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Subject Matter Jurisdiction Over Transnational Securities Fraud: A Suggested Roadmap to the New Standard of Reasonableness

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SUBJECT MATTER JURISDICTION OVER TRANSNATIONAL SECURITIES FRAUD: A SUGGESTED ROADMAP TO THE NEW STANDARD OF REASONABLENESS

Recent years have seen a dramatic internationalization of the securities markets as investors seek greater portfolio diversification and businesses search for new financing sources across national borders.[1] Many courts have used a traditional jurisdictional analysis to define the scope of American regulatory authority over international securities transactions, relying on formal links between the transaction in question and American territory.[2] To better reflect the increased irrelevance of national borders to participants in the international securities market and to restrain American courts' overly aggressive assertions of jurisdiction, the American Law Institute would require that jurisdiction be "reasonable."[3] In a draft revision of its *Restatement (Second) of the Foreign Relations Law of the United States,* the ALI recommends that courts determine reasonableness through an assessment of competing national interests.

A more rational allocation of regulatory authority is necessary to remedy the increasing friction between nations with valid claims to regulatory power in individual cases.[4] The law must attempt to provide increased certainty for participants in the international mar-

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1 From 1978 to 1982, foreign purchases of stocks in the United States increased from $20.1 billion to $41.8 billion. Foreign sales of stocks and transactions in bonds in the United States showed a similar increase. In the first six months after the SEC instituted a new short form registration statement, 11 foreign companies registered approximately $1.2 billion in offerings. Fedders, Wade, Mann & Beizer, *Waiver By Conduct—A Possible Response To the Internationalization of the Securities Markets,* 6 J. COMP. BUS. & CAP. MARKET L. 1, 2 (1984). *See also* Wayne, *Wall Street's Risky London Bet,* N.Y. Times, Nov. 4, 1984, at F1, col. 1 (describing likelihood of large increase in activity by American firms on London Stock Exchange upon restructuring of that exchange); Chira, *Changes At Tokyo's Big Board,* N.Y. Times, Nov. 2, 1984, at D1, col. 3 (reporting that for first time foreign securities firms can obtain seats on Tokyo Stock Exchange).

2 *See infra* notes 19-54 and accompanying text.

3 RESTATEMENT (SECOND) FOREIGN RELATIONS LAW OF THE UNITED STATES (REVISED) §§ 403, 416 (Tent. Draft No. 2, 1981) [hereinafter cited as DRAFT RESTATEMENT]. The *Draft Restatement* purports to restate "international law that is part of our law, and other U.S. law that relates to foreign relations." *The Draft Restatement of the Foreign Relations Law of the United States (Revised),* 76 AM. SOC. INT'L L. PROC. 184, 187 (1982) (comment of Louis Henkin) [hereinafter cited as *Draft Restatement (Revised)*]. *See* AVC Nederland B.V. v. Atrium Inv. Partnership, 740 F.2d 148, 154 (2d Cir. 1984) (applying *Draft Restatement*).

4 *See infra* notes 74-77 and accompanying text; *see also* Widmer, *The U.S. Securities Laws: Banking Law of the World? (A Reply to Messrs. Loomis and Grant),* 1 J. COMP. CORP. L. & SEC. REG. 39 (1978).

kets and should better conform to market realities. The *Draft Restatement*'s balancing approach, however, may strain the competence of the courts[5] and inject an additional element of uncertainty into international securities transactions.[6]

This Note surveys courts' analyses of the extraterritorial scope of the antifraud provisions of the Securities Exchange Act of 1934[7] under traditional doctrines, and examines the *Draft Restatement*'s incorporation of these doctrines. The Note then analyzes the new factors that the *Draft Restatement* considers relevant to the reasonableness of jurisdiction and suggests an interpretation that should overburden neither the courts nor the parties planning a transaction. This suggested approach retains much of the Supreme Court's pre-*Draft Restatement* analysis but adds an element of awareness of conflicts among different regulatory systems. In addition, it draws on the conflict of laws "internal affairs rule" to suggest a jurisdictional per se rule in certain cases.[8]

I
EXTRATERRITORIAL JURISDICTION OVER SECURITIES FRAUD UNDER THE TRADITIONAL CONDUCT AND EFFECTS TESTS

American courts have long recoguized that international law restrains their power to regulate international activities.[9] These limits reflect the notion that a state's jurisdiction depends on a nexus between the activity and the state's territory. International law principles allow a state to assert jurisdiction over conduct occurring within its territory under the subjective territorial principle or "conduct test."[10] Similarly, jurisdiction exists under the objective territorial principle or "effects test" for extraterritorial conduct that has

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5 *See infra* note 125 and accompanying text.

6 *See ALI Foreign Law Project Would Create Uncertainty In Law, SEC's Goelzer Says,* 16 SEC. REG. & L. REP. (BNA) No. 44, 1748 (Nov. 9, 1984).

See also Nagan, *Conflicts Theory In Conflict: A Systematic Appraisal of Traditional and Contemporary Theories,* 3 J. INT'L & COMP. L. 343, 359 (1982) (conflict of laws field, from which *Draft Restatement* derives its balancing approach, is "replete with incomplete and ambiguous rules."); Lowenfeld, *Public Law in the International Arena: Conflict of Laws, International Law, and Some Suggestions for Their Interaction,* 163 RECUEIL DES COURS 311, 366 (1979) (discussing use of conflicts of laws principles in international law); *see also* DRAFT RESTATEMENT, *supra* note 3, at viii ("Foreword" by Herbert Wechsler, noting similarity between requirement of reasonableness and § 6 of *Restatement (Second) of Conflict of Laws*).

7 15 U.S.C. § 78j(b) (1982).

8 *See infra* notes 154-71 and accompanying text.

9 Murray v. Schooner Charming Betsy, 6 U.S. (2 Cranch) 64, 118 (1804) ("[A]n act of Congress ought never to be construed to violate the law of nations if any other possible construction remains . . . .").

10 *See* RESTATEMENT (SECOND) FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 (1965).

domestic repercussions.[11] International law allows nations great discretion in determining the degree of territorial implication required before that nation may exercise jurisdiction to regulate an activity.[12]

Federal court jurisdiction over transnational securities fraud is based upon federal question jurisdiction.[13] If the federal securities laws do not apply to the transnational activity at issue, then no federal question exists, and the court has no jurisdiction to hear cases arising out of the activity. Thus, courts limit the extraterritorial reach of their jurisdiction by referring to the legislative intent to apply federal securities laws to transnational activity.[14] Congress was silent regarding the extraterritorial application of much of the Securities Exchange Act of 1934,[15] including its general antifraud provision, section 10(b).[16] The Securities Exchange Commission was similarly silent regarding rule 10b-5, the general antifraud rule promulgated under section 10(b).[17] However, courts have imputed to Congress an intent not to regulate securities transactions absent a level of domestic conduct or effects that exceeds traditional international law standards.[18]

A. The Second Circuit's Approach to Extraterritorial Jurisdiction

The Court of Appeals for the Second Circuit is the source for

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11 RESTATEMENT (SECOND) FOREIGN RELATIONS LAW OF THE UNITED STATES § 18 (1965) provides that

> [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.

See also Schoenbaum v. Firstbrook, 405 F.2d 200, 208 (2d Cir.), *modified on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom.* Manley v. Schoenbaum, 395 U.S. 906 (1969); *infra* notes 19-21, 24-28 and accompanying text.

12 Case of the S.S. "Lotus" (Fr. v. Turk.), 1927 P.C.I.J., ser. A, No. 10 (Judgment of Sept. 7).

13 Although foreign parties could conceivably bring suit in federal court for foreign securities fraud under diversity jurisdiction, no such cases apparently exist.

14 DRAFT RESTATEMENT, *supra* note 3, § 403 reporters' note 2.

15 15 U.S.C. §§ 78a-78kk (1982).

16 *Id.* § 78j(b).

17 17 C.F.R. § 240.10b-5 (1985).

18 According to the original *Restatement (Second) of Foreign Relations Law* § 17(a), any conduct within a nation's territory may serve as a basis for jurisdiction. *See* Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 985, 992-93 (2d Cir.) (no jurisdiction on basis of preparatory acts unless domestic effects are consequence of those acts), *cert. denied sub nom.* Bersch v. Arthur Andersen & Co., 423 U.S. 1018 (1975).

much judicial analysis of the extraterritorial scope of rule 10b-5. The Second Circuit first addressed the issue in *Schoenbaum v. Firstbrook,*[19] in which the court found jurisdiction on the basis of the conduct's domestic effects. *Schoenbaum* was a derivative suit brought by American shareholders of a Canadian corporation. The corporation conducted all of its operations in Canada but was listed on the American Stock Exchange. The court found that a sale of treasury shares to the corporation's controlling shareholders, for what the plaintiffs claimed was inadequate consideration,[20] would diminish the value of the corporation's shares traded on the American Stock Exchange. Consequently, the court held that jurisdiction exists "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 court later held that "effects" jurisdiction can also exist where the shares involved are not traded on an American exchange but are held by American investors.[22]

The Second Circuit further developed the "conduct" and "effects" tests in several cases arising from the collapse of the IOS offshore investment fund complex.[23] In *Bersch v. Drexel Firestone, Inc.,*[24] a class of American and foreign investors sued American underwriters and accountants that were involved in a European offering of mutual fund shares. The *Bersch* court developed the relationship between the conduct and effects tests in several ways. First, the court held that absent fraudulent conduct, United States jurisdiction exists only over transactions that directly injure specific "purchasers or sellers . . . in whom the United States has an interest" and not over those transactions that "simply have an adverse effect on the American economy or American investors generally."[25] Such direct injury

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19 405 F.2d 200 (2d Cir.), *modified on other grounds,* 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom.* Manley v. Schoenbaum, 395 U.S. 906 (1969).

20 *Id.* at 205.

21 *Id.* at 208.

22 Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1333-39 (2d Cir. 1972).

23 IOS was a collection of offshore funds. An offshore fund is organized under laws other than those of the United States to sell shares to foreign investors and invest and deal in American securities and real estate. Note, *Offshore Mutual Funds: Extraterritorial Application of the Securities Exchange Act of 1934,* 13 B.C. INDUS. & COM. L. REV. 1225, 1251 (1972). For an account of the IOS collapse, see C. RAW, B. PAGE & G. HODGSON, DO YOU SINCERELY WANT TO BE RICH? (1971).

24 519 F.2d 974 (2d Cir.), *cert. denied sub nom.* Bersch v. Arthur Andersen & Co., 423 U.S. 1018 (1975).

25 *Id.* at 989 (footnote omitted). Plaintiffs' allegations of effects that the *Bersch* court considered too "general" to support jurisdiction included deterioration of foreign investor confidence in American securities markets, large redemptions by IOS shareholders requiring liquidation of American securities, and a breakdown in the offshore investment industry, which had played a substantial role as a conduit of foreign capital into American markets. *Id.* at 987-88.

exists when plaintiffs who reside in the United States incur losses, so rule 10b-5 applies to transactions involving such plaintiffs "whether or not acts (or culpable failures to act) of material importance occurred in this country."[26] The Second Circuit further held that jurisdiction over sales in Europe to foreign citizens, with no specific domestic injury, exists only if substantial domestic conduct "directly caused" their losses.[27] However, the court also held that merely "preparatory" domestic conduct would support jurisdiction over sales to American citizens who resided abroad.[28]

The Second Circuit developed the distinction between "substantial" and "preparatory" conduct in *Fidenas AG v. Compagnie Internationale Pour L'Informatique CII Honeywell Bull S.A.*[29] The *Fidenas* plaintiffs, a German dealer in commercial paper and the family-owned Bahamian and Swiss companies that he managed, charged French and Swiss computer sales companies with issuing fraudulent notes. The plaintiffs had arranged two financings for the defendants through the issuance of promissory notes, which were sold to the plaintiffs' customers.[30] The notes were fraudulent, and a Swiss court convicted the Swiss defendant's chief financial officer of criminal fraud.[31] The plaintiffs claimed that rule 10b-5 applied to the sale of the notes because the American parent of one of the defendant corporations knew of an attempt to "cover up" the fraud. The court found that this "conduct" was at most "secondary or tertiary" and would not support jurisdiction when all of the parties to the action were foreigners residing abroad.[32] Although some of the notes were sold to nonparty Americans, the court found that effects

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26 *Id.* at 993. The Eighth Circuit, in Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973), and the Ninth Circuit, in SEC v. United Fin. Group, Inc., 474 F.2d 354 (9th Cir. 1973), also have relied solely on the effects doctrine when domestic conduct would not support jurisdiction.

27 519 F.2d at 991-93. Consequently, the circuit court instructed the district court to determine on remand whether the defendant underwriter's domestic conduct was substantial and essential to the European offering. *Id.* at 991-92, 1001.

28 *Id.* at 987. See *infra* notes 94-101 for an explanation of the grounds of this distinction. The *Bersch* court held that preparatory conduct had to be of "material importance" and "significantly contribute" to the fraud. *Id.* at 993.

29 606 F.2d 5 (2d Cir. 1979).

30 *Id.* at 7.

31 *Id.* at 8.

32 *Id.* Following dismissal of the action for lack of jurisdiction, the plaintiffs brought suit directly against the American parent of the Swiss corporation that had issued the fraudulent notes. Fidenas AG v. Honeywell Inc., 501 F. Supp. 1029 (S.D.N.Y. 1980). The district court dismissed for want of subject matter jurisdiction because neither the conduct nor the effects test "turn[s] on the nature of the defendant," but rather on the predominantly American or foreign nature of the transaction. *Id.* at 1040-41.

on nonparties were of no jurisdictional significance.[33]

In *IIT v. Cornfeld*[34] the Second Circuit again required that, absent domestic effects, fraudulent conduct must have a predominantly American situs. The action in *Cornfeld* related to a "series of acquisitions by IIT," an investment fund "of securities related to a complex of companies controlled by one John M. King, an American oil and gas entrepreneur."[35] The securities involved in *Cornfeld* included common stock of an American corporation, KRC, and eurodollar convertible debentures of a Netherlands Antilles corporation, KRCC, a wholly owned subsidiary of KRC that owned no operating assets.[36] KRCC's debentures were guaranteed by KRC, convertible into KRC common stock, and were issued simultaneously with a domestic issue of KRC debentures.[37] Allegedly, the managers of two corporations that were part of the IOS complex had received personal kickbacks for inducing IIT to invest in KRC.[38] Plaintiff IIT claimed that this constituted a violation of rule 10b-5.[39] The Second Circuit found that subject matter jurisdiction existed as to plaintiff's purchase of the KRCC eurodollar convertible debentures.[40]

The Second Circuit expressly recognized that the "[d]etermination 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."[41] Thus, the court interpreted the "directness" requirement of *Bersch*[42] to require a balancing of domestic and foreign conduct. Although the domestic conduct in *Cornfeld* appeared similar to that which the court found "merely preparatory"[43] in *Bersch,* the court distinguished *Bersch* on the basis of several factors. First, the domestic citizenship of the *Cornfeld* issuer and defendants gave the United States a greater interest in regulating the issuance.[44] Second, in *Bersch,* the bulk of the preparation of the prospectus and

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33 606 F.2d at 8. The Court, however, noted that in an SEC enforcement proceeding, such effects would be relevant. *Id.*

34 619 F.2d 909 (2d Cir. 1980).

35 *Id.* at 914.

36 *Id.* at 914, 919.

37 *Id.* at 919-20.

38 *Id.* at 915.

39 *Id.* at 914. Defendants in the suit were the American accounting firm and underwriters involved in the transaction, as aiders and abettors, and IIT's securities broker, as both a principal and an aider and abettor. *Id.* at 915.

40 *Id.* at 919-21.

41 *Id.* at 920-21.

42 *See supra* note 27 and accompanying text.

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

44 *Id.* at 920.

financial statements "had to be done abroad,"[45] where the foreign issuing company maintained its records. In *Cornfeld,* however, these activities necessarily occurred in the United States. Thus, the court recognized that not only was the proportional quantity of domestic conduct relevant, but the necessity of the domestic situs also affected the jurisdictional inquiry.

B. Extraterritorial Jurisdiction in Other Circuits

Instead of developing a conduct test that balances the domestic and foreign aspects of a transaction, other circuits using the "conduct" test have concentrated solely on whether the conduct alleged to have occurred within the United States was "preparatory" or "significant," without comparing domestic and foreign aspects of a transaction. In *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.,*[46] the Eighth Circuit found that the partial negotiation and ultimate signing of a contract in the United States satisfied the conduct test.[47] The court framed the test as an analysis of the "relationship between defendants' conduct . . . and the alleged fraudulent scheme, specifically whether defendants' conduct in the United States was significant . . . . The conduct in the United States cannot be 'merely preparatory.' "[48]

In *SEC v. Kasser,*[49] the Third Circuit found jurisdiction based on domestic conduct similar to that in *Continental Grain.* The transaction in *Kasser* had no domestic effects because the sole victim of the allegedly fraudulent conduct was a corporation entirely owned by the Canadian Province of Manitoba.[50] However, the court held that the negotiation and execution of a contract in New York directly caused the fraud, providing a sufficient basis for jurisdiction.[51] The court implied that even less domestic conduct would support jurisdiction, stating that jurisdiction exists "in transnational securities cases where at least some activity designed to further a fraudulent scheme occurs within this country."[52] The Third Circuit justified its finding by explaining that it was "reluctant to conclude that Congress intended to allow the United States to become a 'Barbary Coast,' as it were, harboring international securities 'pirates.' "[53]

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45 *Id.*

46 592 F.2d 409 (8th Cir. 1979).

47 *Id.* at 412-15. The closing and delivery of stock took place in Australia. *Id.* at 412-13.

48 *Id.* at 420.

49 548 F.2d 109 (3d Cir.), *cert. denied sub nom.* Churchill Forest Indus. Ltd. v. SEC, 431 U.S. 938 (1977).

50 *Id.* at 111-12.

51 *Id.*

52 *Id.* at 114.

53 *Id.* at 116.

The Ninth Circuit relied on this rationale to find jurisdiction on similar facts in *Grunenthal GmbH v. Hotz*.[54]

These cases demonstrate that other circuits have not followed the Second Circuit's balancing of the quantity and quality of domestic and foreign conduct. They rely instead on the distinction between significant and preparatory acts. This distinction allows them to find subject matter jurisdiction on the basis of nearly any act within the United States that furthers a fraud. That the American location is coincidental or merely a matter of convenience is irrelevant to their inquiry. This expansive approach results in a greater likelihood of concurrent jurisdictional claims by other nations. The formalism of the approach ignores the irrelevance of national borders to participants in international markets and results in applications of American securities laws to transactions more appropriately governed by other regulatory systems.

II

JURISDICTION OVER EXTRATERRITORIAL SECURITIES FRAUD UNDER THE *DRAFT RESTATEMENT*

Courts have given great deference to the jurisdictional provisions of the *Restatement (Second) of the Foreign Relations Law of the United States*.[55] The *Restatement* provided authority for courts' application of both the conduct and effects tests to jurisdictional disputes in rule 10b-5 cases.[56] The American Law Institute (ALI) recently reexamined the question of extraterritorial applicability of American regnlation, or "jurisdiction to prescribe,"[57] in a proposed revision to the *Restatement*. In a tentative draft promulgated in 1981, the ALI reporters suggested that extraterritorial jurisdiction should be subject to a rule of "reasonableness."[58]

Section 416 of the *Draft Restatement*[59] establishes threshold

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54 712 F.2d 421 (9th Cir. 1983).

55 *Draft Restatement (Revised), supra* note 3, at 195 (comment of John Huock).

56 *See* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1339 (2d Cir. 1972); Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 415 (8th Cir 1979).

57 DRAFT RESTATEMENT, *supra* note 3, § 402.

58 *Id.* § 403(2) & comment a.

59 Section 416 provides that:

> (1) Any transaction in securities carried out, or intended to be carried out, on a securities market in the United States is subject to United States jurisdiction to prescribe, regardless of the nationality or place of business of the participants in the transaction or of the issuer of the securities.
>
> (2) As regards transactions in securities not on a securities market in the United States, but where
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> (a) securities of the same issuer are traded on a securities market in the United States; or

levels of domestic conduct or effects that a court may require before applying American securities regulations to an international transaction.[60] The section includes four jurisdictional tests: (a) consummation of a transaction in a United States securities market,[61] (b) trading in the issuer's securities on American markets,[62] (c) representations or negotiations in the United States,[63] and (d) United States citizenship or residency of the defendant or "person sought to be protected."[64] Two of the section 416 jurisdictional tests ("a" and "c" above) incorporate the conduct test into the *Draft Restatement*'s analysis; the other two ("b" and "d" above) incorporate the effects test. Therefore, none of the provisions depart, in themselves, from established law. However, section 416 differentiates between the jurisdictional tests on the basis of reasonableness.

(b) representations are made or negotiations are conducted in the United States in regard to the transactions; or

(c) the party subject to the regulation is a United States national or resident, or the persons sought to be protected are residents of the United States,

the authority of the United States to exercise jurisdiction to prescribe depends on its reasonableness in light of evaluation under Section 403(2).

Id. § 416.

60 *Id.* § 416(1) comment c & reporters' note 5 (jurisdictional tests provided by § 416 are useful illustrations but are not conclusive).

61 *Id.* According to reporters' note 1, this provision finds precedential support in Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir.), *modified on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom.* Manley v. Schoenbaum, 395 U.S. 906 (1969).

62 DRAFT RESTATEMENT, *supra* note 3, § 416(2)(b). *See* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1337 (2d Cir. 1972).

63 DRAFT RESTATEMENT, *supra* note 3, § 416(2)(a). *See* Grunenthal GmbH v. Hotz, 712 F.2d 421, 425 (9th Cir. 1983); Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 415 (8th Cir. 1979); SEC v. Kasser, 548 F.2d 104, 115 (3d Cir.), *cert. denied sub nom.* Churchill Forest Indus. Ltd. v. SEC, 431 U.S. 938 (1977).

64 DRAFT RESTATEMENT, *supra* note 3, § 416(2)(c). *See* Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir.), *cert. denied sub nom.* Bersch v. Arthur Andersen & Co., 423 U.S. 1018 (1975); *supra* note 32 and accompanying text.

Under the "nationality principle" of interuational law, jurisdiction is valid when the defendant is American. However, the *Draft Restatement* notes that in the securities context jurisdiction might not be reasonable if the security was not registered in the United States and the relevant conduct occurred abroad. DRAFT RESTATEMENT, *supra* note 3, § 416 reporters' note 3. This reporters' note conforms § 416(2)(c) to established law. The nationality principle is an "exceptional" jurisdictional basis, while jurisdiction based on domestic conduct or effects is the "normal" basis. DRAFT RESTATEMENT, *supra* note 3, § 402 comment b; *see* Laker Airways Ltd. v. Sabena, 731 F.2d 909, 935 (D.C. Cir. 1984) (territoriality, not nationality, is customary and preferred basis of jurisdiction). If American jurisdiction is premised on nationality and another nation could reasonably claim jurisdiction under territorial principles, American courts should, absent compelling circumstances, decline to apply American law. However, if no other nation can legally claim jurisdiction, courts might apply the nationality principle to prevent the existence of unregulated activity.

The first jurisdictional test is "per se" reasonable,[65] but the other three are subject to further inquiry under section 403(2) regarding the reasonableness of asserting jurisdiction.[66] In requiring an evaluation of reasonableness, the *Draft Restatement* departs from the established law.

Under the new reasonableness requirement courts are expected to "analyze various interests, examine contacts and links, give effect to justified expectations, search for the 'center of gravity' of a given situation, and develop priorities" to determine whether jurisdiction can be maintained.[67] In the words of one antitrust court, "[t]he

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65 DRAFT RESTATEMENT, *supra* note 3, § 416(1). The reporters' note 2 to § 416, however, indicates that § 416(1) was drafted in light of the principles of § 403.

66 Section 416(2) requires the reasonableness approach of § 403(2) to be applied to subsections (a), (b), and (c) of § 416(2). *See supra* note 59. Section 403(2) provides that:

> Whether the exercise of jurisdiction is unreasonable is judged by evaluating all the relevant factors, including:
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> (a) the extent to which the activity (i) takes place within the regulating state, or (ii) has substantial, direct, and foreseeable effect upon or in the regulating state;
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> (b) the links, such as nationality, residence, or economic activity, between the regulating state and the persons principally responsible for the activity to be regulated, or between that state and those whom the law or regulation is designed to protect;
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> (c) the character of the activity to be regulated, the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regnlation is generally accepted;
>
> (d) the existence of justified expectations that might be protected or hurt by the regulation in question;
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> (e) the importance of regulation to the international political, legal or economic system;
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> (f) the extent to which such regulation is consistent with the traditions of the international system;
>
> (g) the extent to which another state may have an interest in regulating the activity;
>
> (h) the likelihood of conflict with regulation by other states.

DRAFT RESTATEMENT, *supra* note 3, § 403(2).

67 DRAFT RESTATEMENT, *supra* note 3, part IV, ch. 1, introductory note at 93. The *Draft Restatement* represents a siguificant departure from the prior *Restatement,* which contemplated that balancing interests would not be a jurisdictional prerequisite, but merely an "act of good faith in moderating enforcement of jurisdiction authorized by law." *Id.* § 403 reporters' note 10. The *Draft Restatement* claims that the reasonableness requirement is a "principle of international law." *Id.* § 403 comment a. Several implications necessarily follow if reasonableness is a rule of international, rather than domestic, law. For instance, the judgments of courts that lack jurisdiction will not be recoguized by other jurisdictions. Thus, judgments can be attacked collaterally on grounds of unreasonableness. Also, if American courts render judgments without jurisdiction, other nations may deny enforcement assistance and promulgate retaliatory legislation. If jurisdiction exists under international law in a specific case, such acts are not justified. 58 ALI PROC. 263-64 (1981).

The *Draft Restatement* cites no legal systems other than the United States that purport to adhere to a reasonableness approach. Rather, it refers to the tensions caused by conflicting claims to jurisdiction as a basis in international custom for such an approach. Although other nations have objected to "unreasonable" American claims to jurisdic-

framework of this balance is designed to detect when the U.S. interests in the 'foreign' dispute are too weak—and the interests of restraint from extending our substantive law to judge that dispute too strong—making assertion of jurisdiction inappropriate."[68] The goal of the reasonableness requirement is an increased sensitivity to the regulatory interests of other states.[69] The requirement reflects a growing awareness that zealous extraterritorial application of American regulation can damage American interests in several ways. First, in the words of the drafters, "[c]onflict between regulations of two states places the persons regulated in an intolerable situation."[70] Different systems of securities regulation use different methods to pursue different goals.[71] Consequently, an issuer, investor, or broker-dealer with international dealings may be caught between two conflicting regulatory systems.[72] The risk of dual regulation may deter foreign parties from doing business with Americans.[73]

Second, claims to jurisdiction that other nations perceive as extravagant may provoke retaliatory legislation. In 1980 the United Kingdom adopted a statute empowering the Minister of Trade to direct British subjects to disregard the laws or court orders of other countries to the extent they purport to apply extraterritorially. This statute was a direct response to aggressive application of the "effects" doctrine in American courts.[74] Similarly, a bill currently pending before the Canadian Parliament would allow the Canadian

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tion, they may not have recognized such a limit on their own jurisdiction. Thus, courts should not consider the reasonableness requirement a matter of international law, but one of statutory construction.

68 Timberland Lumber Co. v. Bank of Am., 574 F. Supp. 1453, 1464 (N.D. Cal. 1983), *aff'd*, 749 F.2d 1378 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3514 (1985).

69 The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1972). *See also* Scherk v. Alberto-Culver Co., 417 U.S. 506, 517 n.11 (1974) ("To determine that 'American standards of fairness' . . . must nonetheless govern the controversy demeans the standards of justice elsewhere in the world, and unnecessarily exalts the primacy of United States law over the laws of other countries.").

70 DRAFT RESTATEMENT, *supra* note 3, § 403 comment d.

71 Willoughby, *Remarks by an English Solicitor*, PERSPECTIVES ON THE EXTRATERRITORIAL APPLICATION OF U.S. ANTITRUST AND OTHER LAWS 58 (J. Griffin ed. 1979) ("Difficulties arise when broad claims to jurisdiction coincide with material variations in substantive law, and nowhere is this circumstance more apparent than in the fields of antitrust law and securities regulation.").

72 Indeed, the laws of one state may demand conduct that violates those of another. *See SEC To Hold Hearing On German Fund's Plan To Sell Shares to U.S. Investors*, 15 SEC. REG. & L. REP. (BNA) No. 19, 922 (May 13, 1983) [hereinafter cited as *SEC To Hold Hearing*].

73 Widmer, *supra* note 4, at 41.

74 When the statute was introduced in Parliament, the British Secretary of State for Trade cited the application of "this pernicious extraterritorial 'effects' doctrine" to antitrust and securities cases. Blythe, *The Extraterritorial Impact of the Antitrust Laws: Protecting British Trading Interests*, 31 AM. J. COMP. L. 99, 109 (1983) (citing statement of Secretary of State for Trade, Mr. John Nott).

government to order reductions in "excessive" awards by foreign courts and to order Canadian companies not to comply with foreign regulations.[75] France, West Germany, Australia, The Netherlands, and South Africa have also enacted defensive legislation.[76] Thus, increased internationalization of markets has led to increased regulatory nationalism.[77] The consequences of such nationalism become more troublesome as the international market grows. As a result, regulators and courts must nationalize the allocation of jurisdiction.

Under the *Draft Restatement,* concurrent claims to jurisdiction may exist because section 403(2) does not require a court to determine whether American jurisdiction is *the most* reasonable. However, the reasonableness requirement minimizes such situations. One court stated, "This examination . . . satisfies the prohibition of international law against unreasonable assertions of prescriptive jurisdiction . . . [and] assures that concurrent jurisdiction will never be lightly assumed."[78]

III

EVALUATING REASONABLENESS OF JURISDICTION UNDER *DRAFT RESTATEMENT* SECTION 403

Section 403 of the *Draft Restatement* provides a list of factors that affect the reasonableness of jurisdiction. However, the *Draft Restatement* provides little guidance to courts on how to apply the factors. The *Draft Restatement* does not assign weight to the various factors, nor does it explain what combinations of factors should make jurisdiction unreasonable. Ad hoc balancing of the numerous factors in section 403 could result in increased uncertainty as to the extraterritorial scope of American regulation and more frequent application of American law to transactions with substantial foreigu elements. One court commented that no court applying a similar jurisdictional test in the antitrust context had declined jurisdiction when the United States had more than a "de minimis" interest.[79] Furthermore, the complexity of the section 403 analysis could deter courts

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75 *Canadian Government Sponsors Bill To Address Extraterritoriality Issue,* [Jan.-June] ANTITRUST & TRADE REG. REP. (BNA) No. 1168, at 1106 (June 7, 1984).

76 DRAFT RESTATEMENT, *supra* note 3, part IV, ch. 1 introductory note, at 91 & n.8. *See also* Current Developments, *The 1980 French Law on Documents and Information,* 75 AM. J. INT'L L. 382 (1981) (discussing French law raising barriers to discovery).

77 *See* Thomas, *Extraterritorial Application of United States Securities Laws: The Need For A Balanced Policy,* 7 J. CORP. L. 189, 190 (1982) (antagonism and alienation of other nations in response to aggressive assertions of American regulation may "impede the free flow of capital" and lessen prospects for international cooperation).

78 Laker Airways Ltd. v. Sabena, 731 F.2d 909, 952 n.169 (D.C. Cir. 1984).

79 *Id.* at 950-51.

from adopting the *Draft Restatement*'s approach or impede the manageability of litigation.

The goals of the *Draft Restatement* may be enhanced at minimal cost to judicial efficiency by assigning a more structured and limited role to the section 403(2) reasonableness inquiry. Such an analysis should devote primary consideration to the factors that comprise the traditional jurisdictional analysis under the conduct and effects tests. When these factors do not clearly favor asserting or declining jurisdiction, courts should make two further inquiries: an assessment of the degree of conflict between the relevant legal systems,[80] and an evaluation of the interests of the "international system."[81] Recognizing situations in which jurisdiction is presumptively unreasonable would enhance further the utility and manageability of this analysis.

A. Section 403 and Traditional Jurisdictional Analysis

In making jurisdictional determinations courts should rely first on the conduct and effects tests largely as developed by the Second Circuit.[82] This analysis would generally provide a reliable indicator of the extent of American interests in regulating a transaction. When a transaction does not take place in, or affect, the American marketplace, the United States should forbear expending regulatory resources. The Second Circuit's conduct and effects analysis also serves the *Draft Restatement*'s goal of sensitivity to other nations' interests because it recognizes that the extent of domestic conduct and effects must be balanced with the conduct and effects that occur abroad. Finally, the courts have had little difficulty examining these concerns. According such a role to the conduct and effects tests does not reject the section 403 reasonableness requirement. Rather, it recognizes the primary significance of certain section 403 factors in the securities context.

1. *Balancing Conduct and Effects*

The Second Circuit's balancing of domestic and foreign conduct is reflected in two section 403 factors: "the extent to which the activity takes place within the regulating state,"[83] and the "extent to which another state may have an interest in regulating the activ-

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80 *See infra* notes 102-28 and accompanying text. This assessment concerns factors (c), (g), and (h) of § 403. *See supra* note 66.

81 *See infra* notes 131-71 and accompanying text. This evaluation concerns factors (d), (e), and (f) of § 403. *See supra* note 66.

82 *See supra* notes 19-45 and accompanying text.

83 DRAFT RESTATEMENT, *supra* note 3, § 403(2)(a)(i).

ity."[84] The nation where most of a transaction occurs is likely to be the most interested in regulating that conduct. The *Draft Restatement*'s version of the conduct test does not require that the transaction be predominantly domestic, but if domestic conduct is less siguificant than activities in another nation, jurisdiction is unlikely to be reasonable.

Section 403 tradition may, however, expand the Second Circuit's version of the effects test. Under section 403(2)(a)(ii), "the extent to which the activity . . . has substantial, direct and foreseeable effect upon or in the regulating state" bears on the reasonableness of jurisdiction.[85] These effects include the generalized type that the Second Circuit found inadequate by themselves to support jurisdiction in *Bersch*.[86] The court held that such effects alone would not support jurisdiction under the traditional effects test, noting, however, that they seriously implicated American regulatory interests.[87] They should therefore be relevant to a jurisdictional inquiry that focuses on such interests rather than on territoriality. Finally, under section 403(2)(g), which requires consideration of the interests of other states in regulating the activity, courts should apply the effects test relative to other nations' interests. If another nation is the primary place of impact of the fraud, its regulatory interests are stronger than those of the United States. Thus, the *Draft Restatement*'s treatment of the effects test goes further than the holdings of the Second Circuit. However, if not supported by judicial authority, it is based on the same policies that the courts have cited in applying the traditional doctrines.

2. *Links Between the Regulating State and the Parties*

Under section 403(2)(b), ties of nationality, residence, and economic activity between the regulating state and the defendants or plaintiffs are relevant to the reasonableness of jurisdiction. Courts have considered these factors when applying the traditional conduct and effects tests. Significant policies support consideration of the defendant's links. However, the plaintiff's links are relevant only because they can be a source of domestic effects. Consequently, courts should not give independent weight to the plaintiff's links in

84 *Id.* § 403(2)(g).

85 *Id.* § 403(2)(a)(ii).

86 Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987-88 (2d Cir.), *cert. denied sub nom.* Bersch v. Arthur Andersen & Co., 423 U.S. 1018 (1975). In *Bersch* the fraud caused foreign investors to lose confidence in American markets and in offshore funds and damaged the American balance of payments, the prices of American securities in general, and the ability of American corporations to raise capital abroad.

87 *Id.* at 989.

the jurisdictional analysis but should only consider them under the analysis of effects.

a. *Links Between the Defendant and the Regulating State.* Courts should accord relevance to the defendant's links with the regulating state for three reasons. First, if a defendant resides in or has substantial economic links to the United States, its securities fraud may implicate a wide range of domestic regulatory interests, as in *Bersch*.[88] In addition, if the defendant is a citizen of the regulating state, the "nationality" principle of international law strengthens the argument for jurisdiction. Although this principle is disfavored as an independent jurisdictional basis,[89] when sufficient domestic conduct or effect exists, the United States citizenship of the defendant may make exercise of jurisdiction more compelling. The Second Circuit recoguized in *Cornfeld* that the "American nationality of the issuer . . . points strongly toward applying the anti-fraud provisions of our securities laws."[90] Similarly, the *Bersch* and *Fidenas* courts stated that the defendant's identification with another country weighs against a finding of jurisdiction.[91]

Second, other nations may feel there is a greater infringement on their sovereignty when American regulations are applied to their resident citizens than when applied to Americans acting abroad. American securities fraud provisions do not merely compensate plaintiffs but also seek to encourage certain patterns of behavior. Foreigu states may object to the imposition of American goals on their citizens.

Finally, the defendant's links can be the basis for justified expectations by the parties that American regulation will or will not govern their transaction.[92] This concern merely supports the analysis of section 403(2)(d), which suggests consideration of "the existence of justified expectations that might be protected or hurt by the regulation in question."[93]

b. *Links Between the Plaintiff and the Regulating State.* The *Draft Restatement* considers the plaintiff's ties to the regulating state relevant to the jurisdiction inquiry.[94] However, the only independent

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88 *See supra* note 86 and accompanying text.

89 *See supra* note 64.

90 IIT v. Cornfeld, 619 F.2d 909, 918 (2d Cir. 1980). *See also* RESTATEMENT OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965) (nationality is factor in deciding to exercise enforcement jurisdiction).

91 *Bersch,* 519 F.2d at 987; Fidenas AG v. Honeywell Inc., 501 F. Supp. 1029, 1041 (S.D.N.Y. 1980).

92 *See Cornfeld,* 619 F.2d at 921 n.13 (citing Note, *American Adjudication of Transnational Securities Fraud,* 89 HARV. L. REV. 553, 570 (1976)); *Bersch,* 519 F.2d at 992 (identification of defendant with foreign nation militates against jurisdiction).

93 DRAFT RESTATEMENT, *supra* note 3, § 403(2)(d).

94 Fidenas AG v. Honeywell Inc., 501 F. Supp. 1029, 1041 (S.D.N.Y. 1980).

justification for a distinction between nonresident citizens and aliens is the "passive personality" principle of jurisdiction.[95] According to this principle of international law, jurisdiction is justified solely on the basis of the plaintiff's nationality.[96] Courts and commentators have criticized the principle because it "means that the citizen of one country, when he visits another country, takes with him for his 'protection' the law of his own country and subjects those with whom he comes into contact to the operation of that law, [violating the] principle that a person visiting a foreign country falls under the dominion of the local law."[97] In light of the disfavor of the passive personality principle,[98] courts should consider the plaintiff's citizenship relevant to the reasonableness of jurisdiction only to the extent that it relates to a finding of domestic effects.[99] As the Eighth Circuit recognized in *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds,*[100] other links between the plaintiff and the regnlating state, such as residence and economic activity, are also relevant to a finding of domestic effects.[101] However, they also should not be considered for other purposes.

An evaluation of the reasonableness of jurisdiction should thus

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95 The Eighth and Ninth Circuits have questioned the constitutionality of a distinction between such plaintiffs. *See* Grunenthal GmbH v. Hotz, 712 F.2d 421, 426 n.9 (9th Cir. 1983); Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, 592 F.2d 409, 418 n.14 (8th Cir. 1979). The basis of the constitutional question is that alienage is a semi-suspect classification, the use of which is barred by the equal protection clause in the absence of a substantial state interest. U.S. CONST. amend. XIV. *See* J. NOWAK, R. ROTUNDA & J. YOUNG, CONSTITUTIONAL LAW 686 (2d ed. 1983); Note, *supra* note 92, at 569 n.95. However, it is doubtful that equal protection concerns constrain jurisdictional analysis in this manner. The equal protection clause bars any state from denying "to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV. In Plyler v. Doe, 457 U.S. 202, 212-13 (1982), the Supreme Court stated that for equal protection purposes, jurisdiction encompasses control over all persons within the territory of the United States. Thus, a nonresident alien is probably not entitled to equal protection guarantees. Even if the equal protection clause applies, the government has a sufficient interest in distinguishing between nonresidents based on citizenship to satisfy the constitutional standard. *See* J. NOWAK, R. ROTUNDA & J. YOUNG, *supra* at 687-88 (merely rational basis required for federal distinctions based on alienage that bear some relationship to foreign relations).

96 *See* DRAFT RESTATEMENT, *supra* note 3, § 402 comment e.

97 Case of the S.S. "Lotus" (Fr. v. Turk.), 1927 P.C.I.J., ser. A, No. 10, at 92 (Judgment of Sept. 7).

98 Laker Airways Ltd. v. Sabena, 731 F.2d 909, 935 (D.C. Cir. 1984); DRAFT RESTATEMENT, *supra* note 3, § 402 comment e; *see also id.* § 402 comment b.

99 Thus, "protection of a United States national residing abroad may not, without some additional factor, warrant exercise of regulatory jurisdiction by the United States" because too much reliance on this factor would be an application of the passive personality principle. DRAFT RESTATEMENT, *supra* note 3, § 416 reporters' note 3.

100 592 F.2d 409 (8th Cir. 1979).

101 *Continental Grain,* 592 F.2d at 420 ("the absence of a domestic plaintiff, domestic securities, or the use of a national securities exchange, in short the absence of a domestic impact or effect").

begin with application of the Second Circuit's pre-*Draft Restatement* analysis. Under this approach, courts should recognize that a finding of "substantial" American conduct or effects requires consideration of both foreign and domestic implications and of the defendant's citizenship. If the transaction's "center of gravity" is clearly domestic, courts should presume that no state's interest in regulating the transaction is as compelling as that of the United States.

B. Balancing National Interests

If two or more states have a substantial nexus to a transaction, the *Draft Restatement* recommends that courts make jurisdictional determinations "by evaluating the respective interests of the regulating states in light of the criteria set forth in § 403(2)."[102] This jurisdictional evaluation assesses the strength of each state's interests by examining the extent of the conflicting regulatory systems, their similarities to the systems of other nations, and their relationship to the needs of the international system.[103]

Other nations' securities laws may differ from United States securities regulation in several respects. For example, actions under rule 10b-5 are closely associated with the class action and derivative suit, procedural devices not necessarily accepted abroad.[104] Many nations consider class actions, contingency fees, and liberal discovery rules representative of an American pro-plaintiff bias.[105] Furthermore, many nations do not share the substantive principles of American securities law antifraud rules. Some, for instance, do not recognize a cause of action for an omission to state a material fact.[106] Foreign plaintiffs may have to prove affirmatively that their

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102 DRAFT RESTATEMENT, *supra* note 3, § 403 comment d.

103 *Id.*

104 In Canada, only the province of Quebec permits class actions. Taylor & Head, *Representing Collective Interests: A Comparative Synopsis,* 58 J. URB. L. 587, 595 (1981). The Canadian federal courts and the courts of the other provinces recognize only "representative actions." *Id.* at 592. A "representative action," while providing a mechanism for group litigation, "may not be brought for recovery of money damages." *Id.* British law is similarly limited. Civil code countries generally reject the concept of private rights of action, relying instead on public officials to represent collective interests. *Id.* at 599-603. Derivative suits are more widely permitted but still are not recognized in some nations. *See, e.g.,* 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION 8-41 (H. Bloomenthal ed. 1985) (no derivative suits in Netherlands) [hereinafter cited as INTERNATIONAL CAPITAL MARKETS].

105 Piper Aircraft Co. v. Reyno, 454 U.S. 235, 252 n.18 (1981). *See also* British Airways Bd. v. Laker Airways Ltd., [1984] 3 W.L.R. 413, 419 (H.L.) ("civil procedure in the federal courts of the United States . . . seems to any English lawyer strange and, indeed, oppressive upon defendants").

106 In the United Kingdom, omissions are apparently only actionable when a prospectus omits a statutory requirement under § 38(4) of the 1948 Companies Act. *See* 10A INTERNATIONAL CAPITAL MARKETS, *supra* note 104, at 6-44. Swiss law has a similar

losses were caused by the defendant's misrepresentation,[107] whereas under American securities law courts may presume causation.[108] Finally, in the United States the statute of limitations applicable to securities fraud is much more lenient than that in many other nations.[109]

The substantive differences between legal systems are particularly apparent in the regulation of insider trading. In the United States, rule 10b-5 and sections 16(b) of the Securities Exchange Act of 1934 are used to regulate trading on inside information.[110] In Europe legislation regarding the improper use of inside information exists only in the United Kingdom and France.[111] The French statute barring insider trading is rarely enforced,[112] largely because "such activities were a tradition on the part of the most respectable directors and officers, and . . . tipping was even a social duty, being expected of relatives and friends."[113] Similarly, one commentator has referred to insider trading as "virtually legal" in the United

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provision. *See International Securities Project,* 30 BUS. LAW. 585, 641 (1975). In Germany omissions only give rise to a cause of action if the omission takes place in a "listing" prospectus or in the sale of shares by an investment company. Otherwise, a deceptive or misleading representation is required. *Id.* at 664-65. *Cf.* 5A A. JACOBS, THE IMPACT OF RULE 10B-5 § 61 (revised ed. 1980) (American standards of what constitutes material omission).

107 France, for instance, requires the plaintiff to show that his damages are "actual and certain, personal to the plaintiff, and a direct consequence of the crime." 10A INTERNATIONAL CAPITAL MARKETS, *supra* note 104, at 7-33. Swiss law also requires that the plaintiff prove causation. *International Securities Project, supra* note 106, at 641.

108 5 A. JACOBS, *supra* note 106, § 64.

109 5C A. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10B-5, at 10-8 (2d ed. 1985) (statute of limitations for rule 10b-5 is that which local state applies to common law fraud actions). Netherlands law provides a six month statute of limitations for an action for omissions or misstatements in a prospectus. *International Securities Project, supra* note 106, at 629. German law applies the same statutory period to actions against investment companies. *Id.* at 665.

110 *See, e.g.,* Dirks v. SEC, 463 U.S. 646 (1983) (discussing application of rule 10b-5 to insider trading activities).

111 Cruickshank, *Insider Trading in the EEC,* 10 INT'L BUS. LAW. 345, 346 (1982). *See also* Briner, *Insider Trading in Switzerland,* 10 INT'L BUS. LAW. 348 (1982) (Switzerland has no legislation on insider trading). *See generally* MULTINATIONAL APPROACHES—CORPORATE INSIDERS (L. Loss ed. 1975).

112 In the four years following adoption of the statute, the French administrative body responsible for regulation of securities trading, the Commission du Bourse (COB), undertook 105 inquiries into possible insider trading. Of these, the COB referred only seven cases to the public prosecutor for enforcement. MULTINATIONAL APPROACHES—CORPORATE INSIDERS, *supra* note 111, at 50. In 1979 the COB transmitted four cases to the public prosecutor and the criminal court of Paris returned convictions in two cases. Macqueron, *Developments in French Law on Disclosure and Trading of Securities,* 5 J. COMP. BUS. & CAP. MARKET L. 71, 74 (1983). As a result, it is unlikely that in an actual instance of insider trading, an aggrieved shareholder would have a criminal conviction on which he could predicate a civil action, which provides victims of crimes with a right to damages, 10A INTERNATINAL CAPITAL MARKETS, *supra* note 104, at 7-32.

113 Tunc, *A French Lawyer Looks at American Corporation Law and Securities Regulation,* 130 U. PA. L. REV. 757, 762 (1982).

Kingdom.[114] In Germany insider trading is regulated by a nongovernmental Board of Inquiry organized by industrial and trade associations.[115] Sanctions are imposed only by the affected corporation, on recommendations by the Board.[116] Rule 10b-5 has also been used as a general prohibition on wrongful corporate conduct. While other nations may closely regulate the actions of officers and directors, their statutes generally do not confer rights on shareholders to enforce such duties.[117]

The differences in securities regulation among nations are not accidental but reflect differing regulatory philosophies. The United Kingdom, France, and Belgium, for instance, rely on direct regulation of internal corporate dealings to protect investors,[118] rather than on affirmative disclosure and creation of private rights. Consequently, these states are less likely to define nondisclosure as fraud and may prefer criminal sanctions to private rights.[119]

The less rigorous disclosure requirements of other nations may reflect different market conditions. For instance, France has avoided increased disclosure requirements for fear of discouraging enterprises from entering capital markets.[120] Many foreign businessmen fear that disclosure of trade information will aid their competitors.[121] Furthermore, one commentator noted that "[f]oreign

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114 10 INTERNATIONAL CAPITAL MARKETS, *supra* note 104, at 1-90. *See also* MULTINATIONAL APPROACHES—CORPORATE INSIDERS, *supra* note 111, at 236.

115 MULTINATIONAL APPROACHES—CORPORATE INSIDERS, *supra* note 111, at 60.

116 *Id.* at 62.

117 In France, article 244 of the 1966 Act on Commercial Companies makes the administrator of a company liable for losses due to his negligence in management, or violation of statutes or regulations. However, for various reasons, this provision has not to date been used to enforce securities laws. 10A INTERNATIONAL CAPITAL MARKETS, *supra* note 104, at 7—32. In England, "[t]here are general . . . duties imposed on directors, which can include securities fraud", e.g. issuing shares for an improper purpose. Shareholders' rights, though, are solely derivative. *Id.* at 6-50. In addition, suits to enforce these rights are rare, occurring if at all on the insolvency of the company. Knauss, *Securities Regulation—A Comparison of Practice and Purpose,* 62 AM. SOC. INT'L L. PROC. 131, 138 (1968). In Belgium, "[s]hareholder action against directors . . . for improper activity . . . is practically nonexistant." *Id.*

118 *See* Knauss, *supra* note 117, at 131; Knauss, *Securities Regulation in the United Kingdom: A Comparison with United States Practice,* 5 VAND. J. TRANSNAT'L L. 49, 53-60, 97 (1971) (British securities regulation is more concerned with "men behind the companies and the 'integrity of management' " than with full disclosure).

119 *See* 10A INTERNATIONAL CAPITAL MARKETS, *supra* note 104, at 7-29 ("The characteristic feature of [French] securities laws . . . is the basic policy decision to favor the use of criminal sanctions.").

120 Note, *Disclosure Requirements in France: Problems in the Development of Effective Securities Regulation,* 12 VA. J. INT'L L. 358, 363 (1972).

121 H. STEINER & D. VAGTS, TRANSNATIONAL LEGAL PROBLEMS 1048 (1976). While a similar fear was voiced in the United States prior to the passage of the Securities Act, "an American firm knows that its competitors are bound to equal disclosure requirements . . . . A corporation in, say, Germany may be reluctant to reveal information that its competitors in Italy can conceal." *Id.* at 1048-49.

business firms inherit a longer and more pervasive tradition of 'secrecy'—a tradition hostile to the notion that a privately-owned company's affairs are properly the public's concern."[122] Finally, European investors rely more heavily on informal communications and are generally considered more informed and able to make investment judgments than the American investment community.[123] As a result, issuer disclosure receives less emphasis, and the investor has primary responsibility to gain access to investment information.

Different nations have adopted different regulatory mechanisms, reflecting varying goals, strategies, and market conditions. Courts cannot presume that because all nations oppose fraud the likelihood of regulatory conflict is minimal.[124] Such an approach conflicts with the *Draft Restatement*'s goal of increased sensitivity to conflicting national policies. Instead, the *Draft Restatement* requires an evaluation of the conflicting national interests and policies involved in the jurisdictional determination.

Where conflicts exist, courts should consider jurisdiction less reasonable because the other nation is more likely to object to imposition of American regulations and regulatory goals. The courts should not need to engage in such an analysis, however, if American interests are clearly compelling under the conduct and effects tests. In such a case, American jurisdiction will be reasonable even if policies directly conflict. Even if the traditional analysis does not produce a clear result, evaluation of interests should not become a normative inquiry into other nations' regulatory systems or an assessment of the significance those states accord to specific legisla-

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122 *Id.* at 1048.

123 *Id.* While we may see this lack of public participation in the market as a problem to be cured through regulation, such a choice as to the desired nature of securities markets is precisely the sort that should be made by the government most affected. *See also* Widmer, *supra* note 4, at 40. In the Federal Republic of Germany investments usually are made only after considerable investigation. Furthermore, the stock market has limited volatility and speculative forms of investment are scarce. Thus, Germany has less need for American-type disclosure requirements. Krauss, *Securities Regulation in Germany? Investors' Remedies for Misleading Statements by Issuers*, 18 INT'L LAW. 109, 124-25 (1984).

124 SEC v. Kasser, 548 F.2d 109, 116 (3d Cir.) (enforcement of antifraud provisions extraterritorially will cause favorable reciprocal responses by other nations), *cert. denied sub nom.* Churchill Forest Indus. Ltd. v. SEC, 431 U.S. 938 (1977); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 989 (2d Cir.) (same), *cert. denied sub nom.* Bersch v. Arthur Andersen & Co., 423 U.S. 1018 (1975); *see also* Grunenthal GmbH v. Hotz, 511 F. Supp. 582, 587 n.7 (C.D. Cal. 1981) (rejecting need for evaluation of interests of other nations on ground that "every civilized nation doubtless has this [rule against fraud] as part of its legal system"), *rev'd on other grounds*, 712 F.2d 421 (9th Cir. 1982); Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1399 (1973).

Indeed, the laws of one state may directly contradict the laws of another. For instance, German law shields individuals associated with a mutual fund from some liabilities that American law would affirmatively impose. *See SEC To Hold Hearings, supra* note 72, at 922.

tion. Analysis at these levels would require courts to perform an essentially political function.[125] Instead, courts merely should ascertain the extent of conflict between the laws and policies of different nations.

Because the policy goals of securities laws cannot be reduced to simple propositions, courts should guard against overlooking important foreign regulatory interests. As one commentator noted, in balancing interests, "the courts [improperly] focus on the national interests reflected [only] in the local laws in conflict, ignoring internal systemic interests."[126] Indeed, even the absence of regulation by another state may reflect "definite policies concerning the character of its commercial climate," according to the Ninth Circuit.[127]

Courts should presume that the more the relevant national interests and policies conflict, the more another state will perceive American regulation as an affront to its power to determine its own regulatory goals.[128] A finding that a high level of conflict exists should require a greater showing that other factors favor American regulation. On the other hand, if there is little conflict, courts should be more willing to apply American law.

C. The Needs of the International System

A second level of analysis that courts should undertake when traditional analyses do not indicate a clearly compelling American or foreign interest is an assessment of the traditions and goals of the

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125 *See, e.g.*, Laker Airways Ltd. v. Sabena, 731 F.2d 909, 949 (D.C. Cir. 1984) (court is not "qualified to evaluate comparatively nor capable of properly balancing" such "purely political factors"); *In re* Uranium Antitrust Litigation, 480 F. Supp. 1138, 1148 (N.D. Ill. 1979) (court has "little expertise . . . to evaluate the economic and social policies of a foreign country").

126 Maier, *Interest Balancing and Extraterritorial Jurisdiction*, 31 AM. J. COMP. L. 579, 591 (1983). For instance, in one case in which the SEC sought information from a Swiss bank, the district court concluded that the relevant foreign interest was maintaining a secret bank account, rather than guaranteeing "confidentiality in order to encourage beneficial local economic activity." *Id.* at 592; SEC v. Banca della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981). Other courts, however, have been more sensitive to the policies of other nations. *See, e.g.*, Timberlane Lumber Co. v. Bank of Am., 749 F.2d 1378 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3514 (1985). Courts also should not interpret one state's choice not to regulate a specific area as an indication that no conflict exists between its policies and those of the United States.

127 Timberlane Lumber Co. v. Bank of Am., 749 F.2d 1378, 1384 (9th Cir. 1984) (antitrust), *cert. denied*, 105 S.Ct. 3514 (1985).

128 This presumption should not be subject to rebuttal through drawn-out litigation but only through a declaration by the other nation that American law would further its interests as well. The Ninth Circuit used this approach in a recent tax case in which the American corporate taxpayer was charged with using a Swiss subsidiary for tax avoidance purposes. United States v. Vetco, Inc., 644 F.2d 1324 (9th Cir. 1981). In upholding the enforcement of a summons to produce documents, the Ninth Circuit cited an affidavit from the Swiss government disclaiming a strong Swiss interest in the outcome of the case. *Id.* at 1331.

international business community. One commentator has noted the "lack of agreed upon [substantive] values and purposes in the international community"[129] and so concluded that the only goals that courts should take into account in determining jurisdiction are the "process goals" of predictability and uniformity of result.[130] However, in the context of international markets, many regulatory systems give greater deference to party autonomy and to the expectations of the parties than in the domestic context. This substantive value furthers the process goals of predictability and uniformity of result. Under this analysis, if a securities transaction spans several nations and does not have its "center of gravity" in one market, a court should determine whether the parties expected the protection of American securities laws.

1. *Explicit Indications of the Parties' Expectations*

Section 29(a) of the Securities Exchange Act of 1934 provides that "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."[131] This section generally bars any provision in securities transactions for arbitration of disputes.[132] However, in *Scherk v. Alberto-Culver Co.*[133] the Supreme Court held that section 29(a) does not bar arbitration clauses in international transactions. The Court balanced the section 29(a) goal of investor protection against the interests of the United States in encouraging "the willingness and ability of businessmen to enter into international commercial agreements"[134] and found that in an international transaction, international goals outweighed the policies of the statutory anti-waiver provision.[135] In so finding, the Court noted that recoguition of the parties' expectations, as embodied in the arbitration clause, would further international commerce by enhancing

129 Maier, *Extraterritorial Jurisdiction at a Crossroads: An Intersection Between Public and Private International Law,* 76 AM. J. INT'L L. 280, 316 (1982).

130 *Id.* at 320.

131 15 U.S.C. § 78cc(a) (1982).

132 Ayers v. Merril Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532 (3d Cir.), *cert. denied,* 429 U.S. 1010 (1976).

133 417 U.S. 506 (1974).

134 *Id.* at 517.

135 The *Scherk* Court relied on The Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1970). The *Bremen* Court upheld a forum-selection clause in an international towage contract. According to the Court, "in an era of expanding world trade and commerce, the absolute aspects of the doctrine [denying effect to such clauses] would be a heavy hand indeed on the future development of international commercial dealings by Americans. We cannot have trade and commerce in world markets . . . on our terms, governed by our laws." *Id.* at 9.

"orderliness and predictability."[136]

In *AVC Nederland v. Atrium Investment Partnership*[137] the Second Circuit extended the scope of the international exception to section 29(a) by holding that choice of law and choice of forum clauses are permissible in international securities transactions as well as arbitration clauses.[138] The court noted that international transactions implicate " 'considerations and policies significantly different from those found controlling in [domestic settings].' "[139] The considerable uncertainty as to which law will govern and the potential for foreign orders enjoining United States proceedings contribute to the uniqueness of international transactions.[140] The *Nederland* court reduced the uncertainties of international transactions by allowing the parties to fix their expectations through a choice of law and forum clause.

The *Scherk* court noted, and the *Nederland* court recognized, that "situations may arise where the contacts with foreign countries are so insignificant or attenuated" that clauses stipulating the applicable law and forum will not be valid.[141] Neither case established clear standards for determining when foreign contacts are so insignificant that a stipulation should be ignored. However, each court based its holding on the "considerable uncertainty [that] existed at the time of the agreement . . . concerning the law applicable to the resolution of disputes arising out of the contract" in the absence of a choice of law and forum provision.[142] When the conduct and effects tests clearly resolve the jurisdictional inquiry, no uncertainty exists, and courts should not give effect to a selection of a foreign forum and law. The concern for uncertainty is not relevant in cases with few foreign contacts because the parties should expect that, absent a stipulation clause, only an American court can settle any controversy arising out of the transaction, under American law. The only justification for a choice of law and forum clause in such a case would be to avoid American law, rather than to clarify the applicable law.[143]

Courts should not apply an objective test in evaluating the com-

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136 417 U.S. at 516.

137 740 F.2d 148 (2d Cir. 1984).

138 *Id.* at 155-59.

139 *Id.* at 157 (citing *Scherk*, 417 U.S. at 515).

140 *Id.* at 157-58 (citing *Scherk*, 417 U.S. at 516).

141 *Scherk*, 417 U.S. at 517 n.11; *Nederland*, 740 F.2d at 158-59.

142 *Nederland*, 740 F.2d at 157-58 (citing *Scherk*, 417 U.S. at 516); *see Scherk*, 417 U.S. at 515-16 (describing various difficulties and conflicts caused by uncertainty as to which law will govern transaction).

143 An additional limitation on the ability of parties to "contract out" of American securities law would of course be the unenforceability of a choice of law clause if the inclusion of "that clause was itself the product of fraud or coercion," *Nederland*, 740 F.2d

plex issue of whether an American court, absent the choice of law and forum clause, can clearly exercise jurisdiction. Rather, they should assess the likelihood that a party to the transaction realistically could have expected that an American court would adjudicate a conflict arising from the transaction.

2. *Implicit Expectations of the Parties*

American conflict of laws principles dictate that courts should give effect to a clear implication of the parties' intent if the parties do not stipulate governing law.[144] Other nations adhere to the same principles.[145] Since *Scherk* and *Nederland* drew on conflicts of law principles in recognizing the validity of a choice of law and forum clause, this principle as well should be made part of the jurisdictional analysis. Courts may infer intent in several situations. First, courts may draw inferences from the defendant's apparent association with one country. In *Bersch* the Second Circuit stated that if the public strongly associated a defendant with one country, a court of another nation would have more difficulty claiming jurisdiction.[146]

Declarations by defendants also could lead investors to believe that a security was essentially American and thus to expect the protection of American law. In *Finch v. Marathon Securities*[147] the defendant's prospectus stated that the offering was subject to United States securities regulations "to the extent that the subject matter of the agreement is within [their] purview."[148] Such statements could

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at 158 n.16 (citing *Scherk*, 417 U.S. at 519 n.14). Similarly, such a clause may not apply to a claim that the entire transaction was induced by fraud. *See id.* at 155.

144 A. EHRENZWEIG, CONFLICT OF LAWS 470 (1962); 1 RESTATEMENT (SECOND) CONFLICT OF LAWS § 187 (1971); H. GOODRICH, CONFLICT OF LAWS 204 (1964).

According to one commentator, "[m]uch of [conflicts] doctrine revolves around the catch-all of 'intent'—if the relevant intent is not reasonably clear from admissible evidence, it is derived from rules that are the result of a mixture of past experience, custom and policy." Katzenbach, *Conflicts on an Unruly Horse: Reciprocal Claims and Tolerances in Interstate and International Law*, 65 YALE L.J. 1087, 1124 (1956). *See also* Simson, *State Autonomy In Choice Of Law: A Suggested Approach*, 52 S. CAL. L. REV. 61, 64-65 (1978) ("[The Supreme] Court has appeared to concede that a choice of law that grossly upsets a party's justified expectations violates the due process clause . . . .").

145 The 1980 European Convention on the Law Applicable to Contractual Obligations gives effect not only to an express choice of law clause, but also to a reasonably certain expression of intent manifest in the circumstances of the case. Convention on the Law Applicable to Contractual Obligations, June 29, 1980, European Economic Community, art. III, para. 1, *reprinted in* III G. DELAUME, TRANSNATIONAL CONTRACTS appendix I, booklet A, at 52. *See also* Compagnie Tunisienne de Navigation v. Compagnie d'Argement Maritime [1971] 1 A.C. 572; Whitwoth St. Estates (Manchester) v. James Miller & Partners [1970] 1 A.C. 583.

146 *Bersch*, 519 F.2d at 986-87 (noting Rolls-Royce and its association with Britain as an example).

147 316 F. Supp. 1345 (S.D.N.Y. 1970).

148 *Id.* at 1348. Similarly, in Wandschneider v. Industrial Incomes, Inc., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,422 (S.D.N.Y. 1972), the defendant's

lead a court to conclude that the defendant sought to create an impression that American law would protect prospective investors. Consequently, courts should protect the imputed intent of the purchasers, while estopping the defendant from denying that he expected American law to govern the transaction.[149] When defendants seek to cloak their activities in an American aura, courts should consider that the reasonableness of asserting jurisdiction is enhanced.

Finally, the decision to structure a deal to avoid conduct within the United States may be based as on much on legal considerations as on a choice of law or forum clause.[150] If a transaction has been so structured, a court should show some deference to the parties' expectations, as manifested in their conduct. Thus, in *Plessey Co. v. General Electric Co.,* the district court found that the imposition of American tender offer regulations on a British corporation would "frustrate [its] legitimate expectations," because the company had deliberately structured its tender offer for another British company to avoid involving American shareholders.[151]

Considering the implicit expectations of the parties will enable courts to avoid one artificiality of the traditional conduct and effects

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prospectus mentioned American banks and emphasized that the issuing company was "regulated" by, and had filed with, the SEC and was a member of the American National Association of Securities Dealers. Only at the end of the prospectus did it mention that the instant transaction was not subject to such regulations. *Id.* One commentator has noted that "[i]n such a situation, the United States clearly has an interest in adjudicating claims against the defendants . . . in order to discourage other potential perpetrators of fraud from taking advantage of American resources and prestige . . . [and thus] protecting the integrity of American securities markets." Note, *supra* note 92, at 570-71.

149 *See* IIT v. Cornfeld, 619 F.2d 909, 921 (2d Cir. 1980) (defendants "with whom we are here concerned acted within the United States and cannot fairly object to having their conduct judged by its laws").

The estoppel analysis applies to suits against broker-dealers as well as suits against issuers. In Mormels v. Girofinance S.A., 544 F. Supp. 815 (S.D.N.Y. 1982), the court declined to apply rule 10b-5 to transactions involving a Costa Rican firm that had claimed to be an agent of E.F. Hutton, because the transactions took place entirely abroad and had no domestic effects. If the plaintiffs could have shown some domestic conduct or effects, jurisdiction would have been reasonable under the approach suggested by this Note because it would satisfy the goal of protecting justified expectations. The Costa Rican defendant sought to convey the impression that it was acting as an American broker and affirmatively created expectations on the part of its clients.

Courts should more readily uphold tbe plaintiff's justified expectations if he is less sophisticated than the defendant. The unsophisticated investor "justifiably places reliance on the good faith of the company . . . . His reasonable expectations in the transaction may not justly be frustrated and courts bave properly molded their interpretive principles with that uppermost in mind." Allen v. Metropolitan Life Ins. Co., 44 N.J. 294, 305, 208 A.2d 638, 644 (1965).

150 Note, *Extraterritorial Application of United States Laws: A Conflict of Laws Approach,* 28 STAN. L. REV. 1005, 1033 n.190 (1976).

151 Plessey Co. v. General Elec. Co., FED. SEC. L. REP. (CCH) ¶ 92,486 (D. Del. Jan. 16, 1986).

tests. The courts' reliance solely on the tests could encourage American corporations seeking to tap foreign capital markets to avoid activity in American territory and thus avoid the impact of rule 10b-5. Because the securities of American corporations will be "essentially American,"[152] investors may expect American law to govern the offering unless the issuer clearly disclaims the applicability of American law. If investor expectations favor applying American law, courts should find jurisdiction even if the conduct within American borders is "secondary." Conversely, if an American purchases foreign securities abroad, courts can infer that the investor did not expect the protection of American law.[153]

3. *Implicit Expectations and the "Internal Affairs Rule"*

Rule 10b-5 provides the basis for direct or derivative actions alleging breach of fiduciary duty.[154] When rule 10b-5 actions involve foreign corporations, courts generally uphold the expectations of the parties if they decline to find subject matter jurisdiction.[155] This approach is consistent with the "internal affairs rule" of conflict of laws, which requires courts to apply the law of the state of incorporation in suits involving internal corporate affairs.[156] In *First National City Bank v. Banco Para el Comercio,*[157] an

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

153 *Id.* at 1030-33.

154 *See* Goldberg v. Meridor, 567 F.2d 209, 217 (2d Cir. 1977) (10b-5 protects against "deception of the corporation . . . when the corporation is influenced by its controlling shareholder to engage in a transaction adverse to the corporation's interests"), *cert. denied,* 434 U.S. 1069 (1978). One particularly common type of breach of fiduciary duty under rule 10b-5 is insider trading. *See* Dirks v. SEC, 463 U.S. 646 (1983).

155 American courts should, of course, assert jurisdiction when a foreign issuer is American in practical effect, such as an American corporation's wholly-owned foreign subsidiary. *See Cornfeld,* 619 F.2d at 920.

156 R. LEFLAR, THE LAW OF CONFLICT OF LAWS 187 (1959).

The internal affairs of brokers, dealers, and banks are exempt from regnlation under § 30(b) of the Securities Exchange Act if they "transac[t] a business in securities without the jurisdiction of the United States." 15 U.S.C. § 78dd(b) (1982). *See generally* Hacker & Rotunda, *The Extraterritorial Regulation of Foreign Businesses Under the U.S. Securities Laws,* 59 N.C.L. REV. 643, 656-60 (1981). This exception applies only to regulations that govern ongoing business affairs. *Id.* at 644. Thus, Hacker and Rotunda argue, it is not applicable to rule 10b-5. *Id.* They claim further that it indicates congressional intent not to regulate the internal operations of foreign corporations. *Id.* at 657.

The special claim of the state of incorporation to regulate the relationship between a corporation and its shareholders is recognized under international law. The International Court of Justice, in Barcelone Traction, Light & Power Co. (Belg. v. Spain), 1970 I.C.J. 3 (Judgment of Feb. 5), held that Belgium lacked the capacity to assert a claim for compensation of its nationals, who were shareholders in a Canadian corporation, against Spain for violations of international law. Rather, "the general rule of international law authorizes the national state of the company alone to make a claim." *Id.* at 46. The court noted that by allowing more than one nation discretion to exercise this right, "an atmosphere of confusion and insecurity in international economic relations" would result. *Id.* at 49.

action against a Cuban bank, the Supreme Court stated that "the law of the state of incorporation normally determines issues relating to the *internal* affairs of a corporation"[158] and "[a]pplication of that body of law achieves the need for certainty and predictability of result while generally protecting the justified expectations of parties with interests in the corporation."[159]

The district court in *Schoenbaum v. Firstbrook*,[160] a derivative suit brought by the American shareholders of a Canadian corporation, also adhered to the internal affairs principle in refusing to find subject matter jurisdiction. The court stated that when a complaint "essentially alleges a breach of the directors' fiduciary duty," the liabilities in question should be determined under the laws of the state of incorporation unless the company is foreign in name only.[161] According to the court, this principle protects "the reasonable expectations of the parties" because the conduct of directors that is permissible under the laws of the state of incorporation should not be attacked under the law of a foreign state and because shareholders "can reasonably be presumed to have agreed that [their] relationship with the corporation is governed by the laws of the state of incorporation."[162]

The Supreme Court's opinion in *Santa Fe Industries, Inc. v. Green*[163] also supports the use of the internal affairs rule as a limit on the extraterritorial scope of the federal securities laws. The *Santa Fe* Court sharply limited the availability of rule 10b-5 to plaintiffs alleging violations of fiduciary duties, noting that actions to enforce the fiduciary duties of directors are more properly the province of state law.[164] Thus, the Court was "reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overriden."[165] The Court reasoned that

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157 462 U.S. 611 (1983).

158 *Id.* at 621.

159 *Id. See* RESTATEMENT (SECOND) CONFLICT OF LAWS § 302 comment e (1971) ("[a]pplication of the local law of the state of incorporation will usually be supported by those choice-of-law factors favoring the needs of the interstate and international systems, certainty, predictability and uniformity of result, [and] protection of the justified expectations of the parties").

160 268 F. Supp. 385, 392-93 (S.D.N.Y.), *aff'd*, 405 F.2d 200 (2d Cir.), *modified on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom.* Manley v. Schoenbaum, 395 U.S. 906 (1969).

161 *Id.* at 392. *See* IIT v. Cornfeld, 619 F.2d 909 (2d Cir. 1980) (asserting jurisdiction as to purchase of debentures of wholly owned subsidiary of American corporation).

162 268 F. Supp. at 392.

163 430 U.S. 462 (1977). *See generally* M. STEINBERG, CORPORATE INTERNAL AFFAIRS 196-97 (1983) (erudite discussion of *Sante Fe*).

164 430 U.S. at 477-80.

165 *Id.* at 479.

" '[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that . . . state law will govern the internal affairs of the corporation.' "[166] This reasoning is even more applicable to foreign corporations. Investors in foreign corporations are likely to be more aware of the nationality of the corporation than investors in American corporations are aware of the state of incorporation. Consequently, investors in foreign corporations are unlikely to assume that United States law governs the internal affairs of the corporation. Moreover, there is no apparent reason why transactions governed by foreign law should be more subject to federal securities regnlation than transactions governed by state law.[167]

Rule 10b-5 often provides a cause of action for suits seeking damages for one particular type of breach of fiduciary duty, trading on the basis of material nonpublic information. Application of the internal affairs rule to preclude United States jurisdiction over trading by insiders of foreign corporations does not conflict with any of the policies underlying the application of rule 10b-5 to such conduct. For instance, commentators have asserted that it is inherently unfair to allow insiders an advantage over public investors.[168] The internal affairs rule is consistent with this rationale. If American investors are less confident in the fairness of investment in foreign corporations, they will avoid investing in foreign firms; if foreign markets suffer as a result, foreign regnlators may provide correction. Commentators also claim that banning insider trading increases market efficiency by facilitating the flow of information to the public.[169] Again, nonapplication of American insider trading standards to foreign corporations will only affect the efficiency of those foreign markets that are more properly regnlated by others, while application of the standards to American corporations will increase their attractiveness to foreign investors.

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166 *Id.* (quoting Cort v. Ash, 422 U.S. 66, 84 (1975)) (emphasis added by Court).

167 Under *Santa Fe,* some claims for breaches of fiduciary duties remain valid under rule 10b-5 because of the need for a uniform federal law to govern entities which have "national investor constituencies and national economic significance." M. STEINBERG, *supra* note 163, at 197.

While in some cases, *see* Goldberg v. Meridor, 567 F.2d 209, 221 (2d Cir. 1977), the need for a federal regulatory scheme justifies "federalizing" the law governing the internal affairs of American corporations, it is arrogant to claim that the need for minimum international standards justifies " 'Americaniz[ing]' the corporation laws of the entire world." IIT v. Cornfeld, 462 F. Supp. 209, 225 (S.D.N.Y. 1978) (citing rationale of *Santa Fe* to support refusal to find subject-matter jurisdiction), *rev'd,* 619 F.2d 609 (2d Cir. 1979).

168 Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation,* 80 MICH. L. REV. 1051, 1051 (1982). *See also* Scott, *Insider Trading: Rule 10b-5, Disclosure, and Corporate Privacy,* 9 J. LEGAL STUD. 801, 805-09 (1980).

169 Haft, *supra* note 168, at 1051-52. *See also* Scott, *supra* note 168, at 809-14.

Finally, the "business property" rationale claims that inside information is corporate property "intended to be available only for a corporate purpose,"[170] and that prohibition of insider trading may enhance the efficiency of corporate decisionmaking.[171] These rationales focus exclusively on the injury to the corporation and not the trading public. Such "corporate governance" concerns are squarely within the purview of the internal affairs rule.

The principles of uniformity and protection of justified expectations which underlie the internal affairs rule are the same principles that American courts recognize as particularly appropriate in the context of international business transactions. The internal affairs rule is also consistent with the rationales underlying the prohibition of insider trading. Thus, this rule, as well as that recognizing choice of law clauses, should be a jurisdictional "per se rule" that is determinative of jurisdiction when the center of gravity of the transaction at issue is not clearly in any one nation. This approach enhances the predictability of results and respects the expectations of the parties.

CONCLUSION

If courts retain expansive jurisdictional rules based on territoriality rather than regulatory interest, the internationalization of the world securities markets will cause increasing conflicts between regulatory systems and enhance the uncertainties of engaging in international commerce. The *Draft Restatement* thus properly recoguizes that jurisdiction is more reasonable when it accounts for the interests of other nations and the interests of the participants in the international business community. The *Draft Restatement*'s approach, however, should not be interpreted to replace traditional jurisdictional rules based on territoriality with little more than an unstructured normative assessment. A better approach would be for courts to utilize the factors enumerated in section 403 to formulate new rules and presumptions.

A judicially manageable approach to reasonableness should begin with a determination of whether the United States is clearly the nation most implicated by the transaction, either because most of the relevant conduct occurred there or because most of the effects were felt there. If it is, jurisdiction should be presumptively reasonable. If the United States is not so clearly implicated, courts should determine whether a conflict in relevant regulatory policies or the expectations of the parties justify accepting or rejecting American

170 Haft, *supra* note 168, at 1052; Scott, *supra* note 168, at 814-15.

171 The presence of widespread insider trading would cause delay and distortion in transmission of information, and loss of internal cohesion, trust, and morale. Haft, *supra* note 168, at 1053-57, 1060-63.

jurisdiction. Finally, courts should not apply American law when the parties have explicitly selected the law of another country to govern their transaction, or when the claim relates to the internal affairs of a foreign corporation. This approach is consistent with the aims of the *Draft Restatement,* enhances judicial manageability and predictability, and precludes substitution of unstructured discretion for reasoned analysis.

David Michaels