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The Second Circuit's Role in Expanding the SEC's Jurisdiction Abroad

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I. INTRODUCTION

The Second Circuit has had such a profound impact on securities law that it has been referred to in this context as the "Mother Court."[1] The breadth and significance of Second Circuit securities law decisions is not surprising. New York City is the financial center of the United States and the securities industry and its legal advisors are located there. In an economy which is increasingly international, New York City has become a center of international, as well as national finance, and the Second Circuit's securities law cases reflect this development.

The threat which globalization of the securities markets posed to the jurisdiction of the Securities and Exchange Commission ("SEC") was countered by SEC efforts to give the federal securities laws extraterritorial application. This Article will discuss the ways in which the Second Circuit assisted the SEC in expanding its jurisdiction abroad. Such expansion involved an interpretation of the court's subject matter jurisdiction to give the securities laws extraterritorial effect and the exercise of personal jurisdiction over defendants physically overseas. These cases generally gave the SEC whatever authority it requested, and sometimes even more than the SEC wanted. The cases have been controversial, but they have influenced other courts and the American Law Institute ("ALI") in its drafting of both the *Federal Securities Code*

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[1] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting).

("*Code*")[2] and the *Restatement (Third) of Foreign Relations Law of the United States* ("*Restatement*").[3]

Yet, New York is no longer the overwhelmingly dominant capital market it was after World War II and the securities markets are now international. The greater potential for conflict between U.S. securities laws and foreign securities laws requires a greater concern for comity in decision making. The *Restatement* reflects this concern. In certain respects, the SEC's claim of worldwide jurisdiction has put U.S. investors at a disadvantage when attempting to invest in foreign securities. Recently, the SEC has been engaged in rulemaking to reverse some of the jurisdictional latitude it received from the Second Circuit. Whether the *Restatement* and recent SEC initiatives will influence the Second Circuit to take a more conservative stance on securities law jurisdictional issues in the future is an open and interesting question.

II. Subject Matter Jurisdiction

A. *Generally*

The term "interstate commerce" is defined in section 2(a)(7) of the Securities Act of 1933 ("Securities Act") to include "trade or commerce in securities or any transportation or communication relating thereto . . . between any foreign country and any State, Territory, or the District of Columbia."[4] Similarly, section 3(a)(17) of the Securities Exchange Act of 1934 ("Exchange Act") defines interstate commerce as "trade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place or ship outside thereof."[5] In both statutes Congress clearly contemplated transnational securities transactions. Further, section 30(b) of the Exchange Act exempted from the Act's provisions or any regulation thereunder "any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as

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[2] FED. SEC. CODE (1980) [hereinafter CODE].

[3] RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (1987) [hereinafter RESTATEMENT].

[4] 15 U.S.C. § 77b(7) (1988).

[5] *Id.* § 78c(a)(17).

the Commission may prescribe."[6] Since the SEC has never passed any rules to implement section 30(b), the courts have been required to interpret this ambiguously phrased exemption.

The interests of international law and comity might have been best served by giving the phrase "without the jurisdiction of the United States" a territorial interpretation. This is because under traditional views of international law the basis of a state's jurisdiction is territorial.[7] Therefore, a statute ordinarily is "intended to be confined in its operation and effect to the territorial limits over which the lawmaker has general and legitimate power."[8] However, the Second Circuit elected to give the Exchange Act extraterritorial effect, interpreting "jurisdiction" as a legal rather than a geographical concept.[9] This interpretation influenced the ALI and the courts of other circuits to formulate exceptions to the presumption against extraterritoriality for conduct occurring abroad which has a substantial effect on U.S. investors or securities markets, or for transactions which occur abroad but where conduct relating to the transactions takes place within the United States.

B. The Effects Test

The 1968 Second Circuit decision of *Schoenbaum v. Firstbrook*[10] is a landmark opinion explicating the law on the extraterritorial application of the Exchange Act. This was a derivative action brought by an American shareholder of a Canadian corporation, Banff Oil Ltd. ("Banff"), whose shares were listed and traded on the American Stock Exchange. The complaint alleged that Banff sold treasury shares at a deflated price to Acquitane of Canada, Ltd. ("Acquitane") and Paribas Corporation ("Paribas").

Banff and Acquitane formed a joint venture to drill for oil in a desolate wilderness area in Alberta, Canada. Acquitane controlled Banff and had three directors on its board. In January 1965, Ac-

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[6] *Id.* § 78dd(b).

[7] *See* S.S. Lotus (Fr. v. Turk.), 1927 P.C.I.J. (ser. A) No. 9, at 18 (Sept. 7); The Apollon, 22 U.S. (9 Wheat.) 362, 370 (1824). The *Lotus* case, however, is doubtful authority. *See* Murano, *Extraterritorial Application of the Antifraud Provisions of the Securities Exchange Act of 1934*, 2 INT'L TAX & BUS. LAW. 298, 305-07 (1984).

[8] American Banana Co. v. United Fruit Co., 213 U.S. 347, 357 (1909); *accord* Foley Bros. v. Filardo, 336 U.S. 281, 285 (1949).

[9] Bersch v. Drexel Firestone, Inc., 389 F. Supp. 446, 453-55 (S.D.N.Y. 1974), *rev'd in part*, 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

[10] 405 F.2d 200 (2d Cir. 1968), *cert. denied sub nom.* Manley v. Schoenbaum, 395 U.S. 906 (1969). The SEC participated in this case as amicus curiae. *Id.*

quitane agreed to buy 500,000 shares of Banff common stock at $1.35, the exchange market price. In September 1965, Paribas, a Delaware subsidiary of a French bank, negotiated a purchase of 270,000 shares of Banff common stock at $7.30, the exchange market price. This issue was placed with ten European investors. These two transactions took place in Canada.

The plaintiff's theory of the case was that Banff was defrauded by its directors and controlling shareholder who combined to force it to sell treasury stock at the prevailing market price when they knew this price was artificially low.[11] In this connection, the directors withheld from public shareholders information about drilling discoveries that would have revealed the true value of the stock.[12]

The defendants argued that the court was without jurisdiction since the entire transaction occurred in Canada and between foreign corporations. The Second Circuit rejected that argument in language frequently utilized in subsequent cases:

> We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities. In our view, neither the usual presumption against extraterritorial application of legislation nor the specific language of Section 30(b) show Congressional intent to preclude application of the Exchange Act to transactions regarding stocks traded in the United States which are effected outside the United States, when extraterritorial application of the Act is necessary to protect American investors.[13]

The broad sweep of this holding was somewhat limited by the fact that Banff was a U.S. listed issuer, as the court stated in its ruling:

> We hold that the district court has subject matter jurisdiction over violations of the Securities Exchange Act although the trans-

[11] *Id.* at 210.

[12] *Id.* at 205-06, 215. After ruling on jurisdictional questions, the court held that there was no antifraud violation cognizable under the Exchange Act because the allegations were merely a breach of fiduciary duty by the controlling shareholders and directors, who were not deceived. *Id.* at 209. The court thus anticipated the Supreme Court's subsequent decision in Santa Fe Indus, Inc. v. Green, 430 U.S. 462 (1977) to the effect that a breach of fiduciary duty by majority shareholders is not actionable under rule 10b-5, 17 C.F.R. § 240.10b-5. *Schoenbaum*, 405 F.2d at 210-14. However, this portion of the opinion was modified in an en banc consideration. *Id.* at 217.

[13] *Schoenbaum*, 405 F.2d at 206.

actions which are alleged to violate the Act take place outside the United States, at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors.[14]

The *Schoenbaum* case is sometimes cited for the proposition that the Exchange Act applies extraterritorially even if conduct occurs wholly outside the United States if there is a substantial effect within the United States as a direct and foreseeable result of the conduct.[15] However, the Second Circuit actually found that negotiations were conducted in the United States and there was a use of the mails from New York.[16]

C. *The Conduct Test*

In 1972, the Second Circuit articulated an alternative rationale for applying the securities laws extraterritorially in *Leasco Data Processing Equipment Corp. v. Maxwell*.[17] In this case, the court refused to grant a motion to dismiss for lack of subject matter jurisdiction based on allegations of fraud in connection with the purchase by a U.S. corporation[18] of stock in a British corporation which was effected over the London Stock Exchange. The defendants were British citizens and corporations who made misrepresentations both in London and New York. A contract relating to the stock purchase was negotiated and signed in New York.

The court held that section 10(b) embraced a fraud in which a foreigner came to the United States and fraudulently induced an American to purchase foreign securities abroad. While the court suggested that, since the issuer was foreign, it was doubtful the statute would be applicable "if the misconduct had occurred solely in England . . . it tips the scales in favor of applicability when sub-

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[14] *Id.* at 208.

[15] CODE, *supra* note 2, § 1905(a)(1)(D)(ii) comment 1(a), at 983. The United States is one of the few countries which imposes liability on actors for conduct abroad that produces adverse economic effects, as opposed to physical harm, within the United States. *See* RESTATEMENT, *supra* note 3, § 402 comment d, at 239.

[16] *See Schoenbaum*, 405 F.2d at 210.

[17] 468 F.2d 1326 (2d Cir. 1972).

[18] *Id.* at 1339. The purchaser was actually a Netherlands Antilles subsidiary of a U.S. corporation, but the court held that since the subsidiary was wholly owned, its debt was guaranteed by the parent and its common stock was convertible into that of the parent, the foreign entity was the alter ego of the American. *Id.* at 1338; *accord* IIT v. Cornfeld, 619 F.2d 909, 919-20 (2d Cir. 1980).

stantial misrepresentations were made in the United States."[19]

The theory articulated in *Leasco* that the federal securities laws could be applied extraterritorially if fraudulent conduct in connection with a securities transaction occurred in the United States was amplified in two cases decided by the Second Circuit on the same day. The opinions in *Bersch v. Drexel Firestone, Inc.*[20] and *IIT v. Vencap, Ltd.*[21] were both written by Judge Friendly, as was the *Leasco* opinion.

Bersch was a class action by predominantly foreign citizens and residents against I.O.S., Ltd. ("IOS"), a Canadian corporation engaged in the sale and management of mutual funds, and affiliated persons, underwriters, and accountants. The action was based on misrepresentations and omissions in prospectuses used in the sale of IOS stock. Although various acts preparatory to the fraud occurred in New York, "[a]t most the acts in the United States helped to make the gun whence the bullet was fired from places abroad."[22] The court therefore eliminated from the plaintiff class all purchasers other than persons who were residents or citizens of the United States,[23] holding that the antifraud provisions of the federal securities law:

> (1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and (2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but (3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses.[24]

The *Vencap* case involved a complex scheme by a Bahamian corporation and various individuals, the primary malefactor being a U.S. citizen residing in the Bahamas, to defraud a Luxembourg investment trust. The court took the position that Congress did

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[19] *Leasco*, 468 F.2d at 1337.

[20] 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

[21] 519 F.2d 1001 (2d Cir. 1975). The SEC participated in this case as amicus curiae. *Id.* at 1003.

[22] *Bersch*, 519 F.2d at 987.

[23] *Id.* at 997.

[24] *Id.* at 993. Imposition of liability for injury to U.S. citizens abroad is more commonly imposed for physical rather than economic harm. *See supra* note 15.

not intend "to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners."[25] Accordingly, the court had subject matter jurisdiction over a suit for rescission and damages by a defrauded foreign investor. However, the court limited this holding to individual plaintiffs as opposed to class action plaintiffs and also limited jurisdiction to the perpetration of fraudulent acts themselves and not "to mere preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries."[26]

The fine distinction drawn in *Bersch* and *Vencap* was reaffirmed and exemplified in *Fidenas AG v. Compagnie Internationale Pour L'Informatique CII Honeywell Bull S.A.*,[27] in which a complaint under section 10(b) of the Exchange Act was dismissed for lack of subject matter jurisdiction. The plaintiffs were a Bahamian corporation and a German citizen residing in Switzerland. The defendants were a Swiss computer sales company operating in Switzerland, and related entities, a Swiss citizen, and a French citizen. The multinational fraud set forth in the complaint involved events and parties in six countries resulting in the issuance of fraudulent and forged notes by the principal corporate defendant. The court found that any acts in the United States were "secondary or tertiary aspects of the fraud at most" and were not committed by the defendants.[28] The court therefore affirmed dismissal of the complaint on the ground that the transactions were predominantly foreign and the court "would be no less than astonished" to learn that Congress would have wished the court's "precious resources" to be devoted "to a case of this nature."[29]

More recently, in *Alfadda v. Fenn*,[29.1] the Second Circuit reversed a lower court dismissal of a section 10(b) complaint, brought by residents and nationals of Saudi Arabia against various foreign financial institutions and two U.S. citizens. The case involved a prospectus that was placed into investor hands outside the United States, which stated that shares would not be sold in the United States. The plaintiffs' voting rights were diluted and

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[25] *Vencap*, 519 F.2d at 1017.
[26] *Id.* at 1018.
[27] 606 F.2d 5 (2d Cir. 1979).
[28] *Id.* at 8.
[29] *Id.* at 10.
[29.1] 935 F.2d 475 (2d Cir. 1991).

the prospectus became fraudulent when additional voting shares were sold domestically. The court upheld the complaint under the "conduct" test because conduct consummating the fraud occurred in the United States. Further, the Second Circuit then gave extraterritorial effect to the Racketeer Influenced and Corrupt Organizations Act ("RICO")[29.2] on the theory that the post-prospectus activities of the defendants were predicate acts which occurred primarily in the United States and could serve as a basis for subject matter jurisdiction for RICO claims.[29.3]

D. Protection of U.S. Interests

The "conduct" and "effects" tests formulated by the Second Circuit are mechanical, black letter law concepts. The policy concern of the court in applying the securities laws extraterritorially has been the protection of U.S. investors and markets, a far more subjective and fact specific concept. In *Bersch*, Judge Friendly stated that "there is subject matter jurisdiction of fraudulent acts relating to securities which are committed abroad only when these result in injury to purchasers or sellers of those securities in whom the United States has an interest, not where acts simply have an adverse . . . [effect] on the American economy or American investors generally."[30]

In *Psimenos v. E.F. Hutton & Co.*,[31] which involved the extraterritorial application of the Commodities Exchange Act,[32] the Second Circuit interpreted *Bersch* as expressing a concern that the court "entertain suits by aliens only where conduct material to the completion of the fraud occurred in the United States."[33] Similarly, in *IIT v. Cornfeld*[34] the Second Circuit upheld subject matter jurisdiction where a foreign company purchased securities of two U.S. companies. The court thought that "Congress would have been considerably more interested in assuring against the fraudulent issuance of securities constituting obligations of American

[29.2] 15 U.S.C. § 1962 (a) - (d) (1988).

[29.3] The court did not discuss the question of whether such post-prospectus activities were sufficient to make the prospectus false or misleading under section 10(b).

[30] *Bersch*, 519 F.2d at 989.

[31] 722 F.2d 1041 (2d Cir. 1983).

[32] 7 U.S.C. § 1 *et seq.* (1982).

[33] *Psimenos*, 722 F.2d at 1046.

[34] 619 F.2d 909 (2d Cir. 1980). The SEC participated in this case as amicus curiae. *Id.* at 912.

rather than purely foreign business."[35] *Arthur Lipper Corp. v. Securities and Exchange Commission*[36] was a petition for review of an SEC disciplinary proceeding against a broker-dealer for paying give-ups at the expense of offshore funds, only one of which had U.S. shareholders. The court held that there was no reason why the United States could not "prescribe a rule for conduct within its borders even if another country having an interest might be less rigorous."[37] The most tenuous Second Circuit case upholding subject matter jurisdiction brought by a foreign investor is *AVC Nederland B.V. v. Atrium Investment Partnership*,[38] in which a Dutch investor brought a securities fraud action against a partnership formed under Georgia law by Dutch citizens for the purpose of purchasing and operating a building in New York. The court recognized that the issuer, although nominally American, was really Dutch, but "by a rather slight margin" decided it was reasonable to apply U.S. law.[39]

The Second Circuit's strong interest in protecting U.S. investors, even in a predominantly foreign transaction, was demonstrated in *Consolidated Gold Fields PLC v. Minorco S.A.*[40] This case arose out of a hotly contested tender offer by Minorco, S.A. for Consolidated Gold Fields PLC ("Gold Fields"). Minorco was a Luxembourg corporation controlled by South Africans which had a 29.9% stake in Gold Fields. Minorco tendered for the 70.1% of Gold Fields it did not already own. Approximately 2.5% of Gold Fields stock with a market value of approximately $120 million was owned by U.S. investors; over half of these shares were held indirectly through nominee accounts in the United Kingdom. The Minorco offer was not mailed into the United States, but it was mailed to British nominees for U.S. shareholders. Minorco stated it would accept tenders from U.S. residents as long as the acceptance form was sent to Minorco from outside the United States. Gold Fields sued Minorco from outside the United States. Gold Fields sued Minorco under the antitrust laws and also under the federal securities laws, alleging that Minorco made false and misleading

[35] *Id.* at 920.
[36] 547 F.2d 171 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978).
[37] *Id.* at 179.
[38] 740 F.2d 148 (2d Cir. 1984).
[39] *Id.* at 154-55. However, in light of a forum selection clause in the agreement between the parties calling for the application of Dutch law and a decision by a Utrecht court, the case was dismissed. *Id.* at 155-56.
[40] 871 F.2d 252, *modified*, 890 F.2d 569 (2d Cir. 1989).

statements concerning the extent to which it was controlled by South African corporations and individuals.

Relying upon *Schoenbaum*, *Leasco*, and *Bersch*, the Second Circuit held that the district court should have found subject matter jurisdiction. Minorco knew that the British nominees were required by law to forward the tender offer documents to shareholders in the United States and this "effect" was a direct and foreseeable result of the conduct outside the territory of the United States. Since American shareholders were allegedly defrauded, there was subject matter jurisdiction.[41]

The SEC as amicus curiae had argued in support of subject matter jurisdiction over the fraud claims, but had urged the court to abstain for reasons of international comity, from enjoining the tender offer worldwide pending corrective disclosure.[42] The court declined to do so, but rather remanded the case to the district court to determine whether an appropriate remedy, consistent with comity principles, could be fashioned.[43] The stand taken by the Second Circuit in *Gold Fields* in support of its vision of U.S. interests was very aggressive in that Minorco arguably was acting contrary to British law in instituting a lawsuit in the United States and the lawsuit defeated the tender offer.[44]

E. Influence on the ALI

There has been a symbiotic relationship between the Second Circuit and the ALI in the development of the law concerning the extraterritorial reach of the federal securities laws. Several of the Second Circuit cases discussed above, including the seminal Judge Friendly conduct test opinions,[45] refer to the *Restatement (Second) of Foreign Relations Law of the United States* ("*Second Restatement*").[46] Subsequently, in drafting the *Code*,[47] the ALI relied heavily on Second Circuit cases in drafting pertinent provisions on extraterritoriality. Similarly, in revising the *Second Restatement* during the 1980's the ALI not only grappled with the Second Cir-

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[41] *Id.* at 262-63.

[42] *Gold Fields*, 890 F.2d at 569.

[43] *Consolidated Gold Fields*, 871 F.2d at 263.

[44] *See* Epstein, *Takeover Panel Regains Control in B.A.T. Ruling*, N.Y.L.J., Dec. 4, 1989, at 41, col. 1.

[45] *See Bersch*, 519 F.2d at 985; *Leasco*, 468 F.2d at 1339.

[46] RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (1965).

[47] *See* CODE, *supra* note 2.

cuit's opinions, but developed a special section on jurisdiction to regulate securities activities.[48] In the *AVC Nederland* case the Second Circuit then rested its finding of subject matter jurisdiction on this provision of the revised *Restatement*.[49]

The Second Circuit cases deal essentially with the extraterritorial application of the antifraud provisions of the Exchange Act, although at least one opinion applied regulatory provisions in an equally expansive way.[50] The *Code* distinguished between the ex-

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[48] *See* RESTATEMENT, *supra* note 3, § 416, at 295-96. Section 416 of the *Restatement* provides:

Jurisdiction to Regulate Activities Related to Securities

(1) The United States may generally exercise jurisdiction to prescribe with respect to

(a)(i) any transaction in securities carried out in the United States to which a national or resident of the United States is a party, or

(ii) any offer to enter into a securities transaction, made in the United States by or to a national or resident of the United States;

(b) any transaction in securities

(i) carried out, or intended to be carried out, on an organized securities market in the United States, or

(ii) carried out, or intended to be carried out, predominantly in the United States, although not on an organized securities market;

(c) conduct, regardless of where it occurs, significantly related to a transaction described in Subsection (1)(b), if the conduct has, or is intended to have, a substantial effect in the United States;

(d) 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; or

(e) investment advice or solicitation of proxies or of consents with respect to securities, carried out predominantly in the United States.

(2) Whether the United States may exercise jurisdiction to prescribe with respect to transactions or conduct other than those addressed in Subsection (1) depends on whether such exercise of jurisdiction is reasonable in the light of § 403, in particular

(a) whether the transaction or conduct has, or can reasonably be expected to have, a substantial effect on a securities market in the United States for securities of the same issuer or on holdings in such securities by United States nationals or residents;

(b) whether representations are made or negotiations are conducted in the United States;

(c) whether the party sought to be subjected to the jurisdiction of the United States is a United States national or resident, or the persons sought to be protected are United States nationals or residents.

Id.

[49] *See AVC Nederland*, 740 F.2d at 154.

[50] *See* Roth v. Fund of Funds, Ltd., 405 F.2d 421, 422-23 (2d Cir. 1968) (per curiam) (short-swing profit provisions), *cert. denied*, 394 U.S. 975 (1969). For a district court opinion applying a regulatory provision to a foreign financial institution, see United States v. Weisscredit Banca Commerciale E D'Investimenti, 325 F. Supp. 1384, 1391 (S.D.N.Y. 1971) (mar-

traterritorial application of the antifraud provisions and the extraterritorial application of registration and other regulatory provisions.

Section 1905(a)(1)(A) provides that the *Code* is applicable to purchases, sales, offers, proxy solicitations, tender offers, and investment advisory activity occurring within the United States, although initiated outside the United States. Section 1905(a)(2) applies the *Code*'s antifraud provisions only to such transactions if they are initiated within the United States, but occur elsewhere. In addition, section 1905(a)(1)(B) applies the *Code* to such nonresidents who have a certain status to which the *Code* attaches significance, even if there has been no conduct by them within the United States. Such persons include registrants, officers, directors, and shareholders of companies which are registered and reporting under the Exchange Act. These formulations rely heavily on Judge Friendly's opinions in *Leasco, Bersch,* and *Vencap* as well as the *Schoenbaum* opinion.[51] However, the *Code*'s formulation is more precise than the conduct or effects tests, and gives the SEC a very free hand in prosecuting and regulating transnational securities transactions.

The revision of the *Restatement* proved more controversial, insofar as the SEC was concerned, since it was premised on a balancing test, labelled "reasonableness," derived from antitrust cases.[52] This test places great weight on comity and the need to

gin regulations).

[51] *See* CODE, *supra* note 2, § 1905(a)-(c) comment, at 983-96. The *Code* does not, however, discriminate against injured foreign investors to the same degree as *Bersch. See id.* § 1905(a)(1)(D)(i), (a)(2).

[52] *See* RESTATEMENT, *supra* note 3, § 403, at 244-45. Section 403 of the *Restatement* provides:

> Limitations on Jurisdiction to Prescribe
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> (1) Even when one of the bases for jurisdiction under § 402 is present, a state may not exercise jurisdiction to prescribe law with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable.
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> (2) Whether exercise of jurisdiction over a person or activity is unreasonable is determined by evaluating all relevant factors, including, where appropriate:
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> (a) the link of the activity to the territory of the regulating state, *i.e.*, the extent to which the activity takes place within the territory, or has substantial, direct, and foreseeable effect upon or in the territory;
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> (b) the connections, such as nationality, residence, or economic activity, between the regulating state and the person principally responsible for the activity to be regulated, or between that state and those whom the regulation is designed to protect;
>
> (c) the character of the activity to be regulated, the importance of regu-

accommodate the interests of foreign states. The SEC's General Counsel submitted extensive comments to the ALI, strongly criticizing the reasonableness test and advocating section 1905 of the *Code* as a straightforward restatement of current law and practice.[53] The ALI then tailored section 416 to address the SEC's concerns.

In so doing, the ALI, while making reference to the "reasonableness" standard, essentially recognized the conduct test as set forth in *Leasco, Bersch, Vencap, Cornfeld, Psimenos,* and *Lipper,* and the effects test as set forth in *Schoenbaum.* The comment to section 416 discusses the policy of protecting U.S. securities markets and investors articulated in those cases. Although the accommodation made by the ALI to the SEC was gratifying to the SEC, the pitfalls of rejecting the more general balancing test can be seen in the *Gold Fields* case. Although under the balancing test the conduct and effects tests can be considered, other relevant factors could have reversed the outcome of the case. These other factors include: justified expectations of the parties; the extent to which U.S. regulation is consistent with the traditions of the international system; the extent to which another state may have an interest in regulating the activity; and the likelihood of conflict with regulation by other states.[54] By drafting a special provision on ju-

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> lation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted;
> (d) the existence of justified expectations that might be protected or hurt by the regulation;
> (e) the importance of the regulation to the international political, legal, or economic system;
> (f) the extent to which the regulation is consistent with the traditions of the international system;
> (g) the extent to which another state may have an interest in regulating the activity; and
> (h) the likelihood of conflict with regulation by another state.
>
> (3) When it would not be unreasonable for each of two states to exercise jurisdiction over a person or activity, but the prescriptions by the two states are in conflict, each state has an obligation to evaluate its own as well as the other state's interest in exercising jurisdiction, in light of all the relevant factors, Subsection (2); a state should defer to the other state if that state's interest is clearly greater.

Id.; *see also* SEC STAFF REPORT, VII INTERNATIONALIZATION OF THE SECURITIES MARKETS 21-23 (July 27, 1987) [hereinafter SEC STAFF REPORT] (criticized reasonableness test).

[53] *See* SEC STAFF REPORT, *supra* note 52; *see also* Goelzer, Stillman, Walter, Sullivan & Michael, *The Draft Revised Restatement: A Critique from a Securities Regulation Perspective,* 19 INT'L LAW. 431, 472-75 (1985) (narrowing of jurisdiction undermines § 1905).

[54] RESTATEMENT, *supra* note 3, at § 403(2)(d), (f)-(h), at 245.

risdiction in securities cases, the ALI left any such balancing of U.S. and international interests to the SEC.

F. Influence on Other Circuits

Only five circuits, in addition to the Second Circuit, have considered the extraterritorial application of the federal securities laws. Those courts that have done so have based their analysis on the conduct and effects tests of the Second Circuit. Very generally, the Eighth, Third, and Ninth Circuits interpreted the reach of the securities laws even more liberally than the Second Circuit, while the D.C. and Fifth Circuits took a more conservative approach and followed the Second Circuit on rejecting mere preparatory conduct in the United States as a sufficient predicate for jurisdiction. Decisions of other circuits, in turn, influenced the Second Circuit in *Gold Fields.*

1. Eighth Circuit

The Eighth Circuit was the first to follow the Second Circuit's lead in applying the securities laws to events abroad when in 1973 it decided *Travis v. Anthes Imperial Ltd.*[55] This was a class action by U.S. shareholders alleging a violation of the Exchange Act by misrepresentations made with regard to a tender offer by one Canadian corporation for shares of another Canadian corporation. The bidder only extended the offer to the Canadian shareholders and falsely misled the U.S. shareholders to believe that another offer would be extended to them at the same value. The district court dismissed the case on the ground that the transaction was an essentially Canadian one. On the authority of *Schoenbaum,* it took the view that there had to be substantial acts with respect to the alleged violations in the United States.[56] The Eighth Circuit reversed on the authority of *Leasco* and the *Restatement,* holding that "subject matter jurisdiction attaches whenever there has been significant conduct with respect to the alleged violations in the United States. And this is true even though the securities are foreign ones that had not been purchased on an American exchange."[57]

[55] 473 F.2d 515 (8th Cir. 1973). The SEC participated in this case as amicus curiae. *Id.* at 516.

[56] *Id.* at 523.

[57] *Id.* at 524.

Five years later, the Eighth Circuit again reversed a dismissal for lack of subject matter jurisdiction in *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*,[58] a case with a foreign plaintiff and foreign defendants, involving a fraudulent nondisclosure in a 100% stock sale. Although the foreign plaintiff corporation was a wholly-owned subsidiary of a Delaware corporation, and its loss in the transaction was reflected in the financial statements of its parent, the court held this was too remote to constitute a domestic effect under the *Schoenbaum* test.[59] However, in the court's view, the conduct and effects tests were alternatives, and the conduct of the defendants in the United States in furtherance of the fraudulent scheme was significant.[60] Although relying on the *Bersch* decision, the court recognized that it was relaxing the standard for the necessary domestic conduct required to find subject matter jurisdiction in the Second Circuit, and sided with the more liberal Third Circuit interpretation of subject matter jurisdiction[61] for admittedly policy reasons.[62]

2. Third Circuit

The Eighth Circuit in the *Continental Grain* case viewed *SEC v. Kasser*[63] as going beyond Second Circuit precedents and other courts and commentators have also taken this view.[64] However, the 1977 opinion by Judge Adams bows to the Second Circuit's "special expertise in matters pertaining to securities,"[65] and is based on Second Circuit jurisprudence. *Kasser* was an action for an injunction by the SEC against defendants who defrauded a foreign corporation with respect to the purchase and sale of various securities in a Canadian and a Delaware corporation, both of which had offices in New Jersey. The court found that there was nothing in

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[58] 592 F.2d 409 (8th Cir. 1979).

[59] *Id.* at 417.

[60] *Id.* One New York district court had held that both conduct and effects were required to find subject matter jurisdiction. Selzer v. Bank of Bermuda Ltd., 385 F. Supp. 415, 418 (S.D.N.Y. 1974); *see also* Karmel, *The Extraterritorial Application of the Federal Securities Code*, 7 CONN. L. REV. 669, 677-82 (1975) (conduct nexus).

[61] Travis v. Anthes Imperial, Ltd., 473 F.2d 515, 524 (8th Cir. 1973).

[62] *Id.* at 521.

[63] 548 F.2d 109 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977).

[64] In Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 31 (D.C. Cir. 1987), Judge Bork viewed *Continental* as a repudiation of the Second Circuit's requirement that domestic conduct constitute the elements of a rule 10b-5 violation. *See* Murano, *supra* note 7, at 311.

[65] *Kasser*, 548 F.2d at 115.

section 10(b) "to thwart [its] application to fraudulent transactions when the actual locus of the harm is outside the territorial limits of the United States."[66] However, the court also found that there "was much more United States-based activity in the present case than in *Bersch*."[67]

The way in which *Kasser* expanded on cases decided to that point was that there were no U.S. victims of the fraud perpetrated. This extension of jurisdiction was seen as a policy decision. The court was "reluctant to conclude that Congress intended to allow the United States to become a 'Barbary Coast,' as it were, harboring international securities 'pirates.' "[68] Such a sentiment was very much like Judge Friendly's view, cited by Judge Adams, that Congress did not intend to allow the United States to be used as a base for manufacturing fraudulent security devices for export.[69]

3. Ninth Circuit

In *SEC v. United Financial Group, Inc.*,[70] the Ninth Circuit affirmed an injunction against U.S. sellers of offshore mutual funds. The defendants claimed that their sales were confined to foreigners, but there was a showing of offers and sales to Americans and substantial activities by the defendants within the United States. Relying on the *Schoenbaum* case, the court rejected the contention that section 30(b) exempted activities outside the territorial limits of the United States, and focusing on the defendant's activities within the United States and the impact of those activities on American investors, found jurisdiction.[71]

Subsequently, in *Des Brisay v. Goldfield Corp.*,[72] the Ninth Circuit upheld jurisdiction in a suit by the former shareholders of a Canadian corporation for fraud perpetrated on them by a U.S. corporation listed on the American Stock Exchange, which took over the Canadian corporation in a stock transaction. Relying on Second Circuit precedents, the court held that the fact that an improper transaction occurred outside the United States or involved parties other than U.S. citizens did not defeat jurisdiction.

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[66] *Id.* at 114.
[67] *Id.* at 115.
[68] *Id.* at 116.
[69] *Id.*
[70] 474 F.2d 354 (9th Cir. 1973).
[71] *Id.* at 357-58.
[72] 549 F.2d 133 (9th Cir. 1977).

Then, in *Grunenthal GmbH v. Hotz*,[73] where the plaintiff and all of the defendants were foreign citizens or corporations, the Ninth Circuit, following the lead of the Eighth Circuit, elected to extend its subject matter jurisdiction more broadly than the Second Circuit. Some conduct had taken place in the United States and instrumentalities of interstate commerce had been used to effect the fraud. While the court stated that it was adopting the *Continental Grain* test and holding that significant conduct alone (without effects) was sufficient to establish subject matter jurisdiction,[74] it cited and interpreted the Second Circuit cases as not inconsistent. It pointed out that in *Cornfeld* the Second Circuit had cited *Continental Grain* with approval and it held that the defendants in *Grunenthal* had made significant representations in the United States that furthered the fraudulent scheme and were not merely preparatory.[75]

4. D.C. Circuit

In *Zoelsch v. Arthur Andersen & Co.*,[76] Judge Bork took the opportunity to interpret the Third, Eighth, and Ninth Circuits' subject matter tests in transnational fraud cases as more relaxed than that of the Second Circuit, and to adopt the Second Circuit's more restrictive approach as better.[77] *Zoelsch* was an action by German investors against a U.S. accounting firm based on misrepresentations made in connection with the sale of interests in a U.S. real estate partnership. A West German affiliate of the U.S. accounting firm had audited the investment plan and the audit mentioned that inquiries had been made of the U.S. accounting firm. The West German accounting firm was being sued in Munich. The court framed the issue as whether American court jurisdiction over securities law claims will lie "against a defendant who acted in the United States when the securities transaction occurred abroad and there was no effect felt in this country."[78]

In Judge Bork's view, such a case should take into account considerations of comity and foreign affairs and not presume that

[73] 712 F.2d 421 (9th Cir. 1983).
[74] *Id.* at 425.
[75] *Id.* at 426.
[76] 824 F.2d 27 (D.C. Cir. 1987).
[77] *Id.* at 31.
[78] *Id.* at 29.

Congress intended to protect foreign investors.[79] Indeed, the court expressed the view that "[w]ere it not for the Second Circuit's preeminence in the field of securities law, and our desire to avoid a multiplicity of jurisdictional tests, we might be inclined to doubt that an American court should ever assert jurisdiction over domestic conduct that causes loss to foreign investors."[80] Accordingly, the court adopted the Second Circuit view on jurisdiction for domestic conduct, which it articulated as follows:

> [J]urisdiction is appropriate when the fraudulent statements or misrepresentations originate in the United States, are made with scienter and in connection with the purchase or sale of securities, and "directly cause" the harm to those who claim to be defrauded, even if reliance and damages occur elsewhere.[81]

Judge Wald, concurring, objected to the rationale of the majority that even under the less strict approach of the Third, Eighth, and Ninth Circuits, the defendant's misrepresentations and omissions were so insignificant and so indirectly related to the overall fraudulent scheme that no federal jurisdiction would exist.[82]

5. Fifth Circuit

The first Fifth Circuit case to consider the extraterritorial application of the securities laws was a criminal prosecution, *United States v. Cook*.[83] The defendants, operating out of Dallas, Texas, defrauded European investors by operating a Ponzi scheme in the offer and sale of fractional undivided interests in oil and gas wells located in the United States. Some investors were defrauded, in

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[79] *Id.* at 33. The court expressed the view that in actions brought by the SEC it might take a more expansive view because the SEC as a responsible governmental agency would take into account in framing its enforcement actions any foreign policy concerns communicated to it by the Department of State. *Id.* at 33 n.3.

[80] *Id.* at 32. A recent law review article has argued that Congress did not intend to give foreigners access to U.S. courts in securities fraud cases. *See* Sachs, *The International Reach of Rule 10b-5: The Myth of Congressional Silence*, 28 COLUM. J. TRANSNAT'L L. 677 *passim* (1990). Despite the useful and interesting legislative history set forth by Sachs, this author finds the data inconclusive.

[81] *Zoelsch*, 824 F.2d at 33.

[82] *Id.* at 36. Actually, the facts in this case were not dissimilar to the facts in AVC Nederland B.V. v. Atrium Investment Partnership, 740 F.2d 148 (2d Cir. 1984) where the Second Circuit upheld jurisdiction, in that the securities involved in both cases were partnership interests in U.S. real estate, but there was more conduct, including misrepresentations, in the United States in *AVC Nederland*.

[83] 573 F.2d 281 (5th Cir.), *cert. denied*, 439 U.S. 836 (1978).

part, in the United States. In the court's view it did not have "to formulate the outer perimeter of American jurisdiction "because the scheme was "so far within the jurisdiction of the American Court as to give us little pause."[84]

However, in *MCG, Inc. v. Great Western Energy Corp.*,[85] the court did undertake to define the perimeter of its jurisdiction and found the facts were outside of it. The plaintiffs were all corporations owned and controlled by Rodney Dockery ("Dockery"), a U.S. citizen, one of which, Croftby Company, Ltd. ("Croftby"), a Hong Kong shell corporation, was organized to purchase shares of Great Western Resources, Inc. ("Great Western"), a Texas corporation, over the London stock exchange. The transaction was intentionally structured by the parties as an offshore offering. Although Dockery claimed that he was fraudulently induced to form Croftby and conduct the transaction abroad, his testimony was impeached soundly. After reviewing the relevant cases in other circuits, led by the Second Circuit,[86] the court categorized the exercise of extraterritorial jurisdiction "to protect innocent foreign investors."[87] In *MCG*, however, the plaintiffs had gone to great lengths "to structure a transaction not burdened by the securities laws," and therefore the court refused to honor their claim that they could "wrap themselves in their protective mantle when the deal sours."[88]

G. *Contradictory Trends*

The recent cases, in the Second Circuit and elsewhere, are the more difficult ones, because the courts have been forced to examine their broad claims of subject matter jurisdiction against a backdrop of globalized securities markets, where both legitimate and fraudulent transactions are increasingly sophisticated and likely to be within the jurisdiction of countries besides the United States. On the one hand, some of the recent cases afford litigants the use of the U.S. courts where the interests of comity, if not relevant precedents, could well have prompted the courts to decline jurisdiction. The Second Circuit opinion in *Gold Fields* belongs in this

[84] *Id.* at 233.
[85] 896 F.2d 170 (5th Cir. 1990).
[86] *See id.* at 173-75.
[87] *Id.* at 175.
[88] *Id.*

category.[89] On the other hand, some courts, and especially the recent D.C. and Fifth Circuit cases discussed above, have taken a skeptical view of plaintiffs claiming U.S. jurisdiction where other jurisdictions appeared to have a greater interest.

The ALI has reflected these contradictory trends by putting out three different formulations of extraterritorial subject matter jurisdiction in securities cases: section 1905 of the *Code* and sections 403 and 416 of the *Restatement*.[90] The effort to bridge the conflicts and confusion of such an approach by the reporters to the *Restatement* is less than convincing, but in any event, the ALI consistently defers to the SEC.[91] This is in accord with the approach of the courts which have accorded the SEC considerable latitude to define the interests of the United States in transnational securities transactions.

III. Personal Jurisdiction

A. *Generally*

In order for a U.S. court to apply the federal securities laws extraterritorially, the court must have personal jurisdiction over the parties. Achieving such jurisdiction is generally not difficult with respect to a transnational securities transaction. According to the *Restatement*, a state has the power to exercise jurisdiction through its courts with respect to a person if the relationship of the state to the person is such as to make the exercise of such jurisdiction reasonable.[92] The Second Circuit has limited its in personam jurisdiction over foreign defendants only by due process re-

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[89] *See supra* notes 40-44 and accompanying text.

[90] *See supra* notes 46-54 and accompanying text.

[91] *See* Restatement, *supra* note 3, § 416 reporter's note 6.

> A somewhat different approach to securities regulation based on minimum contacts with the United States is taken in § 1905 of the proposed Federal Securities Code (1980) of the American Law Institute. As stated in the introduction to that work, § 1905 was designed to make substantive coverage of the Code quite broad, but always "within the limits of international law." This Restatement seeks to define those limits including the principle of reasonableness for the exercise of jurisdiction to prescribe and apply a state's law, and the method for applying it. Since the proposed Federal Securities Code calls for vesting maximum power in the Securities and Exchange Commission subject to narrowing the exercise of that power by regulation, this Chapter would also guide the Commission in its rulemaking.

Id.

[92] Restatement, *supra* note 3, § 421.

quirements. Moreover, it has interpreted the Federal Rules of Civil Procedure liberally in permitting service of process on defendants located abroad. In addition, the Second Circuit has permitted the SEC to freeze assets of such defendants in order to coerce them to enter the jurisdiction and submit to a SEC enforcement action.

A full discussion of these latter cases and their implications is beyond the scope of this Article. However, some mention needs to be made of the Second Circuit's rulings on personal jurisdiction, because these rulings both expand and limit the situations in which the securities laws will be given extraterritorial effect.

B. *Jurisdictional Limits*

According to Second Circuit jurisprudence, Congress meant section 27 of the Exchange Act[93] to extend personal jurisdiction to the full reach permitted by the due process clause.[94] That section grants U.S. district courts exclusive jurisdiction in cases arising under the Exchange Act and provides for service of process, *inter alia*, "wherever the defendant may be found."[95] In the *Leasco* case, the court interpreted this phrase as to "infer that Congress meant to assert personal jurisdiction over foreigners not present in the United States."[96]

Nevertheless, there are constitutional limits to such jurisdiction. Where a defendant is not personally present in a forum state, he cannot be served with process unless he has had minimum contacts with the jurisdiction. There must have been some activity by the defendant by which he purposely availed himself of the privilege of conducting business within the forum state, thus invoking the benefits and protections of its laws.[97] According to Judge Friendly, more is required for a finding of personal jurisdiction than a finding of subject matter jurisdiction. To support in personam jurisdiction, "[t]he person sought to be charged must know, or have good reason to know, that his conduct will have effects in

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[93] 15 U.S.C. § 78aa (1988).

[94] Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 998 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1339-40 (2d Cir. 1972).

[95] 15 U.S.C. § 78aa (1988).

[96] *Leasco*, 468 F.2d at 1340.

[97] Asahi Metal Indus. Co. v. Superior Court, 480 U.S. 102, 109 (1987); Hanson v. Denckla, 357 U.S. 235, 253 (1958); International Shoe Co. v. Washington, 326 U.S. 310, 319 (1945).

the state seeking to assert jurisdiction over him."[98]

Accordingly, in some of the decisions discussed above where the Second Circuit found subject matter jurisdiction, it nevertheless dismissed as to some defendants for lack of personal jurisdiction. In *Leasco*, several defendants moved to dismiss for lack of personal jurisdiction. One was held to have done business in the United States when its managing director came to meetings in the United States and made representations there.[99] However, another defendant, Chalmers, Impey & Co. ("Chalmers") was dismissed because all that was shown was an agreement between Chalmers and a U.S. accounting firm to carry on specific engagements. Although one audit was begun under this agreement, it was never completed.[100]

Similarly, in *Bersch*, the Second Circuit dismissed the case for lack of personal jurisdiction over a Canadian investment house. Its only business activities in the United States were buying and selling American securities traded on Canadian markets. Its underwriting of IOS shares were confined to Canadians. Although one of its partners attended two breakfast meetings in New York relating to IOS, these meetings were preliminary and tenuous.[101]

C. *Notice*

A principal function of service of process is to give notice and an opportunity to be heard.[102] Rule 4(i) of the Federal Rules of Civil Procedure provides that such service may be made upon a party not an inhabitant of or found within the forum state as required in the host country; by letters rogatory; personally; by any form of mail requiring a signed receipt; or as directed by the court.[103] The court has broad discretion to fashion a method of service[104] as long as the defendant receives actual notice of the pendency of the action.[105]

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[98] *Leasco*, 468 F.2d at 1341.

[99] *Id.*

[100] *Id.* The case was remanded for further fact finding as to a third defendant. *Id.* at 1342-44.

[101] Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 999-1000 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

[102] McGee v. International Life Ins. Co., 355 U.S. 220, 224 (1957).

[103] FED. R. CIV. P. 4(i)(1).

[104] International Controls Corp. v. Vesco, 593 F.2d 166, 176 (2d Cir.), *cert. denied*, 442 U.S. 941 (1979).

[105] Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950).

In *SEC v. Tome*[106] the SEC applied for and received permission to serve process by newspaper publication in several European cities, where, in an insider trading case based on circumstantial evidence, the identity of the insider traders was unknown. Swiss and Italian insider trading defendants later challenged the district court's finding of personal jurisdiction over them. The Second Circuit held that they had actual notice of the SEC's action and consciously decided to ignore that action. Alternatively, the court held that service by publication was sufficient in this instance.[107] The *Tome* case enlarged the SEC's effective jurisdiction not only because it held that newspaper publication of an action against then unknown defendants was sufficient, but also because the court ordered a freeze on bank assets of the defendants in the United States. This freeze gave the SEC leverage and relief against defendants which never appeared before the district court.

A similar technique was utilized and upheld with respect to obtaining personal jurisdiction and a freeze of the defendants' assets in *SEC v. Unifund SAL*,[108] another insider trading case. In this case, service of process was initially delivered to the defendant Unifund SAL ("Unifund") by overnight courier in care of the New York office of its U.S. broker-dealer, with instructions to forward the papers by overnight courier to Unifund in Beirut. These instructions were followed and Unifund received the papers. The Second Circuit ruled that Unifund's acknowledged receipt of process rendered service effective and upheld the district court's exercise of personal jurisdiction.[109]

These cases go very far in subjecting anyone who effects transactions in U.S. securities, directly or indirectly through a U.S. financial institution, to the jurisdiction of a U.S. court. When coupled with asset freezes, such cases have the potential for involving the U.S. courts in conflicts with the courts of other jurisdictions.[110]

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[106] 833 F.2d 1086 (2d Cir. 1987), *cert. denied*, 486 U.S. 1014-15 (1988).

[107] *Id.* at 1094.

[108] 910 F.2d 1028, *petition for rehearing denied*, 917 F.2d 98 (2d Cir. 1990).

[109] *Id.* at 1034.

[110] For example, in SEC v. Wang, 699 F. Supp. 44 (S.D.N.Y. 1988), the district court issued an order to cause the removal of assets in the Hong Kong branch of an insider trader's U.K. bank to its New York branch. These events provoked litigation in Hong Kong and a protest when the case was on appeal to the Second Circuit by the British government. *See* Brief for the Government of the United Kingdom of Great Britain and Northern Ireland as amicus curiae, SEC v. Wang, 699 F. Supp. 44 (S.D.N.Y. 1988) (No. 88-6236); Mann & Mari, *Developments in International Securities Law Enforcement*, in R. FERRARA & M.

IV. INTERNATIONALIZATION AND RECENT SEC INITIATIVES

A. *Globalization of the Markets*

The international equity markets have grown tremendously in recent years and the New York securities markets are being increasingly internationalized. Nevertheless, the U.S. markets are the most heavily regulated in the world and the barriers presented by such regulation to foreign issuers are accelerating the development of financial markets in other countries as viable alternatives for international issuers.[111]

The international equity market encompasses the underwriting and distribution of equity securities to investors in one or more markets outside the issuer's home country. In 1989, the primary issuance of equities in the international markets reached a new high of $88.7 billion, the bulk of which represented bonds with equity warrants (mostly Japanese) and convertibles. International issuances of ordinary shares totalled $16.7 billion.[112] In 1988 gross transactions by U.S. investors in foreign corporation stocks totalled over $151 billion, a ninefold increase since 1980 and gross transactions in foreign debt securities were $445 billion, a more than twelvefold increase.[113] In a recent survey, money managers, traders and corporate finance officers predicted rapid growth in international sales and trading of securities in the next five years.[114] The securities of over 2,000 foreign issuers are traded in the United States. Over 150 are traded on securities exchanges; approximately 291 are traded on the NASDAQ system of the National Association of Security Dealers, Inc. ("NASD"). The remainder are traded over-the-counter.[115]

MANN, INTERNATIONAL SECURITIES MARKETS 1990, PLI/CORPORATE LAW & PRACTICE NO. 683, at 223, 821, 873-76 (1990). The case was settled before decision by the Second Circuit. *See id.* at 875. In *Unifund*, the court imposed a 30 day limit on the freeze order of the district court. The SEC then went to trial and lost its motion for a preliminary injunction. *See* SEC v. Heider, [current] Fed. Sec. L. Rep. (CCH) ¶ 95, 961 (S.D.N.Y. Dec. 3, 1990).

[111] *See* Karmel, *SEC Regulation of Multijurisdictional Offerings*, 16 BROOKLYN J. INT'L L. 3, 3-8 (1990).

[112] M. HOWELL & A. COZZINI, INTERNATIONAL EQUITY FLOWS 1990 EDITION: NEW INVESTORS, NEW RISKS, NEW PRODUCTS 47 (Salomon Brothers Aug. 1990).

[113] Multijurisdictional Disclosure, Securities Act Release No. 6,841, Fed. Sec. L. Rep. (CCH) ¶ 84,432, at 80,284 (July 26, 1989) [hereinafter Release No. 6,841].

[114] Sesit, *Global Sales of Securities Seen Growing*, Wall St. J., Nov. 23, 1990, at C1, col. 5.

[115] Release No. 6,841, *supra* note 113, at 80,284.

Despite the growing internationalization of the New York markets, U.S. equity markets are losing ground to overseas markets. For example, in 1985, the New York Stock Exchange, Inc. ("NYSE") enjoyed forty percent of the global market share of U.S. dollar trading value, the NASD ten percent and other U.S. exchanges seven percent. By 1989, overall U.S. market share had fallen to thirty-two percent. The London market had increased from three percent to six percent; the Tokyo market from sixteen percent to thirty-three percent.[116]

The primacy of the United States has also declined as measured in total return in U.S. dollars. According to one report, the U.S. stock market ranked fifteenth out of eighteen major international stock markets over the five years from 1985-1989.[117] For the ten years ending June 30, 1990, the five best performing markets in the world (measured in U.S. dollars) were all overseas; they were: Sweden, Belgium, Japan, Denmark, and Italy.[118] A report by the Bank of England indicated that London had a turnover in 1989 in foreign equities one and one-half times that of New York.[119] Foreign private issuers avoid the public U.S. capital markets for the primary distribution of their securities. On the other hand, institutional investors are increasingly committed to the purchase of foreign securities.[120]

The worldwide jurisdiction over securities fraud which the U.S. courts, led by the Second Circuit, have given to the SEC has not enabled the SEC to regulate the international markets. The markets are too vast and there is too much activity overseas, in which both foreign and U.S. investors participate. The marketplace and political imperatives therefore have compelled the SEC to go forward with an internationalization agenda which involves numerous exemptions from regulatory requirements for transnational conduct.

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[116] N.Y.S.E. Research & Planning (Oct. 1990).

[117] Herman & Sesit, *ADRs: Foreign Issues with U.S. Accents*, Wall St. J., Feb. 8, 1990, at C1, col. 3, C20, col. 1.

[118] *Investing Internationally*, DELOITTE & TOUCHE REV. 90/26, at 7 (Dec. 17, 1990).

[119] Barchard, *London's Strength Revealed by Bank Study*, Financial Times, Nov. 9, 1989, at 10, col. 4.

[120] Bloomenthal, *The Proposed Rule 144A Exemption and Rule 144 Amendments*, 11 SECURITIES & FED. CORP. L. REP. 7 (Clark Boardman Jan. 1989).

B. *Recent SEC Initiatives*

Traditionally, following the opinions of the courts, the SEC has interpreted its regulations to apply to transactions overseas in which the U.S. investors participate. More recently, however, the SEC has reinterpreted certain of its regulations to cover activities within the territory of the United States, but not to cover activities abroad even to protect U.S. investors in foreign markets. Two of these recent reinterpretations are regulation S,[121] which articulates an exemption from the registration provisions of the Securities Act for offshore offerings and rule 15a-6 under the Exchange Act[122] pertaining to broker-dealer registration. In addition, the SEC has negotiated a multijurisdictional disclosure system with Canadian securities regulations based on principles of comity.[123]

In general, under section 5 of the Securities Act,[124] any issuer, whether foreign or domestic, that makes use of any means or instruments of transportation or communication in interstate commerce or the mails to offer or sell any security must register that offering with the SEC and make the disclosures required in a U.S. prospectus. In 1964 the SEC took the position that it would not insist on the initial registration of a foreign offering, whether by a U.S. or foreign issuer, if the circumstances of the offering were reasonably designed to prevent the distribution or redistribution of the securities into the United States or to U.S. nationals living abroad.[125] During the past year, to meet the demand by U.S. investors for foreign securities, whether or not registered with the SEC, the SEC reversed its prior view that any sale to a U.S. national triggered the registration requirements, and provided a safe harbor for securities distributions abroad.

Regulation S consists of a general statement providing that Securities Act registration requirements do not apply to offers and sales made outside the United States and two nonexclusive safe harbors: one for issuers and securities professionals involved in the distribution process and their affiliates ("issuer safe harbor") and the other for resales by all other persons ("resale safe harbor"). In addition to the specific requirements of each safe harbor, two gen-

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[121] 55 Fed. Reg. 18,372 (1990) (to be codified at 17 C.F.R. § 230.901).

[122] 17 C.F.R. § 240.15a-6 (1990).

[123] *See* Multijurisdictional Disclosure and Modifications, Securities Act Release No. 6,902 (June 13, 1991).

[124] 15 U.S.C. § 77e (1988).

[125] Securities Act Release No. 4708 (July 11, 1964).

eral conditions apply to all offers and sales made in reliance on regulation S: a requirement that the offer and sale of securities be made in an offshore transaction and a prohibition against directed selling efforts in the United States.[126] To qualify as an offshore transaction, no offers may be made to persons in the United States and either (a) the buyer is (or the seller reasonably believes that the buyer is) offshore at the time the buy order is placed; or (b) the sale is made on a foreign securities exchange (for the issuer safe harbor) or through a designated offshore securities market (for the resale safe harbor).[127]

The issuer safe harbor distinguishes among three categories of securities based on the nationality and reporting status of the issuer and the extent of U.S. market interest in the issuer's securities.[128] The resale safe harbor is available to persons other than an issuer, a distributor, and their affiliates and imposes restrictions beyond the two general conditions only where the securities were sold by a dealer or similar person. Resales on established foreign securities exchanges or organized markets are permitted.[129]

In its release promulgating regulation S, the SEC explained that it was adopting a territorial approach to section 5 of the Securities Act for reasons of comity and the reasonable expectations of participants in the global markets.[130] However, the SEC reserved a broader jurisdiction for application of the antifraud

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[126] 55 Fed. Reg. 18,326-27 (1990) (to be codified at 17 C.F.R. § 230.903(a) and (b)).

[127] *Id.* at 18,324 (to be codified at 17 C.F.R. § 230.902(i)(1)(i)-(i)(1)(ii)).

[128] The first category, which imposes no restrictions other than the general conditions that the securities be sold in an offshore transaction and that there be no directed selling efforts in the United States, applies to offerings by foreign issuers with no substantial U.S. market interest, whether or not the issuer is subject to Exchange Act reporting requirements, and offerings by foreign issuers targeted at a single foreign country, whether or not the issuer's home country. *Id.* at 18,326 (to be codified at 17 C.F.R. § 230.903(c)(1)). The second issuer safe harbor applies to offerings of U.S. reporting issuers, foreign reporting issuers with substantial U.S. market interest and offerings of debt and other securities of nonreporting foreign issuers. Such offerings may not be sold to U.S. persons for 40 days and are required to be made in conformity with specified offering restrictions. *Id.* (to be codified at 17 C.F.R. § 230.903(c)(2)). The third issuer safe harbor category is of use primarily for offerings of nonreporting U.S. issuers and equity offerings of foreign issuers with substantial U.S. market interest for the class of securities offered. This category imposes more restrictive procedures designed to guard against flowback of securities to the United States. Equity offerings in this category may not be sold to U.S. persons for a one-year period and debt securities are subject to a 40-day restricted period. Specified offering restrictions also apply. *Id.* (to be codified at 17 C.F.R. § 230.903(c)(3)).

[129] 55 Fed. Reg. 18,327 (1990) (to be codified at 17 C.F.R. § 230.904).

[130] Offshore Offers and Sales, Securities Act Release No. 6863, Fed. Sec. L. Rep. (CCH) ¶ 84,524, at 80,665 (Apr. 24, 1990).

provisions.[131]

In a similar vein, the SEC recently adopted a territorial approach to broker-dealer registration, whereby broker-dealers physically operating within the United States that effect securities transactions are required to register as broker-dealers with the SEC, even if their activities are directed only to foreign investors outside the United States.[132] However, a foreign broker-dealer effecting securities transactions entirely offshore, even for U.S. clients, need not so register.[133] Moreover, the SEC has solicited comments on a possible rule that would exempt from SEC registration foreign broker-dealers subject to regulatory regimes comparable to U.S. regulation so long as their business is predominantly foreign.[134]

U.S. securityholders are frequently excluded from foreign rights, exchange and tender offers because of the high cost of compliance with U.S. securities registration and disclosure requirements. In order to remedy this situation, the SEC has proposed a possible regulatory framework for facilitating the inclusion of U.S. securityholders in certain transnational rights, exchange and tender offers.[135] Proposed new rules are based on a conceptual approach that would permit multinational tender and exchange offers to be made in the United States with documentation prepared in compliance with foreign disclosure, procedural, and accounting requirements in those cases where U.S. investors hold only a small portion of a foreign company's security holdings. Furthermore, the provisions of the Williams Act would not apply to such offers. However, the antifraud provisions would still apply. The principles of international cooperation and comity on which these proposals are based are difficult to reconcile with the Second Circuit's extraterritorial solution to jurisdictional conflicts in *Gold Fields*.

V. Conclusion

Thus far the Second Circuit has not shown any inclination to

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[131] *Id.*

[132] Registration Requirements for Foreign Broker-Dealers, Exchange Act Release No. 27,017, Fed. Sec. L. Rep. (CCH) ¶ 84,428, at 80,237 (July 11, 1989).

[133] *Id.* at 80,238.

[134] *See* Recognition of Foreign Broker-Dealer Regulation, Exchange Act Release No. 27,018, Fed. Sec. L. Rep. (CCH) ¶ 84,429 (July 11, 1989).

[135] Cross Border Rights Offers, Securities Act Rel. No. 6896 (June 5, 1991); International Tender and Exchange Offers, Securities Act Rel. No. 6897 (June 4, 1991).

pull back its extraterritorial reach in securities cases in response to developments in the international securities markets or at the SEC. However, the D.C. and Fifth Circuits have done so,[136] and the Second Circuit may be influenced to follow their lead. Such a restraint is most likely to occur in an action instituted by a foreign plaintiff, but in *Alfadda* the court did not seize this opportunity. Where a U.S. investor goes abroad and structures a transaction outside of the SEC's regulatory scheme, a hesitation about exercising jurisdiction is also possible.

History would suggest that the Second Circuit will be influenced by the SEC in crafting its extraterritorial jurisdiction, and will be reluctant to overrule or distinguish its prior precedents unless the SEC suggests that such a pull back is warranted for reasons of comity. Furthermore, as demonstrated by *Gold Fields,* the Second Circuit may reject the SEC's comity arguments and assert jurisdiction according to its own views about protecting U.S. economic interests.[137]

The Second Circuit's historical approach can be criticized as insufficiently deferential to the interests of other nations. The *Restatement* approach suggests a need for such comity in today's globalized markets. Yet, it perhaps behooves the SEC, which has been so influential in shaping circuit court opinions, as plaintiff and as amicus curiae, to lead the way in suggesting cases where the courts should refrain from exercising jurisdiction.

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[136] *See supra* notes 76-88 and accompanying text.

[137] *See supra* notes 40-44 and accompanying text.