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Comment: Jurisdiction in Transnational Securities Fraud Cases - Securities & (and) Exchange Commission v. Kasser, 548 F.2d 109 (3d Cir. 1977)

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CASE COMMENT

Comment: Jurisdiction in Transnational Securities Fraud Cases—Securities & Exchange Commission v. Kasser, 548 F.2d 109 (3d Cir. 1977)

I. INTRODUCTION

SEC v. Kasser[1] is a recent decision in the series of transnational securities fraud cases wherein the federal courts have devised tests to determine when subject matter jurisdiction is proper under SEC rule 10b-5,[2] promulgated pursuant to section 10(b)[3] of the Securities Exchange Act of 1934.[4] The holding of *SEC v. Kasser* purports to extend subject matter jurisdiction in transnational securities fraud cases beyond any prior decisions. It is submitted, however, that the holding may be limited somewhat by reference to the facts of the case, which facts could satisfy more conservative tests of subject matter jurisdiction. The *Kasser* decision also makes an important contribution by articulating policies which identify U.S. interests in applying rule 10b-5 to transnational securities transactions.

The events in this case leading up to an alleged rule 10b-5 violation began in the mid-1960s when the Canadian provincial government of Manitoba created the Manitoba Development Fund in order to interest private enterprise in the creation of a

1. 548 F.2d 109 (3d Cir. 1977).
2. 17 C.F.R. § 240.10b-5 (1977) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility or any national securities exchange,
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> (a) To employ any device, scheme, or artifice to defraud,
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> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or,
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> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

3. 15 U.S.C. § 78j(b) (1970).
4. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78hh-I (1970).

forestry complex.[5] Kasser and his codefendants allegedly induced the Fund to enter into investment contracts with and acquire debentures of two defendant corporations, largely owned and dominated by Kasser.[6] Under the investment contracts, the Fund was to make loans to the two defendant corporations in exchange for debentures. The Fund entered into the contracts and acquired the debentures based on false representations that Kasser and his associates, or corporations they controlled, had invested and would invest capital in equity securities of the two defendant corporations over and above the proceeds obtained from debenture sales to the Fund. However, the defendants never made the equity investments. Instead, they recirculated the proceeds of the loans and debenture transactions, making the required equity investments not with additional capital but with the very money previously made available by the Fund. Over several years the Fund invested about $45,000,000 in debt securities issued by the defendant corporations. These payments were made because of misrepresentations to and concealment of material facts from the Fund. The defendants falsely represented that substantial equity capital had been invested in the two defendant corporations and spent for development of the forestry complex. Moreover, the defendants diverted much of the money invested in the two defendant corporations to their own personal use. As a result, both corporations went bankrupt.[7]

The court noted that the following conduct forming part of the defendants' scheme occurred in this country: (1) various negotiations; (2) execution of one of the investment contracts in New York; (3) utilization of the instrumentalities of interstate commerce (*e.g.*, telephones and mails) to further the scheme; (4) incorporation of defendant companies in the United States, or at least the establishment of corporate offices; (5) use of the New York office of a Swiss bank as a conduit for the moneys received from the Fund; (6) the maintenance of books and records in this country; (7) drafting of agreements executed elsewhere; and (8) transmittal of proceeds from the transactions to and from the United States.[8]

5. 391 F. Supp. 1167, 1169 (D.N.J. 1975).
6. 548 F.2d at 111.
7. *Id.*
8. *Id.*

The Third Circuit court held that it is proper to exercise jurisdiction in an SEC suit for injunctive relief[9] against violations of the antifraud provisions of the 1933 and 1934 Securities Acts "in transnational securities cases where at least some activity designed to further a fraudulent scheme occurs within this country."[10]

II. BACKGROUND

A. *Development of Effect and Conduct Theories*

The application of rule 10b-5 to transnational securities fraud cases is limited to those transactions with which the United States has a significant connection or interest. Principles of international law form the basis of theories devised by the courts to assess this connection. These principles of international law[11] distinguish between jurisdiction to prescribe a rule of law and jurisdiction to enforce a rule of law. A country is permitted to prescribe a rule of law (a) for conduct occurring within its territory,[12] (b) when conduct outside a territory produces a substantial, direct and foreseeable effect within its territory,[13] and (c) for conduct of its nationals wherever the conduct occurs.[14] A country has jurisdiction to enforce in a

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9. *See* notes 35 & 36 *infra.*

10. 548 F.2d at 114.

11. Principles of interntional law formulated by the RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES represent the opinion of the American Law Institute as to the rules that an international tribunal would apply in deciding a controversy in accordance with international law [hereinafter cited as RESTATEMENT].

12. RESTATEMENT § 17 provides:

> A state has jurisdiction to prescribe a rule of law
>
> (a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and
>
> (b) relating to a thing located, or a status or other interest localized, in its territory.

13. RESTATEMENT § 18 provides:

> A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if . . .
>
> (b) (i) the conduct and its effect are constituent elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems.

14. RESTATEMENT § 30 provides:

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

proceeding brought within its territory any rule of law that it has jurisdiction to prescribe.[15] The major theories applied by the courts in deciding whether to assume subject matter jurisdiction in a transnational securities fraud case have been based upon a certain effect occurring within the United States or certain conduct taking place here. No support has been generated for a theory that would authorize the United States to apply rule 10b-5 in every case where an American national is charged with fraud regardless of where the conduct or effect occurs.[16]

In the transnational securities fraud context,[17] effects-based jurisdiction was first proposed in *Schoenbaum v. Firstbrook*.[18] In that case, an American shareholder of a Canadian corporation, Banff, brought a shareholder derivative action for damages to the corporation resulting from the sale of Banff treasury stock to defendant corporations. The plaintiff alleged a violation of rule 10b-5 in the nature of a conspiracy between the Banff board of directors who were individual defendants and the defendant corporations to defraud Banff by making Banff sell treasury shares at the market price which the defendants, who had inside information not yet disclosed to the public, knew did not represent the true value of the shares.[19] The court formulated the effects test of jurisdiction based on congressional intent in enacting the Exchange Act. The court

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

15. RESTATEMENT § 20 provides: "A state has jurisdiction to enforce within its territory a rule of law validly prescribed by it."

16. *Compare* IIT v. Vencap, Ltd., 519 F.2d 1001, 1016 (2d Cir. 1975) *and* F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., 400 F. Supp. 1219, 1223 (S.D.N.Y. 1975), where American nationality of the defendant is not alone sufficient to confer subject matter jurisdiction, *with* notes 49, 63, and 75 and accompanying text *infra*, where control by a U.S. defendant from the United States would support subject matter jurisdiction.

17. For application of the effects theory in a criminal context, see Strassheim v. Dailey, 221 U.S. 280 (1911). For application of the effects theory in an antitrust case, see, *e.g.*, United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945); Timberlane Lumber Co. v. Bank of America, N.T. & S.A., 549 F.2d 597 (9th Cir. 1976).

18. 405 F.2d 200 (2d Cir.) (holding that lower court had jurisdiction, but that plaintiffs failed to state a cause of action under rule 10b-5), *rev'd in part and remanded*, 405 F.2d 215 (2d Cir. 1968) *(en banc)* (reversing dismissal for failure to state a claim), *cert. denied*, 395 U.S. 906 (1969), *noted in* 1 LAW & POL'Y INT'L BUS. 168 (1969).

19. 405 F.2d at 204.

believed "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."[20] Therefore, the court held that it had

> subject matter jurisdiction over violations of the Securities Exchange Act although the transactions which are alleged to violate the Act take place outside the United States, at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors.[21]

The conspiracy and sale of stock at less than true value to defendant corporations in Canada were detrimental to the interests of the American plaintiff because they lowered the price of his stock of the same issue which was registered and listed on a national exchange.[22]

The conduct theory of subject matter jurisdiction was developed in *Leasco Data Processing Equipment Corp. v. Maxwell.*[23] In that suit for damages, an American corporation alleged that defendants conspired to cause plaintiff to buy stock in the defendant British corporation at prices in excess of its true value by making misrepresentations in violation of section 10(b) of the 1934 Act and rule 10b-5.[24] Misrepresentations were made in New York and London.[25] A contract was signed in New York whereby plaintiff offered to buy shares of the defendant corporation and defendant agreed to accept the offer.[26] However, before the agreement was closed, plaintiff purchased the shares on the London Stock Exchange through a London banking firm, because defendants informed plaintiff of rumors of a counter-takeover bid.[27]

The court first examined the conduct occurring within this country and developed a causation test to determine whether

20. *Id.* at 206.
21. *Id.* at 208.
22. *Id.*
23. 468 F.2d 1326 (2d Cir. 1972).
24. *Id.* at 1330.
25. *Id.* at 1331-32, 1335.
26. *Id.* at 1332.
27. *Id.*

the conduct would be sufficient under international law principles to permit jurisdiction.[28] According to its causation test, the American activity must be an essential link inducing the purchase. Although the precise details causing the loss need not be reasonably foreseeable, the damages must be within the area where the defendant had unlawfully created a risk of loss.[29] The court found that significant conduct occurred in this country and that the contract was an essential link inducing the purchases, irrespective of whether the purchases were triggered by the misrepresentations made in New York or London.[30]

After concluding that the conduct in this country provided a sufficient basis for jurisdiction under principles of international law, the court considered whether Congress would have wished the antifraud provision to apply to the transaction.[31] The court concluded that in section 10(b) of the 1934 Act, Congress intended to prevent fraud in the sale or purchase of securities whether or not traded on organized U.S. markets, and that such protection was not limited to securities of American issuers.[32] The court held that subject matter jurisdiction existed because there was an impact on an American company and its shareholders, and because substantial misrepresentations occurred in this country.[33]

Whether the effect and conduct theories enunciated in *Schoenbaum* and *Leasco* should be applied concurrently, or alternatively, or if they should be balanced is a point raised in *Recaman v. Barish.*[34] Based on the distinction between the facts of *Schoenbaum* and *Leasco,* it is suggested that these theories may be applied alternatively. Where the transactions which violate the Act take place outside the United States, but a domestic investor suffers a loss from his purchase of foreign securities which are registered and listed on a national exchange, then subject matter jurisdiction would vest under rule 10b-5 according to the *Schoenbaum* holding. However, where an American corporation suffers a loss from its purchase

28. *Id.* at 1334-35.
29. *Id.* at 1335.
30. *Id.* at 1334-35.
31. *Id.* at 1335.
32. *Id.* at 1336.
33. *Id.* at 1337.
34. 408 F. Supp. 1189, 1196 (E.D. Pa. 1975).

abroad of foreign securities that are not registered or listed on a national exchange, then according to the *Leasco* holding, substantial misrepresentations must occur in this country, in addition to the impact felt by an American corporation and its shareholders, before jurisdiction will vest under rule 10b-5.

B. *Foreign Victims*

Where foreign individuals or foreign corporations seek to invoke the protection of rule 10b-5 in suits on their own behalf, or in class or derivative actions, or where the SEC sues to enjoin[35] fraudulent activity perpetrated against foreigners, the law is in flux regarding the conduct or effect within the United States that is necessary before jurisdiction will vest.[36] The jurisdictional section of the 1934 Act provides little insight into the issue of when it is proper to exercise subject matter jurisdiction in such cases.[37] Nor does section 30(b)[38] automatically exempt transnational securities transactions from the application of rule 10b-5.[39] No legislative history illuminates this issue.[40] Nor

35. 15 U.S.C. § 78u(d) (Supp. V 1975).

36. Each type of action may present different considerations in the decision to assume jurisdiction. In a class action there is the problem of "the dubious binding effect of a defendants' judgment (or a possibly inadequate plaintiff's judgment) on absent foreign plaintiffs or the propriety of purporting to bind such plaintiffs by a settlement." Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 986 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975). "Such problems are not presented where the SEC seeks to enjoin activity as in SEC v. Gulf Intercontinental Finance Corp., 223 F. Supp. 987 (S.D. Fla. 1963), and SEC v. United Financial Group, Inc., 474 F.2d 354 (9th Cir. 1973), . . . or when the action is by named plaintiffs, as in *Leasco* or in IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975) . . . ." *Id.* at 986 n.26. *Cf. IIT*, 519 F.2d at 1017-18: "If there would be subject matter jurisdiction over a suit by the SEC to prevent the concoction of securities frauds in the United States for export, there would also seem to be jurisdiction over a suit for damages or rescission by a defrauded foreign individual." *See also* Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 563-68 (1976) for a discussion of the problems presented in assuming jurisdiction over suits by individual victims of fraud, suits by or on behalf of corporations, and derivative suits against corporate management.

37. *See* 15 U.S.C. § 78aa (1970).

38. 15 U.S.C. § 78dd(b) (1970) provides:

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

39. Section 30(b) did not exempt the transaction in Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir.), *rev'd in part and remanded*, 405 F.2d 215 (2d Cir. 1968) *(en banc), cert. denied*, 395 U.S. 906 (1969), because it was not part of "a business in securities without the jurisdiction of the United States," but was only an isolated

do any SEC rules or regulations provide any guidance.

The usual presumption is against extra-territorial application of legislation.[41] The courts have found this presumption is rebutted where the United States has a significant interest or connection with a transnational securities transaction. In assessing this connection, the cases discussed below[42] have examined first whether the United States has a sufficient basis under principles of international law to exercise subject matter jurisdiction, and secondly, if this basis exists, whether Congress would have wished the Securities Acts to apply. Policy considerations are important in determining congressional intent.[43] This approach was taken in the leading cases of *Bersch v. Drexel Firestone, Inc.*,[44] and *IIT v. Vencap, Ltd.*,[45] in formulating tests[46] for subject matter jurisdiction over the claims of foreign plaintiffs. These tests examined the conduct occurring

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foreign transaction. *Id.* at 207. Nor did section 30(b) exempt the transaction in SEC v. United Financial Group, Inc., 474 F.2d 354 (9th Cir. 1973), where the court distinguished the words "without the jurisdiction of the United States" from the concept of without the territorial limits of the United States. *Id.* at 357-58. Finally, section 30(b) had no application in Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1336 n.6 (2d Cir. 1972).

40. "The legislative history is silent respecting the jurisdictional scope questions at issue here." SEC v. Kasser, 548 F.2d 109, 114 n.21 (3d Cir. 1977). *See also* Venture Fund v. Willkie Farr & Gallagher, 418 F. Supp. 550, 554 (S.D.N.Y. 1976). For a summary of the legislative history of the Exchange Act *see* 2 L. LOSS, SECURITIES REGULATION 784 n.2 (1961).

41. Recaman v. Barish, 408 F. Supp. 1189 (E.D. Pa. 1975); *See* Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *rev'd in part and remanded*, 405 F.2d 215 (2d Cir. 1968) *(en banc), cert. denied*, 395 U.S. 906 (1969).

42. Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975); IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975); Recaman v. Barish, 408 F. Supp. 1189 (E.D. Pa. 1975); F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., 400 F. Supp. 1219 (S.D.N.Y. 1975). These cases take an approach similar to that of Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972). *See* text accompanying notes 23-33 *supra*.

43. *See, e.g.*, SEC v. Kasser, 548 F.2d 109, 116 (3d Cir. 1977); notes 90-92 and accompanying text *infra*.

44. 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

45. 519 F.2d 1001 (2d Cir. 1975).

46. This author's use of the term "test" does not mean to imply that the decision to assume jurisdiction is reached simply by a process of matching new facts to an old paradigm of effect or conduct. *See, e.g.*, Venture Fund v. Willkie Farr & Gallagher, 418 F. Supp. 550, 555 (S.D.N.Y. 1976). For the view that an effects test has "little independent analytic significance," see Note, *supra* note 36, at 563, where the author suggests that the securities fraud cases "appear to turn [instead] on a reconciliation of American and foreign interests in regulating their respective economies and business affairs."

within this country. The case law subsequent to *Bersch* and *IIT* has generally adhered to their holdings. *SEC v. Kasser,* however, purports to break new ground by liberalizing the conduct required in this country before jurisdiction will vest.[47]

In one line of cases, the courts have outlined those effects within the United States which will support subject matter jurisdiction and those effects which will not trigger application of rule 10b-5 when foreigners are defrauded in transnational securities transactions. In SEC actions to enjoin fraudulent activity injuring American and foreign investors, the courts have upheld subject matter jurisdiction based on the adverse effect on American investors. This effect was demonstrated where offers to sell were made in the United States in *SEC v. Gulf Intercontinental Finance Corp.*[48] or where Americans suffered a loss from their purchase of securities in a fraudulent transaction as in *SEC v. United Financial Group, Inc.*[49] In *Des*

47. *See* text accompanying notes 83-89.

48. 223 F. Supp. 987 (S.D. Fla. 1963). In this case, the individual defendants' scheme to defraud began by creating the defendant Canadian corporation and offering 8 and 8½% notes to the public through Canadian newspapers which circulated in Canada and the United States. The Canadian corporation made loans to the defendant Florida corporations which were created by the individual defendants. Funds from the Florida corporation bank accounts were withdrawn by the individual defendants for salaries and travel expenses, causing a material working capital impairment for the Florida corporations. The Florida corporations had no realized net income or any earnings available to meet interest requirements on the funds advanced by the Canadian corporation. The Canadian corporation paid interest to its noteholders out of the principal, causing a substantial principal impairment, without disclosure to note holders of the actual source of the interest payments.

This was the first suit brought by the SEC to enjoin a fraudulent scheme perpetrated against foreign investors. It was decided prior to *Schoenbaum* and *Leasco,* and hence the court did not have the benefit of the guidance provided by their effect and conduct theories. However, the court upheld subject matter jurisdiction on the basis that some misleading offers to sell the notes were made in the United States, through Canadian newspapers sold here, and held that it was not necessary to make a showing that the offers were accepted by actual sale in this country, or that the alleged misrepresentations were in fact successful in inducing the sale of such securities by reliance thereon.

In commenting upon the *Gulf* holding, the court in Recaman v. Barish, 408 F. Supp. 1189, 1200 (E.D. Pa. 1975) noted: "[O]f equal importance is the fact that . . . the 'true issuers' of the notes of Gulf Intercontinental . . . were the individual and corporate Florida defendants and that Gulf Intercontinental was nothing more than a conduit for the securities issued by the Florida corporation."

49. 474 F.2d 354 (9th Cir. 1973). Here, the defendant was an American holding company owning and from its home base in the United States controlling a large number of service and investment companies incorporated in foreign countries. Offers and sales of shares in mutual funds of the various investment companies were made

Brisay v. Goldfield Corp.,[50] a class action for damages where only one member of the class was American, subject matter jurisdiction was upheld on the basis of an adverse effect on the American securities market from the improper use of securities of an American corporation which were registered and listed on a national exchange.

The court in *Finch v. Marathon Securities Corp.*,[51] held that there was no effect within the United States to support subject matter jurisdiction where a foreign investor had been

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to foreigners. The SEC sought a preliminary injunction alleging that defendants had violated various antifraud provisions of the 1933 and 1934 Acts and rule 10b-5 by obtaining money from investors by means of untrue statements and omissions to state material facts. The court upheld subject matter jurisdiction on much the same basis as it had in *SEC v. Gulf Intercontinental Fin. Corp.* While foreign investors were defrauded in both cases, in the *Gulf* case offers to sell were made in the United States, and in the *UFG* case, stock was actually sold to at least three Americans who lost $10,000 from their investment. The court assumed subject matter jurisdiction based upon this impact on American investors as a result of substantial activity within the United States. This holding was supported by evidence that (a) there were American owners of shares of the defendant companies, (b) there were offers and sales of stock to American citizens, (c) the foreign companies were directed and controlled from the United States, and (d) the mails and other facilities of interstate commerce were used in the preparation and distribution of misleading prospectuses, to set up sales meetings and to consummate investment transactions.

50. 549 P.2d 133 (9th Cir. 1977). This class action was brought to recover damages based upon an allegedly fraudulent stock transaction between a Canadian corporation and the defendant Goldfield Corporation, an American corporation. Members of the class were former shareholders of the Canadian corporation, only one of whom was an American citizen. The alleged fraud involved defendant Goldfield's contract to purchase and take over the assets of the Canadian corporation, including all its stock. The purchase price of $3,000,000 was to be paid in Goldfield stock which was registered and listed on the American Stock Exchange. The manner in which the takeover transaction was effected violated particular substantive provisions of the securities acts and proximately resulted in the collapse of the American market in Goldfield's shares. The court held that subject matter jurisdiction would vest under the *Schoenbaum* effects theory because the improper use of securities of an American corporation which were registered and listed on a national exchange adversely affected not only the plaintiffs but also the American market in that corporation's securities.

51. 316 F. Supp. 1345 (S.D.N.Y. 1970). In this private action for damages, the British plaintiff charged that violations of section 10(b) and rule 10b-5 were committed by another British individual as agent of defendant EICL, a Bermuda investment company. The plaintiff signed an agreement in Great Britain to purchase EICL's interest in another British corporation. The agreement was signed allegedly in reliance upon misrepresentations made in London. The securities purchased in London were neither registered nor traded on an American exchange. Applying the *Schoenbaum* effects theory, the court held that it was without subject matter jurisdiction because there was no injury to domestic investors who purchased foreign securities on American exchanges, nor was there an adverse impact on the domestic securities market from improper foreign transactions.

defrauded in his purchase abroad of securities which were not registered or listed on an American exchange. Where a fraudulent transaction outside of the United States allegedly results in loss of foreign investor confidence in American underwriters and securities and in increased problems of U.S. corporations seeking to raise capital abroad, and has a general adverse effect on the prices of American securities, these effects will not support subject matter jurisdiction where there is no intention that the securities should be offered to anyone in the United States.[52] Also, where any loss to Americans is a result of a fraud practiced upon the trust in which they have invested, and not a fraud practiced upon individual Americans in their purchase of securities, this effect is insufficient for jurisdiction to vest.[53]

Assuming no adverse impact on U.S. investors who have purchased securities on American exchanges, and no adverse impact on the domestic securities market from improper foreign transactions in American securities, another line of cases has also upheld subject matter jurisdiction over actions where foreigners are defrauded when certain conduct occurs within the United States. In *Wandschneider v. Industrial Incomes of North America,*[54] the court held that where misrepresentations

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

53. IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975); Venture Fund v. Willkie Farr & Gallagher, 418 F. Supp. 550 (S.D.N.Y. 1976). IIT allegedly had 300 U.S. citizens and residents as fundholders which amounted to only .2% of IIT's fundholders. The court found that this was not the substantial effect of RESTATEMENT § 18. *IIT,* 519 F.2d at 1016-17. Similarly, Venture Fund had 22,000 shareholders, only two of whom were American citizens. *Venture Fund,* 418 F. Supp. at 553-54. The indirect injuries to these American shareholders "as a result of a fraud allegedly perpetrated on Venture Fund could not of themselves constitute effects within the United States substantial enough to sustain jurisdiction . . . ." *Id.* at 554 n.6.

54. [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,422 at 92,054 (S.D.N.Y. 1972). The defendant was a New York corporation engaged in managing mutual funds and selling their shares. It employed the defendant agent who visited the plaintiff in West Germany to induce her to invest in Industrial Incomes. The agent explained the general prospectus written in English and containing several misrepresentations and omissions to state material facts and also communicated some additional oral misrepresentations, including a statement that Industrial Incomes was regulated by the SEC when in fact the stock of Industrial Incomes had not been registered with the SEC. The plaintiff relied on these material misrepresentations in purchasing $50,000 worth of Industrial Incomes stock. Shortly after purchasing the stocks, plaintiff could not redeem them as had been represented to her, and the stocks were worthless. The court cited *Schoenbaum* in holding that there was subject matter jurisdiction under rule 10b-5 where the misrepresentations were devised within the

are devised within the United States by U.S. residents, where the sale is effected within the United States,[55] and where U.S. mails are used for fraudulent misrepresentations,[56] subject matter jurisdiction will vest over a foreigner's claim for damages. Conversely, when the false and misleading prospectus and oral statements are communicated abroad and the purchase of shares also takes place abroad, subject matter jurisdiction will not vest over a class action for damages brought by foreigners, as the court held in *Recaman v. Barish.*[57]

The two leading cases in formulating conduct tests to determine the existence of subject matter jurisdiction when foreigners are defrauded are *Bersch v. Drexel Firestone, Inc.*[58] and

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United States by U.S. residents, where the sale was effected within the United States, and where the U.S. mails were used for the fraudulent misrepresentations.

It is suggested that the reliance on *Schoenbaum* is misplaced. *Schoenbaum* held that subject matter jurisdiction would vest where a transaction outside the United States involved stock registered and listed on a National Securities Exchange and was detrimental to the interests of American investors. *See* text accompanying notes 20-22 *supra*. This effect is clearly lacking in *Wandschneider*. For the suggestion that the court upheld jurisdiction in part because of defendant's misuse of the SEC name, *see* Note, *supra* note 36, at 570 n.101.

55. Regarding the locus of the sale, *compare* [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶¶ 92,058 and 92,065 where plaintiff signed an application to purchase shares in West Germany, withdrew funds from a West German bank and sent them to New York where the share certificates were issued, and the court found that the sale was effected in New York; *with* Recaman v. Barish, 408 F. Supp. 1189, 1200 (E.D. Pa. 1975) where an application for purchase was filled out in Colombia and the authorization was made there to withdraw funds from plaintiff's Miami bank account, and the court found that the purchase took place in Colombia.

56. *Compare* Schoenbaum v. Firstbrook, 405 F.2d 200, 210 (2d Cir.), *rev'd in part and remanded*, 405 F.2d 215 (2d Cir. 1968)*(en banc)*, *cert. denied*, 395 U.S. 906 (1969), *with* SEC v. Gulf Intercontinental Fin. Corp., 223 F. Supp. 987, 995 (S.D. Fla. 1963).

57. 408 F. Supp. 1189 (E.D. Pa. 1975). The named plaintiffs who were citizens of Colombia, South America, sought damages for themselves and all who purchased shares of U.S. Investment Fund (USIF). Plaintiffs alleged that the prospectus and oral statements pursuant to which offers and sales were made were false and misleading and violated rule 10b-5 and other antifraud provisions. The court granted defendants' motion to dismiss on the ground that it lacked subject matter jurisdiction. The court first applied the *Schoenbaum* rule that if securities were registered and listed on a national exchange, then the alleged fraud would have an impact on the domestic securities market. However, in the *Recaman* case this impact did not occur because the USIF securities were never listed on a U.S. stock exchange or traded over the counter within the United States. The court also cited *SEC v. United Financial Group, Inc.* and *Bersch* where an impact within the United States occurred when sales of securities were made to U.S. citizens or residents. Since the two named plaintiffs were neither citizens nor residents of the United States, no impact occurred in that respect. Nor, presumably, were the other members of the class Americans, since the trust deed, prospectus and investment program certificate provided that shares were not eligible

IIT v. Vencap, Ltd.,[59] companion cases decided on the same day by the Second Circuit. In *Bersch*, the court held that where acts or culpable failures to act within the United States directly cause a loss to foreigners, subject matter jurisdiction will vest over their claims.[60] Where the sale to foreign investors occurred abroad, simply preparing the offerings and part of the prospectus in the United States was not conduct directly causing the loss.[61] Rather, the *Bersch* court found that these activities within the United States were merely preparatory or took the form of culpable nonfeasance, and were relatively small in comparison to those abroad.[62]

In *IIT v. Vencap, Ltd.*,[63] the court held that where fraudu-

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for ownership by residents of the United States. The court also applied the *Leasco* test requiring significant conduct within the United States with respect to the alleged violation before jurisdiction would vest under the antifraud provisions. The court found that this test was not satisfied since the false and misleading prospectus and oral statements were communicated in Colombia and the purchase of shares took place there also.

58. 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975). In *Bersch*, plaintiff brought an action for damages individually and on behalf of a class of persons who purchased common stock of Investors Overseas Services, Ltd. (IOS), an international sales and financial service organization principally engaged in the sale and management of mutual funds. The class consisted of Americans residing in the United States, Americans residing abroad, and foreigners. Plaintiff alleged that IOS and other defendants violated rule 10b-5 by failing to reveal material facts in their prospectus. The offerings were prepared, in part, in the United States, and a part of the prospectus was also prepared here. Shares, which were neither registered nor listed, were sold under a prospectus outside the United States to foreign nationals. In reaching its conclusion not to assume subject matter jurisdiction over the claims of the foreign plaintiffs, the reasoning of the *Bersch* court was similar to the *Leasco* approach. Although the U.S. based activities in *Bersch* were sufficient for jurisdiction to vest under the principle of international law expressed by RESTATEMENT § 17, the U.S. conduct did not satisfy the test which the court fashioned in its interpretation of congressional intent.

59. 519 F.2d 1001 (2d Cir. 1975).

60. 519 F.2d at 993.

61. *See id.* at 985 n.24, 987.

62. *Id.* at 987.

63. 519 F.2d 1001 (2d Cir. 1975). Plaintiffs, liquidators of IIT, an international investment trust organized under the laws of Luxembourg, brought an action against Vencap, a Bahamian venture capital firm; Pistell, its president and chairman of the board; and Vencap's American lawyers. The agreement for the purchase by IIT of three million dollars in Vencap's preferred securities was drafted in New York by IIT's lawyers and exchanged in New York with Vencap's lawyers. The sale was closed in the Bahamas. Pistell subsequently caused Vencap to enter into several questionable transactions involving dispositions of Vencap funds which plaintiffs alleged were inconsistent with the operation of a bona fide venture capital firm and which may also have been injurious to shareholder interests. The court noted that what are fraudulent acts sufficient to uphold jurisdiction depends upon the theory of fraud. For example, under

lent acts were committed in the United States, subject matter jurisdiction would vest over the claims of the foreign plaintiff investment trust because Congress did not intend "to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners."[64] The court noted that mere preparatory activities, or the failure to prevent fraudulent acts, where the bulk of the activity was performed in foreign countries would not be sufficient conduct for jurisdiction to vest.[65]

In the class action of *F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co.*,[66] the first case to apply the *Bersch* and *IIT* holdings, the court declined to assume subject matter jurisdiction because no activity within the United States directly caused the plaintiff's loss. The court found that the allegedly fraudulent conduct directly causing losses to F.O.F. Proprietary consisted of the sale of the debentures and the distribution of the materially misleading offering circulars to purchasers

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a theory that Pistell committed a fraud through transactions which funneled substantial amounts of Vencap funds into his own hands, the court suggested that fraudulent acts would be committed in this country where a New York office was used as a base for the fraud, including directing the transactions and maintaining transactional records there. The court then remanded for further findings as to the factual basis for different theories of rule 10b-5 liability to determine the existence of subject matter jurisdiction.

64. *Id.* at 1017.

65. *Id.* at 1018.

66. 400 F. Supp. 1219 (S.D.N.Y. 1975). Plaintiff, a Canadian mutual fund, purchased one million dollars in convertible guaranteed debentures from Farrington Overseas Corp. (FOC), a Delaware corporation, allegedly in reliance on a misleading offering circular. In order to comply with the federal securities laws and with federal regulations, the FOC debenture offering circular provided that the debentures were not registered and were not being offered to nationals or residents of the United States, nor to residents of Canada or Canadian corporations. The SEC agreed that the debentures need not be registered if underwriters and their purchasers signed a covenant regarding this restriction on offer and sale of the debentures. Thus F.O.F. Proprietary, a Canadian mutual fund, purchased the debentures in violation of federal regulations, the SEC-mandated agreements signed by underwriters and their purchasers, and the proviso appearing in the offering circular.

In deciding whether to assume subject matter jurisdiction, the court first interpreted *Bersch* and *IIT* to require an evaluation of whether Congress would have intended the antifraud provisions of the federal securities laws to apply to F.O.F. Proprietary's purchase of the FOC debentures. The court held that since plaintiff was not within the group of intended or lawful offerees of the FOC debentures, Congress would not have intended to extend the protection of the securities acts to such a transaction that was predominantly foreign. Moreover, subject matter jurisdiction could not be upheld under the test of *Bersch* and *IIT*, since no conduct within the United States directly caused the plaintiff's loss.

and the misleading information transmitted at closing, all of which occurred abroad.[67] The drafting of the offering circular in the United States was deemed merely preparatory.[68]

In *Arthur Lipper Corp. v. SEC*,[69] the court upheld subject matter jurisdiction based upon the *IIT* holding that the United States was used as a base for manufacturing fraudulent security devices for export.[70] There, the United States was the locus of the fraudulent payment of give-ups from one registered broker-dealer to another in connection with the purchase and sale of securities in the United States over-the-counter market, although the payment of give-ups was at the expense of offshore funds only one of which had American shareholders.[71]

Of the cases applying the conduct theory, *Straub v. Vaisman*[72] is most central to the reasoning of the court in *SEC*

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67. *Id.* at 1223.

68. *Id.*

69. 547 F.2d 171 (2d Cir. 1976), *reh. denied*, 551 F.2d 915 (1977), *cert. denied*, 46 U.S.L.W. 3425 (U.S. Jan. 10, 1978) (No. 77-275). Here, the court considered the application of rule 10b-5 to conduct which formed the basis for revoking petitioner broker-dealer's registration and barring petitioner principal owner from association with any broker or dealer. The conduct involved payment of give-ups by Lipper Corp. to IPC (a registered broker-dealer and subsidiary to IOS) amounting to $1,450,000 out of commissions earned by Lipper Corp. on over-the-counter transactions for three offshore funds for which IOS was investment adviser. The court held that Lipper and his company wilfully aided and abetted IOS in committing a fraud on the funds by diverting to itself, through IPC, rebates which belonged to the funds while IPC was doing nothing in return. Since the United States was used as the base for manufacturing fraudulent security devices, the court upheld jurisdiction under the *IIT* test. The court found that the activity in the United States was not merely preparatory.

70. *Id.* at 179.

71. *Id.*

72. 540 F.2d 591 (3d Cir. 1976). Defendant was a registered broker-dealer in New Jersey. In reliance on a telex from defendant and conversations with the defendant's agent, the West German plaintiff authorized the purchase of 10,000 shares at $4 per share through the defendant broker-dealer. The defendant had inside information that the company whose stock it was recommending was almost bankrupt. The plaintiff alleged that this failure to disclose was a 10b-5 violation. In deciding whether to assume subject matter jurisdiction, the court began with the premise that this was not a predominantly foreign transaction, as in *Bersch* and *IIT*. The court then observed that:

> Conduct within the United States is alone sufficient from a jurisdictional standpoint to apply the federal statutes, Restatement (Second) of Foreign Relations Law of the United States § 17 (1965), and the question may simply be whether, on policy grounds, we should apply the securities legislation. Leasco Data Processing Equipment Corp. v. Maxwell, 478 F.2d 1326, 1334-35 (2d Cir. 1972).

540 F.2d at 595. However, the court upheld subject matter jurisdiction based on the *Bersch* test that the conduct within this country directly caused the loss.

v. Kasser. The *Straub* court held that jurisdiction would vest under the *Bersch* test where the facts directly causing the loss included (1) the fraudulent scheme was conceived in the United States by American citizens,[73] (2) involved stock in an American corporation traded over-the-counter,[74] and (3) a registered American securities broker from his office in New Jersey was responsible[75] for the wrongful omissions.[76]

III. SEC v. KASSER

In *SEC v. Kasser,* the Third Circuit reversed the district court's dismissal for lack of subject matter jurisdiction of the SEC's action for injunctive relief.[77] The district court reasoned that Congress did not intend to confer jurisdiction over an essentially foreign transaction unless that transaction had an impact on domestic investors or securities markets.[78] Since no domestic impact was demonstrated where a Canadian Fund was defrauded in an investment contract involving debentures which were neither registered nor traded in this country, the court declined to assert jurisdiction.[79] The district court also considered whether conduct by the American defendants in the United States, although without effect here, was sufficient to give rise to jurisdiction. It concluded that the various miscellaneous acts committed in the United States did not materially alter the essentially foreign nature of the transaction.[80]

The Third Circuit overruled the district court's holding that a domestic impact was required in this country before jurisdiction would vest under the antifraud provisions of the

73. *Cf.* the holding that mere preparatory activities do not support subject matter jurisdiction over the claims of foreign plaintiffs. Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir.), *cert. denied,* 423 U.S. 1018 (1975); IIT v. Vencap, Ltd., 519 F.2d 1001, 1018 (2d Cir. 1975).

74. *Cf.* Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968), *rev'd in part and remanded,* 405 F.2d 215 (2d Cir. 1968)*(en banc), cert. denied,* 395 U.S. 906 (1969): "Congress intended the Exchange Act to have extraterritorial application in order to protect . . . the domestic securities market from the effects of improper foreign transactions in American securities."

75. *See* note 16 *supra.*

76. The court could have held that the failure to disclose in the telex sent from the United States was an act directly causing the loss which would have supported subject matter jurisdiction. *Cf.* Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir.), *cert. denied,* 423 U.S. 1018 (1975).

77. 548 F.2d at 112.

78. 391 F. Supp. at 1175.

79. *Id.* at 1176.

80. *Id.*

securities acts.[81] The court relied on the decision in *IIT v. Vencap, Ltd.*, that an impact in the United States was not a jurisdictional prerequisite, and on a principle articulated in *Straub v. Vaisman,* that conduct standing alone is enough for jurisdiction to attach under the federal securities laws.[82]

In deciding that the conduct alone in the United States supported subject matter jurisdiction, the court placed the greatest reliance on the principle articulated in *Straub*. The *Kasser* court held that "the federal securities laws do grant jurisdiction in transnational securities cases where at least some activity designed to further a fraudulent scheme occurs within this country."[83]

Notwithstanding this liberal standard, the *Kasser* court also suggested that jurisdiction could be upheld based upon the holdings of *IIT* and *Bersch.*[84] *IIT* held that jurisdiction would vest for a foreign plaintiff's claim where conduct in this country consists of "the perpetration of fraudulent acts themselves and does not extend to mere preparatory activities or the failure to prevent fraudulent acts . . . ."[85] The *Kasser* court found that the conduct of the defendants was not merely preparatory since it was much more substantial than the United States based activities in *IIT*.[86] This analysis, however, ignores the qualitative difference in the *IIT* test between preparatory and fraudulent acts and applies the test in a quantitative fashion, by regarding the *Kasser* conduct as more "substantial" than the United States based conduct of *IIT*. Moreover, while the *Kasser* court finds the United States based activity is not merely preparatory, it nowhere states that it amounts to perpetration of fraudulent acts themselves.

The *Bersch* case held that "the anti-fraud provisions of the federal securities laws . . . do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses."[87] While the *Kasser* court does not state

81. 548 F.2d at 112-13.
82. *Id.* at 113.
83. *Id.* at 114.
84. *Id.* at 115.
85. 519 F.2d at 1018.
86. 548 F.2d at 115.
87. 519 F.2d at 993.

that the United States activity directly caused the loss, the court did "question whether it can be convincingly maintained that such acts within the United States did not directly cause any extraterritorial losses."[88] The court found that there was much more United States based activity in *Kasser* than in *Bersch,* including the execution of a key investment contract in New York and the maintenance of records in this country which were crucial to the consummation of the fraud.[89]

Kasser stressed that policy reasons were important in its decision to assume subject matter jurisdiction. First, the court suggested that to refuse jurisdiction

> might induce reciprocal responses on the part of other nations. Some countries might decline to act against individuals and corporations seeking to transport securities frauds to the United States. Such parties may well be outside the ambit of the power of our courts . . . . By finding jurisdiction here, we may encourage other nations to take appropriate steps against parties who seek to perpetrate frauds in the United States.[90]

The court interpreted congressional intent that "the antifraud provisions of the 1933 and 1934 Acts were designed to insure high standards of conduct in securities transactions within this country in addition to protecting domestic markets and investors from the effects of fraud."[91] The court found it desirable to "enhance the ability of the SEC to police vigorously the conduct of securities dealings within the United States," comporting with "the basic purposes of the federal statutes."[92]

While the court in *Kasser* holds that only "some activity designed to further a fraudulent scheme"[93] is required within this country, it is submitted that the holdings may be limited by the facts of the case. The court deemed various activities which occurred in the United States "significant conduct which formed part of the defendants' scheme."[94] Elsewhere the court observed that "the sum total of the defendants' intranational actions was substantial,"[95] and that "the de-

88. 548 F.2d at 115.
89. *Id.*
90. *Id.* at 116.
91. *Id.*
92. *Id.*
93. *Id.* at 114.
94. *Id.* at 111-12.
95. *Id.* at 115.

fendants' conduct occurring within the borders of this nation was essential to the plan to defraud."[96] These descriptions of the conduct in the *Kasser* case suggest more stringent standards for jurisdiction than merely "some activity."

IV. CONCLUSION

When a U.S. court is presented with a foreign plaintiff's action for damages for violation of rule 10b-5, or when the SEC sues to enjoin violations of rule 10b-5 perpetrated against foreigners, the *Kasser* decision provides a new tool for deciding whether or not to assume subject matter jurisdiction. Notwithstanding the observation that the *Kasser* holding may not be so liberal as to require merely "some activity" within the United States before jurisdiction will vest, this case nevertheless examines the conduct occurring in the United States in a quantitative fashion rather than following the qualitative distinction between fraudulent and preparatory acts of the *Bersch* and *IIT* decisions.

According to *Bersch* and *IIT*, fraudulent acts occurring within the United States upón which subject matter jurisdiction rests would include the misrepresentation, the sale, or acts consummating the fraud. In the *Kasser* case, one of the investment contracts with misrepresentations regarding the defendants' equity investments was entered into in New Jersey. This conduct would satisfy the *Bersch* and *IIT* formulations, since the misrepresentations would have been made in the United States, and a transaction in securities would occur here where the investment contract was executed in the United States.

However, the *Kasser* decision suggests a different theory upon which to premise subject matter jurisdiction. After finding that at least eight activities forming part of the fraudulent scheme occurred in the United States, the court held that only "some activity" was required before jurisdiction would vest. Under the *IIT* test, only the acts consummating the fraud are relevant for subject matter jurisdiction purposes. However, a fraudulent scheme may consist of many acts, not just those consummating the fraud. Therefore, in cases where the theory is a scheme to defraud under rule 10b-5(a) or a fraudulent practice or course of business and rule 10b-5(c) which may

96. *Id.*

consist of many acts, it is suggested that the quantitative approach of *Kasser* is preferable to the qualitative one of *IIT*.[97]

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97. The *Kasser* approach has also been supported in the Federal Securities Code of the American Law Institute, which permits United States antifraud law to apply whenever conduct "occurs to a substantial (but not necessarily predominant) extent within the United States." ALI FEDERAL SECURITIES CODE § 1604(a)(I)(D)(i) (Oct. 1974 revision of Tentative Drafts Nos. 1-3).

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