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I. Introduction

Since December, 1968, the Department of Justice has prosecuted criminally, for violations of the margin regulations, two Swiss banks and a brokerage firm located in Montevideo, Uruguay, as well as two U.S. broker-dealers with which such foreign financial institutions maintained accounts.¹ In July, 1969, the Federal Reserve Board amended the provisions of the margin regulations upon which such prosecutions were based.² Additionally, extraterritorial effect has been given to various sections of the Securities Exchange Act of 1934,³ (hereinafter referred to as "Exchange Act") in a number of recent court cases.⁴ These developments have become a matter of concern to foreign financial institutions which deal in

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¹United States v. Weisscredit Banca Commerciale e D'Investimenti, Docket No. 70 Crim. 29 (S.D.N.Y.); United States v. Lerner, Docket No. 69 Crim. 431 (S.D.N.Y.); United States v. Arzi Bank, A.G., Docket No. 68 Crim. 1011 (S.D.N.Y.). The investigation of possible violations of law by U.S. citizens through foreign bank accounts has generated considerable publicity. E.g., Anderson, *Stock & Trade*, N.Y. Post, Jan. 7, 1970, at 50; Penn, *Cheating on Stocks—Federal Agents Close in on Wall Street Scheme to Evade Tax on Gains*, Wall St. J., Nov. 27, 1968, at 1, col. 6; Rustin, *Crackdown on Concealment—More Indictments Loom in U. S. Assault on Illicit Uses of Swiss Bank Accounts*, Wall St., J., April 23, 1969, at 38, col. 1; Sheehan, *More Americans Cheating with Swiss Bank Accounts*, N.Y. Times, Nov. 30, 1969, at 1, col. 8; *The Shennanigans of the Swiss Banks*, NEWSWEEK, Dec. 23, 1968, at 65. A critical response to such adverse publicity is contained in S. J. Rundt & Associates, *Assault on Privacy—U. S. Officials Ought to Stop Maligning Swiss Banks*, Barron's, Jan. 20, 1969, at 1.

²See notes 45-48, *infra*.

³15 U.S.C. § 78a, *et seq.*, as amended.

⁴Roth v. Fund of Funds, Ltd., 405 F.2d 421 (2d Cir. 1968) (*per curiam*), *cert. denied*, 394 U.S. 975 (1969); Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *cert. denied sub nom.* Manley v. Schoenbaum, 395 U.S. 906 (1969). See Goldman & Magrino, *Some Aspects of Securities Regulation: Towards a Re-evaluation of Section 30(b) of the Securities Exchange Act of 1934*, 55 VA. L. REV. 1015 (1969); Comment, *Extraterritorial Application of the Securities Exchange Act of 1934*, 69 COLUM. L. REV. 94 (1969).

American securities, because the question of whether, or to what extent, foreign financial institutions may be subject to the Exchange Act has been raised, but not satisfactorily answered.

The securities industry is developing along increasingly transnational lines, and a complicated combination of political and economic circumstances has led to an unprecedented use of foreign financial institutions for the financing of various types of transactions in American securities.⁵ Whether this situation is good or bad for the American economy is a political question which is beyond the scope of this article. However, it is a question to which reasonable and informed authorities could give different answers, and which different federal agencies are inclined to approach with different premises and different solutions.⁶ Furthermore, it is a question which affects American foreign policy, as well as the domestic economy.⁷

⁵Ball, *The Bond Americans Can't Buy*, FORTUNE, Sept. 15, 1968, at 69; Malabre, *Cash From Abroad—Foreign Investments in U. S. Rise Sharply After Long Drought*, Wall St. J., Nov. 27, 1968, at 1, col. 6; Mayer, *A Roundup of the World Economy*, FORTUNE, Sept. 15, 1968, at 23; *The Foreign Evasion*, FORBES, Feb. 1, 1969, at 55.

⁶See Haskins, *The Off-Shore Fund*, 8 COLUM. J. TRANSNATIONAL L., No. 1 (1969). The Treasury Department has favored a broad program to alleviate the balance of payments deficit by encouraging foreign investment in U. S. securities, which among other things, has resulted in the passage of the Foreign Investors Tax Act of 1966. Pub. Law No. 89-809, 89th Cong., 2d Sess., Tit. I (1966); S. Rep. No. 1707, 89th Cong., 2d Sess. (1966) 9. The SEC, on the other hand, has urged that foreigners be accorded substantially the same treatment as Americans under the Securities Acts. See, e.g., Brief for the SEC as *Amicus Curiae*, Schoenbaum v. Firstbrook, *supra* note 4; compare Report to the President of the United States from the Task Force on Promoting Foreign Investment in United States Corporate Securities and Increased Foreign Financing for United States Corporations Operating Abroad (1964) (hereinafter cited as "Fowler Report"), with Report of Special Study of Securities Markets of the Securities and Exchange Commission, Pt. 4, Ch.X, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963) (hereinafter cited as "Special Study"). The Federal Reserve Board shares the concerns of both the Treasury Department and the SEC, and accordingly has vacillated on the issue as to whether foreign financial institutions are subject to the margin regulations, see text at notes 49-53 *infra*, and has thus far avoided any position on the issue. See text at notes 47-48, *infra*. The public policy questions involved in this area are subtle and complex, and are unlikely to be resolved by the shibboleths of any one of the federal agencies. At least one critic has persuasively argued that the premises and recommendations of the Fowler Report and similar government pronouncements are politically biased and fail to strike at the heart of the balance-of-payments problem. Hynning, *Balance-of-Payment Controls by the United States*, 2 INT'L LAWYER 400(1968). Although there is reason to believe that foreign investment in U.S. securities is to some extent speculative in nature, *The Foreign Invasion*, *supra* note 5, and that tight money policies of the Federal Reserve Board curtail stock market speculation, Elia, *Brokers Say Fed Policy Will Cut Flow of Funds into Share Purchases*, Wall St. J., Mar. 14, 1968, at 1, col. 8, these views are based more on surmise than information. The recommendation by the SEC that foreign lenders should be subject to the margin regulations, *Special Study*, *supra* at 39, was based on virtually no information about the activities of such lenders, except for information acquired incidental to an investigation of factors. *Id.* at 30-32. The SEC's premise that foreign investors ought to be accorded the same protection as American investors is not necessarily shared by foreign states, which in any event would prefer to pass their own laws. See Securities Exchange Act Rel. No. 7867 (Apr. 21, 1966).

⁷See 21 Rec. Ass'n Bar of N. Y. 240 (April 1966).

Accordingly, the answer to this question, or even the context in which it is raised, should not be left to the discretion of the Department of Justice or a federal grand jury, as has been the case in recent criminal prosecutions, or to the accident of case law development in private lawsuits.

The objective of this article is to explore the legal issues, as well as certain practical problems, which should properly be considered before any of the provisions of the Exchange Act, but particularly the margin regulations, are applied to a foreign bank by a federal agency or court. Additionally, it is hoped that this article will be of assistance to private practitioners in advising clients who are either foreign financial institutions or American broker-dealers which maintain accounts for such institutions as to their possible exposure under the margin regulations.

II. The General Provisions of the Margin Regulations

A. Statutory Authority and Purpose

The statutory authority for the margin regulations is contained in Section 7 of the Exchange Act.⁸ Sections 7(a) and (b) authorize the Federal Reserve Board to prescribe regulations with respect to the amount of credit that may be initially extended and subsequently maintained on securities. Section 7(c) prohibits any member of a national securities exchange or any broker or dealer from directly or indirectly extending or maintaining credit or arranging for the extension or maintenance of credit to or for any customer on securities or on collateral other than securities, except in accordance with the rules and regulations of the Federal Reserve Board.⁹ Section 7(d) makes it unlawful for other lenders to extend or maintain credit or arrange for the extension or maintenance of credit in contravention of the rules and regulations of the Federal Reserve Board. Pursuant to this authority, the Federal Reserve Board has promulgated Regulation T,¹⁰ which applies to brokers, dealers and members of national

⁸15 U.S.C. § 78g, *as amended*.

⁹Prior to July 29, 1968, Section 7(c) applied only to members of a national securities exchange or broker-dealers who transacted a business in securities through the medium of any such member. Further, broker-dealers subject to the margin requirements were permitted to extend credit only on securities registered on a national securities exchange. However, on July 29, 1968, the statute was amended to permit regulation of the amount of credit that may be extended and maintained with respect to securities not registered on a national securities exchange. Public Law 90-437, 82 Stat. 452 (1968). The Federal Reserve Board amended the margin regulations to conform to the amendments to the statute on July 8, 1969. *See* Federal Reserve Bank of New York Circular No. 6347 (June 6, 1969); Federal Reserve Bank of New York Circular No. 6291 (Feb. 11, 1969); Fed. Reg. Doc. Nos. 69-1983-85 (filed Feb. 14, 1969).

¹⁰12 C.F.R. 220.

securities exchanges, Regulation U,¹¹ which applies to banking institutions supervised by federal or state government agencies, and Regulation G,¹² which applies to certain other institutional lenders.

The margin requirements were enacted for the purpose of preventing the excessive use of credit for the purchase or carrying of securities. Their major objective is to regulate and restrict the volume of credit devoted to financing transactions in securities, in order to protect the national economy.¹³ Three separate philosophies have been found in the legislative history of the Exchange Act as a justification for the margin requirements:¹⁴ (1) excessive credit should not be permitted to cause undue market fluctuations;¹⁵ (2) credit should not be diverted from more desirable uses elsewhere in the economy into the stock market;¹⁶ and (3) investors should be protected from buying on too thin a margin.¹⁷

In cases arising under the margin regulations, one or the other of these philosophies has been emphasized in order to justify a particular result.¹⁸ However, the premise upon which the Exchange Act was based was that stock market speculation was inherently evil and largely responsible for the Great Depression.¹⁹ The framers of the bill were primarily concerned

¹¹12 C.F.R. 221.

¹²C.F.R. 207.

¹³*Sutro Bros. & Co.*, 41 S.E.C. 443, 445 (1963).

¹⁴II LOSS, SECURITIES REGULATION 1242-43 (2d ed. 1961); *Comment*, 116 U. PA. L. REV. 103, 114-15 (1967).

¹⁵S. Rep. No. 792, 73d Cong., 2d Sess. (1934) 3.

¹⁶*Id.*; H.R. Rep. No. 1383, 73d Cong., 2d Sess. (1934) 8.

¹⁷S. Rep. No. 792, *supra* note 15, at 3; S. Rep. No. 1455, 73d Cong., 2d Sess. (1934) 11.

¹⁸*Compare* *Remar v. Clayton Securities Corporation*, 81 F. Supp. 1014 (D. Mass. 1949), with *Moscarelli v. Stamm*, 288 F. Supp. 453, 458-60 (E.D.N.Y. 1968). *See also* *Serzysko v. Chase Manhattan Bank*, 290 F. Supp. 74 (S.D.N.Y. 1968), *aff'd per curiam*, 409 F. 2d 1360 (2d Cir.) *cert. denied*, U.S. (1969).

¹⁹*See* Section 2(4), 15 U.S.C. § 78(b)(2). Both the Senate and House Reports quote a message sent by President Roosevelt to Congress on February 9, 1934, which contains the following statement:

"... outside the field of legitimate investment naked speculation has been made far too alluring and far too easy for those who could and for those who could not afford to gamble.

"Such speculation has run the scale from the individual who has risked his pay envelope or his meager savings on a margin transaction involving stocks with whose true value he was wholly unfamiliar, to the pool of individuals or corporations with large resources, often not their own, which sought by manipulation to raise or depress market quotations far out of line with reason, all of this resulting in loss to the average investor, who is of necessity personally uninformed."

The Reports also contain a supplemental letter of March 26, 1934, from President Roosevelt to the Chairman of the Committee on Banking and Currency, which states:

"The people of this country are, in overwhelming majority, fully aware of the fact that unregulated speculation in securities and in commodities was one of the most important

about regulating credit in order to curb stock market speculation, as opposed to directing money into other channels²⁰ or protecting investors.²¹ To some extent the bill was a compromise between those who felt it was wise social policy to prohibit the average investor from purchasing securities on credit, and those who felt that some borrowed money was necessary for a highly liquid market.²²

The Senate Report on the Exchange Act, in the course of enumerating the various economic and social evils which led to the necessity for federal regulation of stock market credit, mentions the withdrawal of foreign money from the New York call market as a factor contributing to the 1929 panic and the subsequent hoarding of gold.²³ However, there is no clear indication in the legislative history that Congress intended to regulate or restrict credit extensions by foreign banks on American securities. The scanty and scattered testimony concerning foreign credit in the stock market primarily reflects the absence of sufficient information upon which any Congressional intent to regulate or refrain from regulating foreign credit could have been formulated.²⁴

B. Persons Subject to the Margin Regulations

Regulation T is applicable to any "creditor" as defined in the regulation,

contributing factors in the artificial and unwarranted 'boom' which had so much to do with the terrible conditions of the years following 1929." S. Rep. No. 792, *supra* note 15, at 1-2; H.R. Rep. No. 1383, *supra* note 16, at 1-2.

Hon. Adolph J. Sabath, a Congressman who testified at the House Hearings on the Exchange Act, likened the stock exchange to a dishonest gambling house. Stock Exchange Regulation, Hearing Before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. (1934) 827, 829. *Cf. id.* at 35-36.

²⁰Mr. E. A. Goldenweiser, Director of Research and Statistics of the Federal Reserve Board, in his testimony on the Exchange Act stated:

"It is often said that the stock exchange diverts funds from business to the stock market. As a general statement, that statement is not, strictly speaking, correct, because the credit does not stay in the stock market. . . .

"It is, however, true that the stock exchange diverts credit from small industries throughout the country into the large corporations." Stock Exchange Regulation, *supra* note 19, at 67-68.

Mr. Goldenweiser and Mr. Woodlief Thomas, who was on the Research Staff of the Federal Reserve Board, were in agreement that excessive stock market credit made securities rise too high and fast and fall too low and fast, and stimulated a rapid expansion and contraction of the total amount of credit in the economy. *Id.* at 57, 67.

²¹The House Report on the Exchange Act explicitly states that the main purpose of the bill is neither to increase the safety of security loans to lenders nor to protect the small speculator, even though "such a result will be achieved as a by-product of the main purpose." H.R. Rep. No. 1383, *supra* note 16, at 8.

²²Testimony of Thomas Gardiner Corcoran, Stock Exchange Regulation, *supra* note 19, at 97.

²³S. Rep. No. 792, *supra* note 15, at 4.

²⁴*E.g.*, Stock Exchange Regulation, *supra* note 19, at 69-71.

namely, "any broker or dealer including every member of a national securities exchange."²⁵ A "broker" is defined in Section 3(a)(4) of the Exchange Act as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." A "dealer" is defined in Section 3(a)(5) as "any person engaged in the business of buying and selling securities for his own account" except "not as a part of a regular business" and except for banks. The term "bank" is limited by Section 3(a)(6) to banking institutions organized under the laws of the United States and supervised and examined by state or federal authorities.

Regulation U applies to banks,²⁶ but it would not apply to a foreign financial institution, which is not organized under the laws of the United States nor supervised by state or federal authorities. Therefore, a foreign bank would not be subject to any of the provisions of Regulation U.

Regulation G applies to a person who is not subject to Regulation T or Regulation U and who, in the ordinary course of business during any calendar quarter, extends or arranges for the extension of \$50,000 or more, or has outstanding at any time during the quarter \$100,000 or more, in credit, secured directly or indirectly, in whole or in part, by collateral that includes any margin securities.²⁷

The separation between commercial and investment banking required under United States law, is not made by foreign banking institutions. Thus a foreign bank usually acts as a broker in effecting purchases and sales of securities for customers, for which it charges a commission, and as a dealer in effecting transactions for its own account, and it also acts as a bank in effecting other types of transactions including the making of loans.²⁸ It would not be subject to Regulation U with regard to its lending activities, because it is not a regulated United States bank, but it could be subject to Regulation G with regard to such activities. However, if a foreign bank is subject to Regulation T, then it could not be subject to Regulation G.

C. Operation of Regulations T and G

In general, a broker or dealer subject to Regulation T is prohibited from extending credit to its customers for the purpose of purchasing or carrying securities, except on margin securities, and then the amount of the loan

²⁵ 12 C.F.R. 220.2(b).

²⁶ 12 C.F.R. 221.1(a).

²⁷ 12 C.F.R. 207.1(a).

²⁸ *The Worldly Banks*, FORTUNE, Sept. 15, 1968, at 107.

may not exceed 20% of the market value of the securities.²⁹ Similarly a Regulation G lender may not loan more than 20% of the current market value on any margin securities which are collateral for a loan to purchase or carry any such securities.³⁰

Section 7(c) of the Exchange Act makes it unlawful for a broker-dealer to "arrange" for the extension or maintenance of credit in contravention of the credit regulations. Section 220.7(a) of Regulation T provides

A creditor may arrange for the extension or maintenance of credit to or for any customer of such creditor by any person upon the same terms and conditions as those upon which the creditor, under the provisions of this part, may himself extend or maintain such credit to such customer, but only upon such terms and conditions, except that this limitation shall not apply with respect to the arranging by a creditor for a bank subject to Part 221 of this Chapter (Regulation U) to extend or maintain credit on margin securities or exempted securities.

A Regulation G lender is similarly precluded from arranging for the extension or maintenance of credit except upon the same terms and conditions upon which he could extend or maintain credit.³¹

In *Sutro Bros. and Co.*,³² the Division of Trading and Exchanges of the Securities and Exchange Commission (hereinafter referred to as "SEC") urged that a broker unlawfully "arranges" for a credit extension if knowing or with reasonable grounds to know that a customer has secured credit in excess of that permitted by Regulation T, the broker performs any act for the purpose of assisting the customer in implementing the loan. Similarly, in *Russell L. Irish*,³³ the National Association of Securities Dealers, Inc. (hereinafter referred to as "NASD") took the position that mere knowledge on the part of a broker that a loan had been made to a customer by a bank collateralized by mutual fund shares bought from the broker, made the broker's participation in the transaction an unlawful arranging where all the broker did was advise the mutual fund to send certificates to him for transmittal to the customer.

²⁹12 C.F.R. 220.8. "Margin securities" are securities registered on a national securities exchange, plus certain over-the-counter stocks which the Federal Reserve Board determines to have the degree of national investor interest, the depth and breadth of market, the availability of information respecting such stocks and their issuers, and the character and permanence of the issuers, to warrant treatment similar to stocks that are registered on national securities exchanges. A list of these stocks is promulgated by the Board from time to time. *Supra* note 9.

³⁰12 C.F.R. 207.5(a).

³¹12 C.F.R. 207.4(f). The comparable provision of Regulation U is 12 C.F.R. 221.3(u).

³²*Supra* note 13.

³³Securities Exchange Act Release No. 7718 (October 5, 1968).

In both cases, the Commission rejected these contentions, stating that

In view of the language and history of Regulation T, we are not prepared to find an "arranging" by a broker-dealer where the customer on his own initiative and without recommendation, assistance or advice from the broker establishes credit and the terms thereof with another for accomplishing collateral loan transactions and the only function, activity or connection of the broker and its employees with the parties and the transactions is to execute the customer's orders and follow the customer's instructions as to delivery of securities and receipt of payment. In our view, Regulation T does not suggest such a result, and to hold otherwise would in effect make the broker an insurer that customers were employing credit, wherever secured, only to the extent that credit could be provided by the broker.³⁴

However, if a broker permits himself to become an intermediary between his customer and another lender, by conveying the customer's communications or instructions to the lender or by responding to requests or directives of the lender concerning the customer's transactions, the broker becomes so involved in the extension or maintenance of credit that he is "arranging." Therefore, in the *Irish* case, the signing of a receipt for payment of mutual fund shares which stated that the broker would deliver the certificates to the bank as collateral for the loan, where the bank would not otherwise have made such payment, was held an unlawful "arranging."

It is important to note that a broker can be liable for unlawful arranging with respect to a credit extension which a broker could not make under Regulation T, even if the lender is not acting in violation of the law. For example, the *Sutro* case involved loans by factors, who at that time were unregulated lenders. *Sutro Bros. & Co.* was in no way assisting its customers or the factors involved to perform any unlawful act, but rather was unlawfully arranging for loans which *Sutro Bros. & Co.* could not have legally made. On the other hand, where a broker arranges for a credit extension by another lender, governed by Regulations U or G, and such other lender acts illegally, the broker can be held liable either on the theory that he is unlawfully arranging, or on the theory that he is aiding or abetting another's violation.³⁵

D. The Activities in which a Foreign Bank Engages

Where a foreign financial institution purchases or sells securities for the accounts of its customers, it is acting as a "broker" as defined in Section 3(a)(4) of the Exchange Act, and where such transactions are effected for

³⁴*Id.* at 3; *Sutro Bros. & Co.*, *supra* note 13, at 451-52.

³⁵*Remar v. Clayton Securities Corporation*, *supra* note 18; 1953 Fed. Res. Bull. 950, 12 C.F.R. 220.111.

its own account, it is acting as a "dealer" as defined in Section 3(a)(5) of the Exchange Act.³⁶ Accordingly, a foreign bank which maintains an account with a U.S. firm through which it purchases and sells securities falls within the literal definition of a "creditor" subject to Regulation T.

Furthermore, such a foreign bank would also fall within the definition of a "broker" or "dealer" under various other provisions of the Exchange Act, such as the broker-dealer registration provisions,³⁷ the SEC's book-keeping rules,³⁸ and the SEC's net capital rule.³⁹ In short, the foreign bank would be subject to the entire gambit of complex and detailed regulations to which U.S. broker-dealers are subject. While an explanation of these regulations is beyond the scope of this article, it is important to note that the various regulations are interrelated, and all of them contain requirements to make and keep books and records which are subject to inspection and examination by the SEC.⁴⁰ In order to comply with such requirements, many foreign banks would be acting in violation of the bank secrecy laws of their own countries.⁴¹ Nevertheless, if a foreign financial institution is subject to Regulation T because it is a "broker-dealer" under the Exchange Act, it is difficult to argue logically that it is not subject to other provisions of the Exchange Act applicable to broker-dealers.

³⁶15 U.S.C. § 78c(a)(4) and (5).

³⁷Section 15(b), 15 U.S.C. § 780(b).

³⁸Section 17(a), 15 U.S.C. § 78q(a) and the various rules promulgated thereunder. The most important of these rules are: Rule 17(a)(3), which requires that certain types of records be made and kept; Rule 17(a)(4), which requires that records be preserved for various periods of time; Rule 17(a)(5), which requires the filing of an annual certified financial statement; Rule 17(a)(7), which requires non-resident (or foreign) broker-dealers to maintain a set of records within the U.S., or make alternative arrangements to facilitate the inspection of records. 17 C.F.R. 240.17a-3, 17a-4, 17a-5, and 17a-7.

³⁹Rule 15(c)(3)(1), 17 C.F.R. 240.15c3-1. *See* Securities Exchange Act Rel. No. 8024 (Jan. 18, 1967).

⁴⁰Certain of the books and records which broker-dealers are required to keep are specifically for the purpose of insuring compliance with the net capital rule. Securities Exchange Act Release No. 8023 (Jan. 18, 1967). Further, failing to keep sufficiently adequate records to determine financial condition may constitute a fraud, *Ackmerge Securities Co., Inc.*, Securities Exchange Act Rel. No. 7962 (Sept. 26, 1966), and is sufficient grounds to obtain an order restraining a broker-dealer from conducting business. *Securities and Exchange Commission v. Dunhill Securities Corp.*, Docket No. 68 Civ. 2152 (S.D.N.Y.); *Securities and Exchange Commission v. Tilney & Company*, Docket No. 67 Civ. 3153 (S.D.N.Y.). Regulation T provides that adequate records shall be maintained for each account carried by a broker-dealer showing the full details of transactions in the account. 12 C.F.R. 220.4(a)(2). These records are the best evidence of whether violations have occurred. *Wesco and Company*, Securities Exchange Act Rel. No. 7928 (Aug. 5, 1966); *Madison Management Corp.*, Securities Exchange Act Rel. No. 7453 (Oct. 30, 1964). Regulation G also contains various record keeping requirements. 12 C.F.R. 207.1(a) and (e) and 207.3.

⁴¹*See* *First National City Bank v. Internal Revenue Service*, 271 F.2d 616 (1959), *cert. denied*, 361 U.S. 948 (1960); *Fontaine v. Securities and Exchange Commission*, 259 F. Supp. 880 (D.P.R. 1966); *S. J. Rundt & Associates*, *supra* note 1.

Some foreign financial institutions which do not purchase or sell securities through an account with a U.S. broker-dealer may nevertheless receive and deliver securities at U.S. banks or broker-dealers, and such transactions may be incidental to loans involving such securities. In such a situation, the foreign financial institution probably is not acting as a broker-dealer so as to possibly be deemed a "creditor" under Regulation T, but the transactions may nevertheless pose a problem under the credit regulations.

E. Types of Accounts which a Foreign Bank May Maintain with a U.S. Broker-Dealer

A foreign financial institution which effects transactions in U.S. securities through a United States broker-dealer may do so in either a "general" (or margin) account, a "cash" account or an "omnibus" account. Transactions effected through a margin or cash account would be governed under Regulation T by the same rules relating to such accounts maintained by any customer of the firm. In a cash or margin account a foreign bank would have to (1) make full cash payment for securities other than margin securities, including most over-the-counter securities, purchased within seven days after the date of purchase;⁴² or (2) deposit at least 80% of the market value, in cash or securities, of any margin securities it purchases.⁴³ In certain situations, the foreign bank could arrange for deliveries against payment of securities purchased, and then it might have as much as 35 days to pay for purchases of securities, but this device could not be used to evade the necessity for prompt and good faith cash payment.⁴⁴

Although transactions effected by one broker-dealer for the account of another broker-dealer are generally governed by the same provisions applicable to any customer,⁴⁵ a member firm may maintain an omnibus account for another broker-dealer under the terms and conditions set forth in Section 220.4(b) of Regulation T. In this type of account, the member firm is restricted as to how much credit it may extend to its broker-dealer customer only by the rules of the New York Stock Exchange rather than any provision of Regulation T. The broker-dealer customer would only have to deposit 25% of the market value of all securities "long" in the account and from 30% to 100% (depending upon the price of the security) of all securities "short."⁴⁶

⁴²12 C.F.R. 220.4(c)(2).

⁴³12 C.F.R. 220.3(b).

⁴⁴12 C.F.R. 220.4(a)(3); 12 C.F.R. 220.4(c)(5).

⁴⁵12 C.F.R. 220.5(c).

⁴⁶Rule 431(a) of the New York Stock Exchange.

Prior to July 8, 1969, Section 220.4(b) of Regulation T read as follows:

In a special omnibus account, a member of a national securities exchange may effect and finance transactions for a broker or dealer from whom the member accepts in good faith a signed statement to the effect that he is subject to the provisions of this Part (or that he does not extend or maintain credit to or for customers except in accordance therewith as if he were subject thereto) and from whom the member receives (1) written notice, pursuant to a rule of the Securities and Exchange Commission concerning the hypothecation of customers' securities by brokers or dealers, Rule 8c-1 (17 CFR § 240.8c-1) or Rule 15c2-1 (17 CFR § 240.15c2-1), to the effect that all securities carried in the account will be carried for the account of the customers of the broker or dealer and (2) written notice that any short sales effected in the account will be short sales made in behalf of the customers of the broker or dealer other than his partners.

In February, 1969, a proposed amendment to Regulation T was announced by the Federal Reserve Board which would have required a broker-dealer wishing to maintain an omnibus account to certify that it was actually subject to Regulation T, instead of merely certifying that it would conduct itself as if subject to the Regulation in its credit transactions. In announcing this amendment, the Federal Reserve Board stated:

Credit which is exempt from margin requirements can be extended by broker-dealers through a special omnibus account to persons, including foreign firms, who certify that they observe the regulation even though they are not subject to it.

The proposed change is not designed to make foreign banks or broker-dealers subject to U.S. supervision, but only to limit the use of the special omnibus account privilege to institutions that certify that they are actually subject to Regulation T. The privilege would no longer be available to organizations—including foreign financial institutions and others—that prefer not to make such a certification.

A special omnibus account is an account in which a member of an exchange may make wholesale transactions for other brokers without regard to margin requirements. These transactions involve customers' securities on which margin requirements have already been imposed at the retail level. The Department of Justice and the SEC recently presented to the House Banking and Currency Committee evidence of abuses whereby special omnibus accounts have been used by some foreign financial institutions to avoid U. S. margin requirements.⁴⁷

However, the amendments to the omnibus account provisions which were finally promulgated and became effective on July 8, 1969, limited the exemption from margin regulation available through a special omnibus account to members of national stock exchanges and brokers and dealers

⁴⁷Federal Reserve Bank of New York Circular No. 6291 (Feb. 11, 1969).

registered with the SEC. As amended on July 8, 1969, Section 220.4(b) of Regulation T reads as follows:

In a special omnibus account, a member of a national securities exchange may effect and finance transactions for another member of a national securities exchange or a broker or dealer registered with the Securities and Exchange Commission under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 780) from whom the member receives (1) written notice, pursuant to a rule of the Securities and Exchange Commission concerning the hypothecation of customers' securities by brokers or dealers (Rule 8c-1(17 CFR 240.8c-1) or Rule 15c2-1 (17 CFR 240.15c2-1)), to the effect that all securities carried in the account will be carried for the account of the customers of the broker or dealer and (2) written notice that any short sales effected in the account will be short sales made in behalf of the customers of the broker or dealer other than his partners. No substitutions of collateral securing credit extended to a broker or dealer not described in the preceding sentence shall be permitted after October 6, 1969, and no such credit shall be maintained after July 8, 1970.

In announcing the July 8, 1969, amendments, the Federal Reserve Board issued a statement⁴⁸ which was almost identical to its statement of February 11, 1969. No explanation was given for the revisions in the amendments to the omnibus account provisions.

F. The Abortive Agency Provisions of the Margin Regulations

A proposed amendment to Regulation U published by the Federal Reserve Board on February 8, 1968, would have prevented any regulated bank from acting as agent of any person extending credit which the bank knew, or should have known, was secured directly or indirectly by any registered security, unless the bank accepted in good faith a statement signed by such person that he did not extend or maintain credit to or for customers in violation of Regulations G, T or U. The activities of an agent were defined to include receiving securities to be used as collateral for credit, determining whether the market value of the collateral was adequate and requiring the deposit of additional collateral or the reduction of credit. Similar prohibitions were proposed for Regulations T and G. Compliance with these provisions, which were scheduled to go into effect on March 11, 1968, would have prevented any regulated lender from accepting delivery of securities against payment for the account of a foreign financial institution where the lender knew or should have known that such securities were to be used as collateral in a loan by the foreign financial institution for

⁴⁸Federal Reserve Bank of New York Circular No. 6347 (June 6, 1969).

the purchase of such securities. In announcing these amendments, the Board stated that they were directed against excessive credit flowing into the securities markets in circumvention of the other provisions of Section 7 of the Exchange Act.⁴⁹

Subsequently, the effective date of this amendment was delayed to April 10, 1968,⁵⁰ and then on April 4, 1968, the Federal Reserve Board published a revision of the proposed amendment, which read as follows:

A bank subject to [Regulation U] . . . may, without regard to [the provision requiring a signed statement to the effect that a person for whom a bank is acting as agent does not extend or maintain credit in violation of Regulations G, T or U], act as agent of a bank or similar financial institution . . . formed under the laws of a foreign State . . . if such foreign bank has filed with such domestic bank a statement signed by a duly authorized officer of the foreign bank, and accepted in good faith by a duly authorized officer of the domestic bank, to the effect that the foreign bank will not request the domestic bank to act as agent in respect of any transaction (i) which is connected with an extension of credit by it secured directly or indirectly by any registered equity security to any citizen or resident of the United States, or (ii) as to which the foreign bank knows or should know that any other person is extending credit in connection with such transaction to any citizen or resident of the United States secured directly or indirectly by any registered equity security.

In its announcement of this revised proposal regarding agency prohibitions, the Federal Reserve Board stated that the changes were designed to "mitigate administrative burdens involved in handling a substantial volume of ministerial agency transactions, particularly transactions on behalf of foreign banks."⁵¹ Although this revised amendment went into effect on April 17, 1968, on April 18, 1968, the Board deferred the date on which banks were required to obtain the statements required by the amendment to May 17, 1968,⁵² on which date the amendment was revoked entirely. In discarding the prohibitions relating to acting as agent upon all regulated lenders, the Board merely stated that these provisions were being revoked because they might give rise to disproportionate operational problems, particularly with respect to transactions involving foreign principals.⁵³

At the present time, therefore, there is nothing to prevent a regulated U.S. lender from acting as agent for a foreign financial institution, and the agency prohibitions never really became operative. Nevertheless, the Fed-

⁴⁹33 Fed. Reg. 2691-2706 (Feb. 8, 1968).

⁵⁰33 Fed. Reg. 4249 (March 7, 1968).

⁵¹33 Fed. Reg. 5349 (April 4, 1968).

⁵²33 Fed. Reg. 5943 (April 18, 1968).

⁵³33 Fed. Reg. 7230-31 (May 16, 1968). The comparable amendments to Regulations T and G were similarly revoked on May 7, 1968.

eral Reserve Board has not gone so far as to say that foreign financial institutions are not subject to the margin regulations.

G. The Promulgation of Regulation G

The vacillation of the Federal Reserve Board in applying the margin regulations to the activities of foreign banks, as shown by the history of the abortive agency provisions, is directly related to the promulgation by the Board of Regulation G, which became effective on March 11, 1968, and which applies to lenders which were theretofore not subject to the margin regulations. The impetus for this new regulation originated from the SEC's Special Study of the Securities Markets, which was transmitted by the SEC to Congress on August 8, 1963.⁵⁴ In the chapter of the Special Study devoted to security credit, the SEC recommended that

Under the authority now provided by Section 7 of the Exchange Act, the Board of Governors should subject "all persons" who make loans to U. S. residents, on the collateral of securities traded in U. S. markets, to the same requirements as are applicable to domestic bank loans collateralized by such securities, subject to appropriate exclusions for lenders in specified categories such as those not engaged in a business of lending or those never having aggregate outstanding security loans of more than a specified amount, say \$100,000. To aid in enforcement, domestic lenders should be required to keep specified records and file periodic reports, and domestic banks should be prohibited from furnishing any form of assistance or service to any foreign lender in connection with any loan not in conformity with such requirements.⁵⁵

In support of this recommendation, the Special Study found that loans from foreign sources were important sources of capital for large, active unregulated lenders.⁵⁶

Certain other recommendations made by the Special Study concerning security credit necessitated amendments to Section 7 of the Exchange Act.⁵⁷ The legislative history of these amendments contains no mention of the applicability of the margin regulations to foreign lenders.⁵⁸

On October 26, 1967, the Federal Reserve Board published notice of Regulation G. This notice stated:

The purpose of the proposed regulation is to bring lenders other than banks, brokers, or dealers within the coverage of the Board's rules governing

⁵⁴"Special Study," *supra* note 6.

⁵⁵*Id.* at 39.

⁵⁶*Id.* at 30.

⁵⁷*Supra* note 9.

⁵⁸U. S. Code Cong. & Ad. News 2795-2803, 90th Cong., 2d Sess. (1968).

margin requirements on securities transactions. Available indications suggest that excessive credit may flow into the securities markets from such lenders.

...

Foreign lenders making loans that are used to purchase or carry securities in this country would be subject to Regulation G. In most such cases, as well as in many instances involving domestic lenders subject to the regulation, a reliable agency in this country usually, but not always a bank, must be employed to hold the collateral for the loan, effect substitutions, collect interest, and otherwise represent the interest of the lender. Accordingly, a lender would be prohibited from performing any services in respect to a loan that was secured directly or indirectly by any registered security unless the loan was made and maintained in conformity with the requirements of the regulation. (A corresponding provision is proposed for insertion into Regulation U; Regulation T already forbids brokers or dealers to perform such services.)⁵⁹

In the final announcement of the revisions made in Regulation G and the publication of the regulation, the Federal Reserve Board made no mention of its coverage extending to foreign banks.⁶⁰

Regulation G defines a lender subject to the provisions of the Regulation as "any person subject to the registration requirements of paragraph (a) of this section who, in the ordinary course of his business, extends or maintains or arranges for the extension or maintenance of any credit for the purpose of purchasing or carrying any margin security . . . if such credit is secured . . . by collateral that includes any such security."⁶¹ A person subject to the registration requirements is a person who, in the ordinary course of his business, during any calendar quarter, extends or arranges for the extension of \$50,000 or more or has outstanding \$100,000 or more in credit secured by collateral that includes any margin securities, unless such person is subject to Regulations T or U. Any such person is required, within 30 days following the end of the quarter in which he becomes subject to Regulation G, to register with the Board of Governors of the Federal Reserve Board by filing a Form G-1 with the Federal Reserve Bank of the district in which the principal office of such person is located.⁶²

⁵⁹32 Fed. Reg. 14855 (Oct. 26, 1967). The provisions regarding the servicing of foreign accounts proposed at this time were more lenient than the agency prohibitions proposed in February 1968, *supra* text at note 49, but more stringent than the provisions in effect at the present time, *supra* text at note 53. Proposed § 221.3(t) of Regulation U, published by the Board on October 26, 1967 read:

No bank shall perform any service in respect to a loan which is for the purpose of purchasing or carrying a stock registered on a national securities exchange and is secured by any stock unless such loan is made and maintained in conformity with the provisions of . . . (Regulation G, T or U). 32 Fed. Reg. 14858 (Oct. 26, 1967).

⁶⁰1968 Fed. Res. Bull. 168.

⁶¹12 C.F.R. 207.1(c).

⁶²12 C.F.R. 207.1(a).

Quarterly reports must likewise be filed with the district in which the principal office of the lender is located.⁶³

In *Metro-Goldwyn-Mayer, Inc. v. Transamerica Corporation*,⁶⁴ the plaintiff charged that the financing of a cash tender offer by a German and English bank was in violation of Regulation G. The Court held that Regulation G could not apply to foreign banks because no districts of the Federal Reserve Bank exist abroad. Therefore, the European banks could not register as Regulation G lenders and accordingly could not be subject to the restrictions of the Regulation.

As set forth above, between February and May, 1968, the Federal Reserve Board shifted its position on the agency prohibitions from first announcing that all foreign banks which use domestic banks as agents in U.S. securities transactions must agree to abide by the margin regulations, to then announcing that such agreements need only be obtained regarding loans to U.S. citizens for the purpose of purchasing or carrying registered securities, to then abandoning the requirements for any such agreement. Whether the Board has similarly shifted its position as to applicability of Regulation G to foreign banks is an open and troublesome question. The Board has similarly left open the question of whether foreign banks which effect transactions in U.S. securities are subject to Regulation T. One reason why these questions are so troublesome is that the application of the credit regulations to foreign banks could be in violation of international law.

III. The Extraterritorial Application of Federal Statutes and Section 30(b) of the Securities Exchange Act of 1934

A. General Principles of International Law

International law is a body of principles and rules of conduct which most states regard as an obligatory standard and commonly observe in their relations with one another.⁶⁵ Unless embodied in an international convention, its force is derived from acquiescence by common consent of

⁶³12 C.F.R. 207.3(a).

⁶⁴CCH Fed. Sec. L. Rep. ¶ 92,471 (S.D.N.Y. Aug. 8, 1969).

⁶⁵The *Scotia*, 61 U.S. (14 Wall.) 170, 187-89 (1871); I HYDE, *INTERNATIONAL LAW CHIEFLY AS INTERPRETED AND APPLIED BY THE UNITED STATES* § 1 (2d Ed. 1945), and authorities cited therein. This is essentially an Anglo-American view of international law, which is firmly rooted in the common law tradition. See Dickenson, *The Law of Nations as Part of the National Law of the United States*, Pt. I, 101 U. PA. L. REV. 26 (1952), Pt. II, 101 U. PA. L. REV. 792 (1953). Communist theorists, for example, regard international law as an aggregate of norms regulating relations between nations in their struggle and cooperation, and do not regard themselves as obligated to comply with the norms of bourgeois international law. See GUINS, *SOVIET LAW AND SOVIET SOCIETY* 330-31 (1954); Kelsen, *THE COMMUNIST THEORY OF LAW* 188 (1955).

civilized communities to rules designed to foster amicable and workable commercial relations, rather than from the extraterritorial reach of national laws, or from the abdication of its sovereign powers by any nation.⁶⁶ International law is operative only so far as it is adopted by the laws and usages of a country,⁶⁷ and therefore it is not superior to domestic law, and it cannot make or alter domestic law. Although it aims at stability and order through usages which considerations of comity, reciprocity and long-range interest have developed to define the domain which each nation will claim as its own,⁶⁸ international law may yield to conflicting domestic considerations as expressed by statute.⁶⁹ Nevertheless, "an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains."⁷⁰

Under traditional views of international law, as expressed both by international and United States tribunals, the basis of a state's jurisdiction is territorial,⁷¹ and a nation's laws are operative only within its boundaries. Since all legislation is *prima facie* territorial, a statute is ordinarily construed "as intended to be confined in its operation and effect to the territorial limits over which the lawmaker has general and legitimate power."⁷²

Nevertheless, there are four generally recognized exceptions to the territorial principle, namely: (1) nationality; (2) protective; (3) universality; and (4) passive personality.⁷³ Under the nationality principle, a state has jurisdiction to punish its citizens for violations of its laws, even if such violations are committed outside of its boundaries.⁷⁴ Under the protective principle, a state has jurisdiction to punish a non-resident alien for acts

⁶⁶Lauritzen v. Larsen, 345 U.S. 571, 581-82 (1953); THE PAQUETTE HABANA, 175 U.S. 677, 700 (1900).

⁶⁷The Scotland, 105 U. S. (15 Otto) 25, 29 (1881).

⁶⁸Lauritzen v. Larsen, *supra* note 66 at 582.

⁶⁹Skiriotes v. Florida, 313 U.S. 69 (1941); Patterson v. Bark Eudora, 190 U.S. 169 (1903). See Banco Nacional de Cuba v. Sabbatino, 376 U. S. 398 (1964).

⁷⁰The Charming Betsy, 6 U.S. (2 Cranch) 64, 118 (1804); The Queen v. Jameson, [1896] 2 Q.B. 425, 430.

⁷¹Case of S. S. Lotus, Permanent Court of International Justice Reports, series A, no. 10, at p. 18 (1927); The APOLON, 22 U.S. (9 Wheat.) 362, 370 (1824).

⁷²American Banana Company v. United Fruit Company, 213 U.S. 347, 357 (1909) (Holmes, J.).

⁷³Harvard Research in International Law, *Jurisdiction with Respect to Crime*, 29 J. INT'L L. Supp. 443 (1935). These principles relate primarily to the extraterritorial application of penal laws. The Exchange Act is both a penal and a remedial statute, which complicates the question of whether it can be applied extraterritorially without violating international law. Cf. Comment, 70 YALE L.J. 259, 266-69 (1960).

⁷⁴Blackmer v. United States, 284 U.S. 421 (1932); Chandler v. United States, 171 F.2d 921, 929-30 (1st Cir. 1948), *cert. denied*, 336 U.S. 918 (1949).

committed outside its boundaries, where such acts have a potentially adverse effect on national security or governmental functions.⁷⁵ Under the universality principle, a state has jurisdiction to punish a person in its custody who has committed an offense which is a crime under the laws of all (civilized) nations, without regard to the situs of the crime or the nationality of the defendant.⁷⁶ Under the passive personality principle, a state has jurisdiction to punish a person who has injured one of its citizens.⁷⁷

The nationality and universality theories could not serve as a basis for applying the margin regulations to foreign financial institutions.⁷⁸ Since the margin regulations were intended in part to protect investors from purchasing securities on too thin a margin, the passive personality theory could be used to impose the margin regulations on foreign financial institutions, at least with respect to extensions of credit to U.S. citizens, but an assertion of jurisdiction on this ground would be difficult to justify.⁷⁹

⁷⁵United States v. Bowman, 260 U.S. 94 (1922); United States v. Pizzarusso, 388 F. 2d 8 (2d Cir. 1968).

⁷⁶Historically, this principle was the basis for prosecuting pirates, and it was based on the theory that piracy was an act renouncing allegiance to any nation. United States v. Brig. Malek Adhel, 43 U.S. 210, 232 (1844). The principle has also been used to suppress the slave trade and smuggling. I HYDE, *supra* note 65 §§ 229-35. More recently it has been argued that the principle should be extended to cover crimes against humanity. Cowles, *Universality of Jurisdiction Over War Crimes*, 33 CALIFORNIA L. REV. 177, 181-208 (1945); Comment, 46 CORNELL L.Q. 326 (1961).

⁷⁷Harvard Research in International Law, *supra* note 73. The extent to which this exception is adhered to is questionable. It was impliedly rejected as a basis for jurisdiction by the Permanent Court of International Justice in the case of S. S. Lotus, *supra* note 71, and it was squarely rejected by the United States in Cutting's Case, 11 Moore, INTERNATIONAL LAW DIGEST § 201 (1906). I HYDE, *supra* note 65 § 243.

⁷⁸The nationality theory could be used to prohibit U.S. citizens from obtaining loans from foreign financial institutions in circumvention of the margin regulations, but the prohibitions of the margin regulations are directed only at lenders, rather than at borrowers. Serzysko v. Chase Manhattan Bank, *supra* note 18. In two recent cases, borrowers were indicted for violations of the credit regulations. United States, v. Lerner, *supra* note 1; United States v. Whorl, Docket No. 69 Crim. 486 (S.D.N.Y.).

Although it is questionable whether a borrower can be adjudged guilty of such violations except on a conspiracy theory, the defendant in the Whorl case pleaded guilty and therefore this question has not yet been tested. SEC Litigation Release No. 4478 (November 24, 1969). Chairman Patman of the House Committee on Banking and Currency has made a number of proposals which would make it illegal for U. S. citizens to have financial dealings with foreign financial institutions unless such dealings were reported to the U. S. government. Sheehan, *supra* note 1. Another proposal by Chairman Patman would make it a criminal offense for any U. S. citizen to have financial dealings with a foreign financial institution which does not allow *bona fide* inspection of its records by federal regulatory agencies. Hearing held before House Committee on Banking and Currency, Practices of Foreign Banking Institutions, (Dec. 9, 1968). Cf. S. J. Rundt & Associates, *supra* note 1.

⁷⁹Cf. Schoenbaum v. Firstbrook, *supra* note 4. Protection of small speculators was thought to be only a by-product of the margin regulations, *supra* note 21, and the type of borrower who finances securities transactions through foreign financial institutions is rarely a small investor. Additionally, it is questionable whether the United States adheres to the

The soundest basis upon which the margin regulations could be applied to foreign financial institutions is under an extension of the territorial principle sometimes called the objective territorial principle. This principle has been enunciated as follows:

... any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends, and these liabilities other states will ordinarily recognize.⁸⁰

It has been used extensively by the federal courts in applying the anti-trust laws to the activities of foreign corporations abroad,⁸¹ and at least one court has come close to stating that remedial federal legislation should be presumed to be extraterritorial.

[I]n absence of direct foreign governmental action compelling the defendant's activities a United States Court may exercise its jurisdiction as to acts and contracts abroad, if... such acts and contracts have a substantial and material effect upon our foreign and domestic commerce.⁸²

A recent codification of international law states the objective territorial principle as follows:

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 either

(a) the conduct and its effect are generally recognized as constituent elements of a crime or tort under the law of states that have reasonably developed legal systems, or

(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.⁸³

The Committee on International Law of the Association of the Bar of the City of New York has criticized the above-quoted codification as going

passive personality basis of extraterritorial jurisdiction, *supra* note 77. The passive personality theory is open to the objection that it subjects a person to the rules of different legal systems when dealing with persons of different nationalities and it has been criticized by commentators. See Brierly, *The Lotus Case*, 44 LAW QUARTERLY REVIEW 154, 160-61 (1928).

⁸⁰United States v. Aluminum Company of America, 148 F. 2d 416, 443 (2d Cir. 1945). The origin of this principle is a statement by Justice Holmes that "[a]cts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a State in punishing the cause of the harm as if he had been present at the effect, if the State should succeed in getting him within its power." *Strassheim v. Daily*, 221 U.S. 280, 285 (1911).

⁸¹BREWSTER, ANTITRUST AND AMERICAN BUSINESS ABROAD (1958); Haight, *International Law and Extraterritorial Application of the Antitrust Laws*, 63 YALE L. J. 639 (1954); 6 WHITEMAN, DIGEST OF INTERNATIONAL LAW 118-160 (1968); Comment, 70 YALE L. J. *supra* note 73. The most recent case in this area is *Pacific Seafarers, Inc. v. Pacific Far East Line, Inc.*, 404 F. 2d 804 (D.C. Cir. 1968), *cert. denied*, 393 U.S. 1093 (1969). See *Wall St. J.*, Feb. 25, 1969, at 10, col. 2.

⁸²United States v. Watchmakers of Switzerland Information Center, Inc., 1963 Trade Cas. ¶ 77,415 at 77,457 (S.D.N.Y. 1963).

⁸³Section 18, *Restatement (Second), Foreign Relations Law of the United States* (1965).

beyond the territorial principle as it is recognized by international practice, and being a restatement of U.S. municipal law rather than international law.⁸⁴ In this connection, it should be noted that U.S. courts have frequently applied the same decisional techniques and precedents in cases involving conflict of laws questions between states of the United States and foreign nations.⁸⁵

To a certain extent, the objective territorial theory coalesces with the nationality and protective exceptions to the territorial principle of jurisdiction. This rather ill defined basis for applying federal legislation extraterritorially has been called the national interest theory.⁸⁶ The national interest theory is tantamount to a rejection of international law under the principle that conflicting and overriding considerations of domestic policy, as expressed by statute, may justify a court in declining to apply international law.⁸⁷ The public policy of one nation may not be the public policy of another nation, particularly in the areas of monetary policy and commercial crime.⁸⁸ Further, ascertaining exactly what the public interest is with regard to the application of the margin regulations to foreign financial institutions is no easy matter, because it involves balancing at least two conflicting public policies, namely encouraging foreign investment in U.S. securities and preventing undue speculation in securities.⁸⁹ In view of the increasing internationalization of commercial and financial affairs, and the umbrage which other nations are apt to take at the extraterritorial application of U.S. law,⁹⁰ the courts and federal agencies should pause

⁸⁴21 Rec. *supra* note 7, at 248-49. The manner in which the antitrust laws have been applied extraterritorially has been labelled by one commentator as "judicial aggression." Whitney, *Sources of Conflict between International Law and the Antitrust Laws*, 63 YALE L. J. 655, 656 (1954).

⁸⁵See Dickenson, *supra* note 65. This tendency has been particularly marked in cases involving the exercise of personal jurisdiction. See notes 100-07, *infra*. One of the fallacies of subjecting foreign states in the international law sense to the same principles as "foreign" U.S. states is that a truly foreign state is not bound by the "full faith and credit" clause of the Constitution. Further, the courts of such civilized and legalistic countries as Canada and Great Britain have refused to enforce, and even enjoined the enforcement of U.S. judgments which in their view violated international law. *United States v. First National City Bank*; 379 U.S. 378, 395-96 (1965) (dissent); Whitney, *supra* note 84. This sort of judicial battle makes a mockery of both U.S. and international law.

⁸⁶Comment, *supra* note 3, at 96-97.

⁸⁷*Supra* note 69. The national interest principle has been pushed to its extreme by Communist theorists, who deny that international law is paramount to national law in any case where it conflicts with national goals. Kelsen *supra* note 65. See GOODMAN, *THE SOVIET DESIGN FOR A WORLD STATE* 112-22 (1960).

⁸⁸Comment, 70 YALE L. J. *supra* note 73, at 272-87. To take an extreme example, it is a criminal offense to make a commercial profit under the laws of some countries. Address by Evesy S. Rashba, 1958 ABA Proceedings, Section of Int'l & Comp. L. 55.

⁸⁹See notes 6 and 7, *supra*.

⁹⁰Whitney, *supra* note 84. Although the Court stated, in *United States v. First National*

before attempting to impose as complex and peculiarly American a regulatory scheme as the margin regulations on foreign financial institutions without a clear Congressional mandate to do so.⁹¹

B. The Exemption Provided by Section 30(b) of the Exchange Act

1. INTRODUCTION

Section 30(b) of the Exchange Act provides that

The provisions of this title or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this title.⁹²

No rules have been promulgated by the SEC under this section.

There are three types of separate (although related) jurisdictional concepts to which the phrase "without the jurisdiction of the United States" could relate. First, for constitutional reasons, the securities acts generally only apply to transactions involving the use of the facilities of interstate or foreign commerce. Usually, this jurisdictional requisite to the application of the securities laws exempts wholly intrastate transactions.⁹³ Congress similarly may have intended Section 30(b) to exempt wholly foreign transactions, where no facilities of interstate commerce, including the U.S. mails, are used to consummate a securities transaction.

Second, a U.S. court or federal agency generally cannot subject a foreign person or entity to its personal jurisdiction, unless the foreigner is present in the United States. Since this is primarily a procedural, as opposed to a substantive rule, it is doubtful that Section 30(b) is addressed to this problem. In this connection, it should be noted that the jurisdictional concepts of international law discussed above relate to subject matter, as opposed to personal jurisdiction. Strictly speaking, international law only

City Bank, 379 U. S. 378, 384 (1965) that "overseas transactions are often caught in a web of extraterritorial activities and foreign law beyond the ken of our federal courts or their competence," it proceeded to render a judgment of foreclosure against a foreigner unenforceable in the country where the judgment would have to be enforced. *Id.* at 395-96.

⁹¹*Cf.* 21 Rec. *supra* note 7, at 253. *See* II Loss *supra* note 14 at 1269.

⁹²15 U.S.C. 78dd(b).

⁹³Congressional concern about the constitutionality of the Exchange Act under the commerce clause is evident from the legislative history. *See, e.g.,* Stock Exchange Regulation, *supra* note 19, at 15-42, 917-39. The constitutionality of Congressional legislation which regulates wholly foreign commerce has not been subject to the same type of extensive litigation as the constitutionality of Congressional legislation which regulates wholly intrastate commerce. *But see* Skiriotes v. Florida, *supra* note 69; Pacific Seafarers, Inc. v. Pacific Far East Line, Inc., *supra* note 81; I. O. S., Ltd., Securities Exchange Act Rel. No. 8083, p. 9 (May 23, 1967).

governs relations between states, and the extent to which an individual is a proper subject of international law, having either generally recognized rights or obligations, is unclear.⁹⁴ Accordingly, international law is not well developed on the question of what objections a foreigner can make to a tribunal's assertion of jurisdiction over him based on lack of personal jurisdiction. Further, the Supreme Court has held that one brought into the jurisdiction in violation of international law cannot question the right of a court to try him.⁹⁵

Third, as discussed above, federal statutes generally are not applied extraterritorially because such application offends principles of international law and the comity among nations. Therefore, a court or agency would not have subject matter jurisdiction over such situations. While the exemption of Section 30(b) probably has some relation to this principle, there is nothing in the legislative history of the Exchange Act which would indicate whether Congress was merely stating this principle, reversing the presumption against extraterritorial application, or attempting to alter the principle.⁹⁶

2. USE OF JURISDICTIONAL FACILITIES

In *Securities and Exchange Commission v. Myers*,⁹⁷ a Canadian unregistered investment adviser who mailed materials from Canada to investors in the United States was enjoined from conducting an investment advisory business in this country. The defendant argued that he personally had never made use of the United States mails or any facilities of interstate commerce. The court held that his activities in Canada, including the placing of advertisements in Canadian newspapers which solicited inquiries from United States residents, were an indirect use of jurisdictional facilities.

In this connection, it should be noted that the floor of a national secu-

⁹⁴The traditional view of theorists of international law was that only sovereign states were subjects of international law. I. WHEATON, *INTERNATIONAL LAW* 38-42 (6th ED. 1969). More recently, international law is moving toward wider recognition of the private individuals rights and obligations under international law, I. WHITEMAN, *supra* note 81, at 35-58, although Communist theorists refuse to acknowledge individuals as subjects of international law. Remarks of Mr. Tunkin, I. 1960 Y.B. Int'l L. Comm'n, 568th meeting, ¶41 (A/C N. 4/Serv. A/1960). However, even under the view that states are the only subjects of international law, individuals are objects of international law and may be sanctioned for certain illegal acts. I. HYDE, *supra* note 65, at 33-36.

⁹⁵*Ker v. Illinois*, 119 U.S. 436, 444 (1886); *Chandler v. United States*, *supra* note 74. In such a situation, any wrong done under international law is by one sovereign state to another, rather than to the individual concerned. This principle was a matter of concern in the Eichman case. *See* Comment, 46 CORNELL L. Q. 326 (1961).

⁹⁶Comment, *supra* note 4, at 106. *See* Goldman & Magrino, *supra* note 4, at 1017-19.

⁹⁷285 F. Supp. 743 (D. Md. 1968).

rities exchange is itself a means or instrumentality of interstate commerce. So are the "pink sheets" of the National Quotation Bureau, Inc.⁹⁸ Therefore, any transaction in a security listed on a national securities exchange by a foreign bank would almost necessarily have to involve the use of jurisdictional facilities, and the execution of an order in an o-t-c American stock by an American broker-dealer probably would also involve the use of jurisdictional facilities.⁹⁹

3. PERSONAL JURISDICTION

Generally, in order for a forum to assert personal jurisdiction over a foreign person or corporation, the foreigner must have minimal contacts with the jurisdiction, and requiring the foreigner to enter the jurisdiction and defend the action cannot offend traditional ideas of fair play.¹⁰⁰ In *Securities and Exchange Commission v. VTR, Incorporated*,¹⁰¹ the court held that it had personal jurisdiction over a foreign bank which sold shares of stock over the American Stock Exchange through an account at a member firm, in alleged violation of Section 5 of the Securities Act of 1933. The bank had no place of business in the United States and did no other business in the United States. It was served with process abroad pursuant to the provisions of Rule 4(i)(1)(c) of the Federal Rules of Civil Procedure.¹⁰² It should be noted that another foreign bank defendant in this same action, which consented to the entry of a judgment, did not even sell the securities in question or maintain any brokerage accounts in the U.S., but merely allowed the securities to be delivered against payment to

⁹⁸United States v. Re. 336 F. 2d 306, 315-16 (2d Cir.), *cert. denied*, 379 U.S. 904 (1964); F. S. Johns & Company, Inc. Securities Exchange Act Rel. No. 7972, at 13 note 16 (Oct. 10, 1966).

⁹⁹See Roth v. Fund of Funds, Ltd., *supra* note 4. In *Vanity Fair Mills v. T. Eaton Co.*, 234 F. 2d 633, 641 (2d Cir.), *cert. denied*, 352 U.S. 871 (1956), the Court observed that the commerce power "is now generally interpreted to extend to all commerce, even intrastate and entirely foreign commerce, which has a substantial effect on commerce between the states or between the United States and foreign countries."

¹⁰⁰Hanson v. Denckla, 357 U.S. 235 (1958); *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

¹⁰¹39 F.R.D. 19 (S.D.N.Y. 1966).

¹⁰²Rule 4(e) provides for extraterritorial service whenever a statute of the United States authorizes the court to reach beyond its normal territorial limits. Rule 4(i) prescribes the manner in which such service shall be effected in instances permitted by Rule 4(e). Section 22(a) of the Securities Act of 1933, 15 U.S.C. 77v(a), provides for the service of process in any district "of which the defendant is an inhabitant or wherever the defendant may be found." The Advisory Committee's notes on Rule 4(i) specifically mention Section 22(a) of the Securities Act as a statutory provision authorizing service in a foreign country. Advisory Committee on Civil Rules of the Judicial Conference of the United States, 31 F.R.D. 587,625 (1963).

its account at a U.S. bank.¹⁰³ If this defendant had contested the action, it is possible, but probably unlikely, that a court would have held that such contacts with the U.S. were too minimal to warrant the exercise of personal jurisdiction. This is because the case involved illegal sales of listed securities by Americans, where the foreign banks were intermediaries designed to conceal the identities of the sellers, and in situations involving such attempted evasions of U.S. law, the courts will reach very far in asserting jurisdiction.¹⁰⁴

Further, the transacting of such business in the U.S. may amount to the transacting of business by the principals of a foreign entity as individuals, and expose them to prosecution as individuals. In the *VTR, Incorporated* case, the directors of two foreign banks were individually enjoined from further violations of the securities acts. One of them contested the court's exercise of personal jurisdiction, but neither the court nor the parties focused on the question of whether the nexus between a foreign bank and the forum sufficient to impose jurisdiction was likewise sufficient to impose jurisdiction over a director of the bank as an individual.

In *United States v. Montreal Trust Co.*,¹⁰⁵ the U.S. government brought an action against a Canadian bank as the executor of a Canadian citizen, Klein, to recover income taxes, interest and penalties. Klein was the managing director of a Canadian distiller, the exclusive distributing agent for which was a Cuban corporation. The Cuban corporation entered into a contract with a New York corporation to act as its subagent in distributing whiskey in the U.S., and this New York corporation sold substantial quantities of whiskey in the U.S., including New York, pursuant to the contract. The Canadian corporation also shipped whiskey from Canada to a sole proprietor in New York who re-exported it to American Army posts in Europe, and paid the Cuban distributor for the whiskey. Klein insisted that the sole proprietor share two-thirds of his profits with Klein's brother-in-law who resided in New York. Klein also made the New York corporation put various of his friends and relatives on the payroll.

The theory of the government's case was that the earnings of the U.S.

¹⁰³Affidavit of Thomas F. Fox. There is some support for the proposition that the delivery of a security constitutes a "sale" under the securities acts. See *Creswell-Keith, Inc. v. Willingham*, 264 F.2d 76 (8th Cir. 1959).

¹⁰⁴This matter ultimately resulted in criminal prosecution. *Seven Charged with Illegal Distribution, Sale of 85,000 Unregistered VTR Shares*, Wall St. J., Mar. 21, 1969, at 5, cols. 2-3.

¹⁰⁵235 F. Supp. 345 (S.D.N.Y.), *rev'd*, 358 F.2d 239 (2d Cir.), *cert. denied*, 384 U.S. 919 (1966).

sole proprietor and New York corporation paid to Klein's relatives and friends were income taxable to Klein. However, the legal issue was whether personal jurisdiction over Klein's executor had properly been obtained on the ground that Klein had transacted business in New York, either personally or through agents, namely the New York corporation and U.S. sole proprietor. The district court found that there was no evidence to show that Klein, as an individual, transacted business in New York, and dismissed the action. The Second Circuit reversed, holding that Klein did transact business in the state, through the New York corporation and U.S. sole proprietor, who acted as Klein's personal agents.

It is interesting to note that the district court stated that "the activities of Klein as a corporate officer on behalf of the corporations do not constitute the transaction of business by Klein individually."¹⁰⁶ The Second Circuit was apparently in agreement with this general legal statement.¹⁰⁷

4. SUBJECT MATTER JURISDICTION

The cases interpreting Section 30(b) of the Exchange Act all turn on the issue of subject matter jurisdiction.¹⁰⁸ In order for a court to apply the margin requirements to a foreign financial institution, it would be necessary for the court to decide: (a) that it is appropriate to apply federal law, as opposed to foreign law, under international and conflicts law to the transaction which is the basis of the action; and (b) that no exemption under Section 30(b) is available.

In *Kook v. Crang*,¹⁰⁹ a Canadian broker-dealer, registered with the SEC pursuant to Section 15 (b) of the Exchange Act, was held to be exempted from the credit provisions in sales in Canada of a Canadian security to a United States citizen. The court found that all of the essentials of the transactions occurred without the United States and that the use of the

¹⁰⁶235 F. Supp. at 348.

¹⁰⁷358 F. 2d at 243. A director of the Arzi Bank was named as a defendant in the criminal complaint against the bank, but not in the indictment, *supra* note 1. He is named as a co-conspirator in the indictment returned against Coggeshall & Hicks, *supra* note 1. The President of American Securities Co., a foreign broker-dealer, was named as a defendant in *United States v. Lerner*, *supra* note 1. The general manager of Weisscredit Bank was named as a defendant in *United States v. Weisscredit Banca Commerciale e D'Investimenti*, *supra* note 1.

¹⁰⁸There is a tendency on the part of many courts to assume that if a forum has personal jurisdiction, it has subject matter jurisdiction as well. However, the issues involved in determining subject matter and personal jurisdiction are very different, particularly in an action instituted under the securities act in a federal court. If subject matter jurisdiction is predicated upon a federal statute and some law other than the federal law is applicable to the transaction, for example a foreign law, a court could be compelled to dismiss the action for lack of subject matter jurisdiction. See *Whitney*, *supra* note 84.

¹⁰⁹182 F. Supp. 388 (S.D.N.Y. 1960).

mails and telephone within the U.S. did not change the locale of the transactions for choice of law purposes.

The question here is not whether there are contacts with the United States sufficient to give this Court jurisdiction, no one questions that, but rather whether Congress intended to make the statute applicable to these transactions. We hold that such was not the intention of the legislature and that 'jurisdiction' as used in Section 30(b) contemplates some necessary and substantial act within the United States.¹¹⁰

In *Roth v. Fund of Funds*,¹¹¹ the Second Circuit, in a brief decision, applied Section 16(b) of the Exchange Act to a Canadian mutual fund with offices in Switzerland for short swing profits made in a security listed on the New York Stock Exchange. The court reasoned that since the securities transactions involved were executed on the New York Stock Exchange by New York brokers acting as agent for the fund, and payment for the purchases was made through a New York bank, a Section 30(b) exemption was not available. *Kook v. Crang* was distinguished on the ground that the transactions involved there were effected outside the United States on the Toronto Stock Exchange. By way of dictum, the court also doubted "whether 'transacting a business in securities' can be read to cover the Fund's activities of investing in securities."

The most extensive opinion interpreting Section 30(b) is *Schoenbaum v. Firstbrook*,¹¹² which was a suit by an American shareholder of a Canadian corporation alleging violations of the antifraud provisions of the Exchange Act¹¹³ in the sale of a block of treasury stock to a Canadian corporation and a Delaware corporation conducting business in New York, although a wholly owned subsidiary of a French bank. Although the transaction in question was essentially Canadian, the U.S. mails were used. The stock of the Canadian company was listed and traded on the American Stock Exchange, as well as the Toronto Stock Exchange. The court held that it had subject matter jurisdiction over the action on two grounds: (a) the securities acts are applicable extraterritorially where necessary to protect American investors; and (b) Section 30(b) was not meant to exempt transactions that are conducted outside of the U.S. unless they are part of a "business in securities."¹¹⁴

¹¹⁰*Id.* at 390-91.

¹¹¹*Supra* note 4.

¹¹²*Supra* note 4.

¹¹³Section 10(b) of the Exchange Act and Rule 10(b)(5) promulgated thereunder, 15 U.S.C. § 18j(b) and 17 C.F.R. 240.10b-5.

¹¹⁴This portion of the Court's holding in effect overruled *Ferraioli v. Cantor, CCH Fed. Sec. L. Rep.* ¶ 91,615 (S.D.N.Y. 1965), which exempted under Section 30(b) a private sale in Canada of controlling shares of a New York corporation. In *Ferraioli*, the Court reasoned that if Congress specifically exempted foreign business in securities it intended to also exempt isolated transactions.

The sweeping language of this decision is tantamount to a repeal of Section 30(b). The Court stated:

We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities. In our view, neither the usual presumption against extraterritorial application of legislation nor the specific language of Section 30(b) show Congressional intent to preclude application of the Exchange Act to transactions regarding stocks traded in the United States which are effected outside the United States, when extraterritorial application of the Act is necessary to protect American investors.¹¹⁵

This decision is subject to criticism on a number of grounds. First, the Court assumes that any transaction in an American security affects a national public interest, and therefore any transaction which would be in violation of the securities acts if effected within the U.S. is intended to produce and produces detrimental effects if effected without the U.S., and therefore may constitute a claim for relief in a federal court. The Court's analysis distorts the "plain meaning" of Section 30(b)¹¹⁶ by reducing it to situations where either a court would have no jurisdiction because no facilities of commerce are used, or where transactions are effected over a foreign securities exchange. In part, the Court justifies its *tour de force* of statutory construction by relying on the title of Section 30, namely "Foreign Securities Exchanges." This reliance is unjustified because (a) the title of a statute is not properly a part thereof and should not be considered in ascertaining the meaning of a statute;¹¹⁷ and (b) the title of Section 30 preceded the drafting of Section 30(b) and refers only to the provisions of Section 30(a).¹¹⁸

Faced with an analogous problem of statutory construction, the Court of Appeals of New York held that the language conferring personal jurisdiction over a non-domiciliary in the New York "long-arm" statute "if, in person or through an agent, he * * * commits a tortious act *within* the state'—is too plain and precise to permit it to be read, as has the Appellate Division, as if it were synonymous with 'commits a tortious act *without* the

¹¹⁵405 F.2d at 206.

¹¹⁶It has been persuasively argued that to interpret "jurisdiction of the United States" to mean anything other than "territory of the United States" makes Section 30(b) into a meaningless provision. 69 COLUM. L. REV., *supra* note 4, at 104-05. On the other hand, few legal concepts are as ambiguous or as variously used as that of "jurisdiction." LEFLAR, THE LAW OF CONFLICT OF LAWS § 4 (1959).

¹¹⁷Patterson v. Bark Endora, 190 U.S. 169, 172-73 (1903); United States v. Mouyas, 42 F.2d 743 (S.D.N.Y. 1930).

¹¹⁸69 COLUM. L. REV., *supra* note 4, at 106.

state which causes injury within the state.' The mere occurrence of the injury in this State certainly cannot serve to transmute an out-of-state tortious act into one committed here within the sense of the statutory wording."¹¹⁹

Second, although the Court states in *Schoenbaum* that if the wrong alleged also constitutes the basis for a cause of action under foreign law a district court might decline to exercise its jurisdiction under the doctrine of *forum non conveniens*,¹²⁰ this thought is not carried to its logically proper conclusion, namely that if the acts alleged are legal under foreign law, the court should decline to exercise jurisdiction for reasons of comity.¹²¹

Third, the Second Circuit's exclusion of the defendants as persons transacting a business in securities is inconsistent on its face as applied to one of the defendants, namely Paribas Corporation of New York, the Delaware corporation [hereinafter referred to as "Paribas"]. According to the Court, the phrase "person who transacts a business in securities" is a broader phrase than "broker-dealer" because it also includes banks. The decision rereflects that Paribas is a wholly owned subsidiary of a French banking institution which acted as a broker with respect to the transaction on which the action was based. Paribas purchased the shares in question on behalf of another subsidiary of Paribas' parent for resale to ten European professional investors. There is no justification for the court's apparent finding that this was an isolated foreign securities transaction.¹²²

Fourth, the Court paid virtually no attention to the issues of international law necessarily involved in its decision, but limited itself to interpreting Section 30(b). Inasmuch as the only cases which have arisen under Section 30(b) have been in actions in the Southern District of New York,¹²³ and *Schoenbaum* was the first case to be appealed to the Second Circuit, it is unfortunate that the Court chose to slough off an important

¹¹⁹Longines-Wittnauer Watch Co., Inc. v. Barnes & Reinecke, 15 N.Y. 2d 443, 460, 209 N.E. 2d 68, 72 (1965).

¹²⁰405 F.2d at 209, note 5.

¹²¹Although the doctrine of *forum non conveniens* may have some relevance to actions against corporate directors under Section 10(b) of the Exchange Act, it has no real relevance to the issue of whether a court should apply federal law to activities occurring outside the United States. Even assuming that the jurisdictional issues depend on conflict of law principles, different considerations are pertinent to conflicts between states of the U. S. and conflicts between U.S. and foreign law. See EHRENZWEIG, CONFLICT OF LAWS 16-21, 120-59 (1962).

¹²²It should be noted that Paribas is registered as a broker-dealer with the SEC. File No. 8-8994-1. See Paribas Corporation, 40 S.E.C. 482 (1961).

¹²³Fontaine v. Securities and Exchange Commission, *supra* note 41, was an action for an injunction and declaratory judgment based on Section 30(b), but the court only indirectly ruled on the Section 30(b) issue because it dismissed the action under the doctrines of exhaustion of administrative remedies and primary jurisdiction.

issue which had been a source of concern to the district court.¹²⁴ Further, by failing to interpret Section 30(b) in terms of existing principles of international law, the Court ignored a formidable body of Supreme Court case law.¹²⁵

5. DIFFERENCES BETWEEN REGULATIONS T AND G

If a foreign financial institution is acting as a broker-dealer so as to be subject to Regulation T, there would appear to be no doubt that it is transacting a business in securities under Section 30(b) of the Exchange Act. However, if a foreign financial institution is merely making purpose loans, so as to be more properly covered by Regulation G, if subject to the credit regulations at all, the question arises as to whether the foreign lender is transacting a business in securities.

In the *Schoenbaum* case, the Court stated:

The purpose of this subsection is to permit persons in the securities business to conduct transactions in securities outside of the United States without complying with the burdensome reporting requirement of the Act and without being subject to its regulatory provisions, except insofar as the Commission finds it necessary and appropriate to regulate such transactions to prevent evasion of the Act. . . . The exemption relieves the Commission of the impossible task of enforcing American Securities law upon persons whom it could not subject to the sanctions of the Act for actions upon which it could not bring its investigatory powers to bear.¹²⁶

Although a Regulation G lender is not subject to the same detailed regulation as a Regulation T lender, Regulation G is nevertheless a comprehensive regulatory scheme, which is dovetailed to Regulations T and U. Accordingly, there would appear to be the same reasons for exempting a foreign Regulation G lender from the provisions of the Exchange Act, pursuant to Section 30(b), as for exempting a Regulation T lender.

Further, it would appear that if foreign financial institutions are not subject to Regulation T because of the operation of Section 30(b), they could not for this reason be made subject to Regulation G because it was intended to cover lenders not previously captured by the margin regulations.¹²⁷

C. The Defense of Sovereign Immunity

Traditionally, a sovereign was entitled to absolute immunity from suit in the courts of a foreign jurisdiction.¹²⁸ Further, the United States Supreme

¹²⁴268 F. Supp. 385, 392-94 (S.D.N.Y. 1967).

¹²⁵Text at notes 142-76 *infra*.

¹²⁶405 F.2d at 207.

¹²⁷*Supra* notes 54-64. See text at notes 226-49, *infra*.

¹²⁸THE EXCHANGE, 11 U.S. (7 Cranch) 116 (1812).

Court, in applying this doctrine, made no distinction between public and private (or commercial) activities of a foreign sovereign.¹²⁹ In this connection, an agency or corporation of a foreign government may be deemed an extension of the sovereign entitled to immunity from suit.¹³⁰

In 1952, the Department of State announced a policy of adhering to a more restrictive view of sovereign immunity, and urged that U.S. courts exercise jurisdiction over suits arising out of the private acts of foreign sovereigns. The rationale for this policy was that "the widespread and increasing practice on the part of governments engaging in commercial activities makes necessary a practice which will enable persons doing business with them to have their rights determined in the courts."¹³¹ Since 1952, the courts have therefore limited the application of sovereign immunity for foreign governments, but the Supreme Court has not yet reversed its previous holding that foreign sovereigns are immune from suit with regard to their private or commercial activities.¹³²

The issue of whether a foreign financial institution which is an instrumentality of a foreign sovereign would or should be subject to prosecution by the U.S. government is an interesting and troublesome one. Although an action by the United States under the antitrust laws was maintained against a commercial venture established by the French government,¹³³ sovereign immunity was accorded to an English corporation established by the British government to insure an oil supply for the British Fleet.¹³⁴ In the latter case, the Court held that the corporation was engaged in governmental rather than commercial activities.

Whether a national bank is a commercial trading operation or a government instrumentality would appear to be a question to which there is not a clear-cut answer.¹³⁵ However, the possibility that certain foreign financial institutions could legitimately raise a defense of sovereign immunity ought to be given some consideration in determining whether the margin regulations should be made generally applicable to foreign banks. It would

¹²⁹*Berizzi Bros. Co. v. S. S. Pesaro*, 271 U.S. 562 (1926).

¹³⁰INVESTIGATION OF WORLD ARRANGEMENTS WITH RELATION TO THE PRODUCTION, TRANSPORTATION, REFINING AND DISTRIBUTION OF PETROLEUM, 113 F.R.D. 280, 290-91 (D.D.C. 1952); Section 66, RESTATEMENT, *supra* note 83. *But see* *United States v. Deutsches Kalisyndikat Gesellschaft*, 31 F.2d 199 (S.D.N.Y. 1929).

¹³¹26 Dep't State Bull. 984, 985 (1952).

¹³²*See National City Bank v. Republic of China*, 348 U.S. 356 (1955); 6 *Whiteman*, *supra* note 81, at 553-584, 674-95.

¹³³*United States v. Deutsches Kalisyndikat Gesellschaft*, *supra* note 130.

¹³⁴INVESTIGATION OF WORLD ARRANGEMENTS, *supra* note 130.

¹³⁵*Compare McCulloch v. Maryland*, 17 U.S.(4 Wheat.)316 (1819), with *United States Bank v. Planter's Bank* 22 U.S. (9 Wheat.) 904 (1824). *See* *Mirabella v. Banco Industrial de la Republica Argentina*, 38 Misc. 2d 128, 237 N.Y.S.2d 499 (Sup. Ct. 1963); *Ulen & Co. v. Bank Gospodarstwa Krajowego*, 261 App. Div. 1, 24 N.Y.S.2d 201 (2d Dep't 1940).

appear that the activities of such banks to which the margin regulations would be applicable are private rather than public, and thus under the restricted view of sovereign immunity favored by the Department of State, a defense of sovereign immunity should be rejected. Nevertheless, the rationale for this State Department policy is not relevant to an action instituted by the U.S. government as opposed to a private litigant. The injury which such an action would seek to redress is to the U.S. economy. If such an injury has been caused by an agent of a foreign sovereign, a federal court would appear to be the wrong forum in which to obtain relief, at least if the United States or the SEC is the plaintiff.

Although sovereign immunity has become an unpopular defense, particularly where it is raised in the context of ordinary commercial enterprises, the basis for the doctrine in international law coalesces with and is related to various other doctrines which militate against the application of U.S. law to foreign entities which are closely related to their own governments.¹³⁶ This would be true of many foreign financial institutions. It has, for example, been suggested that the application of Section 30(b) of the Exchange Act to persons transacting a business in securities may have been an expression of Congressional sensitivity to resentment by foreign countries of U.S. interference with the way in which investment banking is conducted abroad.¹³⁷

D. The Extraterritorial Application of Other Statutes

The tendency toward increasing government regulation of commerce in significant sectors of the economy, pursuant to broadly phrased federal legislation, and the tendency toward increasing transnationalism in commercial affairs have resulted in numerous court cases involving the extraterritorial application of U.S. law. Cases of this type usually involve the application of two conflicting canons of statutory construction, namely, the

¹³⁶An analogous area of international law which may serve to bring this problem into focus is that of the flag law doctrine. Traditionally, a flag ship was regarded as the floating territory of the flag state, and the sovereign was personally identified with his ships of war. This was one reason warships were entitled to the defense of sovereign immunity. See *THE EXCHANGE*, *supra* note 128. During a voyage, the sovereign's jurisdiction was delegated to the captain of a vessel. COLOMBOS, *THE INTERNATIONAL LAW OF THE SEA* § 317 (4th ed. 1959). Accordingly, the courts of one country ordinarily declined to interfere with the internal order of a foreign flag ship. *Patterson v. Bark Eudora*, *supra* note 117; *Wildenhus's Case*, 120 U.S. 1, 12 (1886). Although modern courts recognize these concepts to be legal fictions, they connote important foreign policy considerations. In *McCulloch v. Sociedad Nacional*, 372 U.S. 10 (1963), the Supreme Court refused to apply the National Labor Relations Act, 29 U.S.C. § 141 *et seq.*, to disputes involving foreign flag ships on the grounds that such an application of the law would be extraterritorial and in violation of international law, and further, would be contrary to the flag law and internal order doctrines.

¹³⁷69 COLUM. L. REV., *supra* note 4, at 106. Cf. *S. J. Rundt & Associates*, *supra* note 1.

presumption against the extraterritorial application of federal law, and the presumption in favor of the liberal application of a remedial statute.¹³⁸ Further, legislative intent regarding a statute's application to activities abroad is rarely expressed with any specificity, since Congress is primarily concerned with domestic conditions.¹³⁹ In addition, many of these cases have had domestic and foreign political underpinnings¹⁴⁰ which do not support judicial resolution through philosophical concepts which strike the contemporary mind as no more than quaint legal fictions.¹⁴¹

The resulting record of the courts in cases involving the application of federal law to acts which take place outside the territorial limits of the United States has been so inconsistent that any prediction as to whether, or to what extent, the Supreme Court would give extraterritorial effect to the securities acts would be extremely conjectural. An apogee in judicial vacillation in this area was reached by the Supreme Court during its 1948 term. In *Vermilya-Brown Co. v. Connell*,¹⁴² the Court applied the Fair Labor Standards Act¹⁴³ to employees of government contractors engaged in the production of goods on a leasehold of the United States in Bermuda. In *Foley Bros. v. Filardo*,¹⁴⁴ the Court declined to apply the Eight Hour Law¹⁴⁵ to a cook employed by a government contractor for work on construction projects in Iraq and Iran. In his concurring opinion in the *Foley* case, Mr. Justice Frankfurter, who had dissented in *Vermilya-Brown*, remarked that he was able to join in the result only because he did not feel bound by *Vermilya-Brown* since it had been handed down during the same term.¹⁴⁶ Even such noted jurists as Mr. Justice Holmes and Judge Learned Hand have written opinions regarding the extra-territorial application of U.S. law which, although distinguishable, appear to rest upon divergent premises.¹⁴⁷

¹³⁸*Compare* Kook v. Crang, *supra* note 109, with Schoenbaum v. Firstbrook, *supra* note 4. See text at notes 70-72, 108-15, *supra*. The case most frequently cited in recent years for the proposition that the securities acts should be liberally construed to accomplish their remedial purpose is Securities and Exchange Commission v. Capital Gains Bureau, 375 U.S. 180, 195 (1963).

¹³⁹*Vermilya-Brown Co. v. Connell*, 335 U.S. 377, 385 (1948).

¹⁴⁰See notes 167-76, *infra*.

¹⁴¹Cases involving the application of maritime law are a prime example, and many of the principles of international law are moored to the maritime law of a more simplistic age. See note 136, *supra*.

¹⁴²*Supra* note 139.

¹⁴³29 U.S.C. § 201 *et seq.*

¹⁴⁴336 U.S. 281 (1949)

¹⁴⁵40 U.S.C. § 324.

¹⁴⁶336 U.S. at 291. The discrepancies between the two decisions were further highlighted by *United States v. Spellar*, 338 U.S. 217 (1949).

¹⁴⁷*Compare* *Uravic v. F. Jarka Co.*, 282 U.S. 234 (1931), with *American Banana v. United Fruit Co.*, *supra* note 72. *Compare* also *United States v. Aluminum Co. of America*, *supra* note 80, with *Kyriakos v. Goulandris*, 151 F.2d 132, 139 (2d Cir. 1945) (dissent).

The difficult and theoretical jurisdictional principles utilized to decide these cases have obscured rather than clarified the basis upon which decisions have been made. To some extent, this is because the courts have frequently honored in the breach the principle that international law limits the extent to which one country can regulate conduct which occurs beyond its borders.

A relatively early case¹⁴⁸ arose out of an action against the master of a French schooner for patent infringement of a device useful in the gaff of sailing vessels. The question presented for decision was whether any improvement in the construction or equipment of a foreign vessel, placed on the vessel in a foreign port, for which a U.S. patent has been obtained, could be used by such vessel within the jurisdiction of the U.S., without the consent of the patentee. The Supreme Court decided this question affirmatively and dismissed the complaint, reasoning that although Congress could have conditioned the entry of foreign vessels, under its commerce clause powers, upon compliance with the patent laws, the patent laws were passed under the power of Congress to promote the progress of science and the useful arts, which power was domestic in its character, and necessarily confined within the limits of the U.S. The Court further felt that the literal construction of the statute urged by the plaintiff would give patentees political power, enabling them to interfere with the treaty making powers of Congress.

Similarly, in *American Banana Co. v. United Fruit Co.*,¹⁴⁹ the plaintiff sued for treble damages under the Sherman Act¹⁵⁰ for monopolization of the Central American banana trade. Mr. Justice Holmes, speaking for the Court and dismissing the complaint, said that since "the acts causing the damage were done, so far as it appears, outside the jurisdiction of the United States . . . it is surprising to hear it argued that they were governed by the act of Congress."¹⁵¹

A directly opposite approach was taken by the Supreme Court and Mr. Justice Holmes in *Uravic v. F. Jarka Co.*,¹⁵² which arose under the Jones Act.¹⁵³ Under the general language of the statute, a wrongful death action was granted to the personal representative of "any seaman" killed by an

¹⁴⁸*Brown v. Duchesne*, 60 U.S. (19 How.) 183 (1856). At this period of history, American judges were more inclined toward judicial abnegation than their English brethren. Compare *Caldwell v. Vanvlissenger*, 9 Hare 415, 68 Eng. Rep. 571 (Ch. 1851).

¹⁴⁹*Supra* note 72.

¹⁵⁰15 U.S.C. §§ 1-7.

¹⁵¹213 U.S. at 355.

¹⁵²*Supra* note 147.

¹⁵³46 U.S.C. § 688.

injury suffered in the course of employment. The decedent was an American stevedore whose death was caused by an injury received while unloading a German flag ship in New York harbor. To the contention that seamen on foreign vessels were not specifically included in the act and could not therefore be covered by its provisions, the Court responded: "But the question is not whether they were thought of for the purpose of inclusion, but whether they were intentionally excluded from a description that on its face includes them."¹⁵⁴ A judgment for the decedent's administrator was rendered.

Neither the *Banana* nor *Urvic* cases have been overruled, but over the years since they were decided both the Sherman Act and the Jones Act have been selectively applied to activities of both American and foreign nationals abroad. The Sherman Act cases are so complex, both factually and legally, that it is very difficult to set forth a standard which differentiates those cases where the Sherman Act was given extraterritorial effect and those cases where it was not.¹⁵⁵ However, most of the cases involve acts abroad by American corporations, or the subsidiaries or parents of American corporations, or acts within the United States by foreign corporations. Nevertheless, at least in theory, the antitrust laws could be applied to conspiracies between foreign competitors alone where they are intended to, and actually do, result in substantial anti-competitive effects on American foreign commerce.¹⁵⁶ The notion that foreign activities having a sufficiently substantial impact on American commerce justify the application of American law to foreigners is an aberration from the general standard, even in anti-trust cases, and statements to this effect have been severely criticized.¹⁵⁷

¹⁵⁴282 U.S. at 239.

¹⁵⁵The cases in this area are set forth and analyzed in 6 WHITEMAN, *supra* note 81, at 118-160. They have been collected and reported in full in the Appendix to International Aspects of Antitrust, Hearings Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 89th Cong., 2d Sess. (1967).

¹⁵⁶Report of the Attorney General's National Committee to Study the Antitrust Laws 76-77, March 31, 1955. *Cf.* Section 18, RESTATEMENT, *supra* note 83.

¹⁵⁷*Supra* notes 81 and 84. The facts of the leading cases do not go as far as the language sometimes used by the courts, for reasons peculiar to the antitrust laws. One of the cases most frequently relied upon to justify the extraterritorial application of American law, *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951), involved a conspiracy between a U. S. corporation and two foreign subsidiaries. Although the court undoubtedly was influenced in finding that it had jurisdiction to apply the antitrust laws to the conspiracy by the interest of the American corporation in the foreign corporations, it was constrained not to collapse these legal entities into an ultimate U. S. person because this could have had the effect of destroying the conspiracy between them. Nevertheless, in other fields the court has likewise refused to look behind the incorporation of a foreign entity to ultimate U. S. ownership and control, when it could have done so in order to apply federal law extraterritorially. *McCulloch v. Sociedad Nacional*, *supra* note 136.

In *Steele v. Bulova Watch Co.*,¹⁵⁸ the Supreme Court applied the Lanham Trade-Mark Act of 1946¹⁵⁹ to award relief to an American corporation against acts of trademark infringement and unfair competition consummated in Mexico by a citizen and resident of the United States. In so doing, the Court primarily relied on the nationality exception to the rule that legislation should not be applied extraterritorially. The Court also felt that the defendant's activities could have an adverse effect on U.S., as well as foreign, markets. Finally, the Court found that since Mexico had nullified the defendant's trademark registration, no interference with the sovereignty of another nation was involved. The Court disregarded as immaterial the fact that all of the elements of the violation occurred abroad by linking the defendant's acts abroad to certain acts in the U.S. and categorizing his conduct as "a device [to] evade the thrust of the laws of the United States in a privileged sanctuary beyond our borders."¹⁶⁰

In *Vanity Fair Mills v. T. Eaton Co.*,¹⁶¹ the Second Circuit refused to extend the holding of the *Steele* case or apply the Lanham Act to the activities of Canadians in Canada. The Court viewed the *Steele* case as being based on the power of the U.S. to govern the conduct of its own citizens, and then only when the rights of other nations or their nationals are not infringed.¹⁶²

A noteworthy effort to give selective extraterritorial effect to the Jones Act was made by the Supreme Court in *Lauritzen v. Larsen*.¹⁶³ The Court recognized the problem of determining whether a federal statute should determine rights and liabilities *prima facie* regulated by the statute, where the United States and a foreign country possess concurrent jurisdiction over the action, as falling into the category of conflict of laws, and Mr. Justice Jackson set forth a standard for resolving the conflict which was subsequently dubbed the "substantial contacts" test.¹⁶⁴ This test valued points of contact between the transaction and the states whose competing laws are involved, and weighed the significance of one or more connecting factors between the transaction regulated and the national interest served

¹⁵⁸344 U.S. 280 (1952).

¹⁵⁹15 U.S.C. § 1051 *et seq.*

¹⁶⁰344 U.S. at 287. The dissenting justices were of the view that the acts of the defendant within the United States were not illegal, and his acts abroad were not within the control of Congress. 344 U.S. at 291-92.

¹⁶¹*Supra* note 100.

¹⁶²234 F.2d at 642-43.

¹⁶³345 U.S. 571 (1953).

¹⁶⁴*Bartholomew v. Universe Tankships, Inc.*, 263 F.2d 437 (2d Cir.), *cert. denied*, 359 U.S. 1000 (1959).

by the assertion of authority.¹⁶⁵ The difficulty with this standard is its uncertainty, and the inconsistent results to which it can lead.¹⁶⁶

The variety of different contentions and considerations which can go into a determination of whether to give extraterritorial effect to federal legislation is demonstrated by a series of Supreme Court cases concerning the applicability of the National Labor Relations Act to the Panlibhon fleet.¹⁶⁷ The factual and political background to these cases was efforts by American labor unions to organize the crews of foreign flag ships which had been built and organized abroad by American shipowners. In *Benz v. Compania Naviera Hidalgo, S.A.*,¹⁶⁸ the Supreme Court refused to apply the National Labor Relations Act to bar the power of a federal district court to award damages against an American union which struck a Panlibhon shipper, where the contacts of the plaintiff's vessel with American commerce were irregular and insubstantial. However, in *Marine Cooks v. Panama Steamship Co.*¹⁶⁹ the Supreme Court held that the Norris-LaGuardia Act¹⁷⁰ prohibited a federal district court from enjoining the shoreside picketing of a foreign flag ship. In the interim, the National Labor Relations Board [hereinafter referred to as "NLRB"] assumed jurisdiction over labor disputes involving Panlibhon vessels where their contacts with American commerce were regular and substantial.¹⁷¹

The jurisdiction of the NLRB to assume jurisdiction over controversies with foreign flag ships was ultimately tested in *McCulloch v. Sociedad Nacional*.¹⁷² The *McCulloch* case originated in a petition by the National Maritime Union filed with the NLRB against United Fruit Company, a New Jersey corporation which was the sole stockholder of a Honduran corporation which owned a Honduran flag ship. The Union sought to be certified as the representative of the unlicensed foreign seamen aboard the Honduran flag ship. The Supreme Court held that the coverage of the National Labor Relations Act was limited to American workingmen, and that the NLRB's exercise of jurisdiction over foreign flag ships had created

¹⁶⁵345 U.S. at 582.

¹⁶⁶*Compare* *Gkiafis v. Steamship Yiosonas*, 387 F.2d 460 (4th Cir. 1967), with *Anastasiadis v. S. S. Little John*, 346 F.2d 281 (5th Cir. 1965), *cert. denied*, 384 U.S. 920 (1966). See *Karros v. S/S Liryc*, 247 F. Supp. 554 (E.D. Va. 1965); *Moutzouris v. National Shipping & Trading Co.*, 194 F. Supp. 468 (S.D.N.Y. 1961).

¹⁶⁷See Comment, 36 N.Y.U.L. REV. 1342 (1961); Comment, 69 YALE L.J. 498 (1960); *supra* note 136.

¹⁶⁸353 U.S. 138 (1957).

¹⁶⁹362 U.S. 365 (1960).

¹⁷⁰29 U.S.C. §§ 101-15.

¹⁷¹*West India Fruit & S. S. Co.*, 130 N.L.R.B. 343 (1961).

¹⁷²*Supra* note 136.

international discord. The Court rejected the NLRB's adoption of the "substantial contacts" test of *Lauritzen v. Larsen* on the ground that it "would inevitably lead to embarrassment in foreign affairs and be entirely infeasible in actual practice."¹⁷³

In the *McCulloch* case, the position of the NLRB was opposed in *amicus curiae* briefs filed by the United States (on behalf of the Department of State) and the Governments of the United Kingdom and the Republic of Honduras. The position of the NLRB was supported in an *amicus curiae* brief filed by the American Federation of Labor and Congress of Industrial Organizations. The Court was unanimous in accepting the views of the State Department over those of organized labor and the NLRB.¹⁷⁴

The views of the State Department, when expressed in cases of this type, are influential. Further, where such views are ignored, they may ultimately prevail in Congress. In *Vermilya-Brown v. Connell*,¹⁷⁵ where the Court rejected foreign policy consideration urged by the State Department, Congress amended the Fair Labor Standards Act to agree with the views of the State Department, and in effect reversed the Supreme Court's decision.¹⁷⁶

What the foregoing cases portend regarding the extraterritorial application of the securities acts is difficult to predict. If precedents from the anti-trust field are relied upon, the margin regulations could be made applicable to foreign financial institutions on the ground that their lending activities have a substantial effect on the volume of credit in the U.S. securities markets.¹⁷⁷ Further, Congress presumably could condition trading in American securities markets upon compliance with the margin regulations, particularly where such trading is effected on behalf of U.S. citizens or residents.¹⁷⁸ The crucial question then becomes whether Congress

¹⁷³372 U.S. at 19.

¹⁷⁴Mr. Justice Douglass, in a concurring opinion, stated that he had expressed his views in his dissenting opinion in *Benz v. Compania Naviera Hidalgo, S.A.*, and he was therefore bowing to the "inexorable extension" of the *Benz* case by joining in the result. 372 U.S. at 23.

¹⁷⁵*Supra* note 139.

¹⁷⁶74 Stat. 417 (1960).

¹⁷⁷Congress did not have sufficient information to make such a finding when it enacted the Exchange Act, note 24, *supra*, and the SEC Special Study contains no such data, note 56, *supra*. Whether the lending activities of a single foreign financial institution are sufficiently substantial to affect the U. S. economy seems questionable. A determination as to whether the effect of loans made by foreign lenders generally is substantial would appear to fall within the expertise of the SEC or Federal Reserve Board, rather than a court faced with a single action. However, such a determination appears more appropriate to the rule-making rather than the prosecuting or adjudicatory functions of the agencies. See text at notes 226-49, *infra*.

¹⁷⁸*Cf. Brown v. Duchesne*, *supra* note 148; *Fontaine v. Securities and Exchange Commission*, *supra* note 41.

intended to do so by the language of Section 30(b) of the Exchange Act. This is essentially the approach which has been taken by the Second Circuit in applying the Exchange Act to foreign activities.¹⁷⁹

On the other hand, if the experience of the NLRB in attempting to assert jurisdiction over foreign flag ships is taken as a guide, an attempt by the SEC to assert jurisdiction over foreign financial institutions in their dealings with foreigners could be denounced by the Courts, particularly if the Department of State chooses to express a point of view contrary to the SEC. In this connection it should be noted that the Treasury Department's position that increased foreign investment in U.S. securities is necessary to improve the country's balance-of-payments¹⁸⁰ would only indirectly be contravened by a holding that foreign financial institutions must comply with the margin requirements in their dealings with Americans.¹⁸¹

E. Factual Considerations—Differences in the Activities of Foreign Financial Institutions

One reason it is difficult to predict how Section 30(b) of the Exchange Act will be interpreted relative to the imposition of the margin requirements on foreign financial institutions is that the practices of such institutions in lending money on U.S. securities vary widely. At one extreme, a foreign bank may purchase securities through an omnibus account at a member firm for American customers, and extend credit to such customers for the purpose of purchasing such securities on easier terms than the margin regulations permit, and use the securities purchased to collateralize such loans. These were the alleged facts underlying the indictments against Arzi Bank, A.G., American Securities Co. and Weisscredit Bank.¹⁸² Since the banks had voluntarily agreed to abide by the margin regulations,¹⁸³ they are in a poor position to contest being subjected to such regulations.¹⁸⁴

At the other extreme, a foreign financial institution may extend credit to

¹⁷⁹In *Roth v. Fund of Funds, Ltd.*, and *Schoenbaum v. Firstbrook*, *supra* note 4, the Second Circuit cited precedents from the antitrust area in giving extraterritorial effect to the Exchange Act, and particularly relied upon *United States v. Aluminum Company of America*, *supra* note 80.

¹⁸⁰*See* note 6, *supra*.

¹⁸¹The recommendations of the Fowler Report are all designed to increase truly foreign investment in U. S. securities. However, a campaign to apply the margin regulations to foreign financial institutions in any way could dampen the enthusiasm of such institutions for investing in U. S. securities. *See* S. J. Rundt & Associates, *supra* note 1.

¹⁸²*Supra* note 1.

¹⁸³*See* text at notes 45-48, *supra*. Since July 8, 1969, a foreign financial institution may not open an omnibus account unless it is registered as a broker-dealer with the SEC.

¹⁸⁴Arzi Bank, A.G. pleaded guilty to the indictment against it and was fined \$2,500.

foreigners abroad, in loans collateralized by U.S. securities, for the purpose of purchasing or carrying such securities, and the foreign financial institution may not even maintain a brokerage account at a U.S. firm.¹⁸⁵ In such a situation, although an argument could be made in favor of applying the margin regulations to this transaction,¹⁸⁶ it would be difficult to justify such an application under customary principles of international law or any reasonable interpretation of Section 30(b) of the Exchange Act.

A more common situation, however, is that of the foreign financial institution which maintains either a cash or margin account at a U.S. firm, through which it purchases U.S. securities for customers and extends credit to such customers for the purpose of purchasing such securities on easier terms than the margin regulations permit, and uses the securities purchased to collateralize such loans. In such a situation, the foreign financial institution would appear to be acting as a broker, and therefore fall within the literal definition of a "creditor" under Regulation T.¹⁸⁷ Further, since its purchases are effected in the U.S. securities markets, a court could find that such brokerage transactions are "within" the jurisdiction of the United States, even if the foreign institution places its orders abroad, either at a foreign branch office of a U.S. broker, or through some facility of foreign commerce such as a telex communication.¹⁸⁸ On the other hand, if the loan transaction is executed abroad, a court could find that the extension of credit which is the gravamen of any violation of the margin regulations, is "without" the jurisdiction of the United States. Whether the collateral for the loan is physically maintained within or outside the United States could be a relevant, but not necessarily a controlling, factor. Likewise, a court could find that even the brokerage transaction is effected "without" the jurisdiction of the United States if the contract to purchase the securities between the foreign institution and its customer is made abroad.

In this type of a case, a court's predilections in determining the law to apply in ordinary conflict of laws questions in contract cases could influence its findings as to whether the brokerage and/or loan transactions of a foreign bank are within or without the United States. Unfortunately, this is an area where any of the following principles could be applied: (1) place where the contract is executed; (2) place where the contract is to be

¹⁸⁵Nevertheless, such a situation probably would involve delivery of the securities against payment to a bank in the United States for the account of the foreign bank. *Cf. Metro-Goldwyn-Mayer, Inc. v. Transamerica Corporation, supra* note 64.

¹⁸⁶See text at note 220, *infra*. See also text at notes 101-04, *supra*.

¹⁸⁷Text at notes 25-26, *supra*. See *II Loss, supra* note 14, at 1240, note 1.

¹⁸⁸*Roth v. Fund of Funds, Ltd., supra* note-4.

performed; (3) intent of the parties; or (4) center of gravity.¹⁸⁹ The most commonly followed rule in the case of brokerage contracts is the place of performance, which would be the United States.¹⁹⁰ However, the most commonly followed rule in the case of loan contracts, is the intent of the parties, and absent such expressed intent, the place where the loan instrument is signed.¹⁹¹ If precedents are gathered from cases involving assertedly usurious contracts, which could possibly be considered analogous, almost any choice of law could be justified, since the courts tend to uphold such contracts unless they violate a strong public policy of the forum.¹⁹²

Although conflict of law principles have influenced courts in determining the extraterritorial application of federal legislation,¹⁹³ cases arising under "long-arm" service-of-process statutes and turning on the issue of personal jurisdiction are possibly more pertinent. This is because the jurisdictional hook of such statutes is frequently the transacting of business "within" the jurisdiction by the defendant. Presumably, if the defendant was found not to be transacting business "within" the jurisdiction, he was transacting business "without" the jurisdiction, in the same sense as the word "without" is used in Section 30(b) of the Exchange Act.¹⁹⁴

In *Boas & Associates v. Vernier*,¹⁹⁵ a business broker and industrial consultant sued the principal stockholder and chief executive officer of a French corporation for commissions earned pursuant to an oral contract in introducing the defendant to certain French underwriters leading to a merger of two French corporations. The court held that there was no evidence that the defendant transacted business within the State under the New York "long-arm" statute, and dismissed for lack of jurisdiction:

¹⁸⁹Leflar, *supra* note 116, at §§ 121-29. See generally EHRENZWEIG, *supra* note 121, at 453-511.

¹⁹⁰Gratz v. Claughton, 187 F.2d 46, 49 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951) (relied upon by the district court in *Roth v. Fund of Funds, Ltd.*, 279 F. Supp. 935 (S.D.N.Y. 1968), *aff'd supra* note 4); MEYER, THE LAW OF STOCK BROKERS AND STOCK EXCHANGES § 181 (1931). In the case of transactions over a securities exchange, the law of the place of the exchange is regarded as the best and is the most common choice of law no matter what theory is utilized in selecting this law. See EHRENZWEIG, *supra* note 121, at 524, 532.

¹⁹¹Leflar, *supra* note 116, at § 133. Banking transactions are generally governed by the law where the bank is located, and there are important policy considerations for adhering strictly to this rule. Ehrenzweig, *supra* note 121, at 523-24.

¹⁹²*Id.*, at 482-85; Leflar, *supra* note 116, at § 131.

¹⁹³Lauritzen v. Larsen, *supra* note 173.

¹⁹⁴The Railway Labor Act was held inapplicable to employees of domestic airlines flying between points outside the United States because the jurisdiction of the Railway Labor Board is limited to carriers engaged in transportation "within" the United States. *Air Line Stewards v. Trans World Airlines, Inc.*, 267 F.2d 170 (8th Cir.), *cert. denied*, 361 U.S. 901 (1959).

¹⁹⁵22 App. Div. 2d 561, 257 N.Y.S. 2d 487 (1st Dep't 1965) (*per curiam*).

In the absence of any showing that the oral agreement with defendant was negotiated or concluded by defendant in New York, or that defendant did any other act with respect to the oral agreement in New York, it cannot be said that the causes of action arose from an act of defendant in the transaction of business within the State. . . . The fact that a prior written agreement [negotiated and executed in New York] was historically necessary to the inception of the subsequent oral agreement does not alone, for purposes of the jurisdiction statute, support personal jurisdiction.

This same logic perhaps could be used to contend that a loan by a foreign bank to a customer is not transacted within the United States, even if the purchase of a U.S. security is necessary to the transaction.

One factor which could determine whether the margin requirements are applied to a foreign financial institution is whether the customer of the institution is a U.S. or foreign national. Since the margin regulations are directed at the lender, rather than the borrower, the assertion of jurisdiction over a foreign bank which extends credit to U.S. citizens or residents cannot be justified under the nationality exception to the territorial principle of international law.¹⁹⁶ However, a distinction between U.S. and foreign borrowers could be justified under the objective territorial theory, particularly as extended by the antitrust cases. Where a foreign bank deals with a U.S. borrower, it can be argued that such transactions have a more direct, foreseeable and substantial effect within the United States which is in contravention of the objectives of the margin regulations.¹⁹⁷ Further, given the expense and inconvenience of effecting securities transactions through foreign banks, the majority of such transactions are more obviously intended to evade the margin requirements or some other U.S. law. For this reason, and because the margin regulations were intended, in part, to protect U.S. borrowers against themselves, the United States would appear to have a more legitimate interest in attempting to regulate such transactions than in attempting to regulate transactions between foreign lenders and foreign borrowers.¹⁹⁸ Additionally, the affront to the sovereignty of another nation, on a practical, if not a theoretical level, is not as great if the United States attempts to regulate relationships between its citizens and foreign banks as it would be if the United States attempted to regulate relationships between foreign nationals and foreign banks.

A letter which was sent by the Swiss Bankers Association to its members in December 1968 (following the Arzi Bank prosecution) is some indication of how a distinction between foreign and U.S. borrowers in the

¹⁹⁶*Vanity Fair Mills v. T. Eaton Co.*, *supra* note 100.

¹⁹⁷Text at note 83, *supra*; *United States v. Aluminum Company of America*, *supra* note 80.

¹⁹⁸*Cf.* 68 COLUM. L. REV., *supra* note 4, at 106, 108.

application of the margin regulations would be received. The letter stated that it was the position of the Association that Regulations G, T and U were made in the interest of American credit policy and could not, from a legal point of view, be applied to foreign financial institutions. Nevertheless, the Association recommended that Swiss banks keep informed as to the margin rates in force and consider in a suitable way these margin rates when granting credits to American customers against American securities.¹⁹⁹

Another factor which could be determinative in deciding whether a foreign financial institution is transacting a securities business within the jurisdiction of the United States is whether a power of attorney has been given to a U.S. citizen or resident to place orders for the purchase and sale of securities at a U.S. firm.²⁰⁰ If a foreign financial institution is engaging in such a practice, a court could find that the institution is transacting business in the U.S. through an agent. In *United States v. Scopony Corporation of America*,²⁰¹ the question was raised as to whether a British corporation, with its offices and principal place of business in London "transacted business" or was "found" within the Southern District of New York under the venue and service-of-process provisions set forth in Section 12 of the Clayton Act.²⁰² The British corporation had transferred its most crucial business interests to an American subsidiary, and the Court found that the subsidiary was completely dominated and controlled by its foreign parent. Further, the foreign corporation had given a comprehensive power of attorney to one of its directors to act with regard to its interests in the United States, including those of its American subsidiary. Based on these facts, the Court found that the British corporation was transacting business of a substantial character in New York, so as to establish venue there, and that the corporation was found in New York, so as to be amenable to service-of-process.²⁰³

Nevertheless, in attempting to clarify the extent to which the antitrust laws may regulate the activities of foreign companies, the Department of Justice has stated that "[t]he mere maintenance or absence of agents or

¹⁹⁹Swiss Bankers Ass'n Circular No. 3925 (Dec. 4, 1968). See *Swiss Bankers Group Acts to Dispel Idea of Illegal Activities*, Wall St. J., Dec. 12, 1968, at 14, col. 3, Cf. EHRENZWEIG, *supra* note 121, at 523-24.

²⁰⁰If a European bank is acting on behalf of a U. S. citizen or resident who is trading actively, such an arrangement frequently would be necessary because of the time difference between Europe and the United States.

²⁰¹333 U. S. 795 (1948).

²⁰²15 U.S.C. § 22. The section of the Exchange Act setting forth venue and service-of-process requirements is very similar in its wording. 15 U.S.C. § 78aa.

²⁰³Cf. *United States v. Montreal Trust Co.*, *supra* note 105.

subsidiaries in the United States neither grants nor negatives jurisdiction, which depends rather upon a complete review of all activities of the foreign company in the United States of a substantial character." Further, such "substantial" activities which justify the assertion of jurisdiction, need not be pursuant to the agreement illegal under the antitrust laws.²⁰⁴

It should be noted that the credit restrictions placed upon a U.S. broker-dealer which maintains a cash or margin account for a foreign financial institution are not affected by the question of whether such institutions are subject to the margin regulations. If a foreign customer of a U.S. broker-dealer is violating the margin regulations, the U.S. broker-dealer is not liable for such violations unless it aids or participates in them.²⁰⁵ For example, a U.S. broker-dealer could not direct its customers to a foreign bank for the purpose of avoiding the margin regulations because this would be arranging for credit on terms other than the U.S. broker-dealer could give. There is no question of international law involved because the U.S. broker-dealer would be prohibited from such activities whether the foreign bank is subject to the margin regulations or an unregulated lender.²⁰⁶

IV. The Positions of the Federal Regulatory Agencies

A. The Federal Reserve Board

There are very few interpretations by the Federal Reserve Board dealing with the applicability of the credit regulations to foreign financial institutions. The Board has ruled that when a creditor having a foreign branch office which is carrying securities for a foreign customer executed within the United States an order for the purchase of a registered security for such foreign customer, such transaction is subject to the provisions of Regulation T.²⁰⁷ This interpretation implies that the nationality of the customer of a foreign bank is not relevant to the issue of whether the bank is subject to the margin regulations.

In another ruling, the Board was asked whether a domestic broker may borrow in the ordinary course of business from a foreign broker on regis-

²⁰⁴Memorandum prepared by Dep't of Justice and transmitted to Embassy of Japan, Washington, D. C., with note of July 3, 1958, M.S. Dep't of State, file 411.946/5-1458, quoted in 6 WHITEMAN, *supra* note 81, at 135-36.

²⁰⁵Russell L. Irish, *supra* note 33.

²⁰⁶Sutro Bros. & Co., *supra* note 13. See *United States v. Lerner*, *supra* note 1; *United States v. Coggeshall & Hicks*, *supra* note 4. In *United States v. Weisscredit Banca Commerciale e D'Investimenti*, *supra* note 1, the U.S. broker-dealer at which Weisscredit Bank maintained an account was not named as a defendant or co-conspirator, but a vice-president and registered representative of the firm was indicted.

²⁰⁷1934 Fed. Res. Bull. 692. The Board recently reaffirmed this interpretation in response to an inquiry by the New York Stock Exchange. M. F. Educational Circular No. 244 (Nov. 8, 1968).

tered non-exempted securities. The foreign broker maintained no place of business in the United States but transacted business in securities through a member firm. The Board denied the domestic broker permission to effect such loans and stated that it was therefore "unnecessary for present purposes to determine whether, or to what extent, the foreign broker would be required to comply with Regulation T." However, the Board stated that the foreign broker "appears to fall within the definition of the term 'creditor.'" ²⁰⁸

Between the date of this ruling (1939) and the present, the Federal Reserve Board has either not decided or not stated whether foreign financial institutions are subject to Regulation T. In its initial announcements of proposed amendments to the omnibus account provisions (set forth above), the Board stated that the amendments were not intended to make foreign banks or broker-dealers subject to Regulation T, but it did not state that such institutions were not subject to the Regulation.²⁰⁹ By then amending the omnibus account provisions so that only broker-dealers registered with the SEC may now open or maintain omnibus accounts,²¹⁰ the Board avoided making any determination as to whether foreign financial institutions are subject to the margin regulations, and probably left the resolution of this problem to the SEC, Department of Justice and private litigants.

Similarly, although at the time the Federal Reserve Board initially promulgated Regulation G, it announced that foreign lenders would be subject to the Regulation, this announcement was directly related to the proposed agency provisions to Regulation T, U and G, and the agency provisions never became effective.²¹¹ However, when the Board revoked the agency provisions, it did so on the ground that they were unenforceable, rather than on the ground that the credit Regulations were inapplicable to foreign institutions.²¹²

The abortive history of the agency provisions indicate that the Federal Reserve Board would draw a distinction between situations in which foreign financial institutions are extending credit to U.S. citizens or residents and situations where credit is extended to foreign nationals. Such a distinction would appear to have some basis under principles of international law.²¹³ Also, it is a distinction which has been made by the SEC with

²⁰⁸1939 Fed. Res. Bull. 721.

²⁰⁹Text at note 47, *supra*.

²¹⁰Text at notes 47-48, *supra*.

²¹¹Text at notes 49-60, *supra*.

²¹²Text at note 53, *supra*.

²¹³*Supra* notes 197-99.

respect to registration requirements the agency has imposed upon foreign issuers.²¹⁴ Further, such a distinction would complement the Foreign Investors Tax Act.²¹⁵

At the same time, a ruling that foreign financial institutions which extend purpose credit to U.S. citizens or residents are subject to the margin regulations, whereas institutions which only extend credit to foreign nationals are not, probably would encourage widespread evasion of the law. Since a corporation has the nationality of the jurisdiction in which it is incorporated,²¹⁶ there would be nothing in the securities acts to prevent Americans wishing to avoid the margin regulations by obtaining credit from foreign banks from forming a foreign corporation to do so.²¹⁷ Further, a U.S. citizen could become a customer of one foreign bank which could than obtain a purpose loan from another foreign bank. Nevertheless, it may be that because of the conflicting monetary public policy questions, and the delicate international and foreign policy questions involved, this is an area where the Federal Reserve Board would be willing to adopt a compromise which would eliminate some, if not all, foreign credit flowing into the U.S. securities markets. By amending the omnibus account provisions so as to make the easier credit which may be obtained through an omnibus account available only to broker-dealers registered with the SEC, the Board displayed restraint and flexibility in this area, and a disinclination to assert its jurisdiction beyond its powers to enforce its regulations.

B. The SEC

Although the Federal Reserve Board promulgates and interprets the credit regulations, the SEC is primarily responsible for enforcing them. In general, and with regard to the credit regulations, the SEC takes a very expansive view of its own jurisdiction.

In the *amicus curiae* brief which the SEC filed with the Second Circuit in *Schoenbaum v. Firstbrook*,²¹⁸ the argument was made that Section 30(b) of the Exchange Act does not exempt any transactions in securities listed

²¹⁴69 COLUM. L. REV., *supra* note 4, at 109-11.

²¹⁵*Supra* note 6.

²¹⁶Section 27, *Restatement*, *supra* note 83. This is an over-simplified statement of the general rule in a complex and fluid area. See Kronstein, *The Nationality of International Enterprises*, 52 COLUM. L. REV. 983 (1952); Vagt, *The Corporate Alien: Definitional Questions in Federal Restraints on Foreign Enterprise*, 74 HARV. L. REV. 1489 (1961).

²¹⁷Although the courts might pierce the corporate veil and find ultimate American ownership and control in such a situation, they probably would not do so unless the corporation was a mere sham to evade the law. See *McCulloch v. Sociedad Nacional*, *supra* note 136. *But see Bartholomew v. Universe Tankships, Inc.*, *supra* note 164. See also *Timken Roller Bearing Co. v. United States*, *supra* note 157; *United States v. Scophony Corporation of America*, *supra* note 201; Kronstein, *supra* note 216; Vagt, *supra* note 216.

²¹⁸*Supra* note 4.

on a national exchange from the operations of the securities acts, if such transactions affect a significant national interest, even if no jurisdictional means are used in connection with these transactions. Further, the SEC expressed the view that evasion or avoidance of the margin requirements would be detrimental to a significant national interest.

Excessive speculation in listed securities, which [§§ 7 and 8 of the Exchange Act] are designed to prevent, may have an adverse effect upon American securities markets wherever it occurs. Indeed, in its report on the proposed statute the Senate Committee expressly referred to the harmful effect caused by heavy withdrawals of foreign funds from the call-money market in 1929.²¹⁹

Similarly, in an interpretative release,²²⁰ the SEC stated that it would generally raise no objections if a foreign broker-dealer performed certain limited functions in underwritings of American securities entirely or in part abroad, without registering as a broker-dealer. This release was prompted by the Fowler Report.²²¹ The limitations which the SEC placed on foreign broker-dealers participating in underwritings were (1) taking down securities sold outside the jurisdiction of the United States to persons other than American nationals; and (2) participating solely through membership in the underwriting syndicate in activities of the syndicate in the United States. The SEC pointed out that participation in such distributions would not insulate a foreign broker-dealer from the broker-dealer registration requirements if it engages in other activities which require registration. Further, "such other activities would include either selling securities into the United States or purchasing securities in the United States for sale to American investors abroad." It therefore would appear that where a foreign broker-dealer maintains an account at an American broker-dealer through which American securities are purchased and sold, the SEC would claim that the foreign broker-dealer is effecting securities transactions within the United States.²²²

The impetus behind the recent indictments against foreign banks for violations of the credit regulations has come, at least in part, from the SEC.²²³ However, these institutions were maintaining omnibus accounts,

²¹⁹P. 19, note 11. The legislative history of the Exchange Act does not support a conclusion that Congress intended to regulate foreign financial institutions. *Supra* notes 23-24. The SEC's position is criticized in 69 Colum. L. Rev., *supra* note 4, at 103, note 58.

²²⁰Securities Exchange Act Release No. 7366 (July 9, 1964). *See also* Securities Exchange Act Release No. 8537 (Feb. 25, 1969).

²²¹*Supra* note 6.

²²²*Cf.* II Loss, *supra* note 14, at 1291-92, note 15.

²²³The SEC transmits evidence of violations of the securities acts to the Attorney General for criminal prosecution. Section 21(e) of the Exchange Act, 15 U.S.C. § 78u(e). An SEC employee swore out the information on which the indictment in the Arzi Bank case was based.

and in connection therewith signed written statements that they were either subject to the provisions of Regulation T or would extend and maintain credit to customers only as if subject thereto and in accordance therewith. Therefore, these indictments do not necessarily stand for the proposition that Regulation T applies to the credit relations between a foreign bank and its customers if the bank is maintaining a cash or margin account.

As a practical matter, the extent to which foreign banks are or will become subject to the credit regulations may depend on the extent to which the SEC and the Justice Department decide to exert jurisdiction over foreign banks. This type of informal administrative law does not lend itself to theoretical analysis or easy prediction, but in areas such as this, it is nevertheless often the only law there is. In a December 1968 Hearing Before the House Committee on Banking and Currency regarding Practices of Foreign Banking Institutions, testimony was given by representatives of the SEC and the Justice Department regarding, among many other things, evasion of the margin requirements by Americans through Swiss bank accounts. These authorities indicated that they were primarily concerned with preventing Americans from concealing violations of federal law through the use of Swiss bank accounts.²²⁴ Since a borrower who obtains illegal credit is not guilty of any violation of the law, the interest of the SEC in this area might be further limited to situations where U.S. broker-dealers are assisting their customers to obtain financing through foreign banks which the U.S. firms could not give.²²⁵

C. The Rule Making Power of the Regulatory Agencies

Section 30(b) of the Exchange Act specifically delegates to the SEC the power to prescribe necessary or appropriate rules and regulations to prevent evasion of the Exchange Act.²²⁶ Although the House and Senate reports on the Exchange Act do little more than paraphrase Section 30(b), without elucidating its purpose, the language of the Senate report gives an emphasis to this subsection which is worth noting:

Subsection (b) provides that nothing in the act or rules and regulations shall apply to business in securities outside the jurisdiction of the United States unless such rules and regulations expressly so provide in order to prevent evasion.²²⁷

²²⁴Report of Proceedings, Practices of Foreign Banking Institutions, Hearing before House Committee on Banking and Currency (Dec. 9, 1968).

²²⁵*Sutro Bros. & Co.*, *supra* note 13, at 445. This would appear to be one of the concerns of the Federal Reserve Board in amending the omnibus account provisions. *See* text at note 47, *supra*. The principle that a borrower who obtains illegal credit is not guilty of any violation of law has been clouded by two recent cases. *See* note 78, *supra*.

²²⁶Text at note 92, *supra*.

²²⁷S. Rep. No. 792, *supra* note 15, at 23.

The SEC has not prescribed any rules or regulations under Section 30(b). The district court in *Schoenbaum v. Firstbrook* viewed such inaction in the "obvious situation" of transactions in American securities effected abroad as "further indication of the lack of interest by the United States in such transactions."²²⁸

The Federal Reserve Board similarly has authority to prescribe rules and regulations to prevent evasion of the margin regulations by persons who are not members of national securities exchanges, broker-dealers or members of the Federal Reserve System.²²⁹ The first such regulation passed by the Federal Reserve Board was Regulation G, which was primarily designed to capture the activities of factors and similar unregulated U.S. lenders. The extent to which Regulation G was intended to capture unregulated foreign lenders has never been made clear.²³⁰ Moreover, most foreign financial institutions act as broker-dealers and banks, rather than as ordinary Regulation G lenders.²³¹ Nevertheless, Regulation U could not possibly be made applicable to foreign banks,²³² and Regulation T would be a singularly inappropriate regulation to attempt to apply to foreign banks.

This is because Regulation T covers all credit transactions between a broker-dealer and its customers,²³³ in a highly complex and technical fashion. The New York Stock Exchange has its own margin regulations,²³⁴ and the NASD has adopted Regulation T as part of its Rules of Fair Practice.²³⁵ The day-to-day enforcement and interpretation of the credit regulations is conducted primarily by these regulatory agencies, rather than the SEC, and although the Federal Reserve Board interprets Regulation T to the extent that it is queried about its meaning, the Board has no power to institute any action to enforce Regulation T.²³⁶

This diffused regulatory authority is viable only because U.S. broker-dealers, and particularly member firms of the New York Stock Exchange, have structured their back office operations in a manner designed

²²⁸268 F. Supp. at 393. *Cf.* *Kook v. Crang*, *supra* note 109, at 391.

²²⁹Section 7(d) of the Exchange Act, 15 U.S.C. 78g(d). *See* S. Rep. No. 792, *supra* note 15, at 16; H. Rep. No. 1383, *supra* note 16, at 19.

²³⁰Text at notes 54-64, *supra*.

²³¹*Supra* note 28. *See* Kelly & Webb, *Credit and Securities: The Margin Requirements*, 24 Bus. Law. 1153 (1969).

²³²Text at notes 26-27, *supra*.

²³³WEISS, REGISTRATION AND REGULATION OF BROKERS AND DEALERS 74, notes 12 and 13 (1965).

²³⁴Rules 421, 431 and 432 of the New York Stock Exchange.

²³⁵N.A.S.D. Manual ¶¶ 4001-25, 5267.

²³⁶*See* Special Study, *supra* note 6, at 1-9. The SEC may review decisions of the NASD, and overturn the agency's interpretations of Regulation T. *See, e.g.*, Russell L. Irish, *supra* note 33.

to comply with Regulation T. Such firms have a "margin department," composed of "margin clerks" and their supervisors, whose primary function is to insure that adequate and proper margin is maintained in customers' accounts. This system is geared to the way in which U.S. securities transactions are settled and cleared, particularly over the national securities exchanges. To direct foreign financial institutions to alter their daily method of doing business in order to fit into this scheme would be preposterous.²³⁷

At the same time, there may be valid and justifiable reasons for subjecting foreign financial institutions to appropriate and workable rules and regulations in their lending activities on U.S. securities, particularly to U.S. citizens or residents. However, the crux of the problem is whether *excessive* foreign credit is flowing into the U.S. securities markets, through *evasions* of the margin regulations, or rather, whether the amounts of foreign credit is a mere leak which annoys the regulatory agencies. Both the answer to this question and the solution to this problem, if indeed, a serious problem exists, would appear to be peculiarly within the rule-making functions of the SEC or the Federal Reserve Board.²³⁸

The views expressed by the SEC in *Schoenbaum v. Firstbrook*, indicate that the agency does not regard its failure to enact rules or regulations under Section 30(b) as fatal to the extraterritorial application of the margin regulations.²³⁹ The Federal Reserve Board has been extremely guarded in stating whether Regulations T or G apply to foreign financial institutions.²⁴⁰ If at this point the SEC should take action against a foreign financial institution for violations of the margin regulations, it could well be exceeding its jurisdiction and abusing its discretion in failing to proceed by its rule-making powers.

²³⁷Most security credit is extended by member firms of the New York Stock Exchange. In 1962, net debit balances at such member firms accounted for over 98% of such balances of all broker-dealers registered with the SEC. Special Study, *supra* note 6, at 1. Regulation T contemplates that the New York Stock Exchange will play an active role in its day-to-day operation. For example, the Exchange has the power to grant extensions of time for the payment of funds into customers' accounts. 12 C.F.R. §§ 220.3(f) and 220.4(c)(6). In the case of a non-member, the NASD may grant such extensions. *Id.* These extensions are an important part of the mechanism by which Regulation T operates, and exemplify the impracticality of applying Regulation T to foreign banks. *Cf.* 12 C.F.R. 207.3(a). In the Special Study, *supra*, at 5, the SEC stated that foreign banks were unregulated lenders, subject to neither Regulations T nor U. Procedures to insure compliance with the margin requirements are required to be adopted and followed by member firms as part of their day-to-day supervisory responsibilities. *See* Dep't of Member Firms of the New York Stock Exchange, SUPERVISION AND MANAGEMENT OF REGISTERED REPRESENTATIVES AND CUSTOMER ACCOUNTS, 3, 8, 13, 17, 22 (1967).

²³⁸69 COLUM. L. REV. *supra* note 4, at 108-11.

²³⁹Text at note 219, *supra*.

²⁴⁰Text at notes 47, 51-53, 208-10, *supra*.

The construction put on a statute by the agency charged with administering it is entitled to deference by the courts, and ordinarily that construction will be affirmed if it has a reasonable basis in law. However, the courts are the final authorities on issues of statutory construction, and may reverse an administrative decision which is inconsistent with a statutory mandate, or the congressional policy underlying a statute.²⁴¹ Further, the rules and regulations of an administrative agency may not extend a statute or modify its provisions.²⁴² Where an agency acts in excess of its delegated powers, the courts may examine and overturn the agency's exercise of jurisdiction.²⁴³ Where international affairs or foreign policy considerations are jeopardized by the action of an administrative agency, the authority delegated to the agency becomes particularly subject to judicial scrutiny because the power to act on behalf of the United States in this area is peculiar to the executive, rather than the legislative branch of the government.²⁴⁴

Whether an administrative agency proceeds by general rule or by individual, *ad hoc* litigation is a choice that lies primarily within the agency's discretion. However, since an agency has the ability to make new law through the exercise of its rule-making power, it has less reason than a court to rely upon *ad hoc* adjudication, for the purpose of formulating standards of conduct for the future. In situations involving the retroactive application of a new standard, the agency should generally proceed by rule-making rather than adjudication except where (1) the agency cannot reasonably foresee the problems involved when it institutes a case; (2) the agency has insufficient experience with a problem to warrant the imposition of a hard and fast rule; or (3) the problem is so specialized and varying in nature as to be impossible of capture within a general rule.²⁴⁵

²⁴¹*Volkswagen Aktiengesellschaft v. Federal Maritime Commission*, 390 U.S. 261, 272 (1968).

²⁴²*Campbell v. Galeno Chemical Company*, 281 U.S. 586, 610 (1930); *Morrill v. Jones*, 106 U.S. 466 (1882).

²⁴³*McCulloch v. Sociedad Nacional*, *supra* note 136, at 16-17.

²⁴⁴*Id.*; *see United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304, 318 (1936). There is no real question that Regulations T and G were promulgated pursuant to legislative power constitutionally delegated to the Federal Reserve Board. *United States v. McDermott*, 131 F.2d 313 (7th Cir. 1942), *cert. denied*, 318 U.S. 765 (1943); *Collateral Lenders Committee v. Board of Governors*, 281 F. Supp. 899 (S.D.N.Y. 1968). *See generally* SCHWARTZ, AN INTRODUCTION TO AMERICAN ADMINISTRATIVE LAW 26-54 (1958). However, powers incidental to sovereignty in the international sense, are inherent in the executive, and were never delegated to Congress by the states. This is why Congress cannot enact legislation which is contrary to the law of nations. An administrative agency, being a creature of the legislative branch, would similarly be prohibited from adopting or applying regulations contrary to the law of nations. *United States v. Curtiss-Wright Export Corp.*, *supra*. *But see Branch v. Federal Trade Commission*, 141 F.2d 31 (7th Cir. 1944).

²⁴⁵*Securities and Exchange Commission v. Cheney Corp.*, 332 U.S. 194 (1947).

Since the question of whether an agency should proceed by its rule-making or adjudicative procedures in law making is essentially a question of jurisdiction, rather than of power,²⁴⁶ the courts have been reluctant to hold that an agency abused its discretion in failing to take the rule-making route.²⁴⁷ Nevertheless, the rule-making procedures of administrative agencies are probably the most important safeguard in the administrative process for insuring the fair and proper exercise of their powers.²⁴⁸ In an area which impinges upon international relations such as the extra-territorial application of the margin regulations, the SEC and the Federal Reserve Board would be well advised to proceed by their rule-making powers, rather than the less politic procedure of criminal prosecution, or even civil injunctive action.²⁴⁹

V. Liabilities for Violation of the Credit Regulations

A. Action by the SEC

When violations of the credit regulations are discovered by the SEC, the agency may institute an injunctive action pursuant to Section 21(c) of the Exchange Act,²⁵⁰ or administrative proceedings pursuant to Section 15(b)(5) of the Exchange Act.²⁵¹ Although the SEC would have power to institute administrative proceedings against a foreign financial institution, it is extremely unlikely that it would do so, because the only sanction which the agency could impose would be to bar the institution from being registered as a broker-dealer. This is an irrelevant remedy against a foreign financial institution which is not so registered. However, if a U.S. bro-

²⁴⁶National Labor Relations Board v. A.P.W. Prods. Co., 316 F.2d 899 (2d Cir. 1963).

²⁴⁷But see National Labor Relations Board v. Guy F. Atkinson Co., 195 F.2d 141 (9th Cir. 1952).

²⁴⁸SCHWARTZ, *supra* note 244, at 55-75.

²⁴⁹At the very least, an interpretative release would be in order. *Cf.* Text at notes 220-22, *supra*. In *United States v. Lerner*, *supra* note 1, and *United States v. Banca Weisscredit Commerciale e D'Investimenti*, *supra* note 1, indictments for violations of the omnibus account provisions were returned after such provisions had been amended so as to eliminate the possibility of any future violations such as alleged in the indictments. The propriety of such actions, especially as against the foreign defendants, is very questionable.

²⁵⁰15 U.S.C. § 78u(c). There are no reported cases involving injunctive actions instituted by the SEC based on violations of the credit regulations. In 1947, the agency brought four injunctive actions against broker-dealers for violations of the credit regulations. Three of the cases were disposed of without the entry of a final order of permanent injunction. In the other case, one defendant consented to the entry of an injunction and the other defendant defaulted. These were the first injunctive actions brought by the SEC based on Regulation T violations, and they appear to have been test cases. 13 SEC Ann. Rep. 59 (1947). See Comment, 62Nw. U. L. REV. 587 (1967).

²⁵¹15 U.S.C. § 78o(b)(5). The SEC has instituted a number of cases against broker-dealers for violations of Regulation T. However, it has also relied on the stock exchanges and the NASD to enforce the credit regulations against their members. See note 237, *supra*.

ker-dealer should violate the credit regulations in its dealings with a foreign financial institution, administrative proceedings would be appropriate against the U.S. broker-dealer.²⁵²

In an injunctive action, the SEC could obtain a court order prohibiting a foreign financial institution from extending or maintaining credit in violation of the margin regulations. If the bank then refuses to comply with this order, the bank could be held in contempt of court and fined. Because of liberal venue and service provisions of federal law, the SEC could probably obtain personal jurisdiction over a foreign bank which has no place of business in the U.S.²⁵³

Since the SEC has no power to fine, and no money damages can be obtained in an injunctive action, the financial risks of failing to comply with the margin requirements are not great, insofar as possible government action is concerned. However, the adverse publicity from such an action and the damage to a foreign bank's reputation in the American investment community could seriously impair the bank's ability to do business with U.S. broker-dealers or banks.

B. Civil Liability in a Private Lawsuit

The prohibitions of Regulation T run against the lender, rather than the borrower. In an extremely aggravated case, it is possible that a court would hold that the borrower aided and abetted the lender's violations. However, since the regulations were intended, in part, to protect the borrower against his own speculative follies, he may sue the lender for violating the credit regulations, and collect any damages he can prove resulted from such violations. The borrower's participation in the violation does not necessarily preclude him from such recovery.²⁵⁴

Further, Section 29(b) of the Exchange Act²⁵⁵ makes void any contract in violation of the Act or the rules thereunder. Accordingly, a foreign bank which extends credit to a customer in violation of Regulation T may be precluded from suing the customer for breach of a loan or sales contract. Therefore, an unscrupulous speculator has considerable (although not complete) license in this area if the securities he buys on illegal credit decline in price. In *Serzyskso v. The Chase Manhattan Bank*,²⁵⁶ a professional trader

²⁵²*E.g.*, *Sutro Bros. & Co.*, *supra* note 13.

²⁵³*United States v. Scophony Corporation of America*, *supra* note 201; *Securities and Exchange Commission v. VTR, Incorporated*, *supra* note 101.

²⁵⁴*Remar v. Clayton Securities Corp.*, *supra* note 18. *But see Moscarelli v. Stamm*, *supra* note 18. *Kelly & Webb* *supra* note 231, at 1170-74. *See* note 78, *supra*.

²⁵⁵15 U.S.C. § 78cc(b).

²⁵⁶*Supra* note 18.

borrowed money from a bank to speculate in violation of Regulation U and intentionally misled the bank as to the purposes of the loan made. He sued the bank for selling out the collateral pledged for the loan at a loss. The court denied recovery on the ground that he was a professional, engaged in the securities business, and he had intentionally attempted to evade the margin regulations. However, the court also denied the bank recovery on the amount of the loan still due because the bank had violated Regulation U.

C. Criminal Prosecution

Section 32(a) of the Exchange Act²⁵⁷ provides for criminal penalties, of both imprisonment and fine, for willful violations of the provisions of the Act. Although this section states that "no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation" this provision does not affect the power of the government to impose fines for such violations.²⁵⁸ Furthermore, in the Arzi Bank case the federal authorities seized securities which the bank had at member firms as "fruits of the crime," apparently to insure that any fine levied against the defendant would be paid. The bank was fined \$2,500, although a \$10,000 fine for each violation could have been imposed under Section 32(a).

Since the question of whether a foreign financial institution is subject to Regulation T or G is so unsettled at this time, it would appear difficult for the Government to prove that a foreign bank official had knowledge of these regulations to the extent necessary to justify a criminal judgment.²⁵⁹

VI. Conclusion

The Federal Reserve Board and the SEC have shown an inclination to apply the credit regulations, specifically Regulations T and G, to foreign financial institutions in their credit relations with their customers involving loans to purchase or carry U.S. securities, collateralized by such securities. The Federal Reserve Board has indicated that it might distinguish between

²⁵⁷15 U.S.C. § 78ff(a).

²⁵⁸United States v. Guterma, 189 F. Supp. 265, 275 (S.D.N.Y. 1960). Proof of "no knowledge" of a rule requires at least proof of an ignorance of the substance of the rule, proof that the defendant did not know his conduct was contrary to law. United States v. Lilley, Docket No. Cir. 67-H-233 (S.D.Tex. Oct. 2, 1968) (*mem.*).

²⁵⁹See text at notes 100-07, *supra*. Nevertheless, the principals of foreign financial institutions have been indicted for violations of the margin regulations. *Supra* note 107. The only reported judicial opinion involving a criminal prosecution for violations of Regulation T is United States v. McDermott, *supra* note 244.

loans to U.S. citizens or residents and loans to foreign nationals in applying the credit regulations to foreign financial institutions. However, the Federal Reserve Board has not yet rendered a definite interpretation in this area, and the SEC has not taken any definitive action or announced any definitive policy.

The application of the credit regulations to foreign financial institutions would pose very serious questions under international law. To the extent that federal law has been applied extraterritorially in the past, there are no instances where a scheme of federal regulation has been applied to the day-to-day operations of a foreign industry such as banking which is traditionally subject to local regulation. Additionally, Section 30(b) of the Exchange Act provides an exemption from all provisions of the Act for any person insofar as he transacts a business in securities without the jurisdiction of the United States. Accordingly, an attempt by the regulatory agencies to apply the margin regulations to foreign financial institutions might not be upheld by the courts.

No similar problems of international law are presented by the prohibitions upon a U. S. broker-dealer against arranging for credit extensions by a foreign financial institution. Further, the conduct of accounts of foreign financial institutions are generally governed by the rules applicable to the accounts of other customers, insofar as a U. S. broker-dealer is concerned.

The application of Regulation T to foreign financial institutions would pose serious practical, as well as legal, problems. Although Regulation G could be more readily applied as a practical matter, the logic of subjecting them to this Regulation is questionable, because many if not most of the institutions which use jurisdictional facilities in connection with their credit transactions on U.S. securities do so as broker-dealers.

The SEC and Federal Reserve Board probably have the power to subject foreign financial institutions to some type of credit restrictions in their dealings in U. S. securities, at least with regard to U. S. citizens or nationals, if such dealings constitute a serious evasion of the credit regulations. In view of the delicate questions of foreign and economic policy, and the complex legal and practical problems involved in this area, it is submitted that any efforts to subject foreign financial institutions to the credit regulations should be accomplished through the rule-making powers of these agencies.