Europe and Overseas Commodity Traders v. Banque Paribas London: Zero Steps Forward and Two Steps Back

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ABSTRACT

While international securities transactions have become the norm in today's globalized economy, such transactions necessarily implicate the laws of more than one nation, thereby creating both conflict and confusion. Due to the depth and breadth of U.S. securities laws, plaintiffs often prefer to sue in the United States under U.S. law. Yet inappropriately applying U.S. law to transnational transactions may offend notions of comity. This Note discusses the different tools used to decide the following jurisdictional issues. First, under what circumstances do U.S. anti-fraud rules apply to securities transactions? Second, under what circumstances do U.S. registration laws apply? Over the past two decades, the judicially created "conduct" and "effects" tests used to decide whether U.S. anti-fraud laws apply have produced inconsistent results and have created uncertainty and unpredictability for both investors and issuers. Conversely, Regulation S, used to determine whether U.S. registration laws apply, was designed by the Securities and Exchange Commission (SEC) to promote predictability and clarity. While commentators have recommended revising the conduct and effects tests to more closely resemble the bright line of Regulation S, the Second Circuit did the reverse in 1998. In Europe and Overseas Commodities Traders, S.A. v. Banque Paribas London (EOC), *the Second Circuit essentially revised Regulation S to more closely resemble the conduct and effects tests. This Note begins with an historical analysis of the United States securities laws and the effect of globalization on these laws. It then analyzes the issues and holding of* EOC *and the SEC's response. Finally, it evaluates the weakness of the Second Circuit's decision and predicts its international ramifications.*

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I. INTRODUCTION

While transnational flows of capital are not an entirely new phenomenon,[1] at the time that the United States enacted its securities laws in the early 1930s securities transactions were primarily domestic.[2] The intense trend toward globalization in the past decade and the sharp upswing in transnational securities transactions[3] may require reconsideration of those laws. As cross-border transactions have become the norm rather than the exception, foreign and domestic issuers and investors have been left wondering: When are offerings and sales of foreign securities in the United States subject to U.S. registration provisions? What is the extraterritorial scope of U.S. enforcement and antifraud protection?

Due to the strengths of U.S. securities regulation—its extensive liability standards, its competent and knowledgeable federal judiciaries, and its powerful tools for the enforcement of judgments—foreign victims of securities violations are tempted to seek recovery in the United States, rather than in their own countries.[4] In addition to overburdening U.S. courts, however,

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1. *See* JAMES D. COX ET AL., SECURITIES REGULATION 1201 n.1 (2d ed. 1997) (noting that "most of the capital used to fund last century's railroad expansion in the United States came from bonds floated in Europe").

2. *See* Samuel Wolff, *Offshore Distributions under the Securities Act of 1933: An Analysis of Regulation S*, 23 LAW & POL'Y INT'L BUS. 101, 109 (1991-1992).

3. In 1980, American investors purchased $17.9 billion of foreign securities, while in 1994, American investors purchased more than $850 billion in foreign securities. *See* Christopher J. Mailander, *Searching for Liquidity: United States Exit Strategies for International Private Equity Investment*, 13 AM. U. INT'L L. REV. 71, 72 n.2 (1997) (citing J. Carter Beese, Jr., *Reengineering Regulation: Maintaining the Competitiveness of the United States Capital Markets*, 18 WASH. L. Q. 133 (1995) *available in* LEXIS, News Library, Curnews File.). Yearly gross trading in foreign stocks by U.S. investors increased from $30.4 billion in the mid-1980s to almost $560 billion in 1993. *See* Todd Cohen, *The Regulation of Foreign Securities: A Proposal To Amend the Reconciliation Requirement and Increase The Strength of Domestic Markets*, 1994 ANN. SURV. AM. L. 491 (1995). Foreign purchases of U.S. debt securities increased from $122.9 billion in 1980 to approximately $3.9 trillion in 1990, a 3073% growth. *See* Kelly Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927, 930 & n.14 (1994) (citing *Reauthorizations for the Securities and Exchange Commission*, 1992-1994: Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 102d Cong., 1st Sess. 14 (1991)).

4. *See, e.g.*, Testy, *supra* note 3, at 957 (explaining that "since the U.S. securities laws are commonly accorded respect as the most stringent in the world, often the application of such laws will give investors a windfall in the form of more protection than that for which they actually bargained").

this raises serious concerns of regulatory arbitrage, lack of comity, and disrespect for the sovereignty of other nations.[5] Securities regulation requires a careful balance of investor protection and market efficiency.[6] The responsibility for assessing such concerns should not be a judicial one.[7] Yet, because the text of U.S. securities laws provides little jurisdictional guidance and few, if any, jurisdictional limits, courts have often been left to balance these issues case by case.[8]

The tests for jurisdiction over transnational antifraud cases—the "conduct" test and the "effects" test—were judicially constructed.[9] The conduct test scrutinizes the nature of the defendant's conduct in the United States and its relation to the alleged fraudulent securities transaction.[10] The effects test examines the effects of a fraudulent transaction on American investors or on the U.S. securities markets.[11] Over the past two decades, these tests have produced inconsistent results and created uncertainty and unpredictability for investors and issuers. How much conduct and of what type is required to satisfy the conduct test? How much effect? The answers to these questions vary from Circuit to Circuit and from year to year.

Conversely, jurisdiction over registration claims is regulated through a test specifically designed by the Securities and

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5. *See, e.g.*, Jill E. Fisch, *Imprudent Power: Reconsidering U.S. Regulation of Foreign Tender Offers*, 87 NW. U. L. REV. 523, 570-71 (1993) (citing objection and retaliation by other countries against aggressive application of U.S. law).

6. *See* Testy, *supra* note 3, at 954-55 (discussing the need to reconcile equity and efficiency).

7. See, for example, Fisch, *supra* note 5, at 566, stating

> It is difficult for the courts to analyze and weigh the interests of the United States in applying its laws to an international securities transaction. It is even more difficult for the courts to determine the interests of the foreign sovereign and to balance those interests against the interests of the United States as required.

8. *See* Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975); Leasco Data Processing Equip. Corp. v. Kerman, 468 F.2d 1326 (2d Cir. 1972); Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *rev'd with respect to holding on merits*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969).

9. *See Bersch*, 519 F.2d 974; ITT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975); *Leasco*, 468 F.2d 1326.

10. For cases construing the conduct test, see *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980); *Vencap*, 519 F.2d 1001; *Bersch*, 519 F.2d 974; *Leasco*, 468 F.2d 1326.

11. For cases construing the effects test, see *Consolidated Gold Fields PLC v. Minorco, S.A.*, 871 F.2d 252 (2d Cir. 1989), *modified by* 890 F.2d 569 (2d Cir. 1989), *cert. dismissed*, 492 U.S. 939 (1989); *Bersch*, 519 F.2d 974; *Schoenbaum*, 405 F.2d 200.

Exchange Commission (SEC).[12] With Regulation S, the SEC announced a detailed and carefully constructed limit to the extraterritorial application of U.S. registration requirements.[13] The regulation reconciles the conflicting goals of investor protection with the need for an efficient system of international securities regulation.[14] It is specifically designed for predictability and clarity.

Commentators have expressed the need for Congress to outline a more appropriate and clear scope for the antifraud provisions.[15] Specifically, it has been suggested that Congress look to Regulation S as a guide.[16] In 1998, however, the U.S. Court of Appeals for the Second Circuit, referred to as the "Mother Court"[17] and "de facto Supreme Court"[18] of securities regulation, stood this recommendation on its head, foregoing the bright-line text of Regulation S in favor of the heavily fact- and judgment-based conduct and effects analyses.[19]

This Note suggests that the Second Circuit took no steps forward and two steps back when it decided *Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London* (*EOC*). Part II of the Note provides an historical analysis of U.S. securities laws and the effect of globalization on those laws. Part III analyzes the issues and holding of *EOC* and considers the brief submitted by the SEC as *amicus curiae* for the *EOC* case. Finally, Part IV evaluates the weaknesses of the Second Circuit's decision and predicts its international ramifications.

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12. *See* Offshore Offers and Sales, Securities Act Release No. 33, 6863, [1989-90 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,524 (Apr. 24, 1990) [hereinafter Release No. 6863].

13. *See id.*

14. *See, e.g.*, Wolff, *supra* note 2, at 101.

15. *See* Testy, *supra* note 3, at 929 (suggesting that "the time is ripe for either Congress or the SEC to meaningfully grapple with this issue and provide the judiciary with guidance").

16. *See id.*

17. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting); Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 413 (8th Cir. 1979); SEC v. Kasser, 548 F.2d 109, 115 & n.29 (3d Cir. 1977).

18. Jan G. Deutch, Chiarella v. United States*: A Study in Legal Style*, 58 TEX. L. REV. 1291, 1299 (1980); *cf. Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 900 (1967) (comments of Judge Friendly) (noting that "I suppose there is some sort of conclusive presumption that judges of the Second Circuit where so much securities litigation is centered must know something about the securities laws.").

19. *See* Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118, 125-28 (2d Cir. 1998).

II. GLOBALIZATION OF THE SECURITIES MARKETS

A. *Trends*

While historically American investors have shown little interest in foreign securities,[20] within the past ten years investment capital has moved beyond U.S. boundaries at unprecedented rates.[21] In 1990, the large growth in U.S. investments in foreign securities was led primarily by institutional investors seeking higher rates of return as a result of low interest rates and slow corporate earnings growth in the United States.[22] Additionally, individual investors began to recognize that they could lower investment portfolio risk by diversifying holdings to include foreign stock.[23] Fiber optics, satellites, and advances in telecommunications allowed money to move instantaneously from country to country,[24] making the world a smaller place in which to conduct business. Investors worldwide could easily and quickly purchase and sell securities in various national markets.[25]

The rush to foreign markets is illustrated by the following: in the mid-1980s, U.S. investors purchased $2 billion of foreign securities per year, whereas in the third quarter of 1993, they bought $2 billion of foreign securities per week.[26]

Despite the obvious hunger and market for foreign securities, many foreign companies that are eligible to list securities on the New York Stock Exchange remain unlisted.[27] Several reasons account for this reluctance. First, foreign companies, whose own accounting principles, registration, and disclosure practices differ markedly from those that apply to U.S. issuers, often shy away

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20. *See* Mailander, *supra* note 3, at 72-73 (reviewing U.S. Treasury Bulletin statistics on total U.S. purchases and sales of securities in foreign markets).
21. *See id.*
22. *See* Testy, *supra* note 3, at 930.
23. *See* Mailander, *supra* note 3, at 74 & n.12 (citing and quoting Jim Cochrane, Senior Vice President for Research and Planning of the New York Stock Exchange, as stating that "American investors have discovered that by not having foreign securities in their portfolios for the last, say, 15 to 20 years, they have left money on the table. If they had diversified, they would have enjoyed high rates of return at low risk—an example of pure economic gain.").
24. *See* James J. Finnerty III, *The "Mother Court" and the Foreign Plaintiff: Does Rule 10b-5 Reach Far Enough?*, 61 FORDHAM L. REV. S-287, S-288 (1993).
25. *See id.*
26. *See* Cohen, *supra* note 3, at 491.
27. *See id.* at 493.

from the strict regulations of the United States.[28] Second, the United States has paired this extensive system of regulation with a liberal enforcement policy.[29] Commentators note that litigation in the United States "tends to be more intrusive, more time-consuming, and more costly than litigation in other countries."[30]

Issuers may also fear that any negative information divulged in the U.S. market[31] will find its way from the United States to the issuer's home market, where it otherwise would have remained hidden.[32] For example, German companies for years refused to submit to U.S. securities laws, unwilling to forgo the use of German accounting practices that permitted companies to increase profits on paper by using hidden reserves[33] to take advantage of the depth, breadth, and liquidity of the U.S. markets.[34] For example in 1993, Daimler-Benz became the first German company to list on the New York Stock Exchange.[35] As required under U.S. law, Daimler-Benz agreed to publicly disclose for the first time hidden reserves maintained on its balance sheet. When it recalculated its 1993 earnings according to U.S.

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28. *See generally*, Mailander, *supra* note 3, at 87-88. The standard registration forms for the "foreign private issuer" include Forms F-1, F-2, or F-3. Form F-1 is a long-form registration statement filed by foreign issuers prior to making a public offering in the United States. *Id.* at 87-88.

> The most difficult F-1 disclosures for a foreign issuer relate to the financial statements. Issuers are required to provide audited, consolidated balance sheets for the issuer covering the last two years, as well as audited statements of income and cash flows for each of the issuer's three most recent fiscal years.

Id. at 88. These statements must be in accordance with either United States Generally Accepted Accounting Principles (U.S. GAAP) or the accounting principles of the issuer's home country (so long as the issuer also supplies corresponding reconciliation of such statements to GAAP). *See id.*

29. *See* Margaret V. Sachs, *The International Reach of Rule 10b-5: The Myth of Congressional Silence*, 28 COLUM. J. TRANSNAT'L L. 677, 678 & n.53 (1990).

30. Fisch, *supra* note 5, at 531.

31. Form F-1 requires the issuer to provide a description of the company, the nature of its business, its holdings, the existence of material legal proceedings, a discussion of the risk factors related to the securities, information about the shareholders in the company seeking to sell securities in the offering, the intended use of the offering proceeds, and other financial information. *See* Mailander, *supra* note 3, at 88.

32. *See* Cohen, *supra* note 3, at 494.

33. That is, funds were tucked away during good years in order to smooth out or paper over losses during bad years. *See id.* at 495. This is an unacceptable practice under U.S. GAAP.

34. *See* LARRY D. SODERQUIST & THERESA A. GABALDON, SECURITIES REGULATION 689 (4th ed. 1999).

35. *See* Cohen, *supra* note 3, at 494.

accounting standards, Daimler's profit of $97 million became a loss of $548 million.[36]

Alongside the development of a global capital market, therefore, has come conflict, as multinational securities deals have implicated the laws and interests of more than one sovereign nation.[37] The United States views its jurisdiction expansively, often imposing its regulations on transactions that are essentially foreign.[38] As the United States has become more militant in applying its laws to international securities transactions, other countries have objected.[39] Some countries have retaliated by passing legislation designed to protect domestic transactions while discriminating against U.S. businesses.[40] Additionally, some countries have enacted rules aimed at preventing the encroachment of the U.S. litigation process.[41]

Regulation of foreign securities transactions, thus, requires a careful balance of competing risks. While too little protection increases investment risks for Americans, too much protection reduces investment opportunity, as countries opt out of U.S. business for fear of invoking its stringent regulations.

B. *U.S. Securities Laws*

While around-the-clock trading venues and instantaneous multinational communications suggest that capital markets know no national boundaries, regulation of those markets does remain national.[42] The primary U.S. statutes governing the offer, sale, and trading of securities are the Securities Act of 1933 (1933 Act) and the Securities Exchange Act of 1934 (Exchange Act). The difficulty with both Acts is that at the time Congress enacted them, relatively few international securities transactions were

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36. *See id.*

37. *See, e.g.*, Fisch, *supra* note 5, at 570-71; Testy, *supra* note 3, at 954.

38. *See* Fisch, *supra* note 5, at 570.

39. *See, e.g.*, Warren Pengilley, *Extraterritoriality Effects of United States Commercial and Antitrust Legislation: A View from "Down Under,"* 16 VAND. J. TRANSNAT'L L. 833, 835-36 (1983) (describing "furor" in the international community over broad application of U.S. jurisdiction).

40. For instance, in response to aggressive extraterritorial application of U.S. statutes by American courts, Great Britain passed the Protection of Trading Interests Act in 1980. *See* Gregory K. Matson, Note, *Restricting the Jurisdiction of American Courts Over Transnational Securities Fraud*, 79 GEO. L.J. 141, 166-67 (1990). This act allowed the Minister of Foreign Trade to authorize citizens to disobey the law of other nations when that law is applied extraterritorially. *See id.*

41. For instance, "blocking statutes" prohibit documents that are connected with foreign litigation from being disclosed or removed from the enacting country. *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 442 cmt. 4 (1987).

42. *See* SODERQUIST & GABALDON, *supra* note 34, at 688.

taking place.[43] The statutes' effect on global markets was unknown, and some say unconsidered,[44] at the time of their creation. What is the limit of U.S. power under international law to regulate conduct occurring primarily beyond its borders? When must foreign issuers and investors comply with the requirements of U.S. securities laws? Nothing in the language of 10b-5,[45] the primary antifraud provision of the Exchange Act, or § 5,[46] the registration provision of the 1933 Act, specifically defines or limits extraterritorial application. Instead, each statute links federal jurisdiction to the use of interstate commerce.[47]

"Interstate commerce" is defined to include "trade or commerce in securities or any transportation or communication relating thereto . . . between any foreign country and any State, Territory, or the District of Columbia."[48] The potential breadth of this provision is vast. Even a telephone call or letter from a foreign seller to a foreign investor who happens to be in the United States could implicate U.S. securities laws.[49] While the broad reach of U.S. securities laws has been criticized both within

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43. *See* Wolff, *supra* note 2, at 109 & n.46.

44. *See id.* at 108 (characterizing the effect of the statutes on transnational securities transactions as insignificant in 1933).

45. *See* discussion *infra* Part II.B.1.

46. *See* discussion *infra* Part II.B.2.

47. *See* 15 U.S.C. § 77e(a)(1) (1994); 15 U.S.C. § 78j(b) (1988). Section 5 states, "Unless a registration statement is in effect . . . it shall be unlawful for any person, directly or indirectly . . . to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use . . . of any prospectus or otherwise." 15 U.S.C. § 77e(a)(1) (1994). Section 10(b) authorizes the SEC to issue rules making it

> unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1988).

48. 15 U.S.C. § 77b(7) (1994).

49. *See, e.g.,* Doll v. James Martin Assocs., 600 F. Supp. 510, 520 (E.D. Mich. 1984) (in securities cases "the transmission of the letter to Ann Arbor [from Bermuda] was in and of itself a sufficient act to create subject matter jurisdiction"); SEC v. Capital Growth Co., S.A., 391 F. Supp. 593, 597 (S.D.N.Y. 1974) (making telephone calls and sending mail to the U.S. may be "conduct" within the U.S. for purposes of subject matter jurisdiction under the federal securities laws). Additionally, "[p]resumably everybody would agree that the making of an offer from another country into the United States by mail or telephone is subject to [Sections] 5 and 17(a) [of the Securities Act] even though neither the seller nor an agent of the seller sets foot in the United States." FED. SECURITIES CODE § 1905 cmt. 3(b) (American Law Institute 1980).

the United States and abroad[50] as a form of legal and economic "imperialism,"[51] neither Congress nor the SEC has allayed these concerns or provided guidance to courts.[52] Courts, for the most part, continue to decide jurisdictional issues based upon their own discretion, case by case.[53]

The Second Circuit's Judge Friendly once stated:

> We freely acknowledge that if we were asked to point to language in the statutes, or even in the legislative history, that compelled these conclusions, we would be unable to respond. The Congress that passed these extraordinary pieces of legislation in the midst of the depression could hardly have been expected to foresee the development of . . . thirty years later. . . . Our conclusions rest on case law and commentary concerning the application of the securities laws and other statutes to situations with foreign elements and on our best judgment as to what Congress would have wished if these problems had occurred to it.[54]

1. Scope of the Securities Exchange Act of 1934's Antifraud Provisions

When considering the jurisdictional reach of U.S. antifraud rules, courts face a dilemma. On the one hand, U.S. securities laws were designed to protect U.S. investors and the integrity of the U.S. securities markets.[55] Exonerating issuers who violate those regulations simply because the transaction has foreign components undermines this policy. On the other hand, the United States is not the lone sovereign of the world. It is in our national interest to honor foreign sovereignty and to support international comity. Inviting foreign securities litigants to the United States presumes common goals and imposes U.S. policy choices on other nations. Compelling other nations to accept the

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50. *See generally* Fisch, *supra* note 5 (discussing the broad reach of U.S. regulation and proposing a legislative approach based upon choice-of-law issues); Donald H. J. Hermann, *Extraterritorial Criminal Jurisdiction in Securities Law Regulation*, 16 CUMB. L. REV. 207 (1985-86) (rejecting adoption of the proposed *Federal Securities Code* in favor of the revised RESTATEMENT OF FOREIGN RELATIONS LAW that limits the applicability of the conduct and effects tests); Grunenthal Gmbh v. Hotz, 511 F. Supp. 582 (C.D. Cal. 1981) (applying the analysis set forth in §§ 17 and 18 of the RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES).

51. *See* Peter Widmer, *The U.S. Securities Laws—Banking Law of the World?*, 1 J. COMP. CORP. L. & SEC. REG. 39, 40 (1978).

52. *See* Testy, *supra* note 3, at 958 (arguing that Congress should provide clear legislative guidelines, rather than continue to allow courts to regulate in on "ad hoc judicial decision making basis").

53. *See id.*

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

55. *See generally* Cohen, *supra* note 3, at 496-500.

policy choices of the United States fosters international discord and uncertainty. It may also unduly discourage foreign persons from engaging in securities-related behavior with U.S. persons or within the United States.

Choosing to err on the side of investor protection, however, federal courts have applied the antifraud provisions liberally. Without Congressional guidance concerning the scope of the antifraud provisions, the Second Circuit pioneered—and has since been the leader—in prescribing the limits of U.S. jurisdiction over transnational securities transactions.[56] While Congress did not provide express guidance on the extraterritorial application of the antifraud provisions, the Second Circuit felt Congress would not have wanted the United States to become a base for fraudulent conduct that was harmful to foreign investors.[57] Further, the Second Circuit believed Congress would have wanted to remedy harms having a substantial effect on investors within the United States, even if those harms had been perpetrated abroad.[58]

To decide whether U.S. courts would have jurisdiction over fraud cases, two general tests, the conduct test and the effects test, evolved.[59] Historically, these two tests have been phrased as alternative tests. That is, if either test is satisfied, U.S. courts will confer subject matter jurisdiction on the transaction.[60]

The effects test was first articulated in *Schoenbaum v. Firstbrook*, in which the issue was whether to apply the Exchange Act's antifraud provisions to a fraudulent sale of stock involving two foreign corporations.[61] In *Schoenbaum*, an American shareholder in Banff Oil, Ltd., a Canadian corporation that traded

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56. In the field of securities law, the Second Circuit has been deemed the "Mother Court." *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 762 (1975) (Blackmun, J. dissenting).

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

58. *See, e.g.*, Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *rev'd with respect to holding on merits*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969).

59. *See generally Bersch*, 519 F.2d 974; Leasco Data Processing Equip. Corp. v. Kerman, 468 F.2d 1326 (2d Cir. 1972); IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975).

60. In 1995, the Second Circuit combined the tests, deciding that there was "no requirement that [the] two tests be applied separately and distinctly from each other. Indeed, an admixture or combination of the two often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American Court." Itoba Ltd. v. Lep Group PLC, 54 F.3d 118, 122 (2d Cir. 1995), *cert. denied*, 516 U.S. 1044 (1996). Under the "admixture" test, while neither "conduct" nor "effects" individually are sufficient to confer jurisdiction, the two tests combined may be. *See id.*

61. 405 F.2d at 204.

on the American Stock Exchange, brought a derivative suit alleging damages from a fraudulent sale of Banff treasury stock to two foreign companies, Aquitane of Canada, Ltd. and Paribas Corporation.[62] The Second Circuit conferred jurisdiction, reasoning that the transaction could have adversely affected American investors since the stock was traded on an American stock exchange.[63] The *Schoenbaum* case thus marked an adoption of the effects test—a general economic effect on a U.S. securities market will suffice to permit jurisdiction of a U.S. court over a transnational securities transaction.[64]

The conduct test surfaced in *Leasco Data Processing Equip. Corp. v. Maxwell*.[65] Because the issuer in Leasco was not listed on an American stock exchange, the jurisdictional issue was more difficult.[66] In this case, Maxwell, an owner of the British corporation Pergamon Press, allegedly induced, through misrepresentation of financial performance, an American corporation (Leasco) to purchase Pergamon's stock at a price exceeding its actual value.[67] While the actual stock purchase occurred on the London Stock Exchange, some negotiations and misrepresentations occurred within the United States.[68] The jurisdictional issue was thus directed at somewhat remote effects and remote activity occurring, for the most part, outside the United States.[69]

While the Second Circuit ultimately conferred jurisdiction over Leasco's claim, it declined to do so under the effects test, even though the American plaintiff suffered a large financial

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62. The plaintiff alleged that Banff's directors and the officers of Aquitane and Paribas conspired to defraud Banff by selling treasury shares at a price below its actual value. *See id.* at 205-06.

63. *See id.* at 208. The court reasoned that the fraudulent sale of Banff's stock would reduce Banff's shareholders' equity. *See id.* This, in turn, the court explained, would decrease Banff's common stock share prices on the American Stock Exchange. *See id.* at 208-09.

64. *Id.* at 206. The court explained that Congress intended the Exchange Act's antifraud provisions 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." The court ultimately dismissed the Rule 10b-5 claim for failure to state a cause of action, since plaintiff's complaint included allegations of breach of fiduciary duty and not fraud. *See id.* at 209.

65. Leasco Data Processing Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972).

66. *See id.* at 1340.

67. *See id.* at 1330.

68. *See id.* at 1332.

69. *See id.* at 1334.

loss.[70] Instead, jurisdiction was conferred on the basis of Maxwell's conduct, that is, the "substantial misrepresentations" he made in the United States.[71] Although a foreign company had arranged the fraud, and although the victim was a foreign subsidiary of an American corporation, jurisdiction was granted. This second test—the conduct test—states that the Exchange Act applies to securities transactions conducted abroad in which a foreign defendant has engaged in some conduct in the United States related to the fraudulent securities transaction.[72] The Second Circuit felt that Congress would have "wished to protect an American investor if a foreigner comes to the United States and fraudulently induces him to purchase foreign securities abroad."[73]

Three years after Leasco, the Second Circuit decided *Bersch v. Drexel Firestone Inc.* (*Bersch*).[74] In *Bersch*, an American citizen brought a class action suit[75] against a Canadian corporation (IOS), alleging that it had issued a misleading prospectus during its public offering of an offshore mutual fund.[76] The plaintiffs further alleged that American defendants had assisted IOS within the United States with the offering and with the drafting of the prospectus.[77]

Plaintiffs argued that IOS had caused adverse economic effects on U.S. securities markets and on American investors such that U.S. jurisdiction was warranted.[78] Narrowing

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70. *See id.* at 1334. The court reasoned that Congress did not intend for the antifraud provisions to apply in situations "[w]hen no fraud has been practiced in this country and the purchase or sale has not been made here." *Id.*

71. *Id.* at 1337.

72. *See id.* at 1334-35.

73. *Id.* While the actual stock purchase took place in London and involved securities not traded on a U.S. exchange, according to the court, Maxwell's meetings with Leasco and his letters and telephone calls to Leasco "whetted Leasco's interest in acquiring Pergamon," and therefore was an "essential link" in inducing Leasco to purchase the stock. *Id.* at 1335.

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

75. The class consisted of U.S. citizens residing in the United States, U.S. citizens residing abroad, and foreign citizens who had purchased IOS stock outside the U.S. *See id.* at 993-98.

76. *See id.* at 981.

77. *See id.*

78. *See id.* at 987-90. The "effects" claimed by plaintiffs were extensive. *See id.* at 987-88. The plaintiffs' expert stated that the collapse of IOS resulted in a deterioration of both domestic and foreign investor confidence. *See id.* This deterioration, it was argued, caused a "steep decline" in foreign purchases of U.S. securities. *Id.* (quoting plaintiff's expert). This decline then led to a redemption of mutual fund shares, causing a ripple effect that depressed the prices of American securities. *See id.* at 988. Finally, it was argued that the IOS collapse destroyed

Schoenbaum, the Second Circuit concluded that the effects test permitted jurisdiction over fraudulent transnational securities transactions "only when [the transaction] result[s] in injury to purchasers or sellers of those securities in whom the United States has an interest, not where acts simply have an adverse effect on the American economy or American investors generally."[79]

Having declined jurisdiction under the effects test, the court next considered the defendants' conduct[80] in the United States. The Second Circuit concluded that while most of the conduct in the United States was "merely preparatory" to the actual fraud, when the defendant mailed the misleading prospectuses from abroad to U.S. citizens in the United States, it nevertheless subjected itself to U.S. jurisdiction.[81] Thus, while under *Leasco* "some" conduct in the United States was sufficient to confer jurisdiction, the court in *Bersch* made it clear that "merely preparatory" conduct was not sufficient.[82] "While merely preparatory activities in the United States are not enough to trigger application of the securities laws for injury to foreigners located abroad, they are sufficient when the injury is to Americans so resident."[83] Jurisdiction was conferred only for the U.S. citizens residing within the United States.[84]

Since deciding this trilogy of cases, the Second Circuit has refined and amended the conduct and effects tests. In *IIT v. Vencap, Ltd.*,[85] decided on the same day as *Bersch*, the Second Circuit held that jurisdiction existed over a Bahamian corporation

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an offshore investing industry in which European investors "were channeled into American securities markets." *Id.* (quoting plaintiffs' expert).

79. *Id.* at 989.

80. The defendants had held numerous meetings in New York in which the deal was initiated, organized, and structured. *See id.* at 985 n.24. The defendants discussed the deal with the SEC and retained lawyers and accountants to review IOS operations and to prepare reports. *See id.* Defendants drafted part of the prospectus in New York and showed the completed draft in New York to potential secondary underwriters. Finally, the defendants opened bank accounts in New York. *See id.*

81. *Id.* at 991.

82. *Id.* at 992.

83. *Id.*

84. The Second Circuit thus set forth the following three-pronged conduct test based on the effect felt in the United States: (1) no conduct is necessary for a U.S. citizen, (2) some material conduct is necessary for a U.S. citizen residing abroad, and (3) much conduct is necessary for foreign citizens. *See id.* at 993.

85. IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975). In *Vencap*, the Second Circuit established jurisdiction over a Bahamian corporation alleged to have defrauded a Luxembourg investment trust when the acts that consummated the fraud—use of defendant's attorney's office in the United States to maintain records and solicit foreign clients—occurred within the United States. *See id.* at 1018.

alleged to have defrauded a Luxembourg investment trust.[86] While the court found the extent of American holdings in the trust insufficient to support jurisdiction under the effects test, it reasoned that jurisdiction nonetheless existed if conduct of a sufficient "wickedness . . . [was] engineered from the United States."[87] The court concluded that defendant's use of his attorney's office as a "base" from which to solicit foreign clients and to maintain records of transactions was sufficient to confer jurisdiction.[88]

In *IIT v. Cornfeld*,[89] the Second Circuit expanded and thereby complicated the conduct test. In deciding whether conduct was sufficient to confer jurisdiction, the court performed a balancing test, weighing the amount of conduct that occurred in the United States against the amount of conduct that occurred offshore.[90] The court stated that a court's "[d]etermination of whether American activities 'directly' caused losses to foreigners depends not only on how much was done in the United States but also on how much (here how little) was done abroad."[91]

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86. *See id.*
87. *Id.*
88. *Id.* In conferring jurisdiction in *Vencap*, the court broadened its approach. No longer concerned merely with U.S. investor protection, the court suggested an additional concern—the reputation of the American securities markets. The court adopted this approach "to protect the integrity of American securities markets from reputational inroads." SODERQUIST & GABALDON, *supra* note 34, at 711. In so doing, the court also denied a new Congressional purpose for U.S. securities laws:

> We do not think that Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners. . . . [T]he position we are taking here itself extends the application of the securities laws to transnational transactions beyond prior decisions and the line has to be drawn somewhere if the securities laws are not to apply in every instance where something has happened in the United States, however large the gap between the something and a consummated fraud and however negligible the effect in the United States or its citizens.

Vencap, 519 F.2d at 1017-18.
89. IIT v. Cornfeld, 619 F.2d 909 (2d Cir. 1980). In *Cornfeld*, the plaintiff (IIT) was a Luxembourg trust fund holding a portfolio of securities investments in which several thousand fundholders participated. *Id.* at 913. Before IIT entered bankruptcy under Luxembourg law, two Americans, including Cornfeld, controlled the fund through a series of offshore shell corporations organized in Luxembourg, Panama, and Canada. These companies were operated from Switzerland. *Id.* The challenged transactions involved three IIT securities purchases of several companies owned by a third American, Kind, who offered investments in natural resource tax shelters. IIT v. Cornfeld, 462 F. Supp. 209, 211-14 (S.D.N.Y. 1978), *rev'd and remanded*, 619 F.2d 909 (2d Cir. 1980).
90. *See Cornfeld*, 619 F.2d at 920.
91. *Id.* at 920-21.

Finally, in *Itoba Ltd. v. Lep Group PLC*,[92] the court for the first time combined the conduct and effects test. In *Itoba*, a foreign company, ADT, was allegedly defrauded in purchasing Lep's stock on the London Stock Exchange.[93] This purchase was made partly in reliance on Lep's required SEC filings.[94] ADT's stock was traded on the New York Stock Exchange, and half of its shareholders of record were residents of the United States.[95] The loss complained of, however, was the loss in value of the stock bought in London.[96] The court found that, while a large number of ADT's shareholders were American, and although its stock was traded on the New York Stock Exchange, Itoba was a foreign company.[97] Under *Schoenbaum*, there was an insufficient effect in the United States to justify the assertion of jurisdiction.[98] Additionally, the court declined to confer jurisdiction on conduct alone.[99] Nevertheless, the court then combined the conduct and effects tests,[100] and using this "admixture" test, the Second Circuit conferred subject matter jurisdiction.[101] In other words, while there was insufficient connection to qualify under either the effects test or the conduct test alone, the two tests together provided sufficient U.S. connection to justify jurisdiction.

While the conduct and effects tests were designed to provide concrete jurisdictional guidance to courts, courts have varied wildly in applying these tests. While the Second Circuit applies the tests narrowly, other Circuits are far more liberal. Outside the Second Circuit, for instance, jurisdiction has been granted based solely on a phone call, mail coming into the United States from abroad,[102] or a single meeting in the United States between foreigners.[103]

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92. Itoba Ltd. v. Lep Group PLC, 54 F.3d 118 (2d Cir. 1995), *cert. denied*, 116 S. CT. 702 (1996).
93. *See id.* at 121.
94. *See id.*
95. *See id.* at 120.
96. *See id.* at 121.
97. *See id.* at 120.
98. *See id.* at 124.
99. *See id.*
100. *See id.* at 122. The court stated that "[t]here is no requirement that these two tests be applied separately and distinctly from each other. Indeed, and admixture or combination of the two often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court." *Id.* at 122.
101. *See id.* at 124.
102. *See, e.g.*, Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 420 n.18 (8th Cir. 1979) (stating that for the purpose of subject matter jurisdiction under the federal securities laws, "[b]oth the place of sending and the place of receipt constitute locations in which conduct takes place when the mails or instrumentalities of interstate commerce are use[d]. . . ."); Doll v.

2. Scope of the Securities Act of 1933's Registration Provision

Congress passed the registration provisions of the 1933 Act "to assure full and fair disclosure in connection with the public distribution of securities."[104] Through mandatory disclosure, Congress sought to promote informed investing and to deter the kind of fraudulent conduct that was believed to have led to the market collapse of 1929.[105] Unless a registration statement has been filed with the SEC, § 5 makes it unlawful to "make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security."[106] As with Rule 10b-5,[107] since virtually no offering can escape "interstate commerce," § 5 could be construed to apply to securities transactions having only trivial connections to the United States.[108] Under this broad reading of § 5, issuers must comply both with the 1933 Act's registration requirements and with foreign securities laws, even when no U.S. purchasers are involved.

As under Rule 10b-5, the following questions come to mind with respect to § 5: What is the limit of U.S. power under international law to regulate conduct occurring primarily beyond its borders? When must foreign issuers and investors comply with the registration requirements of U.S. securities laws? The answers are not always easy. While the SEC gave courts the discretion to limit 10b-5's jurisdictional reach, the SEC restricted judicial discretion under § 5. In view of the potential reach of § 5 and of the increasing importance of international securities offerings, the SEC acted affirmatively to limit its scope.

In 1964, the SEC issued Securities Act Release Number 4708 (Release 4708), designed to govern and clarify the scope of § 5 in relation to offshore transactions.[109] In that release, the SEC

James Martin Assocs., 600 F. Supp. 510, 520 (E.D. Mich. 1984) (stating that in securities cases "the transmission of the letter to Ann Arbor [from Bermuda] was in and of itself a sufficient act to create subject matter jurisdiction. . . ."); SEC v. Capital Growth Co., 391 F. Supp. 593, 597 (S.D.N.Y. 1974) (stating that "making telephone calls and sending mail to the United States" may be deemed conduct within the United States for purposes of subject matter jurisdiction under the federal securities laws).

103. *See, e.g., Continental Grain*, 592 F.2d at 420.

104. COX ET AL., *supra* note 1, at 45.

105. *See id.* at 14.

106. 15 U.S.C. § 77e(a)(1)(a) (1998).

107. *See* discussion *supra* notes 45-49 and accompanying text.

108. *See* 15 U.S.C. § 77e (1988).

109. Registration of Foreign Offerings by Domestic Issuers, Securities Act Release No. 4708 [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶¶ 1361-1363 (July 9, 1964).

declared that it would take no enforcement action for failure to register securities distributed abroad solely to foreign nationals if the distribution was effected in a manner that would result in the securities "coming to rest abroad."[110] Unfortunately, because the SEC neglected to define "coming to rest abroad," Release 4708 set an imprecise standard and resolved little. To determine whether securities fit Release 4708, many companies were forced to seek individualized determinations by the SEC that their particular offerings did not fall within § 5's scope.[111] This process increased, rather than decreased, burdens for companies wishing to accomplish offshore transactions.

As offshore securities transactions became more common, and in order to achieve "a truly global market system,"[112] the SEC adopted Regulation S on April 24, 1990.[113] Regulation S was designed both to "clarify the extraterritorial application of the registration requirements" of the 1933 Act[114] and to address the SEC's principal fear—that unregistered securities sold abroad would flow back to the United States, leaving U.S. investors unprotected.[115] An important SEC stipulation with regard to Regulation S is that it "relates solely to the applicability of the

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110. *Id.*

111. *See, e.g.*, Proctor & Gamble Co., SEC No-Action Letter, 1985 No-Act LEXIS 1870 (Feb. 21, 1985); Raymond Int'l, Inc., SEC No-Action Letter, 1976 WL 12937 (May 28, 1976).

112. Policy Statement on Regulation of International Securities Markets, Securities Act Release No. 6807, 53 Fed. Reg. 46,963 (Nov. 21, 1988). Other internationalization initiatives include (1) Rule 144A, which is designed to provide institutional investors a liquid market for securities issued in exempt offerings (including Regulation S offshore distributions), *see generally* Private Resales of Securities to Institutions, 17 C.F.R. Section 230.144A (1993); (2) Rule 15a-6, a limited exemption for foreign broker-dealers transacting business with United States institutional investors, *see* Registration Requirements for Foreign Broker-Dealers, Exchange Act Release No. 27017, 54 Fed. Reg. 30,013 (July 11, 1989); and (3) a multi-jurisdictional disclosure system (MJDS) between the United States and Canada, *see* Multi-jurisdictional Disclosure, Securities Act Release No. 6841 to the Current Registration and Reporting System for Canadian Issuers, (July 24, 1989) (proposal); Multi-jurisdictional Securities Disclosure and Modifications, Securities Act Release No. 6879, 55 Fed. Reg. 46,288 (Oct. 22, 1990) (re-proposal).

113. *See* Release No. 6863, *supra* note 12. In this release, the SEC stated that

> reliance upon Securities Act Release No. 4708 and the no-action and interpretative letters relating thereto is not appropriate for offerings of securities commencing after the ninetieth day following publication of this release in the Federal Register. Offers and sale previously made in reliance upon no-action or interpretative letters are not adversely affected by the adoption of Regulation S.

Id. at 80,662.

114. *Id.*

115. *Id.* ¶ 80,665.

registration requirements of § 5 of the 1933 Act, and does not limit the scope or extraterritorial application of the antifraud or other provisions of the federal securities laws."[116] The SEC thereby distinguished the extraterritorial scope of U.S. registration provisions that it was willing to delineate from the extraterritorial scope of U.S. antifraud provisions that it was not willing to delineate.[117]

Rule 901 of Regulation S provides that "the terms offer, offer to sell, sell, sale and offer to buy shall be deemed to include offers and sales that occur within the United States and shall be deemed not to include offers and sales that occur outside the United States."[118] Regulation S thereby codified the SEC's position that registration was required only for securities transactions "within the United States"—a territorial principle. This territorial approach was important since it allowed investors, in choosing their investment market, to also choose the laws and regulations that they must follow.[119]

In addition to the general statement of Rule 901, Regulation S also provides two safe harbors for offshore transactions deemed to be "outside the United States." Essentially, these safe harbors enable some issuers to escape legal repercussions when they sell securities offshore without U.S. registration.[120] By fulfilling certain conditions, the sale is considered to be "outside of the United States," and, thus, exempt from burdensome U.S. registration requirements.[121] The requirements to satisfy either safe harbor, contained in Rules 903 and 904,[122] reflect Congress's primary fear that offers of unregistered securities might flow back to the United States, thereby leaving U.S. investors unprotected. Both rules include conditions to prevent unregistered, nonexempt offerings[123] from flowing into U.S.

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116. *Id.* ¶ 80,665.

117. *See* Joel P. Trachtman, *Extraterritorial Jurisdiction—U.S. Securities Laws—Applicability of Antifraud Provisions to Wholly Foreign Transaction*, 84 AM. J. INT'L L. 755, 756 (1990).

118. Regulation S Rules, 17 C.F.R. § 230.901 (1993).

119. Release No. 6863, *supra* note 12, at 80,665 (stating that "[a]s investors choose their markets, they choose the laws and regulations applicable in such markets").

120. *See* Julie L. Kaplan, *"Pushing the Envelope" of the Regulation S Safe Harbors*, 44 AM. U.L. REV. 2495, 2497 (1995).

121. *See id.*

122. Commodities and Securities Exchange, 17 C.F.R. §§ 230.903-.904 (1999).

123. An important means of accomplishing the objectives of U.S. securities laws is through registration of securities. *See* SODERQUIST & GABALDON, *supra* note 34, at 3-4. Registration provides disclosure of material facts about the issuing company and about the securities themselves and helps to prevent fraud or misrepresentation in securities sales. *See id.* Generally, these registration

markets.[124] If the conditions of either safe harbor are met, the transaction is considered "outside the United States," and thus, beyond the reach of § 5.[125]

To satisfy either safe harbor, the offer (1) must be made in an "offshore transaction,"[126] and (2) may not involve a "directed selling effort" in the United States.[127] In addition to these two basic conditions, issuer offerings must satisfy additional flowback safeguards[128] that vary according to the kind of issuer and the type of securities. "Offshore transaction" is defined as one in which no offer is made to a "person in the United States,"[129] and the sale is accomplished in one of the following ways: (1) the buyer must be outside the United States at the time the buy order is originated; or (2) the transaction must be executed on any established foreign securities exchange;[130] or (3) the sale must be executed on a designated offshore securities market and the transaction must not be prearranged with a buyer in the United States.[131]

To determine whether a transaction is "offshore," one must first know whether an offer has been made to a "person in the United States." Are transients "person[s] in the United States"? What if the "transient" is merely on vacation in the United States? What if the "transient" spends three months out of every year in the United States? Six months? The SEC has specifically stated that "offers and sales to transients in the United States are transactions in the United States and may not be part of an offering relying on the safe harbors of Regulation S."[132] Yet until

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requirements apply to both U.S. and foreign securities sold in U.S markets. *See id.* at 4. There are, however, certain exemptions. *See id.* For instance, registration is not required for private offerings to a small number of persons who already have access to the type of information a registration statement would disclose. *See id.* at 4-5. Rules 903 and 904 are not concerned with these "exempt" transactions. *See* Commodities and Securities Exchange, 17 C.F.R. §§ 230.903-.904 (1999). Rather, they are concerned with those securities that are neither registered nor exempt from registration. *Id.*

124. 17 C.F.R. §§ 230.903-.904.

125. *Id.*

126. 17 C.F.R. § 230.903(a)(1).

127. 17 C.F.R. § 230.903(a)(2).

128. In other words, these safeguards are designed to assure that the securities will "come to rest" outside of the United States, and that they do not somehow "trickle back" in. SODERQUIST & GABALDON, *supra* note 34, at 691-93.

129. 17 C.F.R. § 230.902(h)(1)(i) (1993).

130. *See* Regulation S Rules, 17 C.F.R. § 230.902(h)(1)(ii)(B)(1). However, "offers and sales of securities specifically targeted at identifiable groups of U.S. citizens abroad, such as members of the U.S. armed forces serving overseas, shall not be deemed to be made in 'offshore transactions.'" 17 C.F.R. § 930.902(h)(2).

131. *See* 17 C.F.R. § 230.902(h)(1)(ii)(B)(2). A designated offshore securities market is defined in Rule 902(b)(2). *See* 17 C.F.R. §§ 230.902(b)(2).

132. Release No. 6863, *supra* note 12, at 80,676 n.115.

June 4, 1998, there was neither a case nor an SEC decision construing Regulation S with respect to "transients." On June 4, 1998, the Second Circuit[133] decided *Europe and Overseas Commodity Traders S.A. v. Banque Paribas London*[134] (*EOC*). In *EOC*, the court held that a series of fraudulent telephone calls and faxes from a foreign company to a foreign national temporarily living in Florida (*i.e.*, a "transient") were insufficient to invoke jurisdiction over the transactions under either U.S. antifraud laws or U.S. registration laws.[135] Thus, the court decided for the first time that a "transient" was not a "person in the United States."[136]

While the *EOC* decision alone is significant, it was the manner in which the court reached this decision that will prove far more consequential. In its decision, the Second Circuit proposed for the first time that courts deciding the extraterritorial scope of U.S. registration laws may apply the same conduct and effects tests historically reserved for fraud issues.[137] In so holding, the Second Circuit pushed aside the carefully tailored provisions of Regulation S and obliterated Congress's efforts to provide clear guidelines separate and distinct from the antifraud provisions.

III. *EUROPE AND OVERSEAS COMMODITY TRADERS, S.A. V. BANK PARIBAS LONDON* (*EOC*)

A. *Influence of the Second Circuit*

The Second Circuit is recognized as the leading commercial court in the United States, the "de facto Supreme Court",[138] and the "Mother Court"[139] of securities laws. The Second Circuit derived these titles from the fact that it hears appeals from the

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133. *See* discussion *infra* Part III.A. regarding the importance of the Second Circuit in securities law.
134. Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118 (2d Cir. 1998).
135. *See id.* at 126-27.
136. *Id.* at 124-25.
137. *See id.* at 125.
138. *See supra* note 18 and accompanying text.
139. *See, e.g.*, Blue Chips Stamps v. Manor Drug Stores, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting); Continental Grain (Austl.) Pty Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 413 (8th Cir. 1979); SEC v. Kasser, 548 F.2d 109, 115 n.29 (3d Cir. 1977).

U.S. District Court for the Southern District of New York,[140] which encompasses New York City—domicile of both the New York and American Stock Exchanges and financial center of the nation.[141] Thus, the Second Circuit has drawn a disproportionate share of the country's major securities litigation. From 1961 to 1997, the number of opinions from the Second Circuit was nearly five times the average of the other federal courts.[142] Thus, any opinion produced by the Second Circuit presumably carries great weight.

B. *Facts of* EOC

In *EOC* the Second Circuit dismissed, for lack of subject-matter jurisdiction, the plaintiff's claims seeking recovery under the antifraud provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the registration provisions of the Securities Act and the Investment Company Act of 1940.[143] Plaintiff Europe and Overseas Commodity Traders, S.A., a Bahamian corporation whose sole business was the investment of its capital in securities and other ventures, was wholly owned by Alan Carr, a citizen of Canada.[144] Defendants were Banque Paribas (Paribas), Paribas Global Bond Futures Fund, S.A. (Fund), Paribas Asset Management, Ltd. (PAM), and John Arida, a U.K. national who worked as an account manager in the London office of Paribas.[145] Paribas was a French bank, the Fund was organized under the laws of Luxembourg, and PAM was a Bahamian corporation that managed the Fund.[146] No U.S. party was involved.

EOC established a securities trading account with Paribas in London in October 1992.[147] While Carr was visiting England in October 1993, Arida approached Carr and proposed an investment opportunity.[148] Carr expressed interest in the

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140. *See* Margaret V. Sachs, *Judge Friendly and the Law of Securities Regulation: The Creation of a Judicial Reputation*, 50 SMU L. REV. 777, 791 (1997).

141. *See id.*

142. *See id.* at 793. Up to 70% of the U.S. Courts of Appeals opinions considered to be principal cases in securities regulation casebooks have come from the Second Circuit. *See id.*

143. *See* Europe and Overseas Commodity Traders, S.A. v. Banque Paribus London, 147 F.3d 118 (2d Cir. 1998).

144. *See id.* at 120.

145. *See id.*

146. *See id.*

147. *See id.* at 121.

148. *See id.*

proposal, placed an initial purchase of shares in the Fund,[149] and explained that since he was preparing to leave for his vacation home in Florida in two days, he would like to hear more about the proposal once he arrived in Florida.[150] After Carr's arrival in Florida, a series of telephone conversations took place between Carr and Arida regarding the investment proposal.[151] Carr, on plaintiff's behalf, made seven purchases (six of which took place from Florida) of shares in the Fund totaling approximately $1,800,000[152] (EOC-Paribas transactions). Carr alleges that during the course of solicitation—both before and after the initial purchase in London—Arida made various misrepresentations regarding the nature of the Fund.[153] The value of the Fund declined in the months that followed plaintiff's purchases.[154] As a result of the decline in the Fund's value, plaintiff claimed a loss of $1,000,000.[155] Plaintiff then initiated an action in the U.S. District Court for the Southern District of New York against the defendants.

C. *The Issues*

The issues at the heart of *EOC* were: (1) Do misrepresentations by a foreign investment company to a non-U.S. citizen on U.S. soil violate the antifraud provisions of the 1933 Act and the Securities Exchange Act?;[156] and (2) Does the sale of unregistered securities of an unregistered investment company to a non-U.S. citizen on U.S. soil violate § 5 of the 1933 Act?[157] The Second Circuit concluded that the EOC-Paribas transactions did not implicate U.S. securities laws.[158]

1. Do Misrepresentations by a Foreign Investment Company to a Non-U.S. Citizen on U.S. Soil Violate the Antifraud Provisions of the Securities Exchange Act?

As expected, in deciding this issue the Second Circuit applied the conduct and effects tests. Under the effects test, the court

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149. *See* Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 940 F. Supp. 528, 532 (S.D.N.Y. 1996).
150. *See Europe and Overseas Commodity Traders*, 147 F.3d at 121.
151. *See id.*
152. *See id.*
153. *See Europe and Overseas Commodity Traders*, 940 F. Supp. at 532-33.
154. *See id.* at 533.
155. *See id.* at 533.
156. *See Europe and Overseas Commodity Traders*, 147 F.3d at 123-27.
157. *See id.* at 127-31.
158. *See id.* at 127, 131.

concluded that the U.S. interest affected by the transaction was "indiscernible."[159] First, the plaintiff was a Bahamian corporation, and the individual who placed the purchase orders and suffered the losses was a Canadian citizen.[160] Second, the securities were not traded on a U.S. exchange.[161] Third, there was no effect on an U.S.-affiliated company.[162] In essence, the court concluded that there was no jurisdiction under the effects test because there was no involvement of a U.S. entity that Congress would have wanted to protect from swindlers.[163]

Under the conduct test, the court concluded that Arida's communications to Carr in Florida were insufficient to implicate the antifraud provisions of the securities laws.[164] The court reasoned that Carr's presence in the United States was "fortuitous," and that the "actual" purchaser was Carr's corporation, which did not have a place of business in the United States.[165] While recognizing that "Congress would not want the United States to become a base for fraudulent activity harming foreign investors,"[166] the court believed it would be inconsistent with the law to accept jurisdiction over this particular dispute since the surrounding circumstances showed no relevant U.S. interest.[167]

2. Does the Sale of Unregistered Securities to a Non-U.S. Citizen on U.S. Soil Violate § 5 of the Securities Act of 1933?

In deciding this issue, the Second Circuit recognized that, in contrast to the antifraud provisions of the Exchange Act, the SEC had provided guidance, by way of Regulation S, on the applicability of the registration provisions to foreign transactions.[168] The court further noted that it "would be violating legislative supremacy by failing to defer to the interpretation of an agency to the extent that the agency had been delegated law-making authority."[169] Under Regulation S, the court noted, there were two ways the sale could have fallen outside the scope of § 5. First, the transaction could have been

159. *Id.* at 128.
160. *See id.*
161. *See id.*
162. *See id.*
163. *See id.* at 125.
164. *See id.* at 128-29.
165. *Id.* at 126.
166. *Id.* at 125.
167. *See id.* at 130-31.
168. *See id.* at 123.
169. *Id.* at 124 n.3.

"outside the United States,"[170] and second, it could have fallen into one of the two safe harbors defined by Regulation S.[171] The court found that the EOC-Paribas transactions did not meet either safe harbor.[172] To begin, the court found that the representations Arida made by telephone and facsimile to Carr in Florida could qualify as either a "directed selling effort" or an offer to a person in the United States.[173] Additionally, the court stated that while Carr was acting merely as an agent of a foreign corporation, Carr could be viewed as a person in the United States for purposes of the safe harbors.[174] Thus, if one were to look only at the safe harbors, the securities were required to have been registered.

However, a transaction may fall outside both safe harbors and yet still fit Rule 901 of Regulation S. That is, the EOC-Paribas transactions could still be "outside of the United States" for purposes of Rule 901, and thus, the securities would not need to be registered.[175] While the SEC had stated that "offers and sales to transients in the United States are transactions in the United States and may not be part of an offering relying on the safe harbors of Regulation S,"[176] at the time *EOC* was decided, there had been no case law construing Rule 901 with respect to transients visiting the United States.[177] To determine whether the EOC-Paribas transactions were "outside the United States," and thereby outside the scope of § 5's registration provisions, the court applied the conduct and effects tests.[178]

Thus, for the first time, a court used the tests specifically tailored for the antifraud provisions to analyze what was "outside the United States" under Regulation S.[179] The court concluded that the "nearly de minimis" U.S. interest in the transaction

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170. The SEC has indicated that for a transaction to qualify under the General Statement of Regulation S—that is, that it has taken place "outside the United States"—both the sale and the offer pursuant to which it was made must be outside the United States. *See* Release No. 6863, *supra* note 12, at 80,663.

171. 17 C.F.R. §§ 230.903-.904.

172. *See* Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118, 125 (2d Cir. 1998) (stating that "we cannot say definitively . . . that such an agent can never qualify as a 'person in the U.S.' for the purposes of the safe harbors.").

173. Significantly, the court cites SEC Release No. 6863, stating that "offers and sales to transients in the United States are transactions in the United States and may not be part of an offering relying on the safe harbors of Regulation S." Release No. 6863, *supra* note 12, at 80,676 n.115.

174. *See Europe and Overseas Commodity Traders*, 147 F.3d at 123-27.

175. *Id.* at 125.

176. Release No. 6863, *supra* note 12, at 80,676 n.115.

177. *See Europe and Overseas Commodity Traders*, 147 F.3d at 125.

178. *See id.*

179. *See id.*

presented in *EOC* precluded a finding that U.S. jurisdiction existed under the conduct and effects tests.[180] Carr's presence in the United States, the court reasoned, was "entirely fortuitous;" Arida "did nothing to encourage a market for securities in the United States;" and "the conduct was not such as to have the effect of creating a market for those securities in the United States."[181] Plaintiff's complaint was thus dismissed for lack of subject matter jurisdiction.[182]

D. *SEC's Reaction to* EOC

In response to a request from the Second Circuit, the SEC submitted a brief as *amicus curiae* to discuss the jurisdictional issues raised in the appeal of *EOC*.[183] In the brief, the SEC disapproved of the decision to dismiss plaintiff's claims.

1. Antifraud Provision

The SEC believed the "substantial effects" that the misrepresentations had on the plaintiff while in the United States satisfied the effects test. The SEC chose, however, to focus its argument to the Second Circuit on the conduct test.[184] The SEC argued that the conduct test was designed not only to protect foreigners residing outside the United States from acts occurring within the United States, but also to protect persons in the United States from fraudulent representations transmitted into this country from abroad.[185] Stating that the focus of the conduct test is the location of the fraudulent conduct that caused the victim's loss, the SEC argued that the district court failed in two ways to correctly apply this test.[186] First, the district court concluded that the defendants' activities in the United States (the six actual purchases) were "outweighed by the acts that were done abroad" (the account opening in London and the original purchase in London).[187] The SEC argued that because the court failed to view each of the six U.S. purchases as separate

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180. *Id.* at 126-27.
181. *Id.* at 127.
182. *See id.* at 132.
183. Brief of the Securities and Exchange Commission, *Amicus Curiae, Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118 (2d Cir. 1998) (No. 96-7900) [hereinafter SEC Brief].
184. *See id.* at 8-9.
185. *See id.* at 9.
186. *See id.* at 12.
187. *Id.* at 11.

transactions, the court was wrong in its balancing test.[188] Each transaction occurred in the United States, and during each transaction, misrepresentations were made.[189] One transaction that happened to take place in London should not negate six transactions that took place in the United States.[190]

Second, the SEC argued that the district court failed to focus on the specific conduct that constituted the violation.[191] While jurisdiction is not extended for conduct that is merely preparatory,[192] in *EOC* the conduct that occurred in the United States was precisely the fraudulent conduct plaintiff alleged to have been the cause of loss. The SEC maintained that the court was "[standing] Bersch on its head,"[193] when it viewed the "preparatory" conduct abroad (opening an account in London and an initial purchase) as more significant than the misrepresentations themselves.[194]

Finally, the SEC claimed that there had been no cases in which a court had failed to find jurisdiction when the misrepresentations that induced a plaintiff's losses were transmitted into the United States.[195] The fact that Carr was living in the United States only temporarily was irrelevant. In fact, the SEC argued, courts that had faced the issue of visitors who purchase securities while in the United States had rejected the idea that a plaintiff's temporary status in the United States should preclude jurisdiction under the conduct analysis.[196] This is particularly true when, as in *EOC*, the plaintiff lived in the United States on a yearly basis for an extended duration.[197] To deny the protection of U.S. securities laws in such circumstances would create a misconception in those who expect to be protected by such laws but are not.[198] A territorial approach, the SEC argued, is appropriate since it produces a relatively bright line and diminishes uncertainty.[199]

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188. *See id.* at 12.
189. *See id.*
190. *See id.*
191. *See id.*
192. *See id.* at 12 (citing Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir.) *cert. denied*, 423 U.S. 1018 (1975)).
193. *Id.* at 13.
194. *Id.*
195. *See id.* at 14.
196. *See id.* at 15-16 (citing AVC Nederland B.V. v. Atrium Inv. Partnership, 740 F.2d 148, 153 (2d Cir. 1984); Grunenthal GmbH v. Hotz, 712 F.2d 421, 426 (9th Cir. 1983)).
197. *See id.* at 17-18.
198. *See id.* at 18.
199. *See id.*

2. Registration Provision

Regulation S provides that § 5 applies to "offers and sales that occur within the United States,"[200] and that an offer "would not be deemed to be outside the United States if made to a person inside the United States . . . by a telephone call soliciting a purchase in the United States or written material offering a security being mailed or delivered to a person in the United States."[201] Thus, the SEC argued that Rule 901 should not apply in *EOC*.

Additionally, the SEC argued that the EOC-Paribas transactions failed both safe harbors.[202] The SEC asserted that an offer made to a person in the United States includes offers made to "transient visitors" not resident in the United States.[203] Since an "offshore" transaction is defined as an offer to sell securities that "is not made to a person in the United States," Carr's purchase did not qualify, as he was in the United States at the time the offer was made.[204]

In adopting Regulation S, the SEC tried to avoid uncertainty by drawing a "clear line."[205] That line, the SEC reasoned, was most effectively drawn at the territorial boundaries of the United States, since those who are offered securities while they are in the United States may tend to purchase those securities with the expectation that they are offered in compliance with the protections afforded under U.S. law.[206] Thus, the SEC concluded, denying jurisdiction in *EOC* conflicted with the purposes of Regulation S.

IV. THE SECOND CIRCUIT'S MISTAKE

A. The Significance of EOC

While the *EOC* decision itself is significant and the court arguably reached the "correct" outcome, the manner in which the court reached its decision is troublesome. In *EOC*, the leading

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200. Release No. 6863, *supra* note 12, at 80,661.
201. SEC Brief, *supra* note 183, at 20 (citing Offshore Offers and Sales, Securities Act Release No. 6779 (June 10, 1988)).
202. *See id.* at 21.
203. *Id.*
204. *Id.*
205. *Id.* at 23.
206. *See id.*

and most influential Circuit regarding securities law proposed for the first time that the extraterritorial reach of U.S. securities registration laws should be determined through application of the conduct and effects tests traditionally reserved for securities fraud claims.[207] Over the past two decades, these tests have produced inconsistent results and have created unpredictability. In deciding *EOC*, the court ignored the advice of those who have recommended the abandonment of these tests in favor of more predictable guidelines, such as those in Regulation S. Worse still, by using the conduct and effects tests as loopholes, the court carelessly unraveled the SEC's craftsmanship of Regulation S.

B. *Regulation S and the Conduct and Effects Tests Are Not Interchangeable*

In creating Regulation S, the SEC recognized that the increasingly transnational character of securities markets required a well-delineated, bright-line standard for determining the reach of U.S. registration laws.[208] After years of confusion over the applicability of U.S. registration laws to transnational securities transactions, the SEC tried to provide predictability to both issuers and investors. In designing Regulation S, therefore, the SEC drew a clear line between those transactions that were subject to the registration provisions and those that were not. That line was represented by the territorial boundaries of the United States.[209]

Regulation S "relates solely to the applicability of the registration requirements of § 5 of the 1933 Act, and does not limit the scope or extraterritorial application of the antifraud or other provisions of the federal securities laws."[210] The release goes on to say that "[i]t is generally accepted that different considerations apply to the extraterritorial application of the antifraud provisions than to the registration provisions of the [1933] Act."[211] The SEC thereby distinguished the extraterritorial scope of U.S. registration provisions (which it was willing to delineate) from the extraterritorial scope of U.S. antifraud provisions (which it was not willing to delineate). Regulation S

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207. *See Europe and Overseas Commodity Traders*, 147 F.3d at 125.
208. *See* SEC Brief, *supra* note 183, at 22-23.
209. *See* Release No. 6863, *supra* note 12, at 80,665.
210. *Id.*
211. *Id.* (citing Consolidated Gold Fields PLC v. Minorco, S.A., 871 F.2d 252, 262-63 (2d Cir.), *modified by* 890 F.2d 569 (2d Cir.), *cert. dismissed*, 110 S.Ct. 29 (1989); Bersch v. Drexel Firestone Inc., 519 F.2d 974, 986 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975) (emphasis added)).

was, in fact, an about-face from its traditional perceptions of the scope of U.S. securities laws. Rather than further expand the scope of U.S. securities laws, the SEC in Regulation S recognized principles of comity[212] and thus adopted a territorial approach to the registration requirements.[213] Behind Regulation S existed a careful balance between the need for investor protection and the need for an efficient system of international securities regulation.[214]

C. *Problems with the Conduct and Effects Tests*

There are two main problems with the conduct and effects tests.

1. Questionable Justifications for the Tests

Both the conduct test and the effects test are problematic. In applying the effects test, for example, courts have not defined precisely which effects should be considered.[215] Many foreign events, such as a fraud that causes the Tokyo stock exchange to collapse, a war in the Persian Gulf, the merger of two large Japanese automakers,[216] have substantial effects in the United States. As the interconnectedness of the global market increases, market events in one country are expected to have worldwide repercussions.[217] For example on "Black Monday," October 19, 1987, the Dow Jones Industrial Average dove 22.6%; trading in Tokyo that same day declined 14.7%, and the London market fell 12.2%.[218] In a world of global markets, the failure of any major securities firm in the United States, Japan, or any other internationally active nation could have detrimental effects on

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212. *See* Release No. 6863, *supra* note 12, at 80,665 (defining "comity" as a doctrine that "emphasizes restraint and tolerance by nations in international affairs").

213. *See id.* (stating that a "territorial approach acknowledges the primacy of the laws in which a market is located").

214. *See* Testy, *supra* note 3, at 955 (discussing the need to reconcile equity and efficiency).

215. *See* Fisch, *supra* note 5, at 561.

216. *See id.* at 562 nn. 218 & 219 (1993) (citing Diana B. Henriques, *Global Investing—A Special Report; In World Markets, Loose Regulation*, N.Y. TIMES, July 23, 1991, at D1 (describing how the Japanese stock market scandal was blamed for the drop in New York stock prices); Sylvia Nasar, *The Economy Lives, But Will It Ever Dance Again?*, N.Y. TIMES, July 28, 1991, Section 3, at 8 ("Saddam Hussein's invasion of Kuwait caused the biggest one-month plunge in American consumer confidence that has appeared in the survey's history.")).

217. *See* SECURITIES & EXCHANGE COMMISSION, DIVISION OF MARKET REGULATION, THE OCTOBER 1987 MARKET BREAK, 11-7, 11-8 (1988).

218. *See* COX ET AL., *supra* note 1, at 29.

markets throughout the world.[219] Does the effects test require more? Presumably, it does. Otherwise, the United States could assert jurisdiction over any and every foreign transaction impacting the United States.

The conduct test is also problematic. While the Second Circuit requires substantial fraudulent activity in the United States when foreigners seek the protection of U.S. securities laws, other Circuits require less.[220] To some courts, making phone calls or sending mail to the United States is "conduct" within the United States for jurisdictional purposes.[221] To others, a single meeting in the United States between foreigners in a transaction that is otherwise conducted offshore and involves no offer or sale in U.S. markets, is sufficient "conduct."[222]

While inconsistency among Circuits itself is problematic, one should also question the reasoning behind the creation of the conduct test. The purpose of the conduct test was to prevent the United States from becoming a "base for fraudulent activity."[223] However, if there is no effect—and none is required under the conduct test—in the United States, it makes little sense to utilize U.S. enforcement powers. In a global market, the more appropriate tribunal to deal with the fraud is that of the country in which the effects were felt.[224] Further, as one commentator[225] has suggested, suppose the country in which the effects were felt does not consider the transaction fraudulent under its own laws. Under such circumstances, there is little sense behind the argument that the United States is being used as a "base for fraudulent activity."[226]

2. Problems with Case-by-Case Analysis

The lack of an inherent bright line in either the conduct or effects test does have one advantage. It permits courts to account for every relevant consideration and to tailor a "fair" result for the particular situation.[227] In practice, however, case-by-case

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219. *See* James R. Doty, *The Role of the Securities and Exchange Commission in an Internationalized Marketplace*, 60 FORDHAM L. REV. 577 (1992).

220. *See supra* note 102 and accompanying text.

221. *See* Tamari v. Bache & Co. (Leb.) S.A.L., 547 F. Supp. 309, 315 (N.D. Ill. 1982), *aff'd*, 730 F.2d 1103 (7th Cir.), *cert. denied*, 469 U.S. 871 (1984).

222. *See, e.g.*, Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 420 (8th Cir. 1979).

223. Psimenos v. E.F. Hutton & Co., F.2d 1041, 1045 (2d Cir. 1983).

224. *See* Fisch, *supra* note 5, at 565-66.

225. *See id.*

226. *Id.*

227. *See* Larry Kramer, Note, *Extraterritorial Application of American Law After the Insurance Antitrust Case: A Reply to Professors Lowenfeld and Trimble*, 89

analyses are questionable, particularly because such analyses produce uncertainty through inconsistent holdings. Issuers and investors are left wondering whether a particular transaction will or will not be covered by U.S. law. Such uncertainty could ultimately undermine business in the United States. To avoid the risk of invoking the notoriously strict U.S. regulations,[228] foreigners may bar all U.S. access to beneficial transactions.[229]

Additionally, it is doubtful that U.S. courts can perform a truly fair analysis on a case-by-case basis. The conduct and effects tests require courts to regulate foreign transactions according to their own concepts of foreign policy.[230] The U.S. courts' general approach to antifraud cases presumes that both the United States and the foreign sovereign involved have a common interest in providing a cause of action for allegations of fraud.[231] As one commentator has mentioned, this overlooks the fact that many nations have not chosen extensive regulation over the system of *caveat emptor*.[232] U.S. markets have become the most heavily regulated in the world because Congress believed such regulation was justified to promote investor protection and economic stability and to promote a more efficient market.[233] While the U.S. securities laws arguably support U.S. policy, the U.S. system is not the only system possible.[234] A foreign sovereign may not concur with U.S. presumptions and policies.[235] Other countries have, in fact, objected to and retaliated against the broad application of U.S. law.[236]

Thus, with every judicial decision, a court would need to consider

> among other things, (i) the effects on domestic markets and United States investors of actions taken abroad by private parties and

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AM. J. INT'L L. 750, 755 (1995) (noting that while case-by-case analysis is an attractive concept, it is ultimately a "bad idea").

228. *See* SODERQUIST & GABALDON, *supra* note 34, at 689 (characterizing the burdens of foreign securities regulation as "significantly less" than the burdens imposed by U.S. securities laws).

229. *See* Fisch, *supra* note 5, at 524.

230. *See id.*

231. *See id.* at 568.

232. *See id.*

233. *See id.*

234. *See id.* at 568-69.

235. *See id.* at 569 (stating that "[e]ven among countries that accept the premise of extensive regulation of securities transactions, a variety of approaches to regulation are possible").

236. *See supra* notes 39-41 and accompanying text. This retaliation takes the form of statutes designed to reverse the effect of a given U.S. statute, legislation designed to protect transactions in the home country or discriminate against U.S. business or business transactions, and rules aimed at preventing the intrusion of the U.S. litigation process.

> foreign regulators; (ii) the international ramifications of the SEC's actions; and (iii) how those international ramifications, in turn, will feed back into or otherwise affect domestic markets and U.S. investors.[237]

With a multitude of policy considerations behind every decision, it is appropriate that the legislative and executive branches be involved in formulating this policy, rather than allowing it to occur through ad hoc judicial decisionmaking. The judiciary has neither the ability nor the resources to assess the economic, political, and social interests of a foreign sovereign.[238] Furthermore, while courts are ill-equipped to analyze the public interests of the United States, they are even less equipped to determine the interests of foreign governments and to balance those interests against the interests of the United States.[239]

Due to the unpredictability of decisions based on the conduct and effects tests, some commentators have suggested that Congress "look to its work in Regulation S"[240] to improve these tests.[241] Instead, the Second Circuit in *EOC* looked to the conduct and effects tests to clarify Regulation S. In so doing, the Second Circuit undermined the purpose of Regulation S and unraveled the delicate craftsmanship of the SEC.

In an area of law that requires certainty and predictability, the conduct and effects tests offer little value. The language of Regulation S, on the other hand, is clear. If a transaction is to qualify for exemption from registration under Rule 901 of Regulation S, both the offer and the sale must be made "outside the United States."[242] Offers and sales may certainly proceed without registration based solely on Rule 901, but the transaction must be deemed, on its face, to occur outside the United States.[243]

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237. Doty, *supra* note 219, at 579.
238. *See* Testy, *supra* note 3, at 958-59.
239. *See* Fisch, *supra* note 5, at 566-67 n.243. "Aside from the fact that the judiciary has little expertise . . . to evaluate the economic and social policies of a foreign country, . . . [i]t is simply impossible to judicially 'balance' these totally contradictory and mutually negating actions." *Id.* (citing *In re* Uranium Antitrust Litig., 480 F. Supp. 1138, 1148 (N.D. Ill. 1979)).
240. Testy, *supra* note 3, at 958-59.
241. *See id.*
242. Release No. 6863, *supra* note 12, at 80,662-80,663.
243. *See* Kaplan, *supra* note 120, at 2515.

V. CONCLUSION

The exercise of jurisdiction over transnational securities transactions involves significant foreign and domestic policy concerns. Thus, it is appropriate that Congress, and not the courts, determine the scope of U.S. laws. While the SEC provided a well-delineated standard for determining the reach of U.S. securities registration laws, unfortunately it left the courts to decide the scope of U.S. antifraud provisions. The correct step for Congress would be for it to fashion an "antifraud test" similar to Regulation S's "registration test."

Because Regulation S resolves the complications of the conduct and effects tests, it serves as an effective guide for Congress to follow. First, Regulation S's clarity and predictability potentially reduces the number of suits brought, effectively decreasing the burden on our court system and therefore our taxpayers. Second, courts basing their decisions on the text of Regulation S are not faced with the impossible task of resolving the overlapping legal, economic, and political concerns involved in transnational securities litigation. Finally, in drawing the jurisdictional line at the territorial boundaries of the United States, Regulation S recognizes the importance of comity and cooperation in our more global world and respects the sovereignty of other nations.

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