



University of Kentucky
UKnowledge

Law Faculty Scholarly Articles

Law Faculty Publications

Winter 1985

The Draft Restatement: A Critique from a Securities Regulation Perspective

Douglas C. Michael

University of Kentucky College of Law, michaeld@uky.edu

Daniel L. Goelzer

Jacob H. Stillman

Elisse B. Walter

Anne H. Sullivan

Follow this and additional works at: https://uknowledge.uky.edu/law_facpub



Part of the [Comparative and Foreign Law Commons](#), and the [Securities Law Commons](#)

[Right click to open a feedback form in a new tab to let us know how this document benefits you.](#)

Recommended Citation

Daniel L. Goelzer, Jacob H. Stillman, Elisse B. Walter, Anne H. Sullivan & Douglas C. Michael, *The Draft Restatement: A Critique from a Securities Regulation Perspective*, 19 Int'l Law 431 (1985).

This Article is brought to you for free and open access by the Law Faculty Publications at UKnowledge. It has been accepted for inclusion in Law Faculty Scholarly Articles by an authorized administrator of UKnowledge. For more information, please contact UKnowledge@lsv.uky.edu.

The Draft Restatement: A Critique from a Securities Regulation Perspective

Notes/Citation Information

The International Lawyer, Vol. 19, No. 1 (Winter 1985), pp. 431-485.

DANIEL L. GOELZER
JACOB H. STILLMAN
ELISSE B. WALTER
ANNE H. SULLIVAN
DOUGLAS C. MICHAEL*

The Draft Revised Restatement:† A Critique From a Securities Regulation Perspective

For the past several years, the American Law Institute has been preparing a proposed revision of the Restatement (Second) of the Foreign Relations Law of the United States (“Draft Restatement”). This article is a critique from a securities regulation perspective of the Draft Restatement’s sections 402, 403, 416, 418, 419, 420 and 431.¹ In short, the Draft Restatement departs substantially from existing law. It would add dangerous vagueness

*Mr. Goelzer is General Counsel, Mr. Stillman and Ms. Walter are Associate General Counsels, and Ms. Sullivan and Mr. Michael are Staff Attorneys, Office of General Counsel of the United States Securities and Exchange Commission.

The views expressed herein are solely those of the Office of the General Counsel and do not necessarily reflect the view of the Commission or other members of the Commission staff. The Commission has neither considered nor expressed any view on this article or the preceding commentary.

This article is an adaptation of an earlier commentary prepared by the authors and presented to the American Law Institute. Ira Paull, Esq., formerly of the Office of the General Counsel, significantly contributed to that commentary.

†AMERICAN LAW INSTITUTE, RESTATEMENT OF FOREIGN RELATIONS LAW OF THE UNITED STATES (REVISED), hereinafter referred to as “Draft” or “Draft Restatement.” Since 1980, five tentative drafts have been issued and the Draft Restatement is tentatively scheduled for completion in May 1985. Reporters, for the project, prepared the various tentative drafts. The Chief Reporter for the revision is Louis Henkin; the Associate Reporters are Andreas F. Lowenfeld, Louis B. Sohn and Detlev F. Vagts. The drafts have appeared since 1980 and have been discussed and voted on annually by the membership, a group of approximately 1,800 eminent practitioners, jurists and scholars.

1. DRAFT RESTATEMENT (Tentative Draft No. 2, 1981, and No. 3, 1982). Section 431 has been renumbered Section 441, *see id.* at xxii (Tentative Draft No. 5, 1984). This article will refer to Section 431, as set forth with notes and comments, in Tentative Draft No.3.

and uncertainty to the jurisdictional analysis used to determine whether the United States securities laws will be applied to transnational securities activities. In particular, the complicated balancing inquiry required under the Draft would increase litigation by introducing new issues into the jurisdictional analysis and by removing the certainty created by past court decisions. The Draft would make it substantially more difficult to apply United States securities laws where their application is necessary, appropriate and noncontroversial. In addition, the Draft's restrictions on access to information located abroad could impair effective and even-handed enforcement of the securities laws. The Draft Restatement would also make it more difficult for the Securities and Exchange Commission ("Commission") to take summary action which may be necessary for the protection of securities markets in the United States.

Section 1905 of the American Law Institute's Federal Securities Code ("Code"),² by contrast, retains the benefits of current judicial analysis by substantially codifying that reasoning, while eliminating the drawback of its case-by-case development. Although Section 1905 of the Code was drafted in the context of a general revision of the securities laws, it is a more accurate and workable "restatement" of foreign relations law. The Code also furthers the investor protection purposes of the securities laws because it takes a broader view of the appropriate application of United States securities laws than the Draft Restatement.

This article compares and contrasts the analysis used under current law with the analysis that would be used under the Code and under the Draft Restatement. Part I consists of a summary review of current judicial analysis of application of United States law (subpart A), a comparison of that analysis with that of the Code (subpart B) and the Draft Restatement (subpart C) and illustrations of the differences using five examples (subpart D). Part II sets forth our principal concerns about the Draft Restatement's approach to application of United States law. Part III critically reviews the Draft's approach to access to information located abroad and the judicial and administrative enforcement mechanisms available to the Commission.

I. Securities Laws Under Current Judicial Analysis, The Federal Securities Code and the Draft Restatement: A Comparison

Jurisdictional analyses under current law, the Code and the Draft Restatement share a common beginning. Each is based primarily on two major principles of international law, the "effects" doctrine and the "conduct"

2. FEDERAL SECURITIES CODE § 1905 (1980) (hereinafter cited without further cross-reference as the "Code").

doctrine. Under the “effects” doctrine, it is permissible to apply United States law if the acts involved had a substantial and foreseeable effect within the United States.³ Under the “conduct” doctrine, United States law can be applied if acts occurred in this country.⁴ A third theory, application of United States law with respect to United States nationals wherever located, is generally disfavored.⁵

From that common starting point, the analyses diverge. Under the approach currently employed by United States courts to determine the applicability of United States securities law, the court first considers whether application of our laws is permissible under the “conduct” or “effects” principles of international law. If not, our laws will not be applied, absent a clear expression of Congressional intent to the contrary.⁶ If international law would permit application of United States law, the court then determines whether Congress intended our laws to apply to the particular situation being considered.⁷ The Code provides clear answers to the full range of jurisdictional inquiries, codifying the results of previous judicial determinations. The Draft, in contrast, substitutes a “reasonableness” analysis in most cases.⁸ The following discussion examines the use of the three fundamental jurisdictional principles of international law—effects, conduct and nationality—as a basis for applying United States securities laws to international activities under current law, the Code and the Draft Restatement.

3. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 18(b) (1965) (current Restatement); *see, e.g.*, *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir.), 405 F.2d 215 (2d Cir. 1968) (en banc)(reh. on other grounds), *cert. denied*, 395 U.S. 906 (1969); Code § 1905(a)(1)(D)(ii); Draft Restatement § 402(1)(c).

4. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 17(a) (1965) (current Restatement); *see, e.g.*, *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972); Code § 1905(a)(1)(D)(i); Draft Restatement § 402(1)(a).

5. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 30 (1965) (current Restatement); *see Laker Airways Ltd. v. Sabena Belgian World Airlines*, 731 F.2d 909, 934-37 (D.C. Cir. 1984) (rejecting assertion of nationality as the “paramount” basis of jurisdiction); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 992 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975) (*see infra* text accompanying note 78). “In general, territoriality [“effects” or “conduct”] is considered the normal, and nationality the exceptional, basis for the exercise of jurisdiction, though no state (and certainly not international law) rejects nationality as a basis for jurisdiction” Draft Restatement § 402 comment b; *see also id.* reporters’ note 1 (citing cases and statutes applying United States law based on nationality).

6. *See, e.g., Leasco*, 466 F.2d at 1334; *Schoenbaum*, 405 F.2d at 206.

7. *See, e.g., Bersch*, 519 F.2d at 985.

8. Under the Draft, as under current law (*see supra* text accompanying note 6), the limitations set by international law do not apply when Congress “ma[kes] clear its purpose” to apply United States law beyond the limits of international law. Draft Restatement § 403(4)(b). In order to illustrate the contrast between the Draft Restatement, on the one hand, and the Code and present law, on the other, in this memorandum we have assumed the absence of a Congressional intent to transcend international law.

A. CURRENT JUDICIAL ANALYSIS

1. *The "Effects" Doctrine*

The seminal case applying⁹ United States securities law on the basis of "effects" in this country is *Schoenbaum v. Firstbrook*.¹⁰ In *Schoenbaum*, an American shareholder of a Canadian corporation, with stock listed on a United States exchange, brought a derivative action against the company's directors, alleging that the company's sale in Canada of treasury stock below its true value violated the antifraud provisions of the Securities Exchange Act of 1934.¹¹ The Second Circuit disagreed with the district court's conclusion that the Act has no extraterritorial application, stating:

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.¹²

The court held that "at least when the transactions involved stock registered and listed on a national securities exchange," the impairment of the value of the corporation's shares held by United States shareholders was a "sufficiently serious effect upon United States commerce to warrant assertion of jurisdiction for the protection of American investors."¹³

a. Effect on United States Citizens

The effects doctrine provides jurisdiction based on adverse effects on United States citizens. In *SEC v. United Financial Group, Inc.*,¹⁴ the Ninth Circuit held that the "impact of [defendant's] activities [carried out within the United States] upon American investors" permitted application of

9. Although the courts frequently speak of the presence or absence of "jurisdiction" or "subject-matter jurisdiction," this characterization is not strictly accurate. The securities laws plainly confer subject matter jurisdiction on the United States district courts. See, e.g., § 22(a) of the Securities Act of 1933, 15 U.S.C. 77v(a). If none of the securities laws apply in a given case, however, a United States court may still have subject matter jurisdiction. It is possible that the diversity standards of 28 U.S.C. 1332 or the requirements of some other jurisdictional statute could be satisfied, even with foreign parties. In that event, a United States court could still hear the case, but could not apply the United States securities laws. However, plaintiffs typically sue in United States courts solely to seek the protections afforded by the relatively strict United States securities laws; thus, if the court decides that those laws do not apply, it has, as a practical matter, disposed of the case. See *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 414 n.5 (8th Cir. 1979); *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1015 (2d Cir. 1975) (discussing various bases of subject matter jurisdiction and holding inapplicable all except those under the securities laws).

10. 405 F.2d 200 (2d Cir.), 405 F.2d 215 (2d Cir. 1968) (en banc) (reh. on other grounds), cert. denied, 395 U.S. 906 (1969).

11. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

12. *Schoenbaum*, 405 F.2d at 206.

13. *Id.* at 208, 209.

14. 474 F.2d 354 (9th Cir. 1973).

United States antifraud law, without distinguishing between United States citizens residing in this country and those residing abroad.¹⁵

Subsequently, in *Bersch v. Drexel Firestone, Inc.*,¹⁶ the Second Circuit did draw this distinction. The court held that no domestic conduct is necessary in an antifraud action if *resident* citizens are affected, but where *nonresident* United States citizens are affected, it is necessary for "significant activities," even if "merely preparatory," to occur in the United States.¹⁷

Similar theories have been used in application of the registration provisions of the securities laws. The Commission requires registration of a foreign public offering of a United States issuer which may never have any effect in or contact with the United States (other than use of interstate or foreign commerce or the mails), if the securities offered are "specifically directed" to United States nonresident citizens.¹⁸ The Commission also requires registration under the Securities Exchange Act of foreign broker-dealers who sell United States securities, unless these sales are made "outside the jurisdiction of the United States to persons other than American nationals."¹⁹

15. *Id.* at 356-57.

16. 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

17. *Id.* at 992, 993. For an analysis of those portions of the *Bersch* case dealing with *conduct* in the United States, see *infra* text accompanying notes 46-53.

18. Securities Act Release No. 4708, 29 Fed. Reg. 9828 (1964). No registration would be required if the distribution of securities abroad "is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to the nationals of, the United States." *Id.* (emphasis added).

The issue of registration of foreign offers and sales arises because the registration provisions of the Securities Act have very broad potential application. Section 5 of the Securities Act, 15 U.S.C. 77e, makes unlawful the use of instruments of transportation or communication in interstate commerce, or the use of the mails, to offer, sell or deliver unregistered securities or to deliver improper prospectuses. Section 2(7) of that Act, 15 U.S.C. 77b(7), defines "interstate commerce" to include foreign commerce. Thus, it would be theoretically possible to require registration under the Securities Act if a foreign issuer made an offer to someone momentarily present in the United States. See *United Financial Group*, 474 F.2d at 357 (under this theory, "[i]f accepted without qualification, there would be jurisdiction in every case regardless of whether American investors were involved").

See also *Bank Leumi le-Israel B.M.* (No-action letter dated July 7, 1983) (no-action position taken by the Commission's Division of Corporation Finance, based in part on foreign issuer's representation that "offers and sales in the U.S. can be made only on a personal basis . . . to non-U.S. persons"); *Israel Discount Bank Limited* (No-action letter dated July 23, 1981) (no-action position taken by the Division of Corporation Finance, based on foreign issuer's representation that sales made in the United States would be made to nonresidents and noncitizens present in the United States only on banking business, and that no offering circular or advertising material would be distributed here).

19. Securities Act Release No. 4708, 29 Fed. Reg. 9828 (1964) (applying generally to any distribution of American securities); see also Securities Act Release No. 5068, 35 Fed. Reg. 12,103, 12,105 (1970) (applying similar rule to distribution of shares of United States registered open-end investment companies). The requirement regarding open-end investment companies "supplements and is consistent with" the general requirement of Release No. 4708. *Id.*

b. Effect on United States Markets

Foreign plaintiffs are of course generally unable to demonstrate that transnational securities activities had an impact on American investors. They can still utilize the effects doctrine, however, if there is an impact on United States markets. For example, in *Des Brisay v. Goldfield Corp.*,²⁰ the former shareholders of a Canadian corporation that merged into a United States corporation claimed fraud in the transaction. The Ninth Circuit upheld jurisdiction because the defendant was a United States corporation with stock listed on a national securities exchange, and there was fraudulent representation in the course of the takeover transaction, that the surviving corporation's shares could be traded in the United States without registration, "proximately resulted in the collapse of th[at] American market" injuring the company's shareholders.²¹ And, in *ITT v. Cornfeld*,²² involving alleged fraud in a foreign investment trust's purchases in the European after-market of eurodollar debentures issued by an American corporation's foreign subsidiary, the Second Circuit found it significant that the securities involved "in substance were American."²³ The court noted its belief that "Congress would have been considerably more interested in assuring against the fraudulent issuance of securities constituting obligations of American rather than purely foreign business."²⁴

In determining whether to apply antifraud provisions based on effects in this country, the courts have generally considered the presence or absence of domestic trading, particularly exchange trading, to be a significant factor.²⁵ The courts usually look at trading generally; it is not important where the particular securities transaction at issue in the case was executed.²⁶

20. 549 F.2d 133 (9th Cir. 1977).

21. Contrary to that representation, registration in the United States was indeed required. The market collapsed when the SEC sought and obtained an injunction suspending trading. *Id.* at 135. While the plaintiff class allegedly included one United States citizen (*see id.* at 133 n.1), the Ninth Circuit did not rely on that factor.

22. 619 F.2d 909 (2d Cir. 1980).

23. *Id.* at 920; *see also* AVC Nederland B.V. v. Atrium Investment Partnership, 740 F.2d 148, 153 (2d Cir. 1984) (discussing *Cornfeld* holding).

24. *Cornfeld*, 619 F.2d at 920.

25. *See* Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 417 n.12 (8th Cir. 1979) (mentioning absence of exchange listing in rejecting application of "effects" test); SEC v. Kasser, 548 F.2d 109, 113 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977) (same); Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir.), 405 F.2d 215 (2d Cir. 1968) (en banc) (reh. on other grounds), *cert. denied*, 395 U.S. 906 (1969) (*supra* text accompanying note 13) (effects found "at least when the transactions involved stock . . . on a national securities exchange").

26. However, in a case involving the similar antifraud provisions of the Commodity Exchange Act, one court has concluded that "where the challenged transactions *involve trading* on domestic exchanges, harm can be presumed because the fraud alleged implicates the integrity of the American market." *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 547 F. Supp. 309, 313

In other cases, where no showing of harm or fraud is required, domestic execution of the transaction at issue can be more important. For example, in *Roth v. Fund of Funds, Ltd.*,²⁷ the Second Circuit applied the short-swing trading provisions of Section 16(b) of the Securities Exchange Act²⁸ to transactions by foreigners carried out on an American exchange. The court noted that "the effect of this kind of insider trading is quite as great as when the trader is an American."²⁹ But, in *Wagman v. Astle*,³⁰ a district court refused to apply Section 16(b) to transactions carried out in Canada. Although the *Wagman* decision rests on the court's failure to find personal jurisdiction,³¹ the court also noted that there was "no actual effect in the United States on which to base jurisdiction."³²

The effect on the United States securities markets alleged by a foreign plaintiff must be somehow related to the allegedly unlawful acts. The effects doctrine "does not support subject matter jurisdiction . . . simply because in the long run there was an adverse effect on this country's general economic interests or on American security prices."³³

2. The "Conduct" Doctrine

The principle that conduct in this country is a basis for applying our nation's securities laws was established in *Leasco Data Processing Equipment Corp. v. Maxwell*.³⁴ Plaintiffs, a United States corporation and its foreign subsidiary, alleged fraud in the subsidiary's purchase of shares of a British corporation from British defendants. The Second Circuit was unwill-

(N.D. Ill. 1982) (emphasis added), *aff'd*, 730 F.2d 1103, 1108 (7th Cir. 1984) ("the domestic marketplace will be artificially influenced, and public confidence in the markets could be undermined"), *cert. denied*, 105 S. Ct. 221 (1984).

27. 405 F.2d 421 (2d Cir. 1968), *cert. denied*, 394 U.S. 975 (1969).

28. Section 16(b), 15 U.S.C. 77p(b), provides that an issuer may recover the profits an officer, director, or ten-percent shareholder, made from any purchase and sale, or sale and purchase, of the issuer's equity securities occurring within a six-month period.

29. *Id.* at 442.

30. 380 F. Supp. 497 (S.D.N.Y. 1974).

31. The *Wagman* court did not reach the issue of subject-matter jurisdiction, because it found that the transaction lacked any contacts with the United States and dismissed for lack of personal jurisdiction. *Id.* at 502. But in deciding the issue, the court looked to the same factors as under the "effects" doctrine. *Id.* at 499-502.

32. *Id.* at 502. The court suggested that "[a] case can be imagined in which individual foreign defendants come into, do business in, or knowingly cause an actual effect in this country, in connection with a transaction which violates the provisions of § 16(b)." *Id.* at 502 n.6. This seems to describe the facts in *Roth*, where application of § 16(b) was upheld.

33. *Bersch*, 519 F.2d at 989; *see also* SEC v. United Financial Group, 474 F.2d 354, 357 n.7 (9th Cir. 1973) (expressing no opinion on "the appropriateness of asserting jurisdiction on the ground of a national interest in protecting this country's reputation abroad or on the ground that the activities of the appellants have an adverse economic impact upon this country's economy.").

34. 468 F.2d 1326 (2d Cir. 1972).

ing to extend the “effects” doctrine of *Schoenbaum v. Firstbrook*³⁵ to the adverse effect on the American entity and its shareholders because the securities, issuer and transaction were all predominantly foreign. The court stated:

[We do not] believe that Congress meant to impose rules governing conduct throughout the world in every instance where an American company bought or sold a security. When no fraud has been practiced in this country and the purchase or sale has not been made here, we would be hard pressed to find justification for going beyond *Schoenbaum*.³⁶

Turning to the conduct that had occurred in this country, however, the court upheld application of United States antifraud law. First, based on the current Restatement,³⁷ the court held that United States law may be applied if conduct occurs within the United States.³⁸ It then reasoned that Congress would have wished to protect a United States company and its shareholders where “substantial representations were made in the United States.”³⁹

Once *Leasco* established that United States jurisdiction could be based on conduct in this country, the amount and type of conduct which would suffice became a major issue in litigation. The following subsections examine different aspects of this sufficient conduct issue. In each case, the court has been concerned with “significant” rather than “substantial” conduct, looking to the quality of the conduct rather than its quantity.⁴⁰

a. Use of the Means or Instrumentalities of Interstate Commerce

The *Leasco* court found that use of interstate or foreign commerce to make fraudulent statements was a sufficient basis for United States jurisdiction even where there was no significant effect in the United States.⁴¹ One subsequent antifraud decision, *Travis v. Anthes Imperial, Ltd.*,⁴² suggested that the use of the jurisdictional means is significant conduct, regardless of what was transmitted via the mails or commerce.⁴³ The *Travis* holding

35. 405 F.2d 200 (2d Cir., 405 F.2d 215 (2d Cir. 1968) (en banc) (reh. on other grounds), cert. denied, 395 U.S. 906 (1969), discussed *supra* notes 10–13 and accompanying text.

36. *Leasco*, 468 F.2d at 1334.

37. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 17(a) (1965).

38. The court dismissed suggestions in the current Restatement that some additional connection with the forum state is required. *Leasco*, 468 F.2d at 1334; see *id.* at 1339.

39. *Id.* at 1337; see *AVC Nederland B.V. v. Atrium Investment Partnership*, 740 F.2d 148 (2d Cir. 1984), discussed *infra* note 53.

40. See Code § 1905(a)(1)(D)(i) (Supp. 1981), changing “substantial” conduct to “significant” conduct, as it better expresses “the contemplated qualitative approach.”

41. *Leasco*, 468 F.2d at 1335.

42. 473 F.2d 515 (8th Cir. 1973).

43. *Travis* was a class action by United States shareholders of Anthes, a Canadian “target” corporation, alleging fraud in a tender offer made by another Canadian corporation for Anthes shares. In applying United States law, the court pointed to numerous letters and telephone calls directed into the United States from Canada. These “incidents,” said the court, “were essential

implied, therefore, that whenever the securities laws can be applied under domestic constitutional law (i.e., the jurisdictional means have been used), they could also be applied under international law (i.e., that same use constitutes sufficient conduct). Subsequent antifraud decisions have not, however, adopted that suggestion.⁴⁴

The analogous use of the jurisdictional means as the sole basis to apply United States law has not been accepted outside the antifraud area. For example, as a matter of discretion, the Commission has determined not to require registration under the Securities Act of 1933 under certain circumstances, even where use of the jurisdictional means to offer or sell the security brings the transaction within the literal language of the registration provisions.⁴⁵

b. Extent of Conduct Required

Both foreign and domestic investors may use the conduct doctrine to seek the protection of United States laws, but different levels of conduct have been required depending on the citizenship or residence of the plaintiffs.⁴⁶ The simultaneous Second Circuit decisions in *Bersch v. Drexel Firestone, Inc.*⁴⁷ and *IIT v. Vencap, Ltd.*⁴⁸ illustrate this. In each case, the court was willing to offer foreigners the protections of United States law, stating in one that “[w]e do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.”⁴⁹

Different standards were used, however, depending on the citizenship and residence of the victims. In *Bersch*, the court did not even consider the

elements in a slowly unfolding scheme to defraud the plaintiffs involving the use of the mails and instrumentalities of interstate commerce.” *Id.* at 526. Thus the conduct in the United States was “significant” *not* because it was itself fraudulent, but because it was “essential” to the fraudulent scheme. While the *Travis* court noted that further misrepresentations and the closing of the sale took place in the United States, it does not appear that these factors were important in its analysis. *Id.*

44. *See, e.g.,* Grunenthal GmbH v. Holtz, 712 F.2d 421, 424 (9th Cir. 1983) (conduct in the United States must further the fraudulent scheme); Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 420 (8th Cir. 1979) (“The conduct in the United States cannot be ‘merely preparatory,’ and must be material, that is, ‘directly cause the losses.’”) (citations omitted); F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., 400 F. Supp. 1219, 1223 (S.D.N.Y. 1975) (no subject matter jurisdiction because plaintiff was unable to prove acts in the United States which directly caused its losses).

45. Securities Act Release No. 4708, 29 Fed. Reg. 9828, 9828 (1964) (“the Commission has not taken any action for failure to register securities of United States corporations distributed abroad to foreign nationals, even though use of jurisdictional means may be involved in the offering.”).

46. *See supra* note 17 and accompanying text.

47. 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

48. 519 F.2d 1001 (2d Cir. 1975). *Bersch* and *Vencap* were decided by the same panel.

49. *Vencap*, 519 F.2d at 1017; *see Bersch*, 519 F.2d at 987.

conduct doctrine with respect to sales to United States resident citizens; the effect on those Americans was sufficient.⁵⁰ With respect to nonresident American citizens, the court held that “preparatory” conduct in the United States was sufficient.⁵¹ Finally, with respect to foreigners located abroad, the court held that there was no jurisdiction because the plaintiffs failed to show more significant conduct in the United States—conduct that “directly caused” their losses.⁵² In *Vencap*, the court refused to attribute any significance to the small number of Americans who had invested in the plaintiff foreign investment trust, but the court nonetheless held that United States law would apply if the “perpetration of fraudulent acts” (in contrast to “mere preparatory activities or the failure to prevent fraudulent acts”) took place here.⁵³

Under *Bersch* and *Vencap*, United States jurisdiction depends on the comparative significance of the domestic and foreign conduct.⁵⁴ *ITT v. Cornfeld*,⁵⁵ a more recent decision by the same court, reiterates this balancing principle.

More expansive language used by other courts suggests that the balance may be tipped more easily toward United States law in compelling cases, when it appears that this country is being used as “a base for manufacturing fraudulent security devices for export.”⁵⁶ In *SEC v. Kasser*,⁵⁷ the court found that the conduct in this country was not “merely preparatory,” and thus upheld jurisdiction according to *Bersch* and *Vencap*, although the only

50. 519 F.2d at 989–93.

51. *Id.* at 992–93.

52. *Id.* at 993. Other courts have questioned the constitutional viability of the Second Circuit’s nationality-based distinction. See *Gruenthal GmbH v. Hotz*, 712 F.2d 421, 426 n.9 (9th Cir. 1983); *Continental Grain*, 592 F.2d at 418 n.14. The apparent theory is that the court’s use of alienage is a suspect classification without an accompanying compelling state interest to justify its use, in violation of the Equal Protection Clause, as implied into the Fifth Amendment. Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 569 & n.95 (1976).

53. *Vencap*, 519 F.2d at 1018; see also *SEC v. Kasser*, 548 F.2d 109, 115 (3d Cir.), cert. denied, 431 U.S. 938 (1977).

Similarly, in its recent decision in *AVC Nederland B.V. v. Atrium Investment Partnership*, 740 F.2d 148 (2d Cir. 1984), the Second Circuit upheld the applicability of United States securities laws to an antifraud case, but refused to do so solely because some misrepresentations allegedly had been made in this country. The court distinguished *Leasco*, noting that there “the allegedly defrauded purchaser was a wholly-owned subsidiary of an American company whose stock was listed on the New York Stock Exchange.” *Id.* at 153. The court went on to state that misrepresentations are not sufficient where they “were an intermediate step in a series that began and ended [abroad], where also the challenged contract was signed and plaintiff’s payments were made.” *Id.*

54. *Vencap*, 519 F.2d at 1017 (rejecting jurisdiction where the preparatory activity took place here, but the “bulk of the activity was performed in foreign countries”); *Bersch*, 519 F.2d at 987 (rejecting jurisdiction where “United States activities . . . are relatively small in comparison to those abroad”).

55. 619 F.2d 909, 920–21 (2d Cir. 1980).

56. See *Vencap*, 519 F.2d at 1017, *supra* text accompanying note 49.

57. 548 F.2d 109 (3d Cir.), cert. denied, 431 U.S. 938 (1977).

victim of the alleged fraud was Canadian. The court hinted at a more expansive standard, stating that "the federal securities laws . . . grant jurisdiction . . . where at least some activity designed to further a fraudulent scheme occurs in this country."⁵⁸ In *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*,⁵⁹ the court upheld United States jurisdiction even though only part of a long series of negotiations took place in this country.⁶⁰

As in *Bersch*, courts in other cases have found that the foreign elements of a transaction preclude application of United States law. For example, when Swiss and Bahamian corporations and a West German citizen sued Swiss and French corporations and individuals, alleging fraud in the sale of one of the defendant corporations' promissory notes, the Second Circuit held the transaction "predominantly foreign" and affirmed the district court's dismissal for lack of jurisdiction.⁶¹ The court noted that the conduct alleged to have occurred in the United States was apparently that of the plaintiffs, not defendants.⁶² In an attempt to cure this problem, the same plaintiffs brought another action against the American parent corporation of the previous defendants.⁶³ The district court still refused to apply United States law, noting that [u]nder neither of these theories [conduct or effects] does the outcome turn on the nature of the defendant."⁶⁴

Conduct in the United States can alone be a sufficient basis for jurisdiction. There need be no effect in this country; much of the conduct can be

58. *Id.* at 114. "By sustaining the decision of the district court as to lack of jurisdiction, we would, in effect, create a haven for . . . defrauders and manipulators. We are reluctant to conclude that Congress intended to allow the United States to become a 'Barbary Coast,' as it were, harboring international securities 'pirates.'" *Id.* at 116.

59. 592 F.2d 409 (8th Cir. 1978).

60. The case involved alleged nondisclosure of a licensing dispute in the sale of Pacific Seeds, an Australian corporation, to the plaintiff Continental Grain, an Australian subsidiary of a United States corporation. The defendants, one Australian and one United States corporation and one United States individual, were the owners of Pacific Seeds. The court found that the only activity in the United States consisted of mail and telephone calls, but nonetheless held that this country was the "origin" of the nondisclosure. *Id.* at 411-12. The court noted that the decision "is largely based upon policy considerations." *Id.* at 416. *Accord Kasser*, 548 F.2d at 116 ("From a policy perspective . . . there are sound rationales for asserting jurisdiction."). See also *United States v. Cook*, 573 F.2d 281, 283 (5th Cir.), cert. denied, 439 U.S. 836 (1978) (dismissing as "simply unimaginable" that "Congress would allow America to be a haven for swindlers and confidence men when the victims are European while expecting the highest level of business practice when the investors are American").

61. *Fidenas AG v. Compagnie Internationale pour L'Informatique CII Honeywell Bull S.A.*, 606 F.2d 5, 8 (2d Cir. 1979). The facts suggest that the transaction was not merely "predominantly" but exclusively foreign. See *infra* note 62.

62. *Id.* The connection with the United States in the *Fidenas* cases (see *infra* notes 63-64 and accompanying text for discussion of a subsequent case on these same facts) is quite remote. It appears that the plaintiffs were simply unable to find any conduct in the United States, except knowledge on the part of the United States corporate parent of the foreign corporate defendants' actions.

63. *Fidenas AG v. Honeywell, Inc.*, 501 F. Supp. 1029 (S.D.N.Y. 1980).

64. *Id.* at 1041.

foreign-based. Nonetheless, although the policy justifications for applying United States law are compelling, they are not limitless.

c. Nature of the Conduct Required

Subsequent Second Circuit decisions answer a critical question left open by *Bersch* and *Vencap*: will United States antifraud law be applied on the basis of conduct in the United States other than the making of the false or misleading statements? In *IIT v. Cornfeld*,⁶⁵ the court upheld jurisdiction under the conduct test based on the combined presence of two factors—securities transactions had occurred in this country (in the over-the-counter market and a face-to-face transaction), and the issuers of the securities were American. Similarly, in *Psimenos v. E.F. Hutton & Co.*,⁶⁶ a commodities antifraud decision, the Second Circuit stated that “[t]rading activities on United States commodities markets were significant acts without which [plaintiff’s] losses could not have occurred, and are sufficient to establish jurisdiction.”⁶⁷

The specific types of conduct occurring in the United States are important to the SEC in determining whether foreign entities are subject to the registration requirements of the Securities Exchange Act. “Foreign private issuers”⁶⁸ can be exempt from the registration and periodic reporting requirements of Sections 12(g) and 13(a) of the Exchange Act⁶⁹ unless their securities are quoted on an automated system in the United States.⁷⁰ Such systems, the Commission explained, are analogous to securities

65. 619 F.2d 909, 917–19 (2d Cir. 1980); see also *AVC Nederland B.V. v. Atrium Investment Partnership*, 740 F.2d 148 (2d Cir. 1984), discussed *supra* note 53.

66. 722 F.2d 1041 (2d Cir. 1983).

67. *Id.* at 1048; see also *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d 1103, 1107–08 (7th Cir. 1984), *cert. denied*, 105 S. Ct. 221 (1984). Extraterritorial analysis under the commodities antifraud provisions is drawn from securities law analysis. See *Psimenos*, 722 F.2d at 1044.

The *Psimenos* court found the domestic creation and trading of the commodity futures contracts constitute “at least as strong a factor in favor of finding jurisdiction as do securities of a United States corporation traded in the United States.” *Psimenos*, 722 F.2d at 1047, discussing *IIT v. Cornfeld*.

68. The term “foreign private issuer” is defined identically in Securities Act Rule 405, 17 C.F.R. 230.405, and Securities Exchange Act Rule 3b–4, 17 C.F.R. 240.3b–4, to include any foreign national or corporation *unless*: (1) the majority of its voting securities are owned by United States residents; and (2) a majority of the officers and directors are United States citizens or residents, or a majority of the assets are located here, or the business is “administered principally in the United States.”

69. Sections 12(g) and 13(a) of the Securities Exchange Act, 15 U.S.C. 78l(g) and 78m(a), and Securities Exchange Act Rule 12g–1, 17 C.F.R. 240.12g–1, require registration of a class of securities and periodic reporting by the issuer if the securities are held by more than 500 persons, and the issuer has over \$3 million in assets.

70. Securities Exchange Act Rule 12g–1, 17 C.F.R. 240.12g–1, provides that securities of foreign private issuers with total assets less than \$3 million, which would otherwise be exempt from the registration and periodic reporting requirements, are not exempt if quoted on such a system. Rule 12g3–2(b), 17 C.F.R. 240.12g3–2(b), exempts securities of foreign private issuers of any size from the registration and periodic reporting requirements under certain conditions, unless quoted on such a system. Rule 12g3–2(d)(3), 17 C.F.R. 12g3–2(d)(3).

exchanges,⁷¹ and “[issuers of] foreign securities included in NASDAQ should be regarded as voluntarily seeking U.S. trading markets, and hence should be denied the information-supplying exemption.”⁷² With respect to foreign underwritings which may involve domestic issuers or broker-dealers, the only activities in the United States that an unregistered broker-dealer can perform are those which are incidental to a distribution for foreigners outside of the United States.⁷³ In both these areas, a balancing of domestic and foreign conduct similar to that in *Bersch*, *Vencap* and *Cornfeld* is evident.

3. The “Nationality” Doctrine

The third ground for applying United States law is nationality. The effects and conduct doctrines are based on international law principles of territoriality—that a nation has jurisdiction over conduct affecting or occurring in its possessions.⁷⁴ The nationality doctrine, in contrast, postulates that a nation has an interest in applying its law with respect to its citizens wherever they are located.⁷⁵

The nationality doctrine has not been extensively applied by our courts.⁷⁶ In *Bersch*, for example, although the court recognized “the power of the United States to impose rules on the conduct of its nationals,”⁷⁷ it refused to apply the antifraud provisions solely on that basis, stating:

Congress surely did not mean the securities laws to protect the many thousands of Americans residing in foreign countries against securities frauds by foreigners acting there, and we see no sufficient reason to believe it would have intended otherwise simply because an American participated so long as he had done nothing in the United States.⁷⁸

B. ANALYSIS UNDER THE FEDERAL SECURITIES CODE

Section 1905 of the Code incorporates much of the existing law on extraterritorial application of the United States securities law.⁷⁹ The section

71. Securities traded on an exchange must be registered pursuant to § 12(b) of the Securities Exchange Act, 15 U.S.C. 78l(b).

72. Securities Exchange Act Release No. 20264, 48 Fed. Reg. 46,736, 46,737 (1983).

73. Securities Exchange Act Release No. 7366, 29 Fed. Reg. 9828 (1964).

74. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 10 introductory note a (1965) (current Restatement); see also *supra* note 5.

75. See generally *Laker Airways Ltd. v. Sabena Belgian World Airlines*, 731 F.2d 909, 921–22 (D.C. Cir. 1984) (discussing territoriality and nationality principles). The Draft Restatement recognizes nationality as a basis for applying United States law, particularly with respect to “private law,” e.g., wills and succession, family, and divorce law. Draft Restatement § 402 comment c.

76. See *supra* note 5 and accompanying text; *Vencap*, 519 F.2d at 1016; Code § 1905, comment 11(f).

77. *Bersch*, 519 F.2d at 985, citing RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 30 (1965) (current Restatement).

78. *Id.* at 992.

79. Code, introduction at vi.

provides for broad and flexible administration, by extensively applying United States law, but also authorizing the Commission to make rules narrowing or broadening the scope of those provisions.⁸⁰

The drafters of the Code state that they intended neither to exceed nor exhaust the limits of international law with these provisions.⁸¹ Nonetheless, there is a tension between the two provisions for applying the Code, Sections 1905 and 1902. Section 1905(a) would direct extraterritorial application of the Code "within the limits of international law," but Section 1902(f) would direct application of the Code "to the full extent of the constitutional authority of the Congress." The former provision is directed primarily at transnational transactions, and the latter primarily at domestic transactions, but neither explicitly so states. Literally, Section 1902(f) would mandate sweeping international application of United States securities laws.⁸² And it is not clear whether Sections 1905(a), limiting the Code to the bounds of international law, would counter the broader constitutional authority in Section 1902.⁸³

1. "Catchall" Provisions

The Code contains "catchall" provisions which are patterned after the effects and conduct doctrines as developed under current judicial analysis. Section 1905(a)(1)(D)(ii) would apply United States law if some or all elements of otherwise actionable conduct occur outside this country but cause a "substantial effect" in this country "as a direct and reasonably foreseeable result." And Section 1905(a)(1)(D)(i) would apply United States law to actionable conduct that occurs "to a significant (but not necessarily predominant) extent within the United States."⁸⁴

2. Conduct Occurring Within the United States

The drafters of the Code believed that the effects and conduct doctrines are "too general and [do] not . . . afford sufficient guidance to the courts."⁸⁵ In addition, they stated that authority in this area should not be the "central responsibility" of the Commission.⁸⁶ Therefore, the drafters wrote specific

80. Code § 1905(c); see Loss, *Extraterritoriality in the Federal Securities Code*, 29 HARV. INT'L L. J. 305, 308 (1979) (Code represents "blending" of judicial expertise in international law with the Commission's expertise in rulemaking).

81. Code § 1905 comment 1(c).

82. See *supra* note 18 and accompanying text (similar potential under current provisions of the Securities Act).

83. The Code drafters note that the same problem exists under current Securities Exchange Act § 30, 15 U.S.C. 78dd. Code § 1905 comment 1(a). See also Draft Restatement § 403(4)(b) (if Congress' purpose is clear, United States law would apply if within constitutional limits).

84. See *supra* note 40 (Section 1905(a)(1)(D)(i) read "substantial" rather than "significant" conduct prior to 1981).

85. Code § 1905 comment 1(b)(ii).

86. The Code drafters gave the Commission ancillary rulemaking authority, see *supra* note 80 and accompanying text, but determined that the major provisions should be statutory. See

statutory rules, applying United States law to any purchase, sale or offer to buy or sell any security, proxy solicitation, tender offer or other circularization of security holders, or activity as an investment adviser which "occur[s] within the United States although . . . initiated outside the United States."⁸⁷ The Code language conforms to current judicial analysis,⁸⁸ but provides the certainty of unambiguous statutory language.

3. *Conduct Occurring Outside the United States*

Additional provisions direct extraterritorial application of certain securities laws regardless of conduct in the United States. Section 1905(a)(2) would apply the Code's antifraud provisions to offers, purchases and sales, proxies, tender offers, and activity as an investment adviser if initiated in this country but "occur[ing]" elsewhere.⁸⁹ This is analogous to the "export of fraud" theory articulated by the courts.⁹⁰ And Section 1905(a)(1)(B) would apply United States law, without regard to the existence of any conduct in this country, to nonresidents who had obtained an identifiable status to which the Code attaches legal consequences. This status includes: (i) registrants under any provisions of the securities laws;⁹¹ (ii) officers, directors and shareholders regulated under Sections 13, 14(d) and 16 of the Securities Exchange Act;⁹² and (iii) banks and participants in registered clearing agencies.⁹³

Code § 1905, comment 1(c) (noting reliance on Commission rules "to tailor that expression of power to the appropriate policy considerations . . . could result in litigation (as many [rules] already have) under the Code").

87. Code § 1905(a)(1)(A). Domestically, the Code would apply generally to registrants, affiliates, and associates, and to anyone who used the mails or interstate or foreign commerce. Code § 1902(b)-(c). These standards may present interpretative problems when construed together with the provisions of § 1905. See *supra* notes 81-83 and accompanying text.

88. See Code § 1905 comment 3 (citing cases involving offers, sales, proxies, tender offers).

89. Code § 1905(a)(2) provides for the application only of Part XVI of the Code, which deals with fraud, misrepresentation and manipulation, and the portion of Part XVII creating civil liabilities for violation of Part XVI. Section 1905(b)(1) covers the remaining portions of the Code, directing that the Code *not* apply in any respect to any other act occurring outside the United States.

90. See *supra* text accompanying note 49.

91. Proxy solicitations under § 14(a) of the Securities Exchange Act, 15 U.S.C. 78n(a), are covered under the Code provision relating to registrants. See Code §§ 1902(b)(1), 603(a).

92. Sections 13(d) and (g) of the Securities Exchange Act, 15 U.S.C. 78m(d), (g), impose reporting obligations on owners of more than five percent of any class of equity securities of a registered corporation. Section 14(d), 15 U.S.C. 78n(d), imposes reporting and other obligations on tender offerors. Section 16(a), 15 U.S.C. 78p(a), imposes reporting obligations on officers, directors, and ten-percent shareholders. Section 16(b), 15 U.S.C. 78p(b) is the "short-swing" profits provision; see *supra* note 28. Code § 1905 comment states that this provision would apply § 16(b) "short-swing" liability to a foreign officer, director or shareholder of a foreign corporation, in transactions abroad. *Wagman v. Astle*, 380 F. Supp. 497 (S.D.N.Y. 1974), reached the opposite conclusion on these facts. See discussion of § 16(b) application *supra* notes 27-32. The Code drafters, noting *Wagman*, nonetheless state that there is "no longer any substantial doubt about the constitutionality of this kind of provision." Code § 1905(e)(3) comment 2.

93. Code § 1905(a)(1)(B), incorporating § 1902(b), which in turn incorporates §§ 605-606.

4. *Other Special Provisions*

The Code drafters believed that the securities laws other than the anti-fraud provisions should have narrower extraterritorial application.⁹⁴ Section 1905(b)(1) recognizes this policy generally, and Sections 1905(b)(2) and (3) would apply it specifically to nonresident brokers, dealers and investment advisers.

No registration would be required under the Code if a nonresident broker or dealer did business with a person outside the United States, or with a nonresident foreigner already a customer and temporarily in the United States,⁹⁵ or if a nonresident broker-dealer had a limited participation in an underwriting initiated in the United States, and all the shares were sold outside the United States.⁹⁶ This would be true regardless of any trading on United States markets that would otherwise satisfy the effects or conduct test.⁹⁷

C. ANALYSIS UNDER THE DRAFT RESTATEMENT

The Draft Restatement uses the traditional bases of jurisdiction, as in current and Code analysis,⁹⁸ but only as a starting point. To make a final jurisdictional determination under the Draft Restatement, it is necessary to "analyze various interests, examine contacts and links, give effect to justified expectations, search for the 'center of gravity' of a given situation, and develop priorities."⁹⁹ This is labelled the "principle of reasonableness"; jurisdiction may be exercised under the Draft Restatement only if it would not be unreasonable.¹⁰⁰

94. Fraudulent offers from the United States should be subjected to our laws "so as to avoid [this] territory's being used as a base to injure persons in other states." But the registration and prospectus requirements of the Securities Act do not have such a broad mission, according to the Code drafters. "As a matter of prosecutor's discretion," these provisions do not extend "as far as [they] might under international law." Code § 1905 comment 4.

95. Code § 1905(b)(2). Similar exemptions for essentially foreign transactions now exist in other circumstances. See *supra* note 18 and accompanying text (Securities Act registration); *infra* notes 195–203 and accompanying text (Securities Exchange Act registration).

96. Code § 1905(b)(3). This standard is taken directly from Securities Act Release No. 4708, 29 Fed. Reg. at 9828, but without that release's limitation that sales outside the United States be only to foreign citizens. See, e.g., Johnson, *Application of Federal Securities Laws to International Securities Transactions*, 45 ALBANY L. REV. 890, 926–27 (1981).

97. See *supra* note 67 and accompanying text (under current law, execution of trade on a domestic exchange is significant); Draft Restatement § 416(2)(a) (trading on United States markets is a significant factor).

98. Compare Draft Restatement § 402(1)–(2) (conduct, effects and nationality as bases for jurisdiction) with Restatement (Second) of the Foreign Relations Law of the United States §§ 17, 18, 30 (1965) (current Restatement) (same).

99. Draft Restatement, Pt. IV, c. 1, introductory note.

100. See Draft Restatement § 403 comment a.

1. The "Effects" Doctrine

Section 402(1)(c) recognizes that a state may exercise jurisdiction with respect to "conduct outside its territory which has or is intended to have substantial effect within its territory." The language regarding "intended effect" is broader than current law; current analysis has not suggested that only an intent to affect United States citizens or markets would, without any actual effect, be a sufficient basis under the effects doctrine to apply United States law.¹⁰¹

The reasonableness analysis under Draft Restatement Section 403 tempers the sweeping language about the effects doctrine that appears in Section 402. Section 403(2)(a)(ii) lists as one of the reasonableness factors "the extent to which the activity . . . has substantial, direct and foreseeable effect upon or in the regulating state." This is a more traditional statement of the effects doctrine.¹⁰² As under current analysis,¹⁰³ Draft Section 403(2)(b) would look to effect upon United States citizens. Also like current law,¹⁰⁴ Draft Section 403(2)(g) would compare foreign effects with domestic effects. Thus, in a few respects, the Draft Restatement fairly restates the effects doctrine, but differs because it would no longer be dispositive. Rather, sufficient effects would become only one factor among many others to be considered.

2. The "Conduct" Doctrine

Section 402(1)(a) recognizes that a state may exercise jurisdiction with respect to "conduct a substantial part of which takes place within its territory." This standard is different from that set by the current Restatement, which recognizes a state's jurisdiction to "attach . . . legal consequences to conduct that occurs within its territory."¹⁰⁵

101. See *supra* text accompanying note 3 (extent of current analysis under effects doctrine).

102. The "substantial, direct and foreseeable" language comes directly from the current Restatement. See RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 18(b) (1965); see also *Schoenbaum v. Firstbrook*, 405 F.2d 200, 208-09 (2d Cir.), 405 F.2d 215 (2d Cir. 1968) (en banc) (reh. on other grounds), *cert. denied*, 395 U.S. 906 (1969).

103. See, e.g., *supra* notes 14-15 and accompanying text.

104. See, e.g., *Wagman v. Astle*, 380 F. Supp. 497 (S.D.N.Y. 1974), discussed *supra* notes 30-32 and accompanying text, finding no personal jurisdiction based on effect in the United States where the plaintiff, defendant, corporation, and transaction were all Canadian; *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975), discussed *supra* notes 16-17 and 33 and accompanying text, finding no subject-matter jurisdiction based on effect in the United States as to foreign plaintiffs.

105. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 17(a) (1965). The Draft's requirement that "a substantial part" of the conduct take place here may qualify the present standard. On the other hand, that language probably recognizes that conduct does not necessarily "occur" in only one place. This is in accord with modern case law, which does not locate the acts in one place, but compares the domestic and foreign conduct. See *supra* text accompanying notes 54-64. The language also differs from that of Code § 1905(a)(1)(D)(i), which states that "significant" conduct is the appropriate standard. See *supra* note 40.

As with the effects doctrine, certain portions of the current judicial application of the conduct doctrine are reflected in the reasonableness factors listed in Section 403. Section 403(2)(a)(i) lists as a reasonableness factor "the extent to which the activity takes place within the regulating state." This statement recognizes that in some cases, while there may be sufficient conduct for the state to apply its own law, conduct elsewhere makes it more reasonable for another state's law to apply. In addition, Section 403(2)(b) looks to a link such as nationality, residence, or economic activity with those protected or prosecuted under the law to be applied. This also reflects one aspect of current law; under *Bersch v. Drexel Firestone, Inc.*,¹⁰⁶ preparatory conduct in the United States is a sufficient basis for jurisdiction over the claims of nonresident American citizens, but not those of foreigners located abroad.

3. The "Nationality" Doctrine

Section 402(2) generally recognizes that a state may exercise jurisdiction with respect to "the conduct, status, interests or relations of its nationals outside its territory." Section 418, a special application of the nationality doctrine,¹⁰⁷ governs United States jurisdiction over foreign branches of United States corporations and foreign corporations controlled by United States corporations or individuals. The United States may exercise jurisdiction over a foreign *branch* of a domestic corporation under Section 418, subject to the "reasonableness" analysis of Section 403. By contrast, the United States may exercise jurisdiction over a foreign *subsidiary* of a domestic corporation under Section 418 only if it is part of a program of economic regulation applicable to United States nationals and in furtherance of a national interest requiring application of United States law.¹⁰⁸

A significant limitation on the exercise of United States jurisdiction is Section 418(4)(a), directing that United States jurisdiction may not be exercised over foreign branches or subsidiaries when compliance with United States law would bring the foreign branches or subsidiaries into conflict with the state "where the branch or corporation is organized or doing business."¹⁰⁹ The section also prohibits United States regulation of "predominantly local" conduct, such as employment practices of branches or subsidiaries outside United States territory.¹¹⁰

106. 519 F.2d 974, 992-93 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975), discussed *supra* notes 50-52 and accompanying text.

107. Section 418 applies only where United States jurisdiction is based on nationality, not on conduct or effects. Draft Restatement § 418 and comment a.

108. *Id.* § 418(2)-(3).

109. *Id.* § 418(4)(a).

110. *Id.* § 418(4)(b). Although § 418 comment f contains a list of examples of such conduct, which are labeled "non-controversial," the entries in that list are far from non-controversial. See *infra* notes 242-244 and accompanying text.

It is not clear whether Section 418's nationality-based jurisdictional framework applies at all to United States securities laws, which are covered, at least in part, in Section 416.¹¹¹ The commentary to Section 418 requires "clear" Congressional intent to apply United States law based on nationality, but does not specify what intent would suffice.¹¹² The antifraud provisions of the securities laws are usually applied based on conduct or effects in the United States,¹¹³ and would not be subject to significant limitation under Section 418.

4. *New Factors in the Draft Restatement*

From the effects, conduct, and nationality beginning described above, the Draft Restatement departs radically from current law. Section 403(1) of the Draft provides that jurisdiction may be exercised only if it is "reasonable" in light of the factors listed in Section 403(2). Although the factors in Section 403(2)(a) and (b) restate some aspects of the effects and conduct doctrines,¹¹⁴ the remaining factors differ significantly from the current Restatement and current judicial analysis.¹¹⁵ The factors listed in Section 403(2) are not all-inclusive, and the weight to be given each is not specified.¹¹⁶

The additional reasonableness factors in Section 403(2)(c)-(h)¹¹⁷ would

111. The comments note that § 418 applies "in contexts not covered by other sections" such as § 416, relating to securities transactions. Draft Restatement § 418 comment a. But it is doubtful that § 416 does or was intended to apply to every area of securities law. *See infra* notes 127-129 and accompanying text (discussing scope of § 416).

112. While "general legislation" or "general phrases" are not sufficient, *see* Draft Restatement § 418 comment g, neither the comment, nor § 403(4)(b) on which it is based, is clear as to what expression of Congressional intent will suffice. The reporters appear to be satisfied that the Foreign Corrupt Practices Act is an example of "explicit" Congressional intent to apply United States law extraterritorially on the basis of nationality, regardless of any foreign conflict. *Id.* § 418 reporters' note 4.

113. Although nationality is a recognized basis for jurisdiction, it is rarely used. *See supra* notes 76-78 and accompanying text.

114. *See supra* notes 102-106 and accompanying text.

115. Compare RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 17, 18, 30 (1965) (conduct, effects and nationality as sufficient bases for jurisdiction) with Draft Restatement § 402 comment a ("while links of territoriality or nationality are generally necessary, they are not sufficient in all cases").

116. "The list of considerations . . . is not exhaustive While the first considerations listed [§§ 403(2)(a)-(b)] relates to the principal bases of jurisdiction—territoriality or nationality—no special significance or scheme of priorities is implied in the order in which the factors are listed." Draft Restatement § 403 comment b. *But see* AVC Nederland B.V. v. Atrium Investment Partnership, 740 F.2d 148, 154-55 (2d Cir. 1984) (finding "factors (a)(i) and possibly (b) pointing in favor of application of [antifraud provisions of United States securities law], factors (g) and (h) against such application, and most of the other factors inapplicable, dubious and neutral," implying that factors (a) and (b) are of greater weight since the court upheld jurisdiction).

117. Those factors are:

(c) the character of the activity to be regulated, the importance of regulation to the

require consideration of new issues even when the court's ultimate decision is that United States law cannot be applied. In the *Fidenas* cases, for example, United States courts refused to apply our laws to either foreign or United States defendants, because the "essential core of the alleged fraud" was outside the United States.¹¹⁸ Under Section 403(2), however, the analysis would not be complete at this point. A court applying the Draft Restatement would be required to consider the new factors: that the activity to be regulated, fraud in a securities transaction, is important in the United States¹¹⁹ and our regulation of such activity is generally accepted, but that on balance, few if any of the parties had a justified expectation that United States law would apply; that although our regulation of securities transactions and fraud in those transactions may be of some importance in the international system, and may in fact be reasonably consistent with the traditions of that system, the interests of other states may be greater than the interests of the United States. Thus, even assuming that the court would reach the conclusion that the facts do not reasonably call for the application of United States law, the Draft Restatement would require a more detailed analysis and a greater expenditure of judicial resources than under current law or under the Code.

Section 403(3) imposes a further restriction upon jurisdiction not imposed by the current Restatement. In the event of an actual conflict among states whose jurisdiction is not unreasonable, an absolute choice should be made among the laws of the various states. Consequently, all but one state are denied jurisdiction.¹²⁰

-
- 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 in question;
 - (e) the importance of regulation to the international political, legal or economic system;
 - (f) the extent to which such 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;
 - (h) the likelihood of conflict with regulation by other states.

See *infra* pp. 456-57 (application of these factors to *Bersch* facts).

118. *Fidenas AG v. Compagnie Internationale pour L'Informatique CII Honeywell Bull S.A.*, 606 F.2d 5, 8 (2d Cir. 1979). In the later case against the United States defendants, the court held that the analysis remains unchanged. *Fidenas AG v. Honeywell, Inc.*, 501 F. Supp. 1029, 1041 (S.D.N.Y. 1980), discussed *supra* notes 63-64 & *infra* notes 161-169 and accompanying text.

119. See *supra* notes 58, 60 (statements of courts emphasizing United States interest in preventing fraud perpetrated on the foreigners).

120. Section 403(3) requires a court to reevaluate its choice of law if, although reasonable, it would require "a person to take action that would violate a regulation of another state which is not unreasonable under those criteria." In essence, the provision directs a court to resolve the problem of inconsistent conduct requirements by trying its balancing process again.

A court, following the Draft Restatement analysis in a securities case, would have come full circle at this point. Having decided that there was sufficient conduct, effects, or nationality, and

Another jurisdictional provision, Section 419, sets forth specific applications of the rules of Section 403(3), "when two states having jurisdiction to prescribe with respect to a person issue contradictory commands."¹²¹ It would change current law, reflected in the current Restatement, by using the reasonableness analysis under Section 403(2) to decide whether to apply United States law when it would directly conflict with another state's requirements.¹²²

If the act in question was to be performed outside United States territory, Section 419(1) would "ordinarily" defer to the contrary government compulsion of the state where the act was to be done or where the actor was a national. If, on the other hand, the act was to be performed in the United States, Section 419(2) would "generally" allow the United States to exercise its jurisdiction, even if the result would force a foreign national to violate his country's law. The provision represents a departure from current law, which generally has been less solicitous of foreign government compulsion which contradicts United States law, regardless of where the act is to be performed.¹²³ Under the current Restatement, in contrast, courts are given greater discretion to allow inconsistent standards of conduct to apply to a person.¹²⁴

5. *Specific Securities Provisions*

Section 416 "illustrate[s]" the application of the Draft Restatement's jurisdictional principles to transnational securities transactions.¹²⁵ Section 416 approaches jurisdiction to apply United States securities laws in terms of

that application of United States law would not be "unreasonable," the court would therefore apply United States law. But if that law directed one of the parties to do something that would be illegal under the law of another nation, which would have a "reasonable" interest in having its law applied, then the United States court would have to begin another reasonableness analysis.

121. Draft Restatement § 419 comment a.

122. Draft Restatement § 419 comment a. *Compare id.* § 403(2) with RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965) (current Restatement), which requires a court to consider more traditional factors: vital national interest, conduct, effects, nationality and practicability.

123. *See* United States v. Bank of Nova Scotia, 691 F.2d 1384 (11th Cir. 1982), *cert. denied*, 103 S. Ct. 3086 (1983); SEC v. Banca Della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981).

124. *See* RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965) (each state is to consider, "in good faith," moderating its enforcement jurisdiction), and *id.* §§ 37, 39 (inconsistent requirements do not necessarily defeat a court's jurisdiction); *see also* Laker Airways Ltd. v. Sabena Belgian World Airlines, 731 F.2d 909, 926-27, 952 n.169 (D.C. Cir. 1984) (noting that courts should permit concurrent exercise of jurisdiction to prescribe, yielding if at all only after reduction to judgment, and criticizing Draft Restatement on this ground).

The Draft states that the existence of concurrent inconsistent judgments by different courts regarding the same person is generally "an intolerable situation." Draft Restatement § 403 comment d. Resolution of such conflicts would be required *before* jurisdiction could be asserted. *Id.* § 403 reporters' note 10.

125. Draft Restatement § 403 comment g.

“transactions in securities” and divides those transactions into two categories: those which are carried out on a securities market in the United States and those which are not.¹²⁶

Under Section 416(1), United States securities law would be applied to “[a]ny transaction in securities carried out, or intended to be carried out, on a securities market in the United States”; it is not necessary to apply the reasonableness analysis of Section 403, because application of United States law under these circumstances is *per se* reasonable.¹²⁷ The drafters of this provision note that this situation “provides the clearest case for regulatory jurisdiction,” and that none of the Section 403 factors “exerts a strong pull against application of United States law.”¹²⁸

Section 416(2) sets forth three additional “links” between securities transactions and the United States: where securities of the same issuer are traded on markets here; where some representations are made or negotiations occur here; and where parties to be protected or subject to regulation are United States residents. But these Section 416(2) links do not have the same effect as does trading on a United States market under Section 416(1). If these links are present, the transaction must nonetheless satisfy Section 403’s reasonableness analysis. And if these links are absent, this “gives strong indication of lack of jurisdiction to apply United States law.”¹²⁹ Thus, the provisions of Section 416(2) do not serve any independent functional purpose in the analysis under the Draft Restatement, because the court must in any event refer back to Section 403, and decide the case based on reasonableness analysis.

D. SPECIFIC APPLICATIONS

This subsection presents five examples which illustrate the contrast between the present law with respect to the extraterritorial application of the federal securities laws and the Code, on the one hand, and jurisdiction under the Draft Restatement, on the other hand. The first three examples are drawn from reported cases involving the antifraud and short-swing trading provisions of the United States securities laws. In the first case,

126. Except as noted *infra* under § 416(1), the reasonableness analysis is still required under § 416. “The overall test of jurisdiction under §§ 402 and 403, however, is reasonableness, and the links set out in this section are illustrative, not exhaustive or conclusive in all cases.” Draft Restatement § 416 comment c.

127. *Id.* § 416 reporters’ note 2. The drafters do not specify the activity under § 416(1) that constitutes trading “on a securities market” or “intent” to do so.

128. *Id.* In the antitrust area, the District of Columbia Circuit has noted that similar “short-circuit” provisions in Draft Restatement § 415(2) could also make any reasonableness analysis unnecessary. See *Laker Airways*, 731 F.2d at 950 n.152 (under § 415(2), “the reasonableness [test] of § 403(2) will often be superfluous”).

129. *Id.* § 416 comment c.

United States jurisdiction was upheld in part and denied in part in an antifraud action involving different classes of plaintiffs. In the second case, two different courts reached opposite conclusions in cases involving the short-swing trading provisions as applied to foreign corporations. In the third case, the court found no connection with the United States antifraud law to either foreign or domestic defendants. The other two examples examine the activities of investment advisers and periodic reporting by foreign issuers of securities.

1. *Bersch v. Drexel Firestone, Inc.*¹³⁰

Bersch was a class action brought on behalf of purchasers of I.O.S., Ltd. ("IOS") common stock. Plaintiffs alleged that there were material omissions and false and misleading financial statements in prospectuses used in three contemporaneous offerings of IOS stock.¹³¹

The first of the three distributions was a primary offering of 5.6 million shares, sold exclusively outside of the United States to foreign nationals residing in Europe, Asia and Australia with a prospectus emanating from London or Brussels. This offering was underwritten by two United States and four European investment banking concerns. The second distribution was a secondary offering of 1.45 million shares, made from Canada solely to Canadian resident nationals, and underwritten by a Toronto investment banker. The third distribution was another secondary offering of 3.95 million shares, made without an underwriter by a wholly-owned subsidiary of IOS, which was organized under the laws of Nassau, Grand Bahamas.¹³² The prospectus for that offering stated that the offering was being made to approximately 25,000 persons who were either employees, existing clients of IOS, or persons with an established professional or business relationship with the company. Despite statements in the prospectus that the shares were not being offered in the United States or any other territory subject to its jurisdiction, at least 22 Americans living in this country purchased 41,936 shares in the third offering.¹³³

a. Current Law

As discussed earlier, the *Bersch* court made three different findings depending on the class of plaintiffs. The court held that United States law applied to the claims of resident United States citizens, because there is "a direct effect" in this country.¹³⁴ With respect to nonresident United States

130. 519 F.2d 974 (2d Cir.), cert. denied, 423 U.S. 1018 (1975), discussed *supra* notes 16-17 & 47-52 and accompanying text.

131. *Bersch*, 519 F.2d at 981.

132. *Id.* at 979-80.

133. *Id.* at 991.

134. See *supra* note 17 and accompanying text.

citizens, the court held that some conduct by the defendants in the United States was necessary; “acts (or culpable failures to act) of material importance in the United States [must] have significantly contributed” to the plaintiffs’ loss. Although the conduct occurring in the United States must be “of material importance,” it need not be the predominant conduct at issue; the court noted that “merely preparatory” conduct, “small in comparison to [the activities] abroad,” would suffice.¹³⁵ As to foreigners, the court held that they must show conduct in the United States by the defendants which directly caused their losses, and that on the facts there was no such conduct.

b. The Code

Analysis under Section 1905 of the Code would substantially parallel that undertaken by the *Bersch* court. Sales to resident citizens would occur “within the United States although . . . initiated outside the United States” under Section 1905(a)(1)(A), and the Code would apply to those sales. Sales to nonresident citizens would be covered under either of two Code provisions. Section 1905 (a)(1)(D)(i) applies the Code to “prohibited, required, or actionable conduct whose constituent elements occur to a significant (but not necessarily predominant) extent within the United States.” This follows the *Bersch* court’s holding that activities in this country relating to nonresident citizens, although “preparatory,” will support application of United States law if they are “of material importance” and “have significantly contributed” to the plaintiff’s losses.¹³⁶ Alternatively, Section 1905(a)(2) applies the Code’s antifraud provisions (at issue here) to sales which occur outside, but are initiated in, the United States. The “preparatory” conduct of the *Bersch* defendants would satisfy this standard.

With respect to offers and sales to foreign nationals abroad, the Code would diverge from the *Bersch* decision. United States law would apply under the same provisions—Sections 1905(a)(1)(D)(i) and 1905(a)(2)—applicable to Americans resident abroad. Unlike *Bersch*, the Code makes no distinction based on the plaintiff’s nationality.¹³⁷

135. *Id.* This is a mixture of the “effects” doctrine, which was used to sustain jurisdiction as to resident citizens, and the “conduct” doctrine, which was relied on exclusively in relation to the foreign plaintiffs. The *Bersch* court apparently viewed nonresident citizens as somewhere in between.

136. 519 F.2d at 993. In discussing § 1905(a)(1)(D)(i), the Code drafters point primarily to *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972), discussed *supra* notes 34–39 and accompanying text. Code § 1905(a)(1)(D)(i) comment 1(b)(ii). *Bersch* is cited for the contrary conclusion, that “merely preparatory” acts do not suffice, *id.*, but that holding in *Bersch* related only to foreign plaintiffs. See *supra* text accompanying note 135.

137. Section 1905 does, however, distinguish between residents and nonresidents. See §§ 1905(a)(1)(B), 1905(b)(2), and 1903(b)(3); see also *supra* note 52 (nationality-based distinction of questionable constitutionality).

c. The Draft Restatement

The Draft Restatement would raise doubts as to whether United States law would apply to sales to citizens abroad. It is not even clear whether there would be jurisdiction where the Second Circuit in *Bersch* found it most compelling—the sales of securities to resident citizens—because of the “reasonableness” evaluation required under Section 403(2).

The first step in the analysis would be to determine whether there is a basis for jurisdiction under Section 402. The *Bersch* court relied on the effects doctrine with respect to resident United States citizens, and the same analysis could be made under the effects doctrine as stated in Section 402(1)(c). The court relied on both the effects and the conduct doctrines with respect to nonresident citizens. Section 402(1)(a), however, requires that “a substantial part” of the conduct take place in this country. It is unlikely that this standard was satisfied with respect to sales to either nonresident Americans or foreigners. Although there were “acts . . . of material importance in the United States [which] . . . significantly contributed” to the offering,¹³⁸ Section 402(1)(a) appears to require a more quantitative evaluation of the extent to which the actionable conduct took place in this country, which might yield no jurisdiction based on conduct.

Turning to Section 416, it is unlikely that any of the sales would call for application of United States law under Section 416(1), as transactions carried out on a market in the United States, because there probably was no such “market” within the meaning of Section 416(1).¹³⁹ Thus, it would be necessary to determine if one of the Section 416(2) jurisdictional links is present; if not, application of United States law would be unlikely.¹⁴⁰ Section 416(2)(c) would apply to the sales of securities to Americans here, since “the persons sought to be protected are residents of the United States.” The nonresident American plaintiffs, however, would not be a relevant jurisdictional link; Section 416(2)(c) mentions only United States residents as a link on the plaintiff’s side. Links on the defendants’ side under Section 416(2)(c) would allow application of that subsection to all of the sales, since three of the ten defendants, the “part[ies] subject to the regulation,” were “United States national[s] or resident[s].” In any event, the

138. *Bersch*, 519 F.2d at 993.

139. As noted above, only a small part of the offering was sold to a relatively small number of United States citizens. Had there been a greater distribution of securities in the United States, conceivably § 416(1) would apply because of the creation of a United States market in IOS securities. This assumes, however, that the term “market” includes informal markets as well as registered exchanges and electronic quotation systems. See *infra* note 232.

If the application of the antifraud provisions of § 17(a) of the Securities Act to the offer of securities (as well as the sale) were at issue, classification under § 416 of the Draft Restatement would be problematic. It is not clear whether an offer absent a sale would be considered a “transaction” in securities.

140. See *supra* text accompanying note 129.

presence of a Section 416(2)(c) link is not “conclusive”; United States jurisdiction “might be reasonable if the person had other close and continuing links with the United States.”¹⁴¹

Any assertion of jurisdiction under Section 402 or Section 416(2) is subject to a further reasonableness evaluation under Section 403(2), and many of the pertinent factors in that subsection could cut against applying United States law. Turning first to Section 403(2)(a)(i), securities were sold to resident Americans only in one of the three offerings. The prospectus for that offering emanated from Geneva or the Bahamas and was presumably mailed into the United States, and there was no other activity here with respect to the offering.¹⁴² Thus, unless activity of United States underwriters in the *primary* offering is taken into account,¹⁴³ nothing took place, to any great extent, in this country. Under Section 403(2)(a)(ii), it may be difficult to establish the extent to which the offer and sale had a “substantial, direct, and foreseeable effect upon or in the [United States].” The sales to nonresidents had no apparent effect within the United States.

Analysis under Section 403(2)(b) is also unlikely to provide support for application of United States law. There were links between the United States and some of the defendants, as well as some of the plaintiffs, but such links were hardly predominant.¹⁴⁴

Under Section 403(2)(c), the court could be required to undertake an exhaustive policy analysis of United States antifraud laws in an international context, considering the “character of the activity to be regulated,” how important that regulation is to the United States, whether there are similar antifraud laws in other nations, and the extent to which such antifraud laws are “generally accepted.” This provision seems to require a survey of national laws and judgments as to the value of such antifraud laws. Such a survey would not have a predictable result. Furthermore, the survey itself may be offensive to foreign governments.¹⁴⁵

Section 403(2)(d) refers to the “existence of justified expectations that might be protected or hurt” by application of United States law. Here, the defendants probably intended that United States law not apply to any of the offerings, but they had no reason to believe that the antifraud provisions would not apply.¹⁴⁶ Moreover, the United States resident citizen purchasers

141. Draft Restatement § 416 reporters’ note 3.

142. The seller of the securities was a Bahamian subsidiary of the issuer, which in turn was a Canadian corporation headquartered in Switzerland. *Bersch*, 519 F.2d at 979–80.

143. See *supra* text preceding note 132.

144. Approximately 11.1 million shares were sold in the three offerings; the court could identify at most 42,000 shares that were sold to United States residents. *Bersch*, 519 F.2d at 979–80, 991.

145. See *infra* note 229 and accompanying text.

146. The transactions were structured to avoid application of the registration requirements. *Bersch*, 519 F.2d at 979–80. However, as the court stated, “[i]t is elementary that the *anti-fraud*

probably expected at least the antifraud provisions of United States law to apply.

The next criteria, Sections 403(2)(e) and (f), require a determination of the "importance" of the regulation to and its "consisten[cy] with the traditions of the international system," but the meaning of "international system" is not explained. Presumably, application of the antifraud provisions to international offerings of securities is important to, and consistent with, the international economic system, but such a determination is not clear.

Section 403(2)(g) refers to the interests of other states "in regulating the activity." Several states were involved in the IOS liquidation process, and states other than this country must have been interested in the IOS offering, since the overwhelming majority of the purchasers did not reside in the United States.¹⁴⁷ Yet, other nations' interest in regulating the offering is not easy to measure.

Finally, Section 403(2)(h) requires consideration of "the likelihood of conflict with regulation by other states," which might require an extended inquiry into foreign law. It is unlikely that prevention of fraudulent sales of securities would conflict with another state's laws. There could, however, be different disclosure standards. If a nation does not require disclosure or if material omissions are not actionable, there could be a conflict.

2. *Roth v. Fund of Funds, Ltd.* and *Wagman v. Astle*¹⁴⁸

In *Roth*, a United States shareholder brought an action on behalf of Dreyfus Corporation, a United States corporation, against Fund of Funds ("FOF"), a Canadian corporation, to recover "short-swing profits" pursuant to Section 16(b) of the Securities Exchange Act.¹⁴⁹ FOF was a beneficial owner of more than ten percent of Dreyfus stock and was thus within

provisions of the federal securities laws apply to many transactions which are neither within the registration requirements nor on organized American markets." *Id.* at 986 (emphasis added). Indeed, the Secretary of the SEC brought this possibility to the attention of the underwriters. *Id.* at 986 n.28.

147. The plaintiff class included "citizens and residents of Canada, Australia, England, France, Germany, Switzerland, and many other countries in Europe, Asia, Africa, and South America." *Id.* at 978.

The liquidation of the various IOS companies and the compensation of defrauded purchasers were being overseen in part by an informal international committee of regulatory agencies. *See id.* at 978 n.4. In a later case involving IOS companies, the Commission argued that in such cases "victims (whether American or foreign) of international securities fraud cannot be denied the protections of United States law without jeopardizing future cooperative efforts to combat international fraud." Memorandum of the Securities and Exchange Commission, *Amicus Curiae* at 5, *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980).

148. *Roth v. Fund of Funds, Ltd.*, 405 F.2d 421 (2d Cir. 1968), *cert. denied*, 394 U.S. 975 (1969); *Wagman v. Astle*, 380 F. Supp. 497 (S.D.N.Y. 1974). These cases are discussed *supra* notes 27-32 and accompanying text.

149. *Roth*, 405 F.2d at 422.

the provisions of Section 16(b).¹⁵⁰ The purchases and sales by FOF of the Dreyfus shares were made on the New York Stock Exchange through New York broker-dealers.

In *Wagman*, a shareholder brought an action on behalf of Dome Petroleum, Ltd., a Canadian corporation, against officers of Dome, also to recover Section 16(b) "short-swing profits."¹⁵¹ The defendants in *Wagman*, as in *Roth*, were clearly within the proscriptions of Section 16(b).¹⁵² However, in *Wagman* the transactions all took place in Canada, although Dome stock was traded on the American Stock Exchange. All the individual defendants were citizens and residents of Canada. Unlike *Roth*, the defendants in *Wagman* engaged in no transactions or other conduct in the United States.

a. Current Law

The *Roth* court found execution of transactions in the United States through a United States broker-dealer had an effect sufficient to warrant application of United States law.¹⁵³ The *Wagman* court dismissed the case for lack of personal jurisdiction, but on grounds similar to those used to determine subject-matter jurisdiction. The court found no conduct or effect in the United States, rejecting plaintiff's argument that subject-matter jurisdiction existed because Dome shares were traded on United States markets.¹⁵⁴

b. The Code

Under Code Section 1905(a)(1)(B), the result would be the same as that reached by the *Roth* court. That section applies United States law "with

150. See *supra* note 28 and accompanying text (application of § 16(b) to *Roth* defendants).

151. *Wagman*, 380 F. Supp. at 498-99.

152. The insider defendants in *Wagman* did not qualify for the exemption from § 16(b) liability in Securities Exchange Act Rule 3a12-3, 17 C.F.R. 240.3a12-3 (which would have disposed of the case), because Dome's shares were traded on the American Stock Exchange. Canadian issuers with exchange-traded securities cannot register them on Form 20-F, see 17 C.F.R. 249.220f, and as a consequence are not exempt under Rule 3a12-3. See *infra* note 203.

153. The Fund's further argument that . . . §16(b) should not be read to apply to transactions by foreigners in securities of American corporations, although carried out in the United States, ignores the fact that the effect of this kind of insider trading is quite as great as when the trader is an American.

Roth, 405 F.2d at 422.

154. The *Wagman* court acknowledged that trading of the securities in the United States might be sufficient to confer subject-matter jurisdiction, citing the discussion in *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir.), 405 F.2d 215 (1968) (en banc) (reh'g on other grounds), *cert. denied*, 395 U.S. 906 (1969), see *supra* text accompanying note 13, but noted that the *Schoenbaum* court did not consider the issue of personal jurisdiction. Although the two jurisdictional tests overlap, the *Wagman* court said, it nonetheless distinguished *Schoenbaum*. "[E]ven were the finding of subject matter jurisdiction to support personal jurisdiction as well, in *Schoenbaum* the court was able to point to substantial, actual effects, resulting from acts considered illegal even abroad. [But] there is in the instant factual situation simply not enough connection between the individual defendants and this country. . . ." *Wagman*, 380 F. Supp. at 502.

respect to a nonresident of the United States that has a status [under the Code] to the extent that the Code attaches consequences to such status.” One such status is that of a beneficial owner of more than ten percent of a class of equity securities of a registrant, and one such consequence is liability for short-swing profits under the Code’s counterpart to Section 16(b).¹⁵⁵ The Code would reverse the *Wagman* result, because jurisdiction under Section 1905(a)(1)(B) “rests on a person’s *status* rather than his acts” and “would produce the same result even with respect to purchases and sales abroad.”¹⁵⁶

c. The Draft Restatement

The Draft Restatement would also yield the same result as in *Roth*, but for a different reason. While *Roth* and the Code confer jurisdiction based on the effect of insider trading, Section 416(1) of the Draft Restatement would confer jurisdiction on the basis of conduct, since the transaction was carried out on a United States market.

Application of the Draft Restatement would be unlikely to alter the *Wagman* result. The transactions would fall under Section 416(2), because they were not carried out on a United States securities market. Section 416(2)(a) would support jurisdiction because securities of the same issuer (Dome) were traded on the American Stock Exchange. Section 416(2)(c) might also apply because the persons to be protected include United States shareholder(s).¹⁵⁷

Even with these links under Section 416(2), however, the full reasonableness analysis of Section 403(2) is required. The links in Section 403(2)(a) and (b) may be weak because the claimant corporation and the individual defendants were Canadian and the transactions took place there.¹⁵⁸ Under Section 403(2)(c), (e), (f), and (h), it would be relevant, as the *Wagman* court observed, that “no other country has a rule such as §16(b), and in fact,

155. See *supra* notes 92–93 and accompanying text (how ten-percent shareholders come within § 1905); Code § 1714(a) (providing for recovery by the issuer of any profit realized “by a person within section 605(a)”).

156. Code § 1905 comment 5(a), citing *Roth* (emphasis in original). The Code’s only reference to *Wagman* is under § 1905(e), requiring nonresidents to file a consent to United States jurisdiction. Section 1905(e)(3) comment (2) suggests that jurisdiction would be valid even without such consent, but cites *Wagman* as contrary authority.

157. The case was, however, an action on behalf of a Canadian corporation, brought by a shareholder whose nationality was not specified.

158. See *supra* note 154. The importance of the plaintiffs’ and defendants’ citizenship in Section 16(b) cases is not clear. Both the reasonableness provision, § 403(2)(b), and the nationality provision, § 402(2), mention the citizenship of the parties. But in an action in which the shareholders are the named plaintiffs yet the recovery goes to the corporation, a nominal defendant, the nationality analysis could be difficult. In *Schoenbaum*, a derivative action under § 10(b) of the Securities Exchange Act, the court had no trouble in looking beyond the nominal beneficiary—the Canadian corporation—to the United States shareholders, in order to find a sufficient effect in the United States. *Schoenbaum*, 405 F.2d at 208.

Ontario has explicitly rejected such a rule.”¹⁵⁹ Under Section 403(2)(d) and (g), it could be argued that Canadian directors of a Canadian corporation would expect their conduct to be regulated, if at all, under Canadian law, especially when they trade securities in Canada.¹⁶⁰ Canada certainly would have an interest in the activities of those who manage Canadian corporations. In sum, the Section 403(2) factors suggest that the United States courts should not apply the short-swing profits provisions to the case.

3. *The Fidenas Cases*¹⁶¹

In these two cases, the plaintiffs were a Bahamian company, a Swiss company, and a German citizen who was the managing executive of each. The alleged fraudulent conduct was the sale by the chief financial officer of one of the defendant corporations to the plaintiffs of forged promissory notes purportedly issued by that corporation. In *Fidenas I*, the plaintiffs brought an antifraud action against the Swiss corporation which purportedly issued the notes, as well as several other Swiss and French companies in various parent-subsidiary relationships, and certain foreign individuals. In *Fidenas II*, the plaintiffs substituted United States corporations for the foreign corporations, moving further up the chain of corporate ownership.¹⁶²

a. Current Law

In *Fidenas I*—the case against the foreign companies—the court found little or no conduct or effects in the United States.¹⁶³ The fact that some of the forged notes were eventually purchased by persons in the United States was “entitled to little weight in the setting of this case, unlike a class or derivative action where the group represented includes American ‘victims’ or an SEC enforcement proceeding.”¹⁶⁴ In *Fidenas II*—the case against the domestic companies—the court reiterated the holding of *Fidenas I*, and noted that neither the effects doctrine nor the conduct doctrine turns on the

159. *Wagman*, 380 F. Supp. at 501.

160. However, the individual defendants did file securities ownership reports on Form 4 with the SEC, as required by Exchange Act § 16(a), 15 U.S.C. 78p(a). *Wagman*, 380 F. Supp. at 499. Thus, the defendants were arguably aware that United States law governed their conduct.

161. *Fidenas AG v. Compagnie Internationale pour L'Informatique CII Honeywell Bull S.A.*, 606 F.2d 5 (2d Cir. 1979) (*Fidenas I*); *Fidenas AG v. Honeywell, Inc.*, 501 F. Supp. 1029 (S.D.N.Y. 1980) (*Fidenas II*). These cases are also discussed *supra* notes 61–64 & 118–119 and accompanying text.

162. The two defendants in *Fidenas II* were Honeywell, Inc. and its subsidiary, Honeywell Information Services, both Delaware corporations headquartered in Minnesota, which partially owned a French company which owned the Swiss corporation which purportedly issued the forged notes. See *Fidenas I*, 606 F.2d at 6.

163. “The events on which plaintiffs rely in order to demonstrate fraudulent activity in the United States are secondary or tertiary aspects of the fraud at most. Noteworthy also is the absence of any allegation that these acts were committed by the defendants.” *Id.* at 8.

164. *Id.*

nationality of the defendant.¹⁶⁵ The court also discussed and rejected jurisdiction based on the “nationality” doctrine.¹⁶⁶

b. The Code

In both *Fidenas* cases, the result under the Code would be the same as in the judicial decisions, due to the absence of a connection between the transaction and the United States. Under Section 1905(a)(1)(A)(i), a “sale or purchase of a security” is under United States jurisdiction only if it “occurs within” the United States. Section 1905(a)(1)(B) does not apply because none of the nonresident defendants was a registrant, officer, director or principal shareholder of a registrant, or had any other status specified in Section 1902(b). Section 1905(a)(1)(D) provides for jurisdiction under the effects or conduct doctrines; but here there was no “significant” conduct or “substantial effect” in the United States. Finally, Section 1905(a)(2) provides for United States jurisdiction as to conduct that occurs outside the United States, but only if it is initiated here. There is no indication that the *Fidenas* transaction was ever discussed here or concerned the United States in more than a tangential matter.¹⁶⁷

c. The Draft Restatement

It is conceivable, although unlikely, that the *Fidenas* cases might be decided differently under the Draft Restatement. The same effects and conduct would be insufficient as bases for jurisdiction to prescribe under Section 402. However, at least in *Fidenas II* where domestic defendants are involved, Section 416(2)(a) and (c) might offer possible bases for jurisdiction.¹⁶⁸ The court would then have to refer to Section 403 to determine reasonableness, with the probable result that United States law would not apply. However, the route to the conclusion reached in the *Fidenas* cases, straightforward under current law, would be considerably more complicated under the Draft Restatement.¹⁶⁹

165. *Fidenas II*, 501 F. Supp. at 1040–41.

166. The court held that the nationality doctrine “has been found insufficient as a basis of jurisdiction under the securities statutes . . . in this circuit.” *Id.* at 1041 (citing *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), cert. denied, 423 U.S. 1018 (1975) and *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975)). Even if the doctrine were viable, the court added, the plaintiffs had not demonstrated any fraudulent acts by the defendant United States nationals. *Fidenas II*, 501 F. Supp. 1041 & n.18. See generally *supra* notes 74–78 and accompanying text (discussion of “nationality” doctrine).

167. See *supra* note 163. The main contact with the United States described by the court was that plaintiffs, as underwriters, sold some of these notes in the United States. *Fidenas I*, 600 F.2d at 7.

168. A jurisdictional basis under § 416(2)(a) would exist because Honeywell’s shares are traded in the United States. And under § 416(2)(c), United States law seeks to protect United States purchasers, although that factor was discounted by the court in *Fidenas I*. See *supra* text accompanying note 164.

169. See the analysis of the *Fidenas* cases under the Draft Restatement *supra* notes 118–119 and accompanying text.

4. *Transnational Activities of Investment Companies and Investment Advisers*

The Investment Company Act of 1940¹⁷⁰ and the Investment Advisers Act of 1940¹⁷¹ impose duties on their respective subjects, relating both to registration and to other conduct. Investment companies registered or required to register under the Investment Company Act are subject to statutory provisions that regulate, among other things, composition of management and accountability to shareholders, approval of investment advisory contracts, changes in fundamental investment policies, transactions between the company and affiliated persons, and the company's capital structure. The Investment Advisers Act includes antifraud provisions, limitations on advisory compensation, and disclosure and recordkeeping requirements.

a. Investment Companies

Under Section 7(d) of the Investment Company Act, no foreign investment company (one not organized under the laws of the United States or one of its states) may use the instrumentalities of interstate commerce to offer or sell its securities in a public offering, absent specific Commission authorization.¹⁷² To grant this authorization, the Commission must find that "by reason of special circumstances or arrangements, it is both legally and practically feasible effectively to enforce the provisions of this title against such company."¹⁷³

Thus, foreign investment companies must meet standards not applicable to other foreign companies selling their shares in the United States. This stems from the Investment Company Act's unique concern with internal

170. 15 U.S.C. 80a-1 to 80a-64.

171. 15 U.S.C. 80b-1 to 80b-21.

172. Investment Company Act § 7(d), 15 U.S.C. 80a-7(d). As in the Securities and Securities Exchange Acts, the term "interstate commerce" includes communication "between any foreign country and any State." Investment Company Act § 2(a)(18), 15 U.S.C. 80a-2(a)(18); see Securities Act § 2(7), 15 U.S.C. 77b(7), Securities Exchange Act § 3(a)(17), 15 U.S.C. 78c(a)(17).

173. Investment Company Act § 7(d), 15 U.S.C. 80a-7(d). The Commission has had difficulty making this finding regarding non-common-law foreign investment companies. Investment Company Act Rule 7d-1, 17 C.F.R. 270.7d-1, provides specific rules for Canadian companies, and the Commission has provided guidelines for other foreign companies. See Investment Company Act Release No. 8959, 40 Fed. Reg. 45,424 (1975). Most recently, the Commission has recognized that these guidelines may not be sufficient in light of the specific finding required under the Act, and has suggested that foreign investment companies wishing to sell shares in the United States form a separate domestic subsidiary rather than attempt to seek permission to register under §7(d). Investment Company Act Release No. 13691, 49 Fed. Reg. 55 (1984).

The Commission has noted that the Investment Company Act's pervasive regulation of foreign investment companies wishing to sell shares in the United States "presents unnecessary obstacles," and has recommended legislation amending § 7(d). *Id.* at 56.

corporate organization and operation.¹⁷⁴ Section 7(d) assures that every investment company using the jurisdictional means to make a public offering of its securities is subject to United States law, absent exemption by the Commission.¹⁷⁵ This is the case without regard to the amount of United States conduct relative to foreign conduct.¹⁷⁶ To be contrasted with Section 7(d) of the Investment Company Act, a specific provision dealing with foreign companies, are the general provisions of the Securities Act and the Securities Exchange Act applicable to both foreign and domestic issuers. Those provisions, as interpreted by the Commission, permit foreign issuers to use United States mails and commerce to offer and sell securities without registration so long as the securities do not "come to rest" in the hands of United States citizens or residents.¹⁷⁷ In addition, the Commission's interpretation of the Exchange Act relating to foreign broker-dealers permits them to participate in underwritings in the United States without registration, so long as their participation is limited to taking down securities for sale to foreigners outside the United States, and to activities as part of the underwriting syndicate in the United States which are carried out by a registered broker-dealer.¹⁷⁸ The Investment Company Act, more than other securities laws, is a clear expression of Congressional intent to apply United States law to a foreign investment company which uses the jurisdictional means to offer its securities. Therefore, it is unrealistic to assume that the Investment Company Act would not apply because international law might dictate otherwise under the Draft Restatement.¹⁷⁹

174. See, e.g., Investment Company Act § 1(b)(2), 15 U.S.C. 80a-1(b)(2) (Congressional finding that companies' internal operations affect "the national public interest and the interest of investors").

175. See generally Investment Company Act Release No. 13691, 49 Fed. Reg. 55 (1984); Investment Company Act Release No. 8959, 40 Fed. Reg. 45,424 (1975), discussed *supra* note 173.

176. However, the relative significance of the conduct or effects in the United States might be a factor in considering an application for exemption of a person or transaction from any provision of the Investment Company Act pursuant to the Commission's general exemptive authority under § 6(c) of the Act. See also Investment Company Act Release No. 6082 (Securities Act Release No. 5068), 35 Fed. Reg. 12,103 (1970) (indicating that disclosure in compliance with the Securities Act was required with respect to sales by registered investment companies because "loss of confidence in the integrity of American registered investment companies could trigger widespread redemptions resulting in losses to foreign and domestic investors and damage to the United States securities market."). The amount and type of conduct in the United States may also be relevant in determining whether there has been a "public offering" within the meaning of Investment Company Act § 7(d).

177. See *supra* note 18 and accompanying text.

178. See Securities Exchange Act Release No. 7366 (Securities Act Release No. 4708), 29 Fed. Reg. 9828 (1964) (permitting domestic activities of unregistered foreign broker-dealers in underwriting foreign distributions of securities), and Securities Exchange Act Release No. 8907 (Securities Act Release No. 5068), 35 Fed. Reg. 12,103, 12,104-05 (1970) (permitting domestic activity of unregistered foreign broker-dealers in foreign sale of shares of open-end investment companies), discussed *supra* notes 18-19 and accompanying text.

179. In this article, we generally have assumed for discussion purposes the absence of

b. Investment Advisers

There are no provisions in the Investment Advisers Act comparable to Section 7(d) of the Investment Company Act.¹⁸⁰ Foreign investment advisers registering in the United States must make only a special service-of-process undertaking to ensure that United States courts will have personal jurisdiction over them.¹⁸¹ It is therefore feasible to discuss the transnational application of the Investment Advisers Act, as previous sections of this subpart have discussed portions of the Securities Exchange Act.

Because there is no case law applying the Investment Advisers Act to particular transnational situations, this discussion will deal with a hypothetical investment adviser with a predominantly but not exclusively foreign clientele.¹⁸² At various points in the discussion below, additional qualifications will be considered: whether the adviser is foreign or domestic, and whether the adviser is registered under the Act.

i. *Current Law.* The effects, conduct, and nationality doctrines discussed earlier have not been applied in reported litigation to the activities of an investment adviser. But they stand as general doctrines of foreign relations law, and should be so applied if the situation arose.¹⁸³

These doctrines would probably be applied to investment advisers as they

Congressional intent to transcend the limitations of international law which would be set by the Draft Restatement. See *supra* note 8. Draft Restatement § 403(4)(b) requires United States courts to give effect to clear Congressional intent which may go beyond international law, provided the exercise of such power is within the constitution.

180. Section 203(c)(1) of the Investment Advisers Act, 15 U.S.C. 80b-3(c)(1), provides for registration of investment advisers without regard to nationality. Registration is generally required if the investment adviser uses interstate or foreign commerce in connection with its business as an investment adviser. *Id.* § 203(a), 15 U.S.C. 80b-3(a). An "investment adviser" is defined in *id.* § 202(a)(11), 15 U.S.C. 80b-(a)(11), as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities," with exceptions listed in that section and in § 203(b), 15 U.S.C. 80b-3(b). The Commission's Division of Investment Management has taken no-action positions when foreign unregistered investment advisers use interstate commerce to acquire information about securities and to effect trades through United States broker-dealers. The staff's position in these cases has been that such activities do not constitute engagement in the business of an investment adviser, which consists rather of "the getting of clients and the providing of advice." *Double D. Management, Ltd.* (No-Action letter dated Dec. 30, 1982).

181. Investment Advisers Act Rule 0-2, 17 C.F.R. 275.0-2, requires foreign investment advisers to consent to service of process on the Commission as agent for them in the United States. See also Rule 204-2(j), 17 C.F.R. 275.204-2(j) (specifying books and records to be maintained in the United States by nonresident investment advisers).

182. The opposite hypothetical situation—an investment adviser with predominantly domestic clients—would present fewer problems regarding application of United States law. This is not to say that such application would be clear in all cases, but that the hypothetical assumption of a foreign clientele provides a better background for discussion and comparison of current law, the Code, and the Draft Restatement.

183. See *supra* note 176 and accompanying text (effects and conduct may be considered in application of the Investment Company Act).

are to other persons involved in transnational securities activities. The Investment Advisers Act, like other federal securities acts, includes registration¹⁸⁴ and antifraud¹⁸⁵ provisions. The doctrines developed in other contexts would apply by analogy in this area. For example, a court could apply the “export of fraud” doctrine¹⁸⁶ to conduct by a domestic adviser with predominantly foreign clients, even if most of the fraudulent activities took place outside the United States.

Assuming that foreign relations law would permit application of United States law, we must examine the applicable United States law to determine if Congress intended it to reach this activity.¹⁸⁷ Analysis under the Investment Advisers Act depends not on the nationality of the investment adviser, but on the use of the jurisdictional means and on whether the investment adviser is registered or required to be registered under the Act. If the jurisdictional means—interstate or foreign commerce—are used in connection with the business of an investment adviser, then registration is required, and the Act applies.¹⁸⁸ It might be possible for a foreign investment adviser to engage in certain conduct in the United States without being required to register, but a domestic investment adviser could probably not seek or provide advice to foreign clients without being required to register.¹⁸⁹ And if the investment adviser, foreign or domestic, is registered under the Act, then all its activities everywhere are subject to the Act.¹⁹⁰

184. Investment Advisers Act § 203(a), 15 U.S.C. 80b-3(a), states the general requirement that investment advisers must register if they use the mails or interstate commerce “in connection with [their] business as an investment adviser.” See *supra* note 180 (staff interpretation of this “in connection with” requirement).

185. Investment Advisers Act § 206, 15 U.S.C. 80b-6 and the rules adopted thereunder proscribe general and specific fraudulent activities by investment advisers.

186. See *supra* notes 56-60 and accompanying text.

187. This is the general approach discussed *supra* notes 6-7 and accompanying text.

188. See *supra* note 266. There are certain specific exemptions in Investment Advisers Act § 203(b), 15 U.S.C. 80b-3(b). The Commission also is generally authorized under *id.* § 206A, 15 U.S.C. 80b-6a, to grant exemptions from the Investment Advisers Act provisions if “necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended” by the Act.

189. See *Double D. Management, Ltd.* (No-Action Letter dated Dec. 30, 1982), discussed *supra* note 180 (certain activities in the United States are permitted because they are not “in connection with . . . business as an investment adviser” as required by the Act).

Investment Advisers Act § 203(b)(3), 15 U.S.C. 80b-3(b)(3), provides an exemption from the Act’s registration requirement for an investment adviser with fewer than 15 clients. In *Alexander, Holburn, Beaudin & Lang* (No-Action letter dated July 13, 1984), the Commission’s Division of Investment Management took a no-action position with respect to a Canadian investment adviser, which had more than 15 clients worldwide, but fewer than 15 clients in the United States, and was not holding itself out as an investment adviser in the United States. See *infra* note 201 (similar distinction under periodic reporting provisions of the Securities Exchange Act for securities of domestic companies held by less than 300 persons and securities of foreign companies held by less than 300 United States residents).

190. The Act’s prohibitions expressly apply to any activities of registered investment advis-

ii. *The Code.* Section 1905(a)(1)(A)(iv) applies the Code to “any activity as an investment adviser that occurs within the United States although . . . initiated outside the United States.” This would provide United States jurisdiction over the foreign investment adviser with regard to *domestic* clients. But depending on where giving advice or obtaining business is held to “occur,” this section may not reach the foreign adviser’s activity with respect to *foreign* clients. Activity that occurs outside the United States generally is not subject to the Code, according to Section 1905(b)(1). One exception is the antifraud provisions, which apply to activity occurring outside the United States if it is initiated within the United States.¹⁹¹

Similarly, the Code might not reach a domestic adviser with foreign clients if no fraud is involved. Sections 1905(a)(1)(A)(iv) and 1905(a)(1)(D), applying the Code to activities in the United States, would not operate if there would be no sufficient conduct or effects here. Similarly, Section 1905(a)(2) and (b), applying the Code to activities in foreign countries, would not operate where fraud is not involved.

If an investment adviser is registered with the Commission, then Section 1902(b) applies the Code without regard to the use of the mails or federal commerce. This rule is applicable to foreign and domestic investment advisers alike.

iii. *The Draft Restatement.* Under the Draft Restatement, we look first to the specific securities provisions of Section 416, and then to the general provisions of Sections 402 and 403. The business of an investment adviser would not necessarily involve “transactions in securities” at all, and may not be covered by Section 416.¹⁹² If Section 416 does not supply a United States court with jurisdiction to apply domestic law, then an independent basis must be found under Section 402. And even if there were sufficient effects or conduct to serve as a basis for United States jurisdiction under Section 402, the reasonableness considerations under Section 403 would cast doubt on application of United States law.¹⁹³

ers “irrespective of any use of the mails or any means or instrumentality of interstate commerce in connection therewith.” Investment Advisers Act § 203(d), 15 U.S.C. 80b-3(d).

See also *SEC v. Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3, 41 (S.D.N.Y. 1968), *aff’d*, 435 F.2d 510 (2d Cir. 1970) (provisions of Investment Company Act that refer to registered companies also apply to companies that should be registered, but are not). The logic of *Fifth Avenue* would also apply to the Investment Advisers Act. See, e.g., § 208(a), (c), 15 U.S.C. 80a-8(a), (c). Other sections of the Act apply by their terms to advisers who are not registered but should be registered, e.g. § 205, 15 U.S.C. 80b-5, which applies to all *non-exempt* advisers.

191. Code § 1905(a)(2). Code § 1601(a)(4) prohibits fraud in connection with “any activity or proposed activity by an investment adviser,” and incorporates the antifraud provisions of Investment Advisers Act § 206(1), (2) and (4), 15 U.S.C. 80b-6(1), (2) and (4). This provision is in Part XVI of the Code, which is applied to acts outside the United States under § 1905(a)(2).

192. For example, advice to hold and not sell a security does not involve “transactions in securities” but is nonetheless clearly covered by the Investment Advisers Act.

193. The court’s reasonableness analysis, pursuant to the factors listed in § 403(2), might proceed as follows. Under § 403(2)(a) and (b), the general effects and conduct doctrines,

If the investment adviser is a United States national, it might meet the effects or conduct test under Section 402 as a result of its nationality.¹⁹⁴ And the Section 403 reasonableness analysis might not disfavor application of United States law when a United States national is involved. The importance of the regulation to the regulating state under Section 403(2)(c), the "nationality" link under Section 403(2)(b), and the foreign client's "justified expectation" that United States law would apply under Section 403(2)(d) are somewhat stronger factors with a domestic investment adviser.

Notwithstanding these considerations with respect to domestic advisers, application of United States law under the Draft Restatement is doubtful in cases involving occasional or limited United States activity by any investment adviser, foreign or domestic. Moreover, the reasonableness analysis required under Section 403(2) would make each case turn on the specific parties, facts and nations involved, thus yielding unpredictable results.

Current law and the Code, by contrast, would allow more expansive application of the Investment Advisers Act, particularly regarding fraudulent activities of advisers. In the investment adviser area, as in the others discussed earlier, the Draft Restatement could restrict application of United States law, and the protection that law would give to investors.

5. *Periodic Reporting by Foreign Issuers*

The Securities Exchange Act requires issuers to register their securities with the Commission, and to supply holders of their securities with periodic information, under certain circumstances. If the issuer is a nonresident of the United States, the Act and the Code contain certain exemptions and accommodations, which would be different under the Draft Restatement.

a. *Current Law*

Unlike the application of antifraud law, the application of the Exchange Act registration and periodic reporting obligations has been determined

minimal effects or conduct would be factors against the reasonableness of application of United States law. Section 403(2)(c) looks at the importance of regulation to the United States; a court might find that the United States interest is outweighed by foreign interests in the case of an investment adviser with predominantly foreign clients. *See supra* note 189 (*Alexander, Holburn* no-action position). Section 403(2)(d) looks to the parties' "justified expectations"; if both parties are foreign, it is unclear what their expectations would be. These results might be different if the adviser's clients were United States citizens. Section 403(2)(e) and (f) examine the relative and traditional importance of investment-adviser regulation in a world-wide context; the Act's provisions might be considered too pervasive and intrusive when applied to an essentially foreign business. Sections 403(2)(g) and (h) require specific comparison of the foreign state's law and the Act; this is difficult to apply hypothetically.

194. Alternatively, if § 416 provides a basis for jurisdiction over the domestic investment adviser, nationality could be the basis of a relevant link under § 416(2)(b) (representations or negotiations in the United States) or § 416(2)(c) (party subject to regulation is a United States national).

administratively, not through frequent litigation under doctrines of international law. The rationale for application of these laws is thus less clear, but the mechanics of that application are not.

Periodic reporting to shareholders is required of issuers under the Act in three circumstances: (1) if an issuer files a registration statement for an offering under the Securities Act, which subsequently becomes effective;¹⁹⁵ (2) if an issuer has its securities traded on a national securities exchange;¹⁹⁶ or (3) if an issuer has more than \$3 million in total assets and more than 500 holders of any class of equity securities.¹⁹⁷ These provisions cover foreign as well as domestic issuers. Although the Commission has made certain modifications to accommodate foreign issuers, the statutory reporting requirements are designed to insure that there is adequate disclosure from *all* issuers to protect the investing public.

The Commission's rules distinguish between foreign issuers that have voluntarily gained access to the United States securities markets, either by issuing securities here or by trading on a national exchange or automated quotation system,¹⁹⁸ and those foreign issuers that are involuntarily subjected to the reporting requirements under the asset and shareholder standard.¹⁹⁹ Certain foreign private issuers²⁰⁰ are exempted from registration under Exchange Act Section 12(g) if they furnish to the Commission all public filings and reports that are required "pursuant to the law of the country of [their] domicile or in which [they are] incorporated or organized," or that are filed with an exchange, or sent to security holders.²⁰¹ This

195. Securities Exchange Act § 15(d), 15 U.S.C. 77o(d).

196. *Id.* § 12(b), 15 U.S.C. 77l(b).

197. *Id.* § 12(g), 15 U.S.C. 77l(g); Securities Exchange Act Rule 12g-1, 17 C.F.R. 240.12g-1. Section 12(g) registration is required of issuers "engaged in interstate commerce, or in a business affecting interstate commerce," or whose securities are traded in interstate commerce.

198. The Commission has treated trading on an automated quotation system such as NASDAQ as equivalent to trading on an exchange for these purposes. *See supra* text accompanying notes 71-72.

199. Foreign private issuers, defined *supra* note 68, become subject to § 12(g) reporting requirements by meeting the asset, shareholder, and commerce test. *See supra* note 197. This can be completely involuntary on the part of the foreign issuer, as when the issuer's shareholders sell to United States residents.

200. *See supra* note 68 for the definition of a foreign private issuer.

201. Securities Exchange Act Rule 12g3-2(b)(1), 17 C.F.R. 240.12g3-2(b)(1). The exemption under Rule 12g3-2(b) is not available to an issuer who has had any other § 12 registration in the past eighteen months, or has an obligation to report under § 15, i.e. has had an effective registration under the Securities Act at any time, or whose securities are quoted on an "automated inter-dealer quotation system." Issuers can continue to use this exemption if their securities were quoted on such a system (such as NASDAQ) in October 1983 and have been continuously traded since, and they continue to furnish the required information. For Canadian issuers, this "grandfathering" applies only through 1985. Securities Exchange Act Rule 12g3-2(d)(1)-(3), 17 C.F.R. 240.12g3-2(d)(1)-(3).

Securities of foreign private issuers are also exempt from the registration requirements under Exchange Act § 12(g) and the issuer is suspended from any reporting obligation under § 15(d) if the securities are held by fewer than 300 United States residents. Securities Exchange Act Rules

exemption is intended to apply where disclosure is already made under other laws or practices.²⁰² In addition, foreign private issuers are generally exempted from requirements relating to shareholder communications and to trading by officers, directors, and substantial shareholders.²⁰³

b. The Code

The Code provisions essentially parallel current law. The voluntary entrants into United States markets would be covered as "registrants" under Section 1905(a)(1)(B).²⁰⁴

Involuntary entrants are not explicitly covered by Section 1905. General periodic reporting about the issuer—except in proxies, tender offers, or other shareholder communication—is not covered by Section 1905(a)(1)(A). Nonregistered involuntary entrants have no relevant "status" covered by Section 1905(a)(1)(B). The only other relevant provision is Section 1905(a)(1)(D), the familiar effects and conduct doctrines.²⁰⁵ It could be argued under either doctrine that United States law can apply to regulate the trading in this country of securities of issuers about which current, accurate, and complete information is not publicly available. But such issues have not been litigated, and domestic law provides many exemptions from registration.²⁰⁶

As under current law, involuntary entrants are specifically covered by domestic law under the Code. Section 402 requires registration of all "persons" with more than \$1 million in assets and 500 security holders.²⁰⁷ And Section 1902(c), the "jurisdictional means" provision, directs that the Code applies if the person's acts involve "Federal commerce."²⁰⁸ Thus, as in current law, the Code substitutes an "interstate commerce" test under Section 1902 for any foreign relations analysis under Section 1905, with the

12g3-2(a) and 12g-4(a)(2), 17 C.F.R. 240.12g3-2(a), 240.12g-4(a)(2). This is not based on any principle of international law, but is a *de minimis* exception which applies in a similar fashion to domestic issuers. *See id.* Rule 12g-4(a)(1), 17 C.F.R. 240.12g-4(a)(1) (exemption from §12(g) reporting); *id.* Rule 12h-3, 17 C.F.R. 240.12h-3 (suspension of § 15(d) reporting obligation).

202. The Rule is intended to require information "material to an investment decision," such as financial condition and changes in business. Securities Exchange Act Rule 12g3-2(b)(3), 17 C.F.R. 240.12g3-2(b)(3).

203. Issuers of securities which may be registered on Form 20-F (all non-Canadian foreign private issuers, and certain Canadian issuers described in 17 C.F.R. 249.220f) are exempt from Securities Exchange Act §§ 14(a)-(c), (f), and 16, 15 U.S.C. 78n(a)-(c), (f), 78p. Securities Exchange Act Rule 3a12-3(b), 17 C.F.R. 240.3a12-3(b).

204. *See* Code §§ 202(137), 402(a) and 403 (definition of "registrant" and application of that definition to offering statements and periodic reports).

205. *See supra* text accompanying note 84.

206. Under Code §§ 404 and 1905(c), as under current law, the Commission retains considerable discretion in requiring periodic reporting.

207. The Code requires registration of issuers, not securities. *See* Code § 402(a) comment 1.

208. "Federal commerce" includes both interstate and foreign commerce. *See* Code § 202(57).

result that a foreign issuer with a few shareholders in the United States could be involuntarily subject to the periodic reporting requirements, absent some exemption provided by the Commission, irrespective of the effects, conduct or nationality doctrines of foreign relations law.

c. The Draft Restatement

Analysis of the Draft Restatement with respect to the periodic reporting requirements may not be necessary, as Congress has expressed an overriding intent regarding those requirements. Such intent is recognized as controlling under the Draft.²⁰⁹ In 1964, Congress specifically considered application of the reporting provisions of the Securities Exchange Act to foreign issuers. By providing statutory coverage of all issuers involved in interstate commerce which meet specified shareholder and asset levels and granting the Commission exemptive power, Congress demonstrated its intent as to the jurisdictional scope of the reporting provisions.²¹⁰ That intent should be honored regardless of the limits of international law, and the commentary to the Draft should so state. Absent such a statement, it is possible that courts, explicitly required to determine Congressional intent under the Draft Restatement, will reach a narrow construction unduly restricting application of the registration and reporting requirements.

The Draft Restatement's securities law provision, Section 416, does not mention jurisdiction with respect to matters which are not "transactions in securities." Therefore, jurisdiction would be available, if at all, under Sections 402 and 403. Since the reporting requirements for voluntary entrants are based on status, Section 402 would be difficult to apply to foreign issuers. Their status is a consequence of *previous* conduct (an offering of securities or listing on an exchange), and thus Section 402(1)(a) may be inapplicable.²¹¹ Section 402(1)(b) would also be inapplicable, because it requires that persons having the particular status be "present within the territory." Section 402(1)(c), however, could apply where a substantial effect within the United States could be shown, e.g., the harm to domestic shareholders buying and selling without the benefit of current, accurate, and complete information about the issuer.

If Section 402 were satisfied, then the Section 403(2) reasonableness factors would have to be considered. On balance, the factors in Section 403(2) suggest that the United States would not have jurisdiction to impose reporting requirements on foreign issuers, particularly if they differ from the regulations of the issuer's country. The strong interest of the United States

209. Draft Restatement § 403(4)(b), discussed *infra* notes 220-221 and accompanying text.

210. See, e.g., 110 Cong. Rec. 17,799 (1964).

211. On the other hand, registrant status based on exchange listing may be viewed as resting on *continuing* conduct—trading on the exchange.

in protecting domestic markets and investors, recognized in Section 403(2)(a)-(b), may not be sufficient when balanced, under the remaining provisions of Section 403(2), with the interests of various other states in which the issuer's securities may be traded.²¹²

Therefore, the Draft Restatement could disrupt current law, which is based on a broad assumption of authority to regulate and the discretionary granting of exemptions. Under the Draft Restatement, unlike the Code or current law, it is possible that decisions to apply the registration and reporting requirements to foreign issuers would be made by courts as a matter of international law, rather than by the Commission as a limited exemption from otherwise applicable domestic law.

II. Problems in Draft Restatement's Approach to Jurisdiction

The Draft Restatement would narrow the limits of international law and curtail the application of United States securities laws to transnational activities. Yet it is essential that the United States securities laws apply whenever necessary to fulfill their purposes. This is increasingly important for United States investors and for foreign investors trading in United States markets, because trading in those markets is more frequently international in scope. The Draft Restatement does not provide sufficiently broad United States jurisdiction. On the contrary, it would alter fundamentally the current approach to jurisdiction, creating extensive uncertainty and possibly an actual conflict between international law and the interpretation of the securities laws necessary to protect this country's interests. The uncertainty is itself troublesome even in those cases where the outcome of the jurisdictional inquiry would ultimately be the same under the Draft and present law.

A. DRAFT RESTATEMENT SECTIONS 402 AND 403

As illustrated in the cases discussed above, under existing law the federal securities statutes, particularly the antifraud provisions, are broadly applied

212. Under the factors in Draft Restatement §§ 403(2)(c)-(f), no general evaluations can be made. The laws of certain countries may indicate a significant interest in periodic reporting by their resident corporations. Where that is the case, the Draft Restatement may look to foreign law.

The Section 403(2) factors are reflected in current law by the Commission's exemption for certain foreign private issuers from the reporting, shareholder communication and short-swing trading provisions of Securities Exchange Act §§ 12(g), 14(a)-(c), (f), 15(d), and 16, 15 U.S.C. 78l(g), 78n(a)-(c), (f), 78o(d), and 78p. See Securities Exchange Act Rules 3a12-3 and 12g3-2(a), 17 C.F.R. 240.3a12-3, 240.12g3-2(a), discussed *supra* notes 201 & 203 and accompanying text. Current law also defers to foreign regulation by permitting certain foreign issuers to furnish to the Commission information required by foreign authorities. See Securities Exchange Act Rule 12g3-2(b), 17 C.F.R. 240.12g3-2(b), discussed *supra* note 202 and accompanying text.

to transnational activities. The analysis required under present law is not extremely complicated. The Federal Securities Code, by codifying much of the current judicial interpretation concerning the application of United States securities laws to transnational activities, would further simplify the necessary analysis.

1. *Draft's Reasonableness Inquiry is Uncertain*

The Draft Restatement would remove the certainty of current law. All securities activities, except transactions carried out or intended to be carried out on a United States market, would be subjected to a wide-ranging and necessarily subjective "reasonableness" inquiry to determine if jurisdiction is permitted under international law. The reasonableness factors of Sections 403(2)(c)–(h)²¹³ represent a value judgment by the reporters rather than a restatement of foreign relations law.

In addition to the many interpretive difficulties involved in applying the non-exclusive reasonableness factors set out in Section 403(2), the critical balancing process is left to individual determination. The results under such a system must vary depending on the decision-maker, and the existence of jurisdiction will be difficult, if not virtually impossible, to predict. The new factors and analysis introduced by the Draft Restatement would encourage parties to litigate jurisdictional issues that are settled under current law.

2. *Draft's Analysis Unduly Restrictive*

Although the results under the reasonableness analysis would be uncertain, the general thrust of the Draft Restatement provisions is away from expanded or continued application of United States law in situations where that result is now accepted. This is implicit in certain of the "reasonableness" factors in the Draft Restatement.²¹⁴

The complex analysis under the Draft Restatement casts doubt upon most of the currently-accepted bases of subject-matter jurisdiction. Under the effects doctrine, it would no longer suffice under the Draft, as under current law, that "fraudulent acts relating to securities which are committed abroad . . . result in injury to purchasers or sellers of those securities in whom the United States has an interest,"²¹⁵ or that there was "impairment of the value of American investments by sales by the issuer in a foreign country, allegedly in violation of the [Securities Exchange] Act."²¹⁶ And under the

213. See *supra* note 117 for a listing of these factors.

214. See, e.g., "the importance of regulation to the international political, legal or economic system" (§ 403(2)(e)), "the extent to which another state may have an interest in regulating the activity" (§ 403(2)(g)), and "the likelihood of conflict with regulation by other states" (§ 403(2)(h)).

215. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 989 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975); see *supra* notes 138–147 and accompanying text.

216. *Schoenbaum v. Firstbrook*, 405 F.2d 200, 208–09 (2d Cir.), 405 F.2d 215 (2d Cir. 1968) (en banc) (reh. on other grounds), *cert. denied*, 395 U.S. 906 (1969).

conduct doctrine, the Draft appears to attach little importance to this country's interest in preventing the use of its territory as a base for exporting fraud to other nations.²¹⁷ The businesses of this country utilize capital invested by foreign, as well as domestic, investors. If the United States is to encourage investment by citizens of other nations, it must be able to assure that this country will not be used as a base for fraud; this country must be able to assure foreign investors that the protections against fraud applicable to wholly domestic transactions will be applied to protect them when they invest in the United States.²¹⁸ Moreover, if we fail to provide needed protections for foreign citizens, their nations will be less likely to provide needed protections for Americans injured by conduct abroad.²¹⁹

The Draft Restatement would increase the burden of the party seeking to apply United States law. Establishing "reasonableness" and conducting a far-reaching investigation into the law of various nations seem to be duties of the party seeking to establish jurisdiction. This would place unwarranted practical and financial hardships on the federal government and those private parties who sought to apply United States securities law.

The Draft Restatement's limitations on jurisdiction do not apply in the face of "clear" Congressional intent to subject a transaction or person to United States law,²²⁰ which would, in certain areas, limit any undue constraint by the Draft Restatement on the operations of the securities laws. However, courts would be forced in more cases to analyze Congressional intent in order to apply United States law. And it is entirely possible that courts would be unwilling to imply such Congressional intent.²²¹

217. See *supra* notes 54–58 and accompanying text; *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983).

218. See *supra* notes 58, 60 (doctrine of preventing export of fraud from the United States to foreign investors).

219. For a discussion of potential adverse reciprocal treatment in other countries, see *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 421 (8th Cir. 1978), discussed *supra* notes 59–60 and accompanying text, citing *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977); and *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975), discussed *supra* text accompanying notes 53–54.

220. Draft Restatement § 403(4)(b). The assertion of United States law must, of course, still be within Congress' constitutional powers. *Id.* Several such provisions exist in current law. For example, §§ 12 and 15 of the Securities Exchange Act indicate Congress' intent to subject every issuer involved in interstate commerce and meeting certain asset, shareholder, or trading requirements to the periodic reporting requirements of the Act. See *supra* text accompanying notes 209–210. Congress also required explicitly that the Commission find that the Investment Company Act's provisions could, as a practical matter, be applied to foreign investment companies before allowing them to trade their shares in the United States. See *Investment Company Act* § 7(d), 15 U.S.C. 80a–7(d), discussed *supra* notes 172–173 and accompanying text.

221. See Draft Restatement § 403 comment f (applying "the general principle that courts will seek to interpret acts of Congress to avoid conflict with international law").

3. *Draft's Shift in Analysis not Justified*

The comments to the Draft in general assume that current analysis is deficient and that there is some problem warranting a change in the current approach to transnational jurisdiction.²²² Yet the Draft does not document any such problem in the securities area. Indeed, the comments acknowledge that ordinary use of the effects or conduct tests is noncontroversial.²²³ There is some controversy regarding use of the effects doctrine based on the economic impact of foreign activity within this country,²²⁴ but that does not justify limiting conduct-based jurisdiction, such as the "export-of-fraud" doctrine.²²⁵ Such assertions of United States jurisdiction have been recognized as appropriate and helpful in the international community,²²⁶ contrary to the charge of the Draft Restatement that Commission actions are "causing annoyance and provoking resentment abroad."²²⁷ The Commission, along with the courts, has continued to develop existing law in response to new problems.²²⁸

The requirements of the Draft Restatement may offend rather than accommodate foreign governments and their interests. For example, Section 403(2)(g) and (h) would require United States courts to evaluate the interests of other states in regulating certain activities. Many foreign nations would take offense at such an attempt by the United States to judge their

222. The major "problem" identified by the Draft is the conflicting assertion by different nations of jurisdiction to prescribe and apply their laws. The Draft asserts that the emerging rules of the modern world, attempting to solve this problem, have produced "reasonableness" analysis. See Draft Restatement pt. IV, c.1, introductory note at 92.

223. See Draft Restatement § 402 comment a; *id.* § 403 reporters' note 3.

224. See, e.g., *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1045 (2d Cir. 1983).

225. See text accompanying note 49.

226. See Johnson, *Application of Federal Securities Laws to International Securities Transactions*, 45 ALBANY L. REV. 890, 930-31 (1981); Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 566-67 (1976). The intent of the "export-of-fraud" doctrine referred to above and discussed *supra* notes 54-58 and accompanying text, is to encourage favorable reciprocal treatment of similar situations in foreign courts, see *supra* note 136 and accompanying text.

227. See Draft Restatement, Part IV, c. 1, introductory note at 91 n.5. Specific examples cited in the Draft of situations where application of United States law has been particularly controversial usually involve the antitrust laws, *id.* (United States investigation into European industry cartels), or the use of certain methods to compel testimony or the production of documents abroad. As an example in the securities area, the Draft cites Widmer, *The U.S. Securities Laws—Banking Law of the World?*, 1 J. COMP. CORP. L. & SEC. REG. 39 (1978). Widmer's main criticism of Commission action is the potential application of broker-dealer regulations to foreign banks while United States banks remain exempt. *Id.* at 42. See generally *Crime and Secrecy: The Use of Offshore Banks and Companies: Hearings Before the Perm. Subcomm. on Investigations of the Senate Comm. on Governmental Affairs*, 98th Cong., 1st Sess. 134-47 (1983) (testimony of Commission Enforcement Director John M. Fedders).

228. See, e.g., Securities Exchange Act Rule 12g3-2, 17 C.F.R. 240.12g3-2 (periodic reporting rules for foreign private issuers); Investment Company Act Release No. 13691, 49 Fed. Reg. 55 (1984) (advice to foreign investment companies seeking to issue shares in the United States, and proposing remedial legislation).

laws and national interests. To the extent that the Draft Restatement would create uncertainty, engender litigation, and force courts to make more decisions on such questions, problems with foreign countries will be exacerbated rather than alleviated.²²⁹

4. *Draft's Approach is Inconsistent with ALI-Approved Code*

The Draft's unjustified departure from current law is troublesome apart from the Federal Securities Code. But the American Law Institute's approval of the Code and its endorsement by the Commission exacerbate the problems with the Draft. As the reporters for the Draft recognize, the language of Section 1905 of the Code confines its scope to the limits of international law.²³⁰ If the Draft Restatement were accepted as the embodiment of the limits of international law, the codification of transnational jurisdiction in Section 1905 of the Code could be undermined in large part. The detailed provisions of Section 1905 could be irrelevant in many instances because of the narrower scope of jurisdiction prescribed by the Draft Restatement.

B. DRAFT RESTATEMENT SECTION 416

Section 416 is intended to "illustrate" the application of the Draft Restatement in the context of the United States securities law.²³¹ Its illustrations, however, do not include many possible applications of United States law to transnational activities. Under Section 416, United States law applies with certainty only in the case of securities transactions on a market in the United States.²³² Other transactions must be analyzed under the reasonableness provisions of Section 403.²³³ This narrow focus on transactions on a securities market overlooks the importance of securities regulation in a variety of other contexts, such as periodic reporting to shareholders, proxies and tender offers, and the activities of investment companies and investment advisers. The failure to address these areas in Section 416 means that

229. Robinson, *Conflicts of Jurisdiction and the Draft Restatement*, 15 LAW & POL'Y IN INT'L BUS. 1147, 1152 (1983).

230. Draft Restatement § 416 reporters' note 6; *see supra* notes 81-83 and accompanying text.

231. *Id.* § 403 comment g.

232. *Id.* § 416(1). The Draft does not define the term "market." Presumably, this would include both exchanges and the over-the-counter markets. This should be clarified, since substantial trading takes place over the counter. *See* Securities Act Release No. 6493, 48 Fed. Reg. 46,736, 46,737 n.4 (1983) (NASDAQ average daily volume for first half of 1983 was three-fourths of NYSE volume and nearly seven times the Amex volume.) Even original offerings under the Securities Act may not be encompassed in the "trading on a market" terminology of § 416(1).

233. Draft Restatement § 416(2).

they are to be treated under Sections 402 and 403; therefore, the cumbersome and uncertain reasonableness inquiry would be required in every case.

In addition, Section 416(2) creates a presumption against United States jurisdiction unless one of three narrowly-drawn links is present.²³⁴ These links enumerate but a few of the bases upon which current judicial analysis has relied to find United States jurisdiction.²³⁵ This is especially true under Section 416(2)(b), which lists only “negotiations” and “representations” as significant elements in cases not involving securities traded on a United States market or cases not involving United States companies, registrants, issuers or traders.²³⁶

C. DRAFT RESTATEMENT SECTION 418

Section 418 limits United States jurisdiction over foreign subsidiaries and branches of United States corporations. Its impact on the securities laws is uncertain, because the Section’s broad prohibitions on application of United States law apply only under narrow circumstances. Section 418 applies only when nationality is the sole basis for jurisdiction over a foreign subsidiary or branch of a United States corporation. It would not apply, for example, if there were conduct or effects sufficient for United States jurisdiction to be reasonable under Section 403.²³⁷ In addition, Section 418 would not apply in the specific contexts covered by other sections of the Draft Restatement, such as Section 416 governing transactions on a securities market.²³⁸

Although Section 418 may be limited in its application, the consequences of that application could be substantial. The United States may regulate subsidiaries of United States corporations only if that exercise of authority is part of a program of regulation dependent for its success on that exercise.²³⁹ In addition, the section would flatly prohibit United States

234. Draft Restatement § 416 comment c.

235. The drafters note that these three “links” are not intended to be exclusive. *Id.* § 416 comment c and reporters’ note 5. However, they do not indicate why these three areas are of primary importance.

236. *See, e.g.,* IIT v. Vencap, Ltd., 519 F.2d 1001, 1018 (2d Cir. 1975), where the court found “an abundance of American activity,” none of which apparently falls within § 416(2)(b). *Vencap* is analyzed by the drafters under § 416(2)(c) “nationality” principles. Draft Restatement § 416 reporters’ note 3. *See also* SEC v. Kasser, 548 F.2d 109, 111 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977) (United States offices, drafting of agreements, keeping books and records and transmittal of proceeds held sufficient to establish jurisdiction; no particular emphasis on negotiations alone).

237. *See supra* note 107.

238. Draft Restatement § 418 comment a. Thus, the exception from coverage under § 418 is only as broad as the coverage under § 416. Because of § 416’s narrow focus on securities transactions, *see supra* text accompanying notes 232–236, § 418’s exception for the federal securities laws as covered by other sections would also be narrow.

239. Draft Restatement § 418(3)(b), applying to foreign corporations controlled by United States persons or corporations. *See supra* notes 108–110 and accompanying text.

jurisdiction where it would create a conflict with the law of "the state where the branch or corporation is organized or is doing business,"²⁴⁰ or if the conduct regulated is "predominantly local."²⁴¹ The commentary suggests several supposedly "noncontroversial" "predominantly local" subjects, such as conditions of employment for non-United States citizens, and industrial and labor relations,²⁴² but there can easily be controversy²⁴³ when United States regulatory provisions are applied to foreign operations.²⁴⁴

Finally, the commentary to Section 418 requires clear congressional intent before United States law is applied to foreign branches or subsidiaries because the parent is a United States national.²⁴⁵ This appears to add a requirement to the text of Section 418, and the drafters do not state explicitly what would suffice as "clear" intent.²⁴⁶ It is thus uncertain whether Section 418 might limit the application of certain provisions of the securities laws.²⁴⁷

III. Problems in Draft Restatement's Procedural and Sanctions Provisions

Once a court has proper jurisdiction—either "subject-matter jurisdiction"²⁴⁸ under current law, or "jurisdiction to prescribe"²⁴⁹ under the Draft Restatement—it may apply United States law to the case before it. In

240. *Id.* § 418(4)(a). Comments to this section notes that primary jurisdiction would exist where the corporation was doing business rather than where it was organized.

241. *Id.* § 418(4)(b), applying to foreign corporations controlled by United States persons or corporations and to foreign branches of United States corporations. *See supra* notes 108–110 and accompanying text.

242. *Id.* § 418 comment f.

243. For example, if a foreign labor union could demand participation on a board of directors which is otherwise elected by the shareholders under United States law, could the union-affiliated board members be held to United States legal standards for directors? Or, a United States broker-dealer may be required to discharge an employee for violation of a New York Stock Exchange rule in conduct off the exchange, while the "local" law would not recognize that conduct as an infraction giving cause for termination.

244. "The interests which are asserted in a foreign subsidiary conflict are usually related to national security or sovereignty, areas in which a state will be less likely to defer to the interests of another state." Thompson, *United States Jurisdiction Over Foreign Subsidiaries: Corporate and International Law Aspects*, 15 LAW & POL'Y IN INT'L BUS. 319, 383 (1983).

245. Draft Restatement § 418 comment g.

246. *See supra* note 112.

247. *See, e.g.*, § 203(d) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-3(d), discussed *supra* note 190 and accompanying text. The statute does not explicitly refer to foreign entities, although foreigners may register as investment advisers; *see supra* notes 180–181 and accompanying text. It is uncertain whether the Act conveys sufficiently "clear" intent within the meaning of Draft Section 418.

248. Courts usually speak of "subject matter" jurisdiction, although this is not strictly accurate. *See supra* note 9. The decisions discussed in Parts I and II combine doctrines of subject-matter jurisdiction with personal jurisdiction, venue, and conflict-of-laws doctrines.

249. *See* Draft Restatement § 401(1).

some cases, however, international law will require a court to stay its hand in proceedings otherwise properly before it, if the court's orders under United States law would leave a party to the litigation with contrary obligations under the applicable laws of a different state. This is known as the "foreign government compulsion" defense to proceedings in the forum state. In other cases, international law may deny the court power to proceed with a case properly before it because the parties were not given notice or opportunity to be heard. The Draft Restatement has provisions in each of these areas. Sections 419 and 420 cover the foreign government compulsion defense generally (Section 419) and in the specific context of production of documents or other information (Section 420). Section 431 covers the "fundamental fairness" required in any court or agency enforcement proceeding.

A. DRAFT RESTATEMENT SECTIONS 419 AND 420

"Foreign government compulsion" is defined by the Draft Restatement as existing "when two states having jurisdiction to prescribe with respect to a person issue contradictory commands."²⁵⁰ This situation most frequently results in the securities area when a party subject to a court's discovery order raises a foreign secrecy²⁵¹ or blocking²⁵² statute as a defense. This subpart first summarizes current law in this area, and then critically reviews the Draft Restatement's treatment.

1. Current Law

In the leading foreign government compulsion case, the Supreme Court stated that a substantive conflict with foreign law does not *per se* prevent United States action.²⁵³ If the United States court has jurisdiction to consider the litigation, the generally accepted approach in this country is that the court has jurisdiction to require production of evidence and compliance with

250. *Id.* § 419 comment a.

251. A secrecy law makes it illegal for a holder of certain information (typically a bank) to disclose that information without the subject's (typically a bank customer) consent. It is most commonly encountered in the securities area when banks refuse to disclose the identities and actions of their customers trading in securities through nominee accounts. See *SEC v. Banca della Svizzera Italiana*, 92 F.R.D. 111, 113 (S.D.N.Y. 1981); see also *In re Grand Jury Proceedings, United States v. Bank of Nova Scotia*, 691 F.2d 1384, 1386 & n.2 (11th Cir. 1982), *cert. denied*, 462 U.S. 1119 (1983) (*Bank of Nova Scotia I*) (Bahamian bank secrecy law raised as defense in tax and narcotics investigations).

252. A blocking statute prevents the removal of any information from the country, or compliance with particular judgments inside the enacting state's jurisdiction. Unlike the secrecy laws, blocking statutes are not intended to protect the relationships or types of information involved, but rather represent foreign refusal to comply with United States policies, procedures, or laws. See Draft Restatement § 420 reporters' note 1.

253. *Societe Internationale pour Participations Industrielles et Commerciales, S.A. v. Rogers*, 357 U.S. 197, 211 (1958).

its judgments, regardless of the existence of contravening foreign law.²⁵⁴ However, even though United States law applies, the good-faith efforts of the party required to make disclosure to avoid the foreign blocking or secrecy statutes may preclude the imposition of certain sanctions.²⁵⁵ The courts have considered foreign secrecy and blocking statutes as equitable defenses, under either the current Restatement²⁵⁶ or the Draft Restatement,²⁵⁷ to determine the propriety of compulsion to enforce the United States order or judgment. The current Restatement directs the court to balance the national interests involved, the hardship imposed on the party required to disclose, the location of performance, the nationality of the party, and the efficacy of disclosure.²⁵⁸ The Draft Restatement indicates the factors a court should consider “[i]n issuing an order directing production of documents or other information located abroad”: the information’s importance to the case, the specificity of the request, where the documents originated, relevant interests of the state where the documents or information are now located, and the existence of any alternative means of securing the information.²⁵⁹

254. *Id.* at 211. “The strength of the United States interest in enforcing its securities laws to ensure the integrity of its financial markets cannot seriously be doubted. . . . It would be a travesty of justice to permit a foreign company to invade American markets, violate American laws . . . , and resist accountability . . . by claiming [its] anonymity under foreign law.” SEC v. Banca della Svizzera Italiana, 92 F.R.D. 111, 114, 119 (S.D.N.Y. 1981).

255. SEC v. Banca della Svizzera Italiana, 92 F.R.D. at 114. Good faith nonetheless does not bar drawing adverse inferences against a nonproducing party. *Graco, Inc. v. Kremlin, Inc.*, 101 F.R.D. 503, 509–10, 516 (N.D. Ill. 1984). *See also* *In re Grand Jury Proceedings, United States v. Bank of Nova Scotia*, No. 83–1(WPB) GJ, slip op. at 15 (S.D. Fla. Feb. 28, 1984), (*Bank of Nova Scotia III*), *on remand from* 722 F.2d 657 (11th Cir. 1983) (*Bank of Nova Scotia II*), *aff’d*, 740 F.2d 817 (11th Cir. 1984) (findings of fact, including lack of good-faith effort to produce documents); and *United States v. First National Bank of Chicago*, 699 F.2d 341, 346 (7th Cir. 1983) (remanded to district court for findings on the “good-faith” issue).

256. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965) (current Restatement).

257. Draft Restatement § 420(1)(c).

258. *See* *United States v. First National Bank of Chicago*, 699 F.2d 341, 345–46 (7th Cir. 1983) (Greek bank secrecy law); *United States v. Vetco, Inc.*, 644 F.2d 1324, 1331–32 (9th Cir.), *cert. denied*, 454 U.S. 1098 (1981) (Swiss business secrets act); *In re Westinghouse Electric Corp. Uranium Contract Litigation*, 563 F.2d 994, 997 (10th Cir. 1977) (Ontario uranium industry blocking statute); *In re Grand Jury Proceedings, United States v. Field*, 532 F.2d 404, 407–09 (5th Cir.), *cert. denied*, 429 U.S. 940 (1976) (Cayman Islands bank secrecy law); *United States v. Chase Manhattan Bank, N.A.*, 584 F. Supp. 1080, 1085–86 (S.D.N.Y. 1984) (Hong Kong bank secrecy law); SEC v. Banca Svizzera della Italiana, 92 F.R.D. 111, 117–19 (S.D.N.Y. 1981) (Swiss bank secrecy law).

259. *See* *Laker Airways Ltd. v. Sabena Belgian World Airlines*, 731 F.2d 909, 948–49 (D.C. Cir. 1984). Some of these factors were taken from *United States v. Vetco*, 644 F.2d at 1332–33. *See also* *Nova Scotia I*, 691 F.2d at 1388 (citing Draft Restatement reporters’ concern for international friction, but relying on executive and legislative branches to resolve); *Graco, Inc. v. Kremlin, Inc.*, 101 F.R.D. at 516 (applying Draft Restatement factors, ordering compliance with discovery request despite assertion of French blocking statute); *United States v. Toyota Motor Corp.*, 569 F. Supp. 1158, 1162–63 (C.D. Cal. 1983) (citing Draft Restatement factors; IRS summonses held valid).

The case law in the United States interpreting these requirements properly accommodates valid foreign restraints. United States subpoenas are enforced overseas only when a legitimate reason for such enforcement exists. For example, in *United States v. Vetco, Inc.*,²⁶⁰ the court, although refusing to give effect to foreign prohibitions on document production in an official investigation for tax fraud, observed that

[t]o the extent that some hardship is imposed on appellants, it was avoidable. I.R.C. 3964(c) requires an American corporation to keep records pertaining to its controlled foreign corporations sufficient to enable a determination as to whether . . . [the tax at issue] is due.²⁶¹

After reviewing all alternatives to an enforcement order and finding them wanting, the court stated that, since appellants had not shown that a "significant hardship" would result from enforcement, it would affirm enforcement of the I.R.S. summons.²⁶² Similarly, in *United States v. Toyota Motor Corp.*,²⁶³ a Japanese corporation and its American subsidiary argued that they should not be required to produce cost figures pursuant to an I.R.S. subpoena because of "principles of international law."²⁶⁴ In response, the court noted that the summons request for cost data was specific, relevant, and important to the I.R.S. audit, that the United States-Japan tax treaty had been ineffective in providing data, and that Japan would not accept or honor United States letters rogatory.²⁶⁵ And in *United States v. First National Bank of Chicago*,²⁶⁶ the court, applying Restatement principles, remanded the case to the district court to determine whether to require the defendant in an I.R.S. subpoena enforcement action to seek in good faith an exemption from the bank secrecy statute at issue.²⁶⁷

260. 644 F.2d 1324 (9th Cir.), *cert. denied*, 454 U.S. 1098 (1981).

261. *Id.* at 1332.

262. *Id.* at 1333.

263. 569 F. Supp. 1158 (C.D. Cal. 1983).

264. *Id.* at 1162.

265. *Id.* at 1162-63. The government of Japan had also suggested that enforcement of the subpoena would eventually lead to Toyota's double taxation. The court found no substantive conflict of law, noting that the tax treaty provided a means to eliminate double taxation, and ordered enforcement of the summons. *Id.* at 1163-64.

266. 699 F.2d 341 (7th Cir. 1983).

267. The court in that case applied the balancing test of § 40 of the current Restatement, discussed *supra* text accompanying note 258, but added that that analysis is reflected "with some modification" in §§ 403, 419 and 420 of the Draft Restatement. *First National*, 699 F.2d at 346. The court held that such a good-faith attempt to obtain an exemption may be required under Draft Restatement § 420(2). It distinguished *Nova Scotia I*, which affirmed a civil contempt for failure to comply with a grand jury subpoena enforcement order. In *Nova Scotia I*, noted the court, "the court of appeals had the benefit of findings by the district court . . . that the bank had not made a good faith effort to comply with the subpoena." *First National*, 699 F.2d at 346-47.

The holding of *First National* may prove troublesome if it alters the burden of quantum of proof in subpoena enforcement actions or discovery requests. It would be inappropriate to require the Commission, or any other administrative agency, which is entitled to a presumption

2. Coverage of Sections 419 and 420

Sections 419 and 420 of the Draft Restatement both address the “foreign government compulsion” defense. Section 419 is a jurisdictional provision dealing generally with conflicting compulsions of different governments, as an application of Section 403(3).²⁶⁸ Section 420, also applying Section 403(3),²⁶⁹ deals with production of documents or other information located abroad. It is not a jurisdictional provision, but rather assumes that a given case is properly before a United States court. Section 420(1) provides that the United States court may order production of documents and things located abroad, that the court may impose sanctions for not so doing, and that the court should consider certain factors before imposing sanctions.²⁷⁰ Section 420(2) would govern when the law of the state where the information is located prohibits disclosure. The United States court could still require a “good-faith effort” by the party to produce the information, but could impose only less severe sanctions for noncompliance.

The two sections overlap somewhat in their coverage. Section 419 deals mainly with compulsion, and Section 420 mainly with production of information; hence, either could apply to compelled production of information in opposition to foreign secrecy or blocking statutes. The drafters have resolved this overlap by analyzing both secrecy and blocking statute defenses under Section 420.²⁷¹

3. Section 420 Imposes Impediments to Application of United States Law

Section 420 would not insulate a party from liability for failure to produce documents or other information merely because a conflict exists.²⁷² Nonetheless, the Section’s procedural requirements reinforce its bias against application of United States law.

Section 420(1)(a) would require, in every case, a United States court order for production of any information located abroad, rather than permitting use of court rules of discovery or the mechanisms of administrative discovery. The Draft would require court participation to ensure that requests for information, particularly those made by private litigants, are consistent with the “long-term national . . . interests” and “international understandings.”²⁷³ However, in the case of administrative litigation, the

of propriety in its investigation or prosecution of a case, to include the extensive data described in the § 420(1)(c) balancing test to meet its burden of proof and persuasion in every subpoena enforcement action or discovery request. In *First National*, the court of appeals requested a finding on the issue of good faith—effectively making a showing of the lack of good faith an element of the government’s burden of proof.

268. See *supra* text accompanying notes 121–124 for a discussion of the provisions of § 419.

269. Draft Restatement § 420 comment d.

270. See *supra* text accompanying note 259, listing the factors to be considered.

271. Draft Restatement § 420 comment d; see also *id.* § 419 comment a.

272. *Id.* § 420 reporters’ note 4.

273. *Id.* § 420 reporters’ note 8.

agency charged with administration of the pertinent statutes should be able to make an adequate determination as to the interests involved.²⁷⁴ In suggesting that agencies may not always make a proper evaluation,²⁷⁵ the drafters ignore the strong presumption of regularity in agency action.²⁷⁶ The obligation to institute separate judicial proceedings would slow or even halt expedited litigation where speed is of the essence.

Section 420(1)(a) would limit foreign disclosure requests to “directly relevant, necessary and material” information, rather than extending access to all non-privileged relevant material. The commentary would also require that the information be admissible, noting that these restrictions are due to “the degree of difficulty in obtaining compliance, and the amount of resistance to the United States ordered discovery that has developed in foreign states.”²⁷⁷

The Draft Restatement deals with potential “overreaching” by the United States in part by adopting a “center of gravity” test to determine which nation’s privilege law should be applied.²⁷⁸ While the reporters seem to favor interpreting fact situations so that conduct is deemed to take place in the United States and this country’s privilege laws apply,²⁷⁹ the Draft itself could allow significant United States securities activities to escape regulation because the communications involved are “centered”²⁸⁰ in another country. Unlike Section 40 of the current Restatement, which requires each nation involved in a conflict to “consider, in good faith, moderating the exercise of its enforcement jurisdiction,” the language of the Draft seems to defer to a conflicting foreign law rather than United States law.²⁸¹

274. The courts have recognized that federal agencies do consider these matters. See *United States v. Toyota Motor Corp.*, 569 F. Supp. at 1162–63 (“the fact that this action was brought by the government . . . weighs heavily towards finding a strong American interest in obtaining the information sought”).

275. Draft Restatement § 420 reporters’ note 8 notes that private parties’ requests for foreign document production require closer scrutiny than those of the United States government, but the Section nonetheless would require government agencies to obtain a court order. The reporters believe that “this may lead to more careful consideration of a request for information within the executive branch, including consideration of alternative means of obtaining the desired information.”

276. See, e.g., *United States v. Morgan*, 313 U.S. 409, 421 (1941); *Pacific States Box & Basket Co. v. White*, 296 U.S. 176, 186 (1935); *National Nutritional Foods Ass’n v. FDA*, 491 F.2d 1141, 1145–46 (2d Cir.), cert. denied, 419 U.S. 874 (1974); *Braniff Airways, Inc. v. CAB*, 379 F.2d 453, 460 (D.C. Cir. 1967).

277. Draft Restatement § 420 comment a.

278. *Id.* § 419 reporters’ note 2; see *id.* § 420 comment c (“the privilege would ordinarily be determined by the law of the state where the subject of the communication is centered.”).

279. See, e.g., Draft Restatement § 419 reporters’ note 5 (advocating broad application of United States law to acts done both abroad and in the United States).

280. See *supra* note 278.

281. For example, although Draft Restatement § 420(2)(c) allows adverse findings to be made against a party as a sanction for refusal to comply with a legitimate request for disclosure, the commentary notes that

The commentary to Section 420 suggests that disclosure "without court intervention" would still be an option if the parties agree, but out-of-court agreements would likely be rare under Section 420.²⁸² The Commission has received information from Switzerland through an individual waiver of bank secrecy, but under unusual circumstances.²⁸³

4. *Policies are Unwarranted Departure from Current Law*

The changes from current law made by Section 420 are based in part on incorrect assumptions. The drafters erroneously believe (1) that there is a substantive conflict of laws warranting modification of United States rules, and (2) that United States law should be more generous in its accommodation of conflicting foreign law.

The notes and comments to Section 420 concern substantive conflicts of law which have arisen principally in the antitrust and maritime areas.²⁸⁴ The foreign statutes involved in securities cases generally present no substantive conflict with American securities law.²⁸⁵ Therefore, it is inappropriate to make changes in an area which has not generated the problems to which these changes are addressed.

While foreign nations may at times resist United States requests for information due to differing systems for pretrial disclosure,²⁸⁶ that alone does not justify blanket restrictions on access to information located abroad when a case has properly been brought in the United States.²⁸⁷ The Report-

[s]uch a finding is appropriate only if there is reason to believe that the information, if disclosed, would be adverse to the non-complying party, and if the court is satisfied that the request was made in good faith, not in hope that the opposite party's non-compliance would enable the requesting party to establish a fact that it could not establish if all the information were available.

Id. § 420 comment e. *See also id.* § 419 comment e (application of French law in *Fruehauf/ France* case in actions in France and in the United States).

282. Compare Draft Restatement § 420 comment a ("nothing in this section prevents parties from agreeing to make disclosure") with *Bank of Nova Scotia II*, 722 F.2d at 658 (difficulties with settlement in case involving production of documents pursuant to grand jury subpoena).

283. *See, e.g.*, *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 113 (S.D.N.Y. 1981); *Crime and Secrecy: The Use of Offshore Banks and Companies: Hearings Before the Perm. Subcomm. on Investigations of the Senate Comm. on Governmental Affairs*, 98th Cong., 1st Sess. 325-28 (1983) (Statement of Commission Enforcement Director John M. Fedders) (discussing Swiss government cooperation in the 1977 Treaty and 1982 Memorandum of Understanding, but noting further need for a general solution, rather than one employed on a case-by-case basis).

284. *See* Draft Restatement § 420 reporters' note 1.

285. Blocking and secrecy statutes do not endorse and encourage fraud, misrepresentations, or manipulation. Thus, there is no substantive conflict as in the income tax, antitrust, or maritime law areas. *See, e.g.*, *Laker Airways Ltd. v. Sabena Belgian World Airlines*, 731 F.2d 909, 948-53 (D.C. Cir. 1984).

286. Draft Restatement § 420 reporters' note 1; *see Feliciano v. Reliant Tool Co.*, 691 F.2d 653, 657 & n.4 (3d Cir. 1982) ("the free wheeling discovery common in American litigation is disfavored in most foreign countries").

287. *See Bank of Nova Scotia III*, slip op. at 14 (foreign government requested showing of relevance, competence, and admissibility of information subpoenaed by grand jury before

ers state that Section 420 "generally supports the United States position" that persons who do business in the United States are subject to United States discovery laws, "subject . . . to the principle of reasonableness."²⁸⁸ But the inflexible strictures of Section 420 do not generally support the United States position.

As a result, the Draft Restatement would require a retreat from the current broad prophylactic coverage of the securities laws. Effective enforcement of the securities statutes would be undermined if persons could avoid compliance with information requests or legitimate disclosure requirements imposed by United States law merely by effecting securities transactions through foreign intermediaries who can invoke secrecy or blocking statutes.²⁸⁹ The Draft Restatement could thus impede evolving transnational commerce, by making it more difficult to hold wrongdoers accountable for their conduct.

B. DRAFT RESTATEMENT SECTION 431

Draft Restatement Section 431²⁹⁰ concerns transnational use of United States jurisdiction to enforce.²⁹¹ In general, enforcement outside the United States is permitted only after notice and hearing, absent an exigency or urgency.²⁹² This requirement is in addition to similar due process rules under the United States Constitution.²⁹³ The goal of the Draft Restatement's requirements is to allow exercise of enforcement jurisdiction only where it is not arbitrary.²⁹⁴

Several provisions in the securities laws now allow *ex parte* action by the Commission. For example, the Commission, when appropriate, may summarily suspend trading in securities for a period not exceeding ten days, pursuant to Securities Exchange Act Section 12(k).²⁹⁵ This provision is

exemption from blocking statute would be permitted; held that accession to such a request would violate United States' traditional secrecy of grand jury deliberations).

288. Draft Restatement § 420 reporters' note 1.

289. Courts have clearly indicated that this was not Congressional intent as a matter of domestic law. *See Sec v. Kasser*, 548 F.2d 109, 116 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977), quoted *supra* note 58; *SEC v. Banca della Svizzera Italiana*, 92 F.R.D. 111, 114, 119 (S.D.N.Y. 1981), quoted *supra* note 254.

290. *See supra* note 1.

291. Jurisdiction to enforce is distinct from jurisdiction to prescribe, which has been discussed up to this point. *See* Draft Restatement § 401. Exercise of jurisdiction to enforce depends on the existence of proper jurisdiction to prescribe. *Id.* § 431(1).

292. *Id.* § 431(2) and comment d(iii), which uses the terms "exigency" and "urgent action."

293. *See, e.g., Sniadach v. Family Finance Corp.*, 395 U.S. 337, 342 (1969) (prejudgment garnishment requires notice and prior hearing). Draft Restatement § 431 comment f notes that the section "does not, of course, confer authority on agencies of the enforcing state to exceed their powers under domestic law."

294. Draft Restatement § 431 comment d.

295. 15 U.S.C. 78l(k). Each suspension requires a new finding of necessity. *See SEC v. Sloan*, 436 U.S. 103 (1978).

generally used where it appears to the Commission that material information is not available to the public. Similarly, the Commission has authority under Securities Act Rule 261(a) to summarily and temporarily suspend any Regulation A exemption from the registration requirements of the Securities Act, if it appears to the Commission that the issuer or its predecessors, promoters, officers, directors or underwriters engaged in certain conduct.²⁹⁶

The commentary to the Draft Restatement suggests that these actions by the Commission would be covered by Section 431.²⁹⁷ And there is no indication that the conditions which permit Commission action are considered "exigent" under Section 431. The only examples of "exigency" given by the drafters are halting a departing planeload of narcotics or the import of impure drugs.²⁹⁸ However, the Commission's summary powers are important in maintaining an effective and orderly securities market, even though the purchase of a security without the safeguards of the summary provisions of the federal securities laws may not reach the level of exigency suggested by the drafters. The ability to prevent harmful or illegal activity is integral to the structure and enforcement of federal securities regulation.

Conclusion

The Draft Restatement would drastically and undesirably change current law as it affects the work of the Commission in two major areas. First, in the area of jurisdiction to apply United States law, the Draft Restatement would replace settled law with vagueness and uncertainty and would severely curtail application of United States law to transnational securities activities. The Draft Restatement adds new and uncertain provisions, tilted against application of our nation's law, even in circumstances where United States law would unquestionably be applicable now. There have been no abuses that justify such a radical departure from current law concerning transnational securities law jurisdiction. In contrast to the Draft Restatement, Section 1905 of the Federal Securities Code, the provision in an already-approved proposal by the ALI concerning the same subject, restates current law and practice. Second, in the area of enforcement, procedures, and sanctions, the Draft Restatement imposes new procedural requirements which would inhibit the production of information located abroad. This could preclude effective and evenhanded enforcement of the securities laws. The Draft Restatement would also make it more difficult for the Commission to take summary action which may be necessary for the protection of securities markets in the United States.

296. 17 C.F.R. 230.261(a). Regulation A, 17 C.F.R. 230.251.264, is an exemption from registration for small issues. See Securities Act Rule 254, 17 C.F.R. 230.254.

297. "[S]uspension . . . of a permit to engage in a particular business activity" is one enforcement measure intended to be within the scope of this provision. Draft Restatement § 431 comment a.

298. See *id.* § 431 comment d(iii).