.

Nationwide, Congress has enacted the National Securities Markets Improvement Act of 1996 ("NSMIA")<sup>124</sup> to preempt individual state's securities registration requirements with regard to certain specified securities.<sup>125</sup>

### A. State Action

Under the current United States regulatory scheme, individual states may require that securities offered within their borders comply with state securities regulations.<sup>126</sup> Such states, however, may carve out compliance exemptions with regard to their securities requirements.<sup>127</sup> Nearly twenty states have exempted online offerings from their registration and advertising requirements.<sup>128</sup>

Pennsylvania set the regulatory pace when it enacted its stat-

*Id.*; see also John F. Olson & D. Jarrett Arp, *Factors a Company Should Consider in Selecting a Market in Which to Trade its Publicly Held Securities*, in *Postgraduate Course in FEDERAL SECURITIES LAW*, at 101, 120 (ALI-ABA Course of Study No. SB09, 1996) (illustrating effects of state's "Blue Sky" regulatory schemes).

<sup>124</sup> National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 101, 110 Stat. 3416, 3417 (codified as amended in scattered sections of 15 U.S.C.). See Olson & Arp, *supra* note 123, at 120 (discussing requirements of limited offerings); Gavis, *supra* note 11, at 374 (illustrating attempts made by SEC to address exemption issues under Regulation S); Aron Natarajan, *India: Net Catches Regulator's Attention*, BUSINESS LINE (Hindu), Sept. 16, 1997, at 1 (stating that United States is aware that on-line offering documents violate several provisions in United States securities laws).

<sup>125</sup> See Charles H.B. Braisted, *Private Placements and State Securities Laws*, in PRIVATE PLACEMENTS, at 945, 963 (PLI Corp. L. and Practice Course Handbook Series No. 983, 1997) (changing United States securities laws in response to NSMIA); see also Gavis, *supra* note 11, at 354 (explaining how NSMIA effectively lodges exclusive authority for registration of investment company offerings and securities offerings listed with SEC on national exchange). *But see* Rutherford B. Campbell, Jr., *Blue Sky Laws and the Recent Congressional Preemptive Failure*, 22 J. CORP. L. 175, 179 (1997) (criticizing NSMIA as "paltry" response to problems generated by state).

<sup>126</sup> See Feldman & Priebe, *supra* note 13, at 435, 439 (indicating existence of state power to regulate securities within its borders); Robert J. Ambrogi, *Internet Has a Wealth of Information for Securities Lawyers*, 20 CHICAGO LAW. Aug. 1997, at 8 (reviewing resources for lawyers in need of help with regulation of securities on Internet); Constance E. Bagley & John Arledge, *SEC Could Ease Offerings of Securities Via the Web*, NAT'L L.J. Jan. 13, 1997, at B9 (discussing CMEA preemption of state registration of offers to facilitate offerings on Internet).

<sup>127</sup> See Feldman & Priebe, *supra* note 13, at 439 (illustrating exemptions in other states for securities offers online); see also Olson & Arp, *supra* note 123, at 120 (discussing Pennsylvania exemption); Gregory C. Yadley, *The Challenges of Technology: The Regulatory Response to Securities Offerings on the Internet*, in 15TH ANNUAL FEDERAL SECURITIES INSTITUTE, at 189, 196 (ALI-ABA Course of Study No. SB69, 1997) (discussing requirements for state exemptions to apply); Gregory C. Yadley, *General Solicitation: Looking for Funds in all the Wrong Places*, 70 FLA. B.J. 80, 81 (1996) (stating that securities commissioners in many states have issued regulations or administrative orders detailing exemptions for online offerings).

<sup>128</sup> See McLaughlin, *supra* note 33, at 21 (discussing extent of Internet exemptions).

ute exempting online securities offers from the state's securities registration requirements in 1995.<sup>129</sup> To qualify for the exemption the offering has to indicate that the securities are not being offered to Pennsylvania residents and that no sales of the securities are made in Pennsylvania as a result of the Internet offer.<sup>130</sup> This exemption is not absolute, however, since the state retains jurisdiction over the offerings pursuant to the state's antifraud provisions.<sup>131</sup>

These exemptions have been spurred by the ease with which online offers are carried across state lines and the subsequent conflicts which arise when an online security offering is required to comply with every state's individual securities registration requirements.<sup>132</sup> The exemption was designed to create minimal state intrusion upon the national offering of securities over the

<sup>129</sup> See Brakebill, *supra* note 16, at 936 (discussing Pennsylvania's exemption of Internet securities offers from state securities requirements); see also Feldman, *supra* note 120, at 444 (stating that at one time Pennsylvania was only state exempting, from its qualification requirements, properly limited Internet offerings); Gavis, *supra* note 11, at 353 (stating that Pennsylvania was first state to address arising issues of application of state securities laws to offerings of securities over Internet).

<sup>130</sup> See Order of the Pennsylvania Securities Commission, *In Re: Offers Effected Through Internet That do not Result in Sales in Pennsylvania*, 1995 PA. SECS. LEXIS 71, at \*1 (Aug. 31, 1995). In 1995, Pennsylvania determined that offerings of securities over the Internet would constitute an offer for the purchase or sale of a security under the Pennsylvania Securities Act of 1972. *Id.* This determination meant that Internet offers would have to register and comply with the Pennsylvania securities laws. *Id.* Pennsylvania was concerned that state regulation could discourage use of the Internet for securities offerings and issued an order exempting from state registration requirements securities that followed certain provisions. *Id.* The provisions necessary to exempt Internet securities offerings from Pennsylvania's securities laws required that 1) the offer indicates directly or indirectly that the securities are not being offered to persons in Pennsylvania; and 2) an offer is not being made to any person in Pennsylvania by other means; and 3) no sales of the issuer's securities are made in Pennsylvania as a result of the Internet offer. *Id.*

<sup>131</sup> See Robert E. Carlson, *Reallocation of Federal-State Regulation of Securities Offerings*, in INVESTMENT COMPANY REGULATION AND COMPLIANCE, at 343, 345 (ALI-ABA Course of Study No. SB76, 1997) (discussing states' roles in regulating securities offerings); *Division of Investment Management the Year in Review: Regulation of Investment Companies, Investment Advisors and Public Utility Holding Companies in 1996*, in THE SEC SPEAKS IN 1997, at 7 n.24 (PLI Corp. L. and Practice Course Handbook Series No. 979, 1997) (comparing legislative history of title I of 1996 Act). See generally Brian J. Fahrney, *State Blue Sky Laws: A Stronger Case for Federal Precaution Due to Increasing Internationalization of Securities Markets*, 86 NW. U. L. REV. 753, 757 (1992) (stating goal of state regulatory Blue Sky laws is to protect investors from fraud).

<sup>132</sup> See Gavis, *supra* note 11, at 353 (discussing possible need for exemption from registration requirements of states due to problems imposed by them); Feldman, *supra* note 120, at 427, 440 (discussing actions of securities commissioners in various states issuing orders exempting registration for securities offers communicated through Internet); see also Brakebill, *supra* note 16, at 936 (discussing jurisdictional problems which happen as result of securities offerings online).

Internet.<sup>133</sup> Such exemptions prompted the North American Securities Administrators Association, Inc. ("NASAA") to adopt a resolution encouraging all state securities regulators to develop a uniform policy regarding the offering of securities over the Internet.<sup>134</sup> The resolution provides a framework for an exemption similar to the Pennsylvania statute.<sup>135</sup> One difference between the Pennsylvania statute and NASAA resolution does, however, exist.<sup>136</sup> The NASAA resolution allows the sales of securities online when the following two conditions are met: (1) no sales are made in the state until the offering is registered in that state and declared effective, and (2) the sales are exempt from registration.<sup>137</sup> The difference is that the NASAA provisions allow an issuer, who relied upon an Internet offering exemption, to register and sell its securities within that state at a later date.<sup>138</sup>

The exemptions offered by state regulatory agencies provide a

133 See Gavis, *supra* note 11, at 353-54 (indicating that states did not want to subject securities offerors, not seeking sales within their state, to be subject to state securities regulations).

134 See Weirick, *supra* note 106, at B6 (indicating NASAA's intentions to develop uniform policy); see also Gavis, *supra* note 11, at 354 (discussing exclusive authority of NSMIA over certain securities).

135 See K. Robert Bertran, *Offers and Sales of Securities on the Internet*, 42 No.7 PRAC. LAW. 23, 27 (1996) (stating that NASAA resolution used basic framework of Pennsylvania order); McCormick & Lewis, *supra* note 33, at 556 (explaining that NASAA exemption approach was in wake of similar Pennsylvania order); Linda C. Quinn & Otilie L. Jarmel, *Federal Disclosure Developments: Company Registration and New Trends in Raising Capital*, in POSTGRADUATE COURSE IN FEDERAL SECURITIES LAW, at 201, 259 (ALI-ABA Course of Study No. SC09, 1997) (indicating January 1996 NASAA resolution encouraged adoption of exemptions similar to Pennsylvania's).

136 See Bertran, *supra* note 135, at 27 (explaining NASAA exemption went one step further than Pennsylvania by allowing issuer who uses exemption to sell securities in that jurisdiction at later date); Quinn & Jarmal, *supra* note 135, at 259 (allowing issuer to resell in jurisdiction that originally granted exemption).

137 See Kristen Geyer & Nancy Sanow, *The Electronic Marketplace and Trading Issues*, in BROKER-DEALER REGULATION, at 241, 247-48 (ALI-ABA Course of Study No. SB35, 1997) (illustrating state activities with respect to NASAA resolution); see also Gavis, *supra* note 11, at 357 (explaining NASAA resolution encouraging all state securities regulators to develop a uniform policy concerning offers on Internet).

138 See Ellen Licberman & Ralph C. Naker, *The Best Entity for Doing the Deal: Securities Laws Considerations*, in THE BEST ENTITY FOR DOING THE DEAL, at 901, 931 (PLI Corp. L. and Practice Course Handbook Series No. 937, 1996) (stating that it is not yet required that acceptable investor suitability standards be established or disclosed in prospectus if security is exchange listed or will be within reasonable amount of time); Therese H. Maynard, *The Uniform Limited Offering Exemption: How 'Uniform' Is It? - An Evaluation and Critique of the ULOE*, 36 EMORY L.J. 357, 479 (1987) (discussing NASAA registration requirements pertaining to member states); Linda A. Wertheimer, *Current Federal and State Securities Laws Developments Affecting Limited Offerings*, in CAPITAL FORMATION: PRIVATE AND PUBLIC FINANCES, at 53, 96 (PLI Comm. L. and Practice Course Handbook Series No. 335, 1984) (illustrating NASAA guidelines which coordinate with Regulation D).

solution to the regulatory problems imposed by foreign IPO's.<sup>139</sup> The individual domestic actions, however, do not form a seamless web since many states have not adopted the Internet exemption from registration.<sup>140</sup>

### *B. National Securities Market Improvement Act of 1996*

The NSMIA, effective as of 1996,<sup>141</sup> intends to streamline the securities laws by striking a balance between conflicting state and federal securities laws.<sup>142</sup> The broad exemption power given to the SEC<sup>143</sup> under the NSMIA, gives Congress the ability to exempt any security or offering from state "Blue Sky" regulations so long as it is in the public's interest.<sup>144</sup>

<sup>139</sup> See Gavis, *supra* note 11, at 353-54 (indicating that Internet exemption from state "Blue Sky" laws is one possible solution); John E. Riley & David M. Katz, *Blue Sky Considerations in Initial Public Offerings*, in HOW TO PREPARE AN INITIAL PUBLIC OFFERING IN THE CURRENT MARKET, at 341, 357 (PLI Corp. L. and Practice Course Handbook Series No. 612, 1988) (stating that there is concern with unequal voting rights and anti-takeover measures, especially in context of securities' listing exemption).

<sup>140</sup> See Feldman & Priebe, *supra* note 13, at 438-39 (stating that state exemptions are not universally applied).

<sup>141</sup> National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, §101, 110 Stat. 3416, 3417 (1996) (codified as amended in scattered sections of 15 U.S.C.).

<sup>142</sup> See H.R. REP. NO. 104-864, at 90 (1996). The house in its report on NSMIA stated that its purpose was both to facilitate and to streamline the registration process for investment companies. *Id.*; see also S. REP. NO. 104-293, at 8-9 (1996). SEC chairman, Levitt, explaining the current problem of conflicting state and federal laws, was quoted stating that "[t]he current dual federal-state regulation is not the system that Congress or the Commission- would create today if we were designing a new system" *Id.* Furthermore, the Senate stated in its report that "[c]urrently the relationship [between state and federal securities laws] is confusing, conflicting, and involves a degree of overlap that may raise costs unnecessarily for American investors and the members of the securities industry." *Id.*; Gregory C. Yadley, *supra* note 127, at 193 (illustrating how NSMIA directly limits the ability of states to regulate the offering and distribution of securities); George Yearsich & Gregory Feis et. al., *Securities Law Aspects of Partnerships, LLC's, and LLP's*, in PARTNERSHIPS, LLC'S, AND LLP'S: UNIFORM ACTS, TAXATION, DRAFTING, SECURITIES, AND BANKRUPTCY, at 813, 927 (ALI-ABA Course of Study No. SB85, 1997) (describing how NSMIA pre-empts state "Blue Sky" regulation of securities offerings).

<sup>143</sup> See Statements by President William J. Clinton Upon Signing H.R. 3005, 32 WEEKLY COMP. PRES. DOC. 2038, at 2 (Oct. 14, 1996). Upon signing NSMIA into law, President Clinton stated that the new legislation gives the SEC a broad new general exemptive authority under both the Securities Act of 1933 and the Exchange Act of 1934. *Id.* The President also explained that the new exemptive power would allow the SEC to deal more effectively with the facts and circumstances of each individual situation. *Id.* See generally Pub. L. No. 104-290; *House Passes Bill to Privatize Edgar*; GOV'T COMPUTER NEWS 75, available in 1996 WL16569144, Vol. 15, No. 14, Issn: 0738-4300, Jun. 19, 1996 PR NEWSWIRE, *NASAA Issues Statement on Passage of H.R. 3005 by the House of Representatives*; John Boehner, *Gov't Press Releases by Federal Document Clearing House Floorprep*, June 18, 1996, available in 1996 WL 8788008.

<sup>144</sup> See Elizabeth Brandon-Brown, *New Law Loosens Rules Affecting Private Offerings*, L.A. BUS. J., May 5, 1997, at 23 (explaining new exemptions which do not require lengthy process of registering securities with SEC or under California "Blue Sky" laws); Lynn Stevens Hume, *Lawyer: Securities Reform Law Could Snag Muni Offerings*, BOND

Prior to the NSMIA, the SEC was limited in its ability to provide exemptions to securities and issuers.<sup>145</sup> Section 3(b) of the Securities Act provided for exemptions of offerings of up to the aggregate amount of five million dollars.<sup>146</sup> The NSMIA, however, authorizes the SEC to make exemptions available for any dollar amount.<sup>147</sup>

Another beneficial effect of the NSMIA is that it exempts state "Blue Sky" regulation of certain "covered" securities that are traded on the national market.<sup>148</sup> "Covered" securities include securities traded by brokers, investment banks, and any security traded on a recognized national exchange.<sup>149</sup> The NSMIA, how-

BUYER, Nov. 20, 1996, at 1 (stating that NSMIA poses potential pitfalls for municipal bond offerings); Yadley, *supra* note 127, at 193 (discussing effects of recently passed NSMIA on securities markets); *Legal Opinion to Boost Internet Securities Offerings*, 4 BANK MUT. FUND REP. No. 48, at 1 (1996) (describing opinion by Orrick, Herrington & Sutcliffe in which issuers of municipal bonds can offer their documents on Internet without violating state-enforced "Blue Sky" laws).

<sup>145</sup> See Braisted, *supra* note 125, at 945, 974 (stating that NSMIA preserved each state's ability to continue to collect a fee); Gordon K. Davidson, *Section 3(A) (10) of the Securities Act of 1933: The Use of State Fairness Hearings in Mergers and Acquisitions After the National Securities Markets Improvement Act of 1996*, in PRIVATE PLACEMENTS 1997, at 1099, 1099 (PLI Corp. L. and Practice Course Handbook Series No. 983, 1997) (illustrating effects of NSMIA on section 3(A)(10) of Securities Act of 1933); Willie R. Barnes, *The California Corporate Securities Law: An Overview of the Private Placement Exemption and Other Select Exemptions From Qualification*, in PRIVATE PLACEMENTS 1997, at 985, 985 (PLI Corp. L. and Practice Course Handbook Series No. 983, 1997) (discussing newly enacted exceptions in California).

<sup>146</sup> See Mary E.T. Beach & Gregory C. Yadley, *The SEC's Small Business Initiatives and Rules Facilitating Capital Raising by Small Business*, in 15TH ANNUAL FEDERAL SECURITIES INSTITUTE, at 203, 203 (ALI-ABA Course of Study No. SB69, 1997) (stating that \$5 million limitation under section 3(b) of Securities Act is limitation on offerings); Mary E.T. Beach, *Unregistered Offerings of Corporate Securities*, in PRIVATE PLACEMENTS 1997, at 45, 48 (PLI Corp. L. and Practice Course Handbook Series No. 983, 1997) (discussing interactions between section 4(6) and 3(b) of Securities Act); Jack H. Halperin, *Small and Exempt Offerings*, in SECURITIES FILINGS 1989: REVIEW AND UPDATE, at 557, 559 (PLI Corp. L. and Practice Course Handbook Series No. 661, 1989) (explaining exemptions and qualifications under section 3(b) of Securities Act).

<sup>147</sup> See Hugh Makens & Willie Barnes, *Blue Sky Practice*, in REGULATION D OFFERINGS AND PRIVATE PLACEMENTS, at 321, 322 (ALI-ABA Course of Study No. SB65, 1997) (analyzing issues arising with state exemption system incorporating Regulation D); Yadley, *supra* note 127, at 189 (stating that dollar limits could be raised to any level SEC deems appropriate).

<sup>148</sup> See Makens & Barnes, *supra* note 147, at 327. Specifically, NSMIA creates a new category of securities called "covered securities". *Id.* These securities are exempt from state blue sky regulation. *Id.*; Gregory G. Yearsich, *Securities Law Aspects of Partnerships, LLC's, and LLP's*, in PARTNERSHIPS, LLCs, AND LLPs: UNIFORM ACTS, TAXATION, DRAFTING, SECURITIES, AND BANKRUPTCY, at 813, 927 (ALI-ABA Course of Study No. SB85, 1997). The NSMIA can be used to preempt state blue-sky regulation of securities offerings of 'covered securities'. *Id.* Further, the NSMIA specifically provides that states also may not conduct so-called merit reviews of these offerings. *Id.*

<sup>149</sup> See Gavis, *supra* note 11, at 354 (discussing scope of NSMIA exemption from state "Blue Sky" requirements); see also Roger D. Blanc, *Broker-Dealer Regulation*, in BROKER-DEALER REGULATION, at 153, 165 (ALI-ABA Course of Study No. CA14, 1996)

ever, does not diminish state antifraud provisions, thereby allowing any state to pursue a cause of action for securities fraud under its own state securities laws.<sup>150</sup>

The goal of the NSMIA, as stated by President Clinton, is to "enhance capital formation and the competitiveness of the American economy by eliminating regulatory overlap between the states and the federal government. . . ."<sup>151</sup> The broad exemption power of the NSMIA empowers the SEC to create a balance between the state and federal securities laws in the United States.<sup>152</sup> It is submitted that the NSMIA has the ability to create an exemption for foreign Internet IPO's, with respect to those who do not seek to sell securities in the United States, while simultaneously keeping the federal securities laws from extending too far beyond American soil.<sup>153</sup>

*C. The Online Exemptions to Initial Public Offerings Over the Internet Currently Offered by Many States Should be Applied on the International Scale by the Federal Government*

The NSMIA is a suitable tool that should be utilized to enact an exemption for foreign online securities offerings from federal

(defining covered securities); Braisted, *supra* note 125, at 945, 972 (distinguishing between covered securities and federal covered securities); Richard H. Rowe, *The Capital Formation Provisions of the 1996 Act*, 11 NO. 5 INSIGHTS 8, 9 (1997) (listing various categories of covered securities).

<sup>150</sup> See Campbell, *supra* note 125, at 175 n. 140 (detailing section 18(c)(1) of Securities Act of 1933 as amended by NSMIA to specifically allow states to retain jurisdiction and to investigate and bring enforcement actions with respect to fraud); Thomas E. Geyer, *Viewing the Columbus Skyline: Incorporating Federal Law Into the Antifraud Standard of the Ohio Securities Act*, 28 U. TOL. L. REV. 301, 302 (1997) (noting NSMIA's express recognition of state plenary nature of state securities antifraud authority); Yearsich & Freis, *supra* note 142, at 974 (stating that states can always initiate cause of action for securities fraud); see also Makens & Barns, *supra* note 147, at 327 (stating that state jurisdiction to investigate and bring enforcement actions for fraud and deceit is not preempted).

<sup>151</sup> *Statements by President William J. Clinton Upon Signing H.R. 3005*, *supra* note 143, at 2.

<sup>152</sup> See Davidson, *supra* note 145, at 1099, 1136 (stating that NSMIA intended to lower costs in capital formation by allowing for dual regulation without duplicating regulation); see also Yearsich, *supra* note 148, at 927 (detailing distinctions between federal and state roles in NSMIA); cf. Blake Campbell, *Fairness Hearings Under the Corporate Securities Law of 1968 After the Enactment of the National Securities Markets Improvement Act of 1996*, State of California Business, Transportation and Housing Agency, Department of Corporations Release No.102-C, in PRIVATE PLACEMENTS 1997, at 1155, 1157 (PLI Corp. L. and Practice Course Handbook Series No. 983, 1997) (questioning whether NSMIA's intent is to require federal registrations of securities in transactions which could be exempt from such registration).

<sup>153</sup> See Weirick, *supra* note 106, at B6 (indicating possibilities of NSMIA).

securities laws.<sup>154</sup> The exemptions currently offered by many states are also a good solution to the problem of online offerings and should be applied in the international arena of United States securities law.<sup>155</sup> This exemption, however, should be subject to foreign issuers complying with the same requirements that the States and NASAA already require and provide that the federal securities antifraud provisions remain in effect.<sup>156</sup>

By utilizing the foreign securities exemption in the NSMIA, the broad reach of the federal securities laws could be curtailed.<sup>157</sup> The potential extraterritorial reach could then be confined to the territorial jurisdiction of the United States.<sup>158</sup> In turn, the use of the Internet to raise funds and develop capital markets is encouraged without subjecting the issuer to the United States securities laws and registration requirements.<sup>159</sup>

#### IV. CONCLUSION

The offering of securities over the Internet poses many new

<sup>154</sup> See Yearsich, *supra* note 148, at 975 (1997) (stating how NSMIA gives SEC and states separate regulation roles, one of which is power to exempt).

<sup>155</sup> See Weirick, *supra* note 106, at B6 (advocating exempting foreign issuers from federal securities laws when they do not seek to sell securities in United States).

<sup>156</sup> See *Interpretation; Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions, or Advertise Internet Services Offshore*, SEC Release No. 33-7516 (last modified Mar. 24, 1998) <<http://www.sec.gov/rules/concept/33-7516.htm>>. The SEC stated a similar view in its interpretive release on the same subject. *Id.* The SEC stated that it believed that foreign Internet offerings would not have to comply with the United States securities laws and registration requirements, but would still have to comply with the antifraud provisions, if those offerings take "adequate measures" not to directly target United States investors. *Id.* The "adequate measures" would depend on the circumstances, but would generally include; disclaimers on the websites indicating that the offering is only directed to countries other than the United States and procedures, such as determining the offeree's home address, to determine that the offeree is not a United States resident. *Id.* If these procedures were performed and the offering also complied with Regulation S's requirement that it be an "offshore transaction", the SEC believed that United States securities laws would not apply. *Id.*; see also Weirick, *supra* note 106, at B6. The author indicated his view that international exemption could be accomplished if same steps and precautions, i.e. disclaimer, etc., are taken as being done right now by state regulators. *Id.*

<sup>157</sup> See Thomas E. Geyer, *Viewing the Columbus Skyline: Incorporating Federal Law Into the Antifraud Standard of the Ohio Securities Act*, 28 U. TOL. L. REV. 301, 317 (1997) (stating that NSMIA lessens state responsibility with respect to securities regulation issues, leaving states to rely on federal standards and case law in fulfilling broad sweep of antifraud standards mandated by Congress).

<sup>158</sup> See SEC Release No. 33-7516, *supra* note 156 (discussing SEC's interpretation of limitations on reach of United States securities laws to qualify for Internet offerings); Geyer, *supra* note 157, at 317 (indicating need for federal legislation to confine reach of securities laws).

<sup>159</sup> See Davidson, *supra* note 145, at 1099, 1104 (indicating that NSMIA exemptions are intended to lower cost capital formation).

problems. At the forefront is the question of how far United States securities laws should be extended extraterritorially. Holding foreign offerors of securities to the stringent requirements of the federal securities laws, when those individuals do not wish to sell securities in the United States, seems unwarranted. Moreover, compliance with every jurisdiction's securities laws is seemingly an impossible obstacle to surmount, and might discourage the use of the Internet to raise capital. The approach taken by many individual states, of exempting certain securities, should be followed by the SEC. With the exemption power embodied in the NSMIA, the SEC can exempt those foreign offerings whose issuers do not wish to sell in United States jurisdictions and which state so in their offerings. The Internet exists in cyberspace, not in any one jurisdiction. To impose United States securities laws on every foreign offering appearing on the Internet would have severe international repercussions and discourages the use of the Internet as a tool to raise capital.

*Paul Hamilton*

