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THE EXTRATERRITORIAL APPLICATION OF THE FEDERAL SECURITIES CODE

*by Roberta S. Karmel**

I. INTRODUCTION

Provisions of the proposed Federal Securities Code (the "Code")¹ may properly be analyzed by at least two different standards. First, since the Code is in part a codification of existing law, its provisions should be scrutinized to determine whether they accurately and adequately restate the federal securities laws presently in effect, as clarified by rules of the Securities and Exchange Commission ("SEC") and as interpreted by the courts. Second, since the Code is also partially a program for legislative reform, its provisions should be discussed to determine whether they rationalize the securities laws and advance the public interest.

Section 1604 of the Code sets forth the relation of the Code to securities activities in foreign countries. Section 1604(a)(1) enumerates activities to which the Code will apply extraterritorially; its most important provision is the establishment of a jurisdictional nexus predicated alternatively upon substantial conduct or substantial effect within the United States. Section 1604(a)(2) provides for a jurisdictional nexus based on fraudulent conduct initiated within, but occurring outside the United States. Section 1604(b) enumerates foreign activities to which the Code will not apply. Section 1604(c) provides for considerable rule-making authority to be lodged with the SEC and § 1604(d) makes the personal jurisdiction coextensive with the subject matter jurisdiction of § 1604(a).

Although the section is a valiant attempt to restate existing law, it is confusing and inadequate because the state of the law is illogical

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1. See Loss, *The American Law Institute's Federal Securities Code Project*, 25 BUS. LAW. 27 (1969). Provisions of the proposed Federal Securities Code will be cited herein from ALI FED. SECURITIES CODE (Reporter's Revision of Text of Tentative Drafts Nos. 1-3, Oct. 1, 1974 [hereinafter cited as Reporter's Revision]). Comments to the Federal Securities Code will be cited from Tentative Draft No. 1 (April 25, 1972), Tentative Draft No. 2 (March 1973), and Tentative Draft No. 3 (April 1, 1974) [hereinafter all cited as Tent. Draft].

and inconsistent. The Comments to § 1604 would be more honest and helpful if they analyzed more critically the disorderly development of the law in this area. Although the Code as now drafted can be supported by the holdings of some cases, it is contrary to the holdings of others. This article will argue that the courts have required more substantial contacts with an impact upon the United States securities markets than the Code indicates is necessary for extraterritorial application of the federal securities laws. These more stringent jurisdictional requirements have been imposed to sustain both subject matter and personal jurisdiction.

Section 1604 also would reform existing law by refusing to perpetuate the vague and irrational language of § 30(b) of the Securities Exchange Act of 1934 ("Exchange Act")² and by substituting a more thorough and meaningful standard for applying the Code extraterritorially. However, § 1604 and the Comments thereto could better advance the cause of legislative reform by dealing with the question of what United States public policy is or should be in applying federal securities laws to activities in foreign countries. The Code sidesteps this fundamental question in two ways. First, the provisions of § 1604 are drafted to be interpreted "within the limits of international law," the appropriate scope of which the Code fails to define. Second, the coverage of the Code is made quite broad and the SEC is relied upon to limit and define such coverage by its rule-making process. The Code's solutions to the variegated problems of extraterritoriality are practical and at this stage of the Federal Securities Code Project, the Reporter's assumptions and attitudes are proper and understandable.

At the same time, it is the view of this writer that a distinction should be made between disclosure and regulation in the extraterritorial application of the federal securities laws. The foreign and economic policies of the United States, and the relation of the United States securities markets to foreign securities markets, are very different today from what they were forty years ago. Moreover, the SEC does not have the expertise and should not have the authority to be the arbiter of the extent to which the securities laws will be given extraterritorial application. In the domestic security markets the SEC views the public policy from the vantage point of the public investor. In the transnational and international security markets, however, public policy should be viewed in the context of foreign and international monetary policy objectives. It is hoped that before § 1604 or any successor

2. SECURITIES EXCHANGE ACT § 30(b), 15 U.S.C. § 78dd(b) (1970) [hereinafter cited as EXCHANGE ACT].

section is enacted some attention will be given to this delicate and significant area of the law, where a coherent statement of public policy is probably a prerequisite to either codification or reform.

II. CODIFICATION OF THE LAW ON EXTRATERRITORIALITY

A. *Rejection of § 30(b)*

The only provision of the federal securities laws which specifically deals with extraterritorial jurisdiction is § 30(b) of the Exchange Act which provides that

[t]he 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.³

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

There is language in some cases indicating that "without the jurisdiction" is a legal rather than a geographical concept.⁴ Some courts, however, have taken the position that in order for the Exchange Act to be applied to a transaction some activity relating to the transaction must have taken place within the territorial confines of the United States.⁵

Further gloss on § 30(b) involves interpretation of "transacting a business in securities." In *Roth v. Fund of Funds, Ltd.*,⁶ the Second Circuit stated in dictum that the security activities of an off-shore mutual fund probably did not constitute transacting a "business in securities." In so stating, the court referred to its decision in *Schoenbaum v. Firstbrook*,⁷ in which it held that defendants could not rely upon § 30(b) to exempt persons who engage in isolated foreign securities transactions. The *Schoenbaum* holding is normally interpreted

3. *Id.*

4. *E.g.*, *Bersch v. Drexel Firestone, Inc.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,889 (S.D.N.Y. 1974), *rev'd in part*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,080 (2d Cir. 1975).

5. *E.g.*, *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972); *Kook v. Crang*, 182 F. Supp. 388 (S.D.N.Y. 1960); *cf. Roth v. Fund of Funds, Ltd.*, 405 F.2d 421 (2d Cir. 1968) (*per curiam*), *cert. denied*, 394 U.S. 975 (1969).

6. 405 F.2d 421 (2d Cir. 1968) (*per curiam*) *cert. denied*, 394 U.S. 975 (1969).

7. 405 F.2d 200 (2d Cir. 1968), *cert. denied, sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969).

to mean that § 30(b) excludes from the coverage of the Exchange Act foreign activities in the ordinary course of a business in securities but not isolated securities transactions. However, applying this standard to either the *Roth* or *Schoenbaum* cases, the results are hard to understand.

The purchase and sale of securities by a mutual fund for its portfolio would certainly appear to be a transaction in the ordinary course of business by an entity in the securities business. However, the Second Circuit seems to have limited the definition of a "business in securities" to a stock brokerage business conducted by a broker-dealer or bank.⁸ Although such a definition might be justifiable in the context of the Exchange Act, it would be too limited for a Code which will replace all of the federal securities laws. Moreover, in the *Schoenbaum* case one of the defendants was 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. Why this defendant was not transacting a business in securities, and if it was, why such business was not without the jurisdiction, was never precisely articulated.

The Code rejects the language of § 30(b) for two reasons. According to Professor Louis Loss, the Reporter for the Federal Securities Code project, § 30(b) is equivocal because it does not specify whether "without the jurisdiction" means the territorial jurisdiction of the United States or its extraterritorial jurisdiction under international and American constitutional law. In addition, the Second Circuit holding that § 30(b) does not exempt isolated acts outside the territorial limits of the United States is viewed as too illogical to be perpetuated in the Code.⁹

The Reporter's decision to scrap § 30(b) and to structure a better exemption for foreign securities transactions is undoubtedly sound. Section 30(b) is contained under the title "Foreign Securities Exchanges" and its inadequacies are no doubt related to its having been drafted as part of a statute which at the time was primarily addressed to regulating transactions on the national securities exchanges. The extension of the Exchange Act by amendment to transactions in the over-the-counter markets and the extension of Rule 10b-5 by court decisions to fraudulent corporate practices generally have made § 30(b) an inappropriately narrow exemption for foreign securities transactions. Moreover, there is no comparable exemption in the

8. *Id.* at 208.

9. Tent. Draft No. 3, at 161.

Securities Act of 1933 ("Securities Act") or any of the other federal securities laws.

B. *The New Approach*

The general approach which the Code takes concerning extraterritoriality is to provide for what is probably the broadest coverage consonant with international and constitutional law principles, and then permit the SEC to create exemptions from the Code's coverage which may be more consonant with national policy.¹⁰ One historical precedent for this approach is the applicability of § 12(g) of the Exchange Act¹¹ to foreign issuers and the special rules governing them fashioned by the SEC.

1. *Historical Precedent—Rule-making under § 12(g)*

When § 12(g) was enacted in 1964, it provided for the registration by every issuer having assets exceeding \$1,000,000 of any class of an equity security held of record by 750 (and ultimately 500) persons. Although the broad language of this provision could have extended to foreign issuers, the SEC was given the authority in § 12(g)(3) to exempt from such registration any security of a foreign issuer if the Commission found that such exemption was in the public interest and was consistent with the protection of investors. In contrast to its failure to formulate rules under § 30(b), the SEC engaged in rule-making under § 12(g). Although the language of the amendments was permissive, as a practical matter the Commission was compelled to tailor the statute to the needs of foreign issuers. Moreover, since the Commission has no effective mechanism for imposing sanctions on foreign issuers which do not register under § 12(g), the registration is essentially voluntary.¹²

Charging the SEC with the responsibility for exempting foreign issuers from specific registration requirements under the Exchange Act is a very different delegation from giving the Commission merely permissive authority to exempt international and transnational securities¹³ transactions from the Code's coverage. Even in the case

10. Tent. Draft No. 3, at 164-65.

11. 15 U.S.C. § 781(g) (1970).

12. SEC Exchange Act Release No. 8068 (April 28, 1967); SEC Exchange Act Release No. 7746 (Nov. 16, 1965); Buxbaum, *Securities Regulation and the Foreign Issuer Exemption*, 54 CORNELL L. REV. 358 (1969); Goldman & Magrino, *Foreign Issuers and Section 12(g) of the Securities Exchange Act of 1934*, 23 BUS. LAW. 135 (1967); 21 REC. ASS'N BAR OF N.Y. 240 (April 1966).

13. For a definition, see text preceding note 168 *infra*.

of foreign issuer registration, it was necessary for the Commission to consider appropriate exemptions for foreign corporations from the proxy and insider trading rules.¹⁴

Any issuer which has a class of equity securities registered pursuant to § 12(g) becomes automatically subject to the SEC's proxy rules under § 14 of the Exchange Act,¹⁵ and the prohibitions against short-swing profits by officers, directors, and ten percent stockholders contained in § 16.¹⁶ When the SEC adopted rules under § 12(g)(3) it exempted foreign issuers except for North American and Cuban issuers from the rules governing proxy solicitations and short-swing profits.¹⁷ Although the Commission might have conditioned the continued use by foreign issuers of the United States capital markets upon adherence to the proxy and short-swing profit rules, such an exercise of power would not have been fair. Protection of American investors, which might have been achieved by forcing a foreign corporation to solicit proxies in accordance with American ideas about shareholder democracy, was outweighed by an interest in fostering comity among nations.¹⁸ In one recent case, the court held that applying § 16(b) to transactions by foreign officers and directors engaging in transactions in a foreign market in foreign securities which also were registered on a United States national securities exchange was sufficiently unfair as to be unconstitutional, since the defendants' contacts with the United States were insufficient to establish personal jurisdiction.¹⁹

14. 17 C.F.R. §§ 240.12g3-1, 240.12g3-2 (1974). At least insofar as insider trading is concerned, rule-making under 12(g)(3) shows the SEC's recognition of the need for greater delicacy in regulating foreign issuers, as opposed to enforcing disclosure by them. See text accompanying notes 102-21 *infra*.

15. 15 U.S.C. § 78n (1970).

16. 15 U.S.C. § 78p (1970).

17. SEC Exchange Act Release No. 8066, at 6-7 (April 28, 1967). This result is achieved by reason of Rule 3a12-3 under the Exchange Act, 17 C.F.R. § 240.3a12-3 (1974).

18. In *Kukatash Mining Corp. v. SEC*, 309 F.2d 647 (D.C. Cir. 1962), the court stated, at 250: "The stock of a foreign corporation . . . can be sold in another jurisdiction only on the terms prescribed by that jurisdiction." This does not make the imposition of all rules applicable to domestic corporations necessary or appropriate. Buxbaum, *supra* note 12, at 368-73. As the SEC recognized in one of its rule changes applicable to the application of the proxy rules to foreign issuers, "[i]n many countries, corporate practice differs sharply from that of the United States; management is not permitted to solicit or exercise proxies; and the widespread use of bearer shares makes it impossible for an issuer to send material directly to its security holders . . ." SEC Exchange Act Release No. 7746, at 4 (Nov. 16, 1965). Apparently North American issuers were not exempted from the proxy rules because they do not have bearer shares. Requiring any foreign corporation to solicit proxies in compliance with American laws offends international legal principles. 21 REC. ASS'N BAR OF N.Y. 240 (April 1966).

19. *Wagman v. Astle*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,783 (S.D.N.Y. 1974).

2. Description of § 1604

Section 1604(a)(1) provides in general that within the limits of international law the Code will apply to any offer, purchase, or sale of securities that occurs within the United States, although initiated outside the United States; to a nonresident of the United States that is an issuer registrant; to a nonresident director, officer, or principal stockholder of an issuer registrant, or to a nonresident registered broker-dealer or investment advisor; and to an attempt, solicitation, or conspiracy outside the United States to commit a violation of the Code within the United States. In addition, the Code is made applicable to

any other prohibited, required or actionable conduct (i) whose constituent elements occur to a substantial (but not necessarily predominant) extent within the United States or (ii) some or all of whose constituent elements occur outside the United States but cause a substantial effect within it (of a type that this Code is designed to prevent) as a direct and foreseeable result of the conduct.²⁰

The above quoted subsection is patterned generally upon §§ 17 and 18 of the Restatement of Foreign Relations Law.²¹ It is so broad that it is difficult to postulate any transactions which would fall within the scope of § 1604(a)(1)(A)—specifically covering offers, sales, purchases, proxy solicitations, and tender requests—which would not also be covered by Subsection (D). Despite the authority of the Restatement, this portion of the Code can be criticized on the ground that by justifying subject matter jurisdiction over a securities transaction on the alternate grounds of conduct within *or* impact within the United States, the Code is expanding the coverage of the federal securities laws beyond existing precedents.²² In addition, the Code fails to sufficiently distinguish between the disclosure and regulation objectives of the securities laws.²³

The broad coverage of § 1604(a)(1) is limited by § 1604(b) in two types of transactions. Section 1604(b)(1) exempts from the provisions of the Code, except the civil liability provisions for fraud, acts which occur outside the United States although initiated within the United States. This section would therefore exempt from the registration provisions of the Code any distributions which occur outside the

20. Reporter's Revision § 1604(a)(1)(D).

21. Tent. Draft No. 3 at 161-62.

22. See text accompanying notes 29-63 *infra*.

23. See text accompanying notes 102-21 *infra*.

United States even if such distributions are initiated by an American issuer within the United States. However, purchasers of securities distributed abroad would nevertheless have a claim if constituent elements of the distribution occurred to a substantial extent within the United States or caused a substantial effect within the United States. Whether this exemption is consistent with existing precedents or changes the law is uncertain.²⁴

Section 1604(b)(2) also will exempt from those provisions regulating broker-dealers and investment advisors any nonresident insofar as he does business with a person outside the United States or nonnational of the United States who is present as a nonresident within the United States and was previously a customer or client. Similarly, nonresident broker-dealers and investment advisors will be exempted insofar as they participate in a distribution abroad. Since the Code provisions requiring registration of broker-dealers and investment advisors and their consequent regulation have not yet been drafted, it is a little difficult to understand how § 1604(b)(2) will operate. At present it is not clear that a foreign broker-dealer which either is required to register or voluntarily registers as a broker-dealer with the SEC will have all of those rules and regulations which pertain to registered broker-dealers made inapplicable to transactions with nonresidents by virtue of the general exemptive provisions of § 1604(b)(2). It should be noted that § 1604(b) does not exempt officers or directors of issuers which are registrants under the Code with respect to any transactions by such persons even if they are nonresident nonnationals of the United States.

Section 1604(c) gives the SEC rule-making authority to exempt in whole or in part from coverage by the Code activities which are the subject matter of § 1604(a) or (b). In addition, the SEC is required to prescribe the extent to which the registration provisions of the Code shall apply to nonresident issuers.²⁵ Whether the SEC should be given such rule-making powers in an area having greater impact upon the foreign relations of the United States than upon the nation's securities markets is a decision which deserves thoughtful debate.²⁶

Sections 1604(d)(1) and (2) of the Code require various categories of registrants and officers, directors, or persons otherwise associated

24. See text accompanying notes 66-76 *infra*.

25. This provision reverses the permissive rule-making of § 12(g)(3) of the Exchange Act, but such rules already have been promulgated by the SEC. See text accompanying notes 11-12 *supra*.

26. See text accompanying notes 145-49 *infra*.

with registrants to file consents to personal jurisdiction in actions based upon the Code. In addition, § 1604(d)(3) provides that when any person, whether or not he is a United States resident or has filed a consent, engages in conduct to which the Code applies as a result of §§ 1604(a) or (c), the United States courts and the SEC shall have jurisdiction with respect to an action or proceeding against him. The thrust of this section is to virtually eliminate the defense of lack of personal jurisdiction in any case where either the court or the SEC has subject matter jurisdiction. Although the Code's Reporter states that "[t]here is no longer any substantial doubt of the constitutionality about this kind of provision,"²⁷ several recent court cases have declined personal jurisdiction over foreigners in situations where the courts indicated that subject matter jurisdiction over the transactions in litigation nevertheless existed.²⁸

C. *The Alternate Nexuses of Conduct or Effect*

The Restatement of the Foreign Relations Law of the United States would provide authority for the extraterritorial application of the securities laws to a transnational securities transaction in which conduct occurred within the geographical territory of the United States and such conduct related to a United States interest within the territory.²⁹ An alternative theory of extraterritoriality contained in the Restatement is the exercise of jurisdiction when conduct occurs outside the territory and causes an effect within the territory if

- (i) the conduct and its effect are constituent elements of activity to which [a rule of law] 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.³⁰

Either of the foregoing principles is subject to the limitation that "[a] state does not have jurisdiction to prescribe a rule of law attaching

27. Tent. Draft No. 3, at 178.

28. See text accompanying notes 137-41 *infra*.

29. RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 (1965) [hereinafter cited as RESTATEMENT].

30. RESTATEMENT § 18(b). This is sometimes called the objective territorial principle. Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1368 (1973).

legal consequences to conduct of an alien outside its territory merely on the ground that the conduct affects one of its nationals."³¹

Although the Comments to § 1604 of the Code indicate that § 1604(a)(1)(D) is based upon the Restatement, the alternate nexuses of conduct or effect set forth in that subsection³² are more expansive jurisdictional hooks than the Restatement or pertinent decisions. Since § 1604(a)(1)(D) is expressly subject to "the limits of international law" its more expansive language is not necessarily violative of international law. Nevertheless, even the narrower Restatement provisions have been criticized as going beyond the bounds of international law, if applied to foreign issuers,³³ and, as the Reporter has noted, what international law is in a given context is a "not insignificant question."³⁴ In the recent case of *Bersch v. Drexel Firestone, Inc.*,³⁵ the court declined subject matter jurisdiction over predominantly foreign transactions even though jurisdiction could have been exercised under the Restatement test. The court felt that when Congress passed the securities laws, it did not direct that the "precious resources of United States courts and law enforcement agencies be devoted"³⁶ to such foreign transactions.

1. *The Conduct Nexus*

In supporting the exercise of jurisdiction over conduct which the Code prohibits, requires, or makes actionable solely because constituent elements occur to a substantial extent within the United States, the Reporter cites three cases involving transnational securities transactions. However, a careful examination of those cases shows that each of them involved, in addition to conduct within the United States, an impact upon an interest protected and localized within the United States. Similarly, the cases relied upon to justify jurisdiction based solely on substantial effect within the United States all involved some conduct or activity within the territory of the United States, including the use of facilities of interstate commerce or the mails.

In *Leasco Data Processing Equipment Corp. v. Maxwell*,³⁷ the plaintiff alleged that Maxwell and others misrepresented the financial

31. RESTATEMENT § 30(2).

32. See text accompanying note 20 *supra*.

33. 21 REC. ASS'N BAR OF N.Y. 240, 252 (April 1966).

34. Tent. Draft No. 3, at 169-70.

35. [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,080 (2d Cir. 1975).

36. *Id.* at 97,796.

37. 468 F.2d 1326 (2d Cir. 1972).

affairs of an English corporation, while encouraging the plaintiffs to tender for its control. These misrepresentations occurred both in the United States and in England. Pursuant to the plan the plaintiff ("Leasco") acquired \$22 million of the English corporation stock on the London Stock Exchange. Some of those shares were sold by the defendants. The misrepresentations were subsequently discovered, and Leasco declined to go forward with the tender offer. It then brought this action for damages. The case is clearly the type envisioned by § 1604(a)(1)(D)(i) of the Code.³⁸ The Reporter cites *Leasco* as if the misrepresentations were the only nexus to the United States. The court initially rejected a contention that jurisdiction could be based solely on an outside act causing an effect within the territory, stating:

[i]f all the misrepresentations here alleged had occurred in England, we would entertain most serious doubt whether, . . . § 10(b) would be applicable simply because of the adverse effect of the fraudulently induced purchases in England of securities of an English corporation, not traded in an organized American securities market, upon an American corporation whose stock is listed on the New York Stock Exchange and its shareholders.³⁹

Another issue was whether jurisdiction could be based solely upon conduct within the territory. The court was troubled by such a jurisdictional holding, pointing out that this could result in the exercise of jurisdiction

where a German and a Japanese businessman met in New York for convenience, and the latter fraudulently induced the former to make purchases of Japanese securities on the Tokyo Stock Exchange.⁴⁰

Accordingly, the court ruled that in addition to conduct within the territory, the conduct must have caused a domestic impact before a sufficient jurisdictional basis could be established.

38. Tent. Draft No. 3, at 163. In the Reporter's Revision, at 233-34, a comment has been added to indicate that jurisdiction would attach on such facts even if all misrepresentations had been made in England. Although this accords with principles of federal jurisdiction over securities law violations, *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953), it is not necessarily a valid choice of law jurisdictional principle. *Finch v. Marathon Securities Corp.*, 316 F. Supp. 1345 (S.D.N.Y. 1970). See Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363 (1973).

39. 468 F.2d at 1334.

40. *Id.* at 1338.

While, as earlier stated, we doubt that impact on an American company and its shareholders would suffice to make the statute applicable if the misconduct had occurred solely in England, we think it tips the scales in favor of applicability when substantial misrepresentations were made in the United States.⁴¹

In *Travis v. Anthes Imperial Ltd.*⁴² a class action was instituted on behalf of the approximately 100 American shareholders of the defendant Canadian corporation ("Anthes"). These shareholders, who held ten percent of the outstanding shares of the defendant corporation, alleged that they had been defrauded by the defendants in connection with the tender by a second Canadian corporation ("Molson") for the Canadian-held shares of Anthes. The defendant officers encouraged the plaintiffs to retain their shares by misrepresenting that at the close of the Canadian tender offer, Molson would acquire the American shares of Anthes at an after-tax price which would be substantially equivalent to that received by the Canadian shareholders. After Molson had acquired the Canadian shares of Anthes, it offered to acquire the American-held shares at only a before-tax price equivalent to the Canadian offer.

The court rejected the defendant's contention that it lacked subject matter jurisdiction, stating that "in our view, subject matter jurisdiction attaches whenever there has been significant conduct with respect to the alleged violations in the United States."⁴³ However, as in *Leasco*, the court was chary about imposing liability merely upon the nexus of conduct within the territory. The court articulated its exercise of jurisdiction in the language of § 18 of the Restatement:

The self dealing in Canada and resulting diminution in the value of the plaintiffs' stock and lesser dividends received by Anthes shareholders in the United States are constituent elements of activity to which the statute and rule apply; the effect on the value of the plaintiffs' stock is substantial; the diminution occurred as a direct and foreseeable result of the conduct outside the territory; and the rule is not inconsistent with principles of justice generally recognized by states that have reasonably developed legal systems.⁴⁴

41. *Id.* at 1337.

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

43. *Id.* at 524.

44. *Id.* at 528. The reading given this case by the Reporter is plausible, however, as

The need for impact upon a significant American interest was also stressed in the last of the cases cited by Professor Loss in support of the conduct within nexus contained in § 1604(a)(1)(D)(i). In *Selas of America (Nederland) N.V. v. Selas of America Corp.*,⁴⁵ the defendant American corporation ("SCA") contracted in the United States, with a number of key employees of its Netherlands subsidiary ("SAN") to sell sixty percent of SAN to a corporation ("GK") organized solely for that purpose. SAN and GK, the plaintiffs in this litigation, alleged that SCA made a number of misrepresentations in connection with the sale of SAN stock to GK. On this issue SCA moved to dismiss, alleging lack of subject matter jurisdiction in that the claim involved the transfer in the Netherlands of ownership of securities of a foreign corporation (SAN) to a foreign purchaser (GK). The court rejected this contention and at the same time recognized the dual nexuses of conduct and effect within the United States, in stating that the court

[n]eed not determine whether the protection afforded by § 10(b) is limited to an American investor since it is clear that sufficient conduct took place within the U.S. to allow applicability of § 10(b) beyond the U.S. and that the transaction in question has a significant impact on American securities markets. SCA is a publicly owned corporation whose stock is registered on the American Stock Exchange.⁴⁶

In *S.E.C. v. United Financial Group Inc.*,⁴⁷ the court declined to decide whether or not mere conduct or use of United States facilities would constitute a sufficient jurisdictional nexus when it stated:

An alternative theory of jurisdiction advanced by respondent is based solely upon appellant's use of the facilities of interstate commerce. If accepted without qualification, there would be jurisdiction in every case regardless of whether American investors were involved.⁴⁸

In *Bersch v. Drexel Firestone, Inc.*⁴⁹ the court found minimal

it concerns the court's holding on the fraud claim and the sufficiency there of conduct alone. The court's discussion of the effect on the shareholders relates only to the self-dealing claim. Arguably, the effect applies equally to the fraud claim, since the same shares were involved, and the court may have been influenced by this fact.

45. 365 F. Supp. 1382 (E.D. Pa. 1973).

46. *Id.* at 1386.

47. 474 F.2d 354 (9th Cir. 1973).

48. *Id.* at 357.

49. [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,080 (2d Cir. 1975).

conduct within the United States relative to a foreign offering of the securities of I.O.S., Ltd., but held that it had no subject matter jurisdiction where the United States had no interest in protecting purchasers or sellers of the securities. In *SEC v. Kasser*⁵⁰ the court refused to apply the securities laws to enjoin a scheme to defraud foreign entities devised in the United States by Americans where there was no significant impact on the domestic investing public or domestic securities markets.

The Reporter's support for jurisdiction based solely on conduct within the United States is questionable at best, and the test should be reevaluated in the light of more recent cases. The same can be said of the cases cited in support of the effect nexus.

2. *The Effect Nexus*

Section 1604(a)(1)(D)(ii) of the Code attaches extraterritorial consequences to any activity, even if occurring wholly outside the United States, which has a "substantial effect within [the United States] as a direct and foreseeable result of the conduct." This language would seem to go beyond the furthest reach of supporting authorities. It is an acceptance of the SEC's position in its *amicus curiae* brief in *Schoenbaum v. Firstbrook* that "there are no so-called territorial limitations" on the Exchange Act, which "is generally applicable whenever such application is necessary and appropriate for the protection of American investors and markets."⁵¹ This position has been criticized and was rejected by the court.⁵²

In *Schoenbaum v. Firstbrook*,⁵³ the Second Circuit had occasion to fully explore the scope of the extraterritoriality of the federal securities acts in a derivative action brought by an American shareholder of a Canadian corporation whose shares were listed and traded on the American Stock Exchange, and were registered with the SEC pursuant to § 12 of the Exchange Act. The complaint alleged that the directors of the corporation, with full knowledge of the corporation's title to certain valuable oil rights, sold treasury shares to a related corporation at a deflated price. The defendants argued that the court was without jurisdiction since the entire transaction occurred in Canada and between foreign corporations. The Second Circuit re-

50. [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,062 (D.N.J. 1975).

51. Brief for SEC as Amicus Curiae on Rehearing at 11, 16, *Schoenbaum v. Firstbrook*, 404 F.2d 200 (2d Cir. 1968).

52. See 21 REC. ASS'N BAR OF N.Y. 240, 249 (1966).

53. 405 F.2d 200 (2d Cir. 1968), *cert. denied, sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969).

jected that contention in language which is frequently cited in this line of cases, and included in the Comments to § 1604 in the Code.⁵⁴ The court held:

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.⁵⁵

Although this language standing alone might support the "effect within" nexus of jurisdiction set forth in § 1604(a)(1)(D)(ii), the court limited its holding as follows:

We hold that the district court has subject matter jurisdiction over violations of the Securities Exchange Act although the transactions which are alleged to violate the Act take place outside the United States, at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors.⁵⁶

Moreover, the court found that negotiations were conducted in the United States and there was a use of the mails from New York.⁵⁷

A more apt case relied upon by the Reporter to support the "effects within" nexus of jurisdiction is *United States v. Aluminum Co. of America*⁵⁸ in which the Court applied the antitrust laws to certain activities occurring outside the United States. The court held that it had jurisdiction, since it found both intent to affect the American market and actual effect. Somewhat more expansively, the court also stated:

54. Tent. Draft No. 3, at 162.

55. 405 F.2d at 206.

56. *Id.* at 208.

57. *Id.* at 210.

58. 148 F.2d 416 (2d Cir. 1945). See Tent. Draft No. 3, at 163-64.

[A]ny 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.⁵⁹

Section 1604(a)(1)(D)(ii) of the Code, however, does not explicitly exempt from extraterritorial application of the Code those activities which are not reprehensible in most civilized countries and which may even be legal within the territory where transacted. If the only nexus with the United States is a detrimental impact, the exercise of jurisdiction over such activities might transgress international law.⁶⁰

A recent district court decision recognized the need for a "significant connection" with the United States, as well as a detrimental effect. In *Selzer v. The Bank of Bermuda, Ltd.*, the court stated:

The Securities Exchange Act is applicable to securities transactions where (1) there is some significant connection in the violations with the United States, and (2) the effects of the violations are detrimental to American investors. The significant connection may be involvement of stock listed on American exchanges, . . . fraudulent misrepresentations in the United States, . . . or other involvement of American investors to their detriment⁶¹

On the other hand, in *Investment Properties International v. I.O.S., Ltd.*,⁶² Judge Frankel explained that the main consideration in determining a court's subject matter jurisdiction over an extraterritorial transaction is: "does the transaction have some significant impact on the domestic securities markets or on domestic investors, and is extraterritorial application therefore necessary to protect securities trading in the United States and/or American investors?"⁶³ The court went on to point out that if there is no such domestic impact, United States courts have "compelling reason *not* to become involved in the

59. *Id.* at 443. The court appears to be speaking of reprehensibility as 'reprehended by Congress.' This is not consistent with the reading of international law in RESTATEMENT § 18(b), which states that the conduct must be "not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems."

60. Since § 1604 is subject to the limits of international law, jurisdiction in such circumstances would not theoretically be found under the Code.

61. [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,876, at 96,996 (S.D.N.Y. 1974) (citations omitted).

62. [1970-71 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,011 (S.D.N.Y. 1971).

63. *Id.* at 90,735.

burdens of enforcement and the delicate problems of foreign relations and international economic policy that extraterritorial application may entail."⁶⁴ Despite the broad hint that jurisdiction could be based on domestic impact alone, the court did not have to resolve that problem, since the impact was lacking, and it found no jurisdiction.

Subsequently, in another case involving I.O.S., Ltd., the Second Circuit squarely rejected the argument that the adverse effect of a predominantly foreign securities transaction on the American economy or American investors generally was sufficient to give a United States court subject matter jurisdiction. Further, the court indicated that both conduct within the United States and effect upon American investors are necessary for jurisdiction, in holding that the anti-fraud provisions of the federal securities laws:

(1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and

(2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but

(3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses.⁶⁵

D. *Fraud Initiated Within the United States*

Section 1604(a)(2) of the Code would give extraterritorial effect to civil liability for fraud provisions with respect to acts initiated within but occurring outside the United States. An analysis of the cases cited by the Reporter indicates that some significant detrimental impact on a protected American interest has usually been required.

In *SEC v. United Financial Group, Inc.*,⁶⁶ the Commission succeeded in obtaining a preliminary injunction and the appointment of a receiver over a Delaware corporation which was a holding company of a large number of offshore funds. The defendant had substantial investments in companies and properties in the United States. There

64. *Id.* (emphasis in original).

65. *Bersch v. Drexel Firestone, Inc.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,080 at 97801-02 (2d Cir. 1975).

66. 474 F.2d 354 (9th Cir. 1973).

was evidence that the defendant had some United States shareholders and offers of its stock had been directed to United States citizens. The court's jurisdictional focus was upon "activities within the United States and the impact of those activities upon American investors."⁶⁷ The court expressed no opinion on whether jurisdiction could be exercised in order to protect "the country's reputation abroad."⁶⁸

In *Branch v. F.T.C.*⁶⁹ the petitioner sought to set aside a cease and desist order of the Federal Trade Commission ("FTC"). The petitioner was a domestic correspondence school distributing materials by mail solely to Latin American countries. Some of these materials claimed that the school was a bona fide institute and "the only officially recognized University in accordance with the laws of the United States for extension courses."⁷⁰ In fact the school was little more than a 'diploma mill' without a faculty or staff except for the owner and clerical help.

The petitioner argued that there could be no subject matter jurisdiction predicated upon the mere initiation of a fraudulent scheme which was in fact carried out totally abroad. The petitioner also argued for dismissal unless some degree of public interest was shown to support the FTC's jurisdiction. Had the court accepted a jurisdictional nexus like that presented by § 1604(a)(2) of the Code, the FTC would not have had to demonstrate "public interest" since under that construct any use of the United States as a base for fraud would be sufficient. However, the court rejected such an approach. Instead it found the requisite "public interest" as follows:

The evidence here shows that there are some fifty or more correspondence schools in this country using correspondence methods to carry on their business. At least a few of these schools were engaged in competition with the petitioner for the business in the Latin-American field. The action of the Federal Trade Commission was aimed at compelling the petitioner to use fair methods in competing with his fellow countrymen.⁷¹

Moreover, the court held the fact "[t]hat the persons deceived were all in Latin America is of no consequence. It is the location of the petitioner's competitors which counts."⁷²

67. *Id.* at 357.

68. *Id.*

69. 141 F.2d 31 (7th Cir. 1944).

70. *Id.* at 33.

71. *Id.* at 34.

72. *Id.* at 34-35. *Cf.* *United States v. Weisscredit Banca Commerciale e d'Investimenti*, 325 F. Supp. 1384 (S.D.N.Y. 1970).

The Reporter uses the case as authority for the proposition that "there is no question of the propriety of a state's applying its laws so as to avoid its territory's being used as a base to injure persons in other states."⁷³ Because of the finding of injury to American competitors, the reliance seems to be misplaced.

In *Wandschneider v. Industrial Incomes, Inc.*⁷⁴ the plaintiffs brought an anti-fraud action to recover \$50,000 from an American corporation. The plaintiffs were foreign nationals who were fraudulently induced to invest in a purported mutual fund. They were led to believe that the United States securities laws would protect their investment. The court found liability, but not predicated solely upon the use of American territory to perpetrate a fraud abroad. It found that, in fact, the fraud was consummated in the United States since the sale was effected in the United States.

In *Finch v. Marathon Securities Corp.*⁷⁵ an English plaintiff sued a Bermudian closed-end investment company for misrepresentations in the sale of securities. The contract of sale was executed in New York but then re-executed and closed in London. The Bermudian defendant was controlled by Americans. The court dismissed the case, holding that it was

[w]ithout subject matter jurisdiction over a cause of action alleging no domestic injury of consequence, brought by a British resident against other foreigners, for injuries sustained as a result of being fraudulently induced in a foreign country to purchase securities of an alien corporation.⁷⁶

In one recent case the court interpreted the intent of Congress as not "to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners."⁷⁷ However, the court drew a distinction between the perpetration in the United States of fraudulent acts themselves, where subject matter jurisdiction would exist, and preparatory activities or failure to prevent fraudulent acts where the bulk of the activities was performed in foreign countries, where subject matter jurisdiction would be lacking.⁷⁸ The court's holding is thus

73. Tent. Draft No. 3, at 166.

74. [1971-72 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,422 (S.D.N.Y. 1972).

75. 316 F. Supp. 1345 (S.D.N.Y. 1970).

76. *Id.* at 1349.

77. *ITT v. Vencap, Ltd.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,092 at 97,833 (2d Cir. 1975).

78. *Id.* See also *SEC v. Gulf Intercontinental Finance Corp.*, 223 F. Supp. 997 (S.D. Fla. 1963), where a court found jurisdiction over the claim of Canadian plaintiff against a Canadian corporation which had been set up by Florida businessmen.

contrary to § 1604(a)(2), which would require only the initiation of fraud within the United States. Similarly, in a case where the SEC was denied injunctive relief against an American who defrauded foreign entities from within the United States, the court declined jurisdiction because of the lack of significant impact on either the domestic investing public or the domestic securities markets.⁷⁹

E. *Nationality as a Nexus*

The Code does not propose nationality as a basis for extraterritoriality. Rather, the Reporter suggests that the SEC could take nationality of the actor into account in rule-making under the Code.⁸⁰ Under international law a state is justified in governing the conduct of its nationals wherever that conduct occurs.⁸¹ Although judges have tended to denigrate nationality as a proper nexus of jurisdiction in securities cases,⁸² the nationality of all parties to a litigation, as well as the nationality of the issuer's securities⁸³ which are the subject of a litigation, has frequently proved a subtle influence in determining the court's jurisdiction.⁸⁴

The Reporter states that absent use of the mails (or, presumably, other conduct by a foreign issuer in the United States), "the mere nationality of the victim as distinct from the actor is not enough" for jurisdiction.⁸⁵ However, courts seem to have been more willing to exercise jurisdiction in close cases where the victim of a fraud has an American nationality.

In *Leasco Data Processing Equipment Corp. v. Maxwell*,⁸⁶ the court entertained jurisdiction over a fraudulently induced transnational securities transaction where the defendants were foreign and the plaintiff was an American corporation.⁸⁷ On very similar facts, the

79. SEC v. Kasser [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,062 (D.N.J. 1975).

80. Tent. Draft No. 3, at 173.

81. RESTATEMENT § 30(1)(a).

82. E.g., *Bersch v. Drexel Firestone, Inc.* [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,889 at 97,024 n.8 (S.D.N.Y. 1974); *rev'd in part* [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,080 (2d Cir. 1975).

83. A corporation has the nationality of the state which creates it. However, where a foreign corporation is owned or controlled by United States nationals, the foreign corporation is subject to indirect control because the United States can control the conduct of its own nationals. RESTATEMENT § 27 & Reporter's Note.

84. Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1387-89 (1973).

85. Tent. Draft No. 3, at 173-74.

86. 468 F.2d 1326 (2d Cir. 1972).

87. Although a Netherlands Antilles corporation and not the plaintiff was the formal party to the sales transaction, the court found that the foreign subsidiary was the alter ego of its American parent.

court declined jurisdiction in *Finch v. Marathon Securities Corp.*⁸⁸ Although many other factors were at work, a possible significant factual difference was that the parties were foreign. Nevertheless, one defendant foreign corporation was American-controlled.⁸⁹ And in *Bersch v. Drexel Firestone, Inc.*,⁹⁰ the court accepted jurisdiction over a fraudulent foreign securities offering only to the extent the securities were purchased by Americans resident in the United States.

In cases where the SEC has been the plaintiff, courts have been willing to pierce the corporate veil to get at the activities of American nationals owning or controlling an offshore enterprise in exercising jurisdiction. In *SEC v. Gulf Intercontinental Finance Corp.*,⁹¹ the court found the defendant Canadian corporation to be a mere conduit for a promotional scheme of some Florida businessmen. In *SEC v. United Financial Group, Inc.*⁹² the court partially based jurisdiction over a U.S. holding company of a number of foreign mutual funds on a finding that the complex of foreign companies was directed and controlled from the United States. Both cases resulted in the appointment of a receiver over the defendant's assets. In a situation where a Canadian corporation sued the SEC to protest against its securities having been placed on the Foreign Restricted List, the court was not as quick to exercise jurisdiction over a foreign entity. Rather, it declined to entertain the suit because the plaintiff was a nonresident alien without assets in the U.S.⁹³

In *Travis v. Anthes Imperial Ltd.*,⁹⁴ jurisdiction was exercised in a suit alleging fraud in the tender of one Canadian corporation for shares of another Canadian corporation where the victims were American stockholders. However, in *Hanover v. Zapata Corp.*⁹⁵ the court declined to enjoin a tender by one Canadian corporation for stock in another Canadian corporation where the plaintiff was a Canadian citizen and resident, although the target corporation had some American stockholders. It stated it had doubts regarding its jurisdiction of the subject matter, since American shareholders had not

88. 316 F. Supp. 1345 (S.D.N.Y. 1970).

89. Even under the Code, the scales are to some extent weighted in the favor of American victims by exercise of jurisdiction based on effect within the United States.

90. [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,080 (2d Cir. 1975).

91. 223 F. Supp. 987 (S.D. Fla. 1963).

92. 474 F.2d 354 (9th Cir. 1973).

93. *Kukatash Mining Corp. v. SEC*, 309 F.2d 647 (D.C. Cir. 1962). The court stated that the plaintiff lacked standing, but factually plaintiff's lack of assets showed the absence of domestic effect, which would go to the subject matter jurisdiction requirement.

94. 473 F.2d 515 (8th Cir. 1973).

95. [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,904 (S.D.N.Y. 1973).

joined, and interstate commerce had not been used to reach the Canadian plaintiff. Where United States corporations have attempted to enjoin tenders for their shares by foreign corporations the courts have tended to be solicitous of the domestic suitor.⁹⁶

The pattern of the cases indicates a judicial attitude which one commentator has labelled discriminatory and contrary to the equal protection principle of the fifth amendment to the Constitution.⁹⁷ It may well be improper and even unconstitutional to deny foreigners access to the courts in cases against Americans which would be accepted if the Americans sued the foreigners. However, there are sound and justifiable reasons for limiting the extraterritorial application of the securities laws, in certain types of regulatory situations, to conduct by Americans. Moreover, there is Exchange Act precedent for using nationality as a nexus for jurisdiction.

During the bull market of the late 1960's, evasions of the United States Margin Regulations were being accomplished by the foreign borrowings of American lenders. In an attempt to control such evasion civil and criminal actions were initiated against foreign financial institutions. Such actions involved an extraterritorial extension of the Exchange Act of dubious authority under international law.⁹⁸ A more acceptable solution to the jurisdictional problems involved in stopping foreign borrowings was the amendment to the Exchange Act worked in Section 7(f).⁹⁹

The amendment made it unlawful for "any United States person, or any foreign person controlled by a United States person or acting on behalf of or in conjunction with such person" to obtain better credit from foreign financial institutions than could legally be given by domestic lenders for the purpose of purchasing or carrying U.S. securities or for the purpose of purchasing or carrying any securities within the United States.¹⁰⁰ Thus the amendment attacked not the foreign lender, but the domestic evader of the margin requirements.

96. *E.g.*, *Graphic Sciences, Inc. v. International Mogul Mines, Ltd.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,834 (D.D.C. 1974); *General Host Corporation v. Triumph American, Inc.*, 359 F. Supp. 749 (S.D.N.Y. 1973). *See also* FOREIGN INVESTMENT STUDY ACT OF 1974, Pub. L. No. 93-479 (1974); SEC Exchange Act Release No. 11003 (Sept. 9, 1974).

97. Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1376 (1973).

98. Karmel, *The Applicability of the Margin Regulations to Foreign Financial Institutions*, 4 INT'L LAW. 496, 511-33 (1970). *But see* *United States v. Weisscredit Banca Commerciale e d'Investimenti*, 325 F. Supp. 1384 (S.D.N.Y. 1971).

99. 15 U.S.C. § 78g(f) (1970).

100. *Id.* Pursuant to § 7(f), the Federal Reserve Board promulgated Regulation X, 12 C.F.R. § 224 *et seq.* (1974). *See* Karmel, *Margin Regulations Updated*, 4 REV. SEC. REG. 832 (1971).

Sections 1604(a)(2) and (b) would generally exempt from the extraterritorial application of the Code margin transactions occurring abroad but initiated within the United States.¹⁰¹ Whether these provisions are intended to reverse the provisions of § 7(f), described above, is unclear. The Code does not use nationality as a nexus of jurisdiction in the manner in which it is used in § 7(f) of the Exchange Act. One possible reason for the Code's failure to utilize this jurisdictional hook is that little effort is made in the Code to distinguish between extraterritoriality for regulation and extraterritoriality for other objectives.

F. *Disclosure and Regulation*

The Securities Act is primarily a disclosure statute which requires any issuer seeking financing from the general investing public to make available accurate and complete information about its business and affairs. Distributions by controlling persons similarly require such disclosure. This basic philosophy is set forth in the preamble to the Securities Act which describes the statute as an act "[t]o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof . . ." ¹⁰²

By contrast, the Exchange Act, the Investment Company Act of 1940,¹⁰³ and the Investment Advisors Act of 1940¹⁰⁴ are essentially regulatory rather than disclosure statutes. The preamble to the Exchange Act describes it as an act "[t]o provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce . . . to prevent inequitable and unfair practices on such exchanges and markets . . ." ¹⁰⁵

101. Section 1604(b) limits the Code's coverage with respect to acts initiated within the United States but occurring outside to conduct in violation of part XIII, Fraudulent Acts, for which there is civil liability specified in part XIV. Section 1414, which is in part XIV, provides for civil liability for credit provisions in part IX.

102. 48 Stat. 74.

103. 15 U.S.C. § 80a *et seq.* (1970).

104. 15 U.S.C. § 80b *et seq.* (1970).

105. 48 Stat. 881. The purposes of the Exchange Act are more fully spelled out in § 2, 15 U.S.C. § 78b (1970), as follows:

"[T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the na-

The Code will to some extent meld the Securities Act and the Exchange Act by requiring registration of issuers rather than securities and requiring such continuous disclosure by registered issuers as is now required of issuers subject to the registration and reporting provisions of the Exchange Act. However, this important change in the structure of the federal securities laws would not give the SEC greater substantive regulatory powers over issuers than it now has. For example, the SEC does not now and would not under the Code be able to dictate the capital structure of a public corporation or to refuse to permit a corporation in one sector of the economy to float a bond issue on the ground that the nation's capital resources should be allocated to a corporation operating in a different sector of the economy. At the same time certain provisions now contained in the Exchange Act and which would be continued by the Code do regulate issuers which have securities trading in the public markets. These regulations cover, among other things, proxy solicitations,¹⁰⁶ takeovers and tender offers,¹⁰⁷ short-swing profits of officers, directors, and principal stockholders,¹⁰⁸ and manipulative trading activities.¹⁰⁹

When a foreign issuer decides to offer its securities to United States nationals or to list its securities on an American securities exchange, Congress and the SEC are entirely justified in requiring that issuer to make the same disclosure of its business and affairs as a United States corporation is required to make. There might also be some justification for formulating different or less exacting disclosure standards if Congress determined that it was in the interest of American foreign and economic policy to encourage United States nationals to invest in foreign securities.¹¹⁰ Either policy can be harmonized

tional banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions."

106. EXCHANGE ACT § 14(a), 15 U.S.C. § 78n(a) (1970); Reporter's Revision §§ 602, 603, & 1412(a).

107. EXCHANGE ACT §§ 13(d) & (e) and 14(d), (e), & (f), 15 U.S.C. §§ 78m(d) & (e) and 78n(d), (e) & (f) (1970); Reporter's Revision §§ 605, 1301, 1412.

108. EXCHANGE ACT § 16, 15 U.S.C. § 78p (1970); Reporter's Revision §§ 604, 606 & 1413.

109. EXCHANGE ACT §§ 9 & 10, 15 U.S.C. §§ 78i & 78j; Reporter's Revision §§ 1308, 1408.

110. Because of the nation's negative balance of payments since the mid-1960's the public policy has been to encourage foreign investment in U.S. securities. However, this policy could change for economic or political reasons. Philosophically, the United States is more committed to a free capital policy than to encouraging or discouraging foreign investment. See generally U.S. TREASURY DEP'T, PUBLIC POLICY FOR AMERICAN CAPITAL MARKETS (1974), reprinted in 239 BNA SEC. REG. & L. REP. at

with international legal principles, and a decision as to which policy is more desirable is primarily political and should be so designated.

Where, however, a federal statute or the rules of a federal agency regulate the conduct of a nonresident nonnational of the United States occurring entirely abroad, a serious conflict with principles of international law is created. Because of the many regulatory provisions of the securities laws, such a questionable exercise of jurisdiction can potentially arise whenever securities of a foreign issuer have been distributed to United States nationals or listed on an American securities exchange. Such a situation was presented to the court in *Wagman v. Astle*,¹¹¹ in which Canadian officers of a Canadian corporation were charged with making illegal short-swing profits in purchases and sales within a six-month period made in the Canadian securities markets. The court stated that even if it had subject matter jurisdiction over the case under the Second Circuit's opinion in *Schoenbaum v. Firstbrook*,¹¹² it would be unconstitutional to exercise personal jurisdiction over the defendants. On similar facts the SEC recently filed a complaint alleging violations of the anti-fraud and tender offer rules, in addition to the short-swing profit rules. In that case, however, the defendants were a nonresident American citizen and two foreign corporations who consented to the court's jurisdiction and the entry of an injunction.¹¹³ The Code would appear to give a court subject matter and personal jurisdiction in actions of this type.¹¹⁴

Such broad coverage may be invalid under international law because the SEC would be granted wide jurisdiction to regulate certain internal affairs of any foreign issuer which had distributed securities, even without design or intention, to United States citizens or residents. If a United States national wishes to buy a foreign security, there seems to be no good reason why the law where the issuer is incorporated should not govern such matters as proxy solicitations, short-swing profits, and tender offers for the securities of that issuer.¹¹⁵ Just as it is reasonable to require a foreign corporation to

D-17-19 (Feb. 13, 1974). See also *Parsky Urges Few Restrictions on Foreign Investment*, 286 BNA SEC. REG. & L. REP., at A-12-13 (Jan. 21, 1975).

111. 380 F. Supp. 497 (S.D.N.Y. 1974).

112. 405 F.2d 200 (2d Cir. 1968), cert. denied, sub nom. *Manley v. Schoenbaum*, 395 U.S. 906 (1969).

113. SEC v. OSEC Petroleum, S.A. [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,915 (D.C. Cir. 1974).

114. Reporter's Revision § 1604(d).

115. Although a better argument can be made for applying the tender offer rules to securities traded in the American markets than for applying the short-swing profit or

assume certain obligations in order to effect a distribution of its securities to United States nationals or to list its securities on an American securities exchange, it is reasonable for United States nationals purchasing a foreign security to assume the risk that the internal affairs of the corporation will be governed by foreign law. Of course, the Code does not ostensibly reach beyond the limits of international law, since it is explicitly limited by it. It would be better, therefore, for the Code to distinguish between regulation and disclosure, thus avoiding apparent overreaching of its regulatory provisions.

It is less difficult to justify the extraterritorial application of the anti-fraud provisions of the federal securities laws to foreign issuers and their officers, directors, and principal stockholders, than it is to justify the extraterritorial application of a provision like § 16(b) of the Exchange Act, which has been specifically rejected by other countries.¹¹⁶ Nevertheless, the Code's more liberal version of what is now Rule 10b-5 could result in the creation of a federal common corporation law which § 1604 would make applicable to many foreign corporations.¹¹⁷ The number and variety of actions under Rule 10b-5 presently pending in the federal courts are some indication that the anti-fraud provisions require a much stricter standard of conduct than many issuers and their officers and directors follow. While it may be desirable social and economic policy to thus forcibly raise domestic corporate manners, for Congress and the SEC to impose this stricter standard of conduct upon issuers everywhere would be legal imperialism.

It would be harsh to assign all of the blame for the extraterritorial reach of the Code to the Reporter. The Code merely accelerates and makes more explicit the trend toward jurisdictional expansion of the securities laws which has been urged by the SEC and agreed to by the courts. Indeed, the SEC has advocated an even more extreme extraterritoriality.¹¹⁸ It is submitted, however, that if the question of

proxy rules, one of the primary persons protected by the tender offer rules is the issuer. Why should a U.S. law protect a foreign issuer?

116. Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn in Order to Kill the Rats,"* 52 CORNELL L.Q. 69, 70-71 (1966). These provisions have been specifically rejected by Canada, Cuba, and England and have not been adopted by other countries. *Id.*

117. As the Comments to § 1303 indicate, a considerable body of federal corporation law has already developed under Rule 10b-5. The Code encourages further future development as a matter of federal jurisprudence. Reporter's Revision at 98-111. *See generally* Fleischer, *Federal Corporation Law: An Assessment*, 78 HARV. L. REV. 1146 (1965).

118. *See* text accompanying note 51 *supra*.

extraterritorial application were to be asked and answered separately with respect to those provisions of the Code relating to disclosure and those provisions of the Code relating to regulation, greater sensitivity to international law and foreign policy considerations should result.

The extraterritorial application of the Code to securities transactions effected by United States issuers abroad requires different legal and policy considerations than such an extraterritorial application to foreign issuers. Under accepted principles of international law a nation can regulate the activities of its citizens anywhere in the world.¹¹⁹ Conversely, in *Bersch v. Drexel Firestone, Inc.*, the court indicated it would not accept jurisdiction over a foreign industrial company identified with a foreign country which perpetrated a fraud upon foreigners from within the United States.¹²⁰ This analysis seems curious in the context of the *Bersch* case, since it was the American identification of I.O.S. and the underwriters which enabled the plaintiff to argue that the court should assume jurisdiction to protect the nation's reputation for economic integrity.

The Code would make a distinction between fraudulent transactions which are initiated within the United States but which occur outside the United States, which would be covered by the civil liability provisions of the Code, and non-fraudulent distributions and other activities which are initiated within the United States but which occur outside the United States, which would not necessarily be regulated.¹²¹ This distinction makes some sense and it draws a line between disclosure and regulation which should be drawn elsewhere as well.

At the same time there are at least two problems of extraterritorial coverage which are not resolved by the Code. The first question is the extent to which the securities laws should regulate securities transactions by foreign subsidiaries of United States corporations. The second is the extent to which the Code should cover attempts by United States corporations to raise capital from wholly foreign sources. Since the Code focuses upon the place where conduct is initiated and occurs rather than upon the nationality of an issuer, these questions are ignored. They are nevertheless important and should be considered seriously.

119. RESTATEMENT § 30(1)(a).

120. [1974-75 Transfer Binder] FED. SEC. L. REP. ¶ 95,080 at 97,796 (2d Cir. 1975).

121. Compare Code § 1604(a)(2) with §§ 1604(a)(1)(A) & 1604(b)(1).

G. *Regulation of Broker-Dealers and Investment Advisers*

Registration as a broker-dealer or an investment advisor by a foreign firm must necessarily be a voluntary act. This does not mean that in certain circumstances the SEC could not take steps to prevent a non-registered foreign firm from soliciting clients in the United States.¹²² At the same time, it is difficult to apply the entire panoply of broker-dealer regulation now contained in the Exchange Act to a foreign firm even if it voluntarily registers as a broker-dealer because of the different economic and legal climates in which foreign firms exist.

The difficulty of applying United States regulations to European broker-dealers was demonstrated in the 1960's when the SEC attempted to apply the margin regulations to foreign credit transactions. Regulation T,¹²³ which governs the amount of credit a United States broker-dealer may extend to a customer for securities purchases, could not readily be exported for application to foreign broker-dealers.¹²⁴ In order to prevent wholesale evasion of the margin regulations it was ultimately necessary to amend the Exchange Act and to promulgate Regulation X,¹²⁵ which prevented United States nationals from obtaining credit abroad on better terms and conditions than they could obtain within the United States.¹²⁶

A primary reason why broker-dealer regulations under the Exchange Act are difficult to apply to foreign firms is that investment banking and commercial banking are not separated abroad as they are required to be in the United States.¹²⁷ Accordingly, foreign firms operate both as banks and broker-dealers. The question of how to equitably regulate institutions which are not truly comparable has recently been asked by the SEC in its request for comments on a wide variety of questions relating to the registration and regulation of foreign broker-dealers in the United States.¹²⁸ These questions indicate that

122. *E.g.*, SEC v. Myers, 285 F. Supp. 743 (D. Md. 1968).

123. 12 C.F.R. § 220 *et seq.* (1974).

124. Karmel, *The Applicability of the Margin Regulations to Foreign Financial Institutions*, 4 INT'L LAW. 496, 543-44 (1970).

125. 12 C.F.R. § 224 *et seq.* (1974).

126. *See* text accompanying notes 98-100 *supra*.

127. Such separation is dictated in the United States by the NATIONAL BANKING ACT OF 1933 (GLASS-STEAGALL ACT), 12 U.S.C. § 21 *et seq.* (1971). *See especially* § 24. This model has been adopted in Japan; *see* Thrope, *The Sale of U.S. Securities in Japan*, 29 BUS. LAW. 411, 418-19 (1974).

128. Request for Public Comment on Issues Concerning Foreign Access to United States Securities Markets, SEC Exchange Act Release No. 10,634 (Feb. 8, 1974). A similar request for comments on issues concerning foreign investment companies has been made. SEC Investment Co. Act Release No. 8596 (Dec. 2, 1974).

if foreign broker-dealers register under the Code in large numbers it is likely that a different set of regulations will have to be made applicable to them. The most perplexing problems in this area are political and economic; that is to say, the extent to which it is beneficial or detrimental for foreign broker-dealers to compete for business with United States broker-dealers and the terms upon which such competition should be permitted or encouraged.

Nevertheless, international law requires some restraint in the extraterritorial application of law to persons and transactions under the protection and regulation of a foreign sovereign. The solicitation by a foreign broker-dealer of purchases and sales of foreign securities within the United States should not result in the application of the net capital¹²⁹ or customer protection¹³⁰ rules to the foreign broker-dealer. The nation's interest in protecting its citizens from purchasing securities from a foreign broker-dealer which may be financially unstable would not seem to warrant that kind of an extraterritorial application of American law. Federal law should not intrude into the internal operations of a foreign entity to the point of dictating the capital structure of the entity.¹³¹ The Code does not presently deal with this problem.¹³² It does not differentiate between preventing a foreign broker-dealer or investment advisor from doing business in the United States and regulating a foreign entity which is permitted to do such business. Whether the Code will address itself to these distinctions when the broker-dealer and investment advisor regulations are drafted remains to be seen.

H. *Personal Jurisdiction*

The basic premise of the Code that whenever subject matter jurisdiction over a transaction exists personal jurisdiction over the parties to that transaction also will exist has been controverted in a number of recent cases. In the previously discussed case of *Leasco Data Processing Equipment Corp. v. Maxwell*,¹³³ the court dismissed as to a foreign accounting firm which the court found had done no act within the United States giving rise to the plaintiff's cause of action.

129. SEC Exchange Act Rule 15c3-1, 17 C.F.R. § 240.15c3-1 (1974).

130. SEC Exchange Act Rule 15c3-3, 17 C.F.R. § 240.15c3-3 (1974).

131. Note, *Extraterritorial Application of the Exchange Act of 1934*, 69 COLUM. L. REV. 94, 104-07 (1969).

132. Section 701 of the Code will not apply to nonresident broker-dealers in connection with certain limited activities involving foreign distribution of U.S. securities, according to § 1604(b)(2)(B). However, since § 701 is not yet drafted, the extent of the exemption is uncertain.

133. 468 F.2d 1326 (2d Cir. 1972). See text accompanying notes 37-41 *supra*.

Although the basis for dismissal was lack of personal jurisdiction, the court's analysis seemed to indicate the failure to state a cognizable claim; that it is to say, the court held that Leasco did not rely on anything the accountants did or failed to do. At the same time, the court indicated there may be a difference between procedural and substantive requirements for tort liability.¹³⁴

However, the dismissal of the foreign accounting firm in *Leasco* presaged a way of disposing of certain types of transnational securities cases. It is a principle of American constitutional law that there must be some connection between a defendant and the state enforcing a liability so that the exercise of jurisdiction does not offend traditional notions of justice and fair play.¹³⁵ This is a due process requirement in addition to notice and an opportunity to be heard.¹³⁶ It would appear that a more meaningful connection between a federal court and a foreign defendant is required for personal jurisdiction than is required for subject matter jurisdiction.

In *Wagman v. Astle*,¹³⁷ a derivative action was brought under § 16(b) of the Exchange Act against three officers of Dome Petroleum, Ltd. ("Dome") for purchases and sales of Dome stock within a six-month period. Although Dome stock was listed and traded on the American Stock Exchange, the purchases and sales in question took place in Canada. The defendants were citizens and residents of Canada. The plaintiff argued that Congress had imposed the conditions of § 16(b) upon insiders of foreign corporations which wished access to the American markets. The court stated that it might have subject matter jurisdiction over the action under the *Schoenbaum* case, but the facts did not show "enough connection between the individual defendants and this country, by which the defendants availed themselves of the privilege of conducting activities here, or caused an effect here, to permit application of 16(b) to them." The court then concluded that to assert personal jurisdiction over the defendants would "offend traditional notions of justice and fair play," and dismissed.¹³⁸ Earlier in its opinion, the court pointed out that a

134. 468 F.2d 1326, 1341 n.11.

135. *Hanson v. Denckla*, 357 U.S. 235 (1958); *McGee v. International Life Ins. Co.*, 355 U.S. 220 (1957); *International Shoe v. Washington*, 326 U.S. 310 (1945). *But see* *Black & Co. v. Nova-Tech, Inc.*, 333 F. Supp. 468 (D. Ore. 1971).

136. Service of process on a nonresident foreign defendant pursuant to FED. R. CIV. P. 4(i) is not difficult to accomplish and such extraterritorial service has been upheld. *SEC v. VTR, Inc.*, 39 F.R.D. 19 (S.D.N.Y. 1966).

137. 380 F. Supp. 497 (S.D.N.Y. 1974).

138. *Id.* at 502 (citation omitted).

prohibition similar to § 16(b) had been specifically rejected by the Ontario authorities. Without fully articulating why this fact might dictate a dismissal of the action, the court seemed to be relying upon comity principles in determining that the alleged illegal conduct did not have a sufficient adverse impact upon the American securities markets to warrant the exercise of jurisdiction over the defendants.

Bersch v. Drexel Firestone, Inc.,¹³⁹ similarly resulted in the dismissal of a case against a Canadian broker-dealer for alleged violations of the anti-fraud provisions in the sale of a foreign security to Canadians on the basis of personal, rather than subject matter, jurisdiction. The district court read *Schoenbaum* and other relevant authorities as holding that there is subject matter jurisdiction for cases involving the extraterritorial application of the securities laws to transactions with which the United States has a significant connection or interest. The connection may be "subjective"—based upon acts which occur within a state's boundaries, even though the effect of such acts is felt without; or "objective"—conduct which occurs outside a territory, but which has an impact within the territory.

The *Bersch* case involved three separate offerings of securities of I.O.S., Ltd. ("I.O.S."), which was at that time a Canadian corporation with its principal offices in Switzerland. The offerings allegedly violated the anti-fraud and other provisions of the Exchange Act. One offering of original issue shares was sold in Europe to Europeans. One secondary offering of shares owned by 490 I.O.S. shareholders, who were primarily American, was managed by Investors Overseas Bank ("I.O.B."), a wholly owned subsidiary of I.O.S. These shares were sold to I.O.S. employees, clients, and other persons with longstanding business associations with I.O.S. Approximately 386 of the purchasers were Americans. The third offering was a secondary distribution managed by J. H. Crang & Co. ("Crang"), a Canadian broker-dealer, which included shares received from I.O.B. None of these shares were sold to Americans.

The district court held that the three offerings were sufficiently integrated and intertwined so as to be appropriately considered a unified transaction for purposes of subject matter jurisdiction considerations. Further, the court found that discussions, investigations, decision-making, planning, and supervision were carried on to a significant extent in the United States, even though formal or ultimate

139. [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,889 (S.D.N.Y. 1974); *rev'd in part on other grounds* [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,080 (2d Cir. 1975).

acts were staged abroad. Since essential elements of the transaction occurred within the United States, and the Crang offering involved the three intertwined offerings, Crang was held to have been implicated in jurisdictionally significant conduct within the United States. Therefore, Crang's assertion that its offering was exempt from the coverage of the Exchange Act by reason of § 30(b) was rejected.

Nevertheless, the case was dismissed as to Crang for lack of personal jurisdiction. Crang was not present or doing business in the United States. It did not have any office, bank account, telephone listing, subsidiary, affiliate, or salesman in the United States. The only acts of Crang within the United States were some breakfast meetings between the president of Crang and an executive officer of I.O.S. at which Crang's offering was discussed. Crang did not sell any I.O.S. shares to Americans and took precautions to prevent such sales. Even if Crang's distribution had an impact upon the United States securities markets, such an impact could not have been reasonably foreseen by Crang.¹⁴⁰ Accordingly, the district court concluded, and the Second Circuit agreed, that Crang's conduct did not justify or permit the exercise of personal jurisdiction over this defendant.

The court's basis for declining jurisdiction over Crang was constitutional rather than by reason of the exemption contained in § 30(b). What is curious about this decision is not the result but the route followed by the judge in reaching that result. That an American court should so seriously consider applying federal law to a foreign distribution by a foreign broker-dealer to foreign customers, and hold that the court has subject matter jurisdiction over such a transaction, shows the vast grasp of the SEC.

Similar issues were presented in the complaint which the SEC filed against OSEC Petroleum, S. A. of Luxembourg, OSEC Petroleum, A. G. of West Germany, and a nonresident American citizen charging violations of §§ 10(b), 13(d), and 16(a) of the Exchange Act in connection with purchases of more than five percent of the stock of Ulster Petroleum Ltd.¹⁴¹ Ulster was a Canadian corporation whose shares were listed on the Pacific Coast Stock Exchange and were registered pursuant to § 12 of the Exchange Act. The transactions in question had been effected in the Canadian securities markets. The

140. Arguably, the lack of reasonably foreseeable impact would also prevent a finding of subject matter jurisdiction under Code § 1604(a)(1)(D)(ii), and hence personal jurisdiction under § 1604(d)(3).

141. SEC v. OSEC Petroleum, S.A., [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,915 (D.D.C. 1974).

case appeared to raise serious questions of whether subject matter or personal jurisdiction existed. However, the court was never given an opportunity to deal with these questions since the defendants waived any objections they might have had to lack of personal jurisdiction and consented to an injunction.

In view of *Wagman* and *Bersch*, § 1604(d) of the Code should be reconsidered. The cases might have been decided differently under the Code, and, since the decisions are based upon an interpretation of constitutional due process, they cannot be reversed by the Code.

III. SEC RULE-MAKING

The philosophy of the Code is to make the Code's coverage as extensive as congressional power may be within the limits of international law, and then to rely upon the SEC to implement that power in appropriate rules and regulations which would formulate national policy. This rule-making authority is set forth in § 1604(c). Unfortunately the SEC does not have any special expertise in foreign relations or international monetary policies, both of which are as important to the formulation of policy concerning the law to be applied in international and transnational securities transactions as the impact of such transactions on the domestic securities markets. Furthermore, the SEC has never demonstrated a willingness to promulgate rules exempting persons or transactions from the agency's jurisdiction.

A. *The Teaching of Experience*

Section 30(b) of the Exchange Act contemplated that implementing rules would be adopted by the SEC. However, in the forty-year history of that section of the securities laws the SEC has never adopted or even proposed any rules. This abdication of responsibility in the area of international securities law does not augur well for rule-making under § 1604(c) of the Code.

The only area in which the SEC succeeded in utilizing the rule-making process to formulate regulations which were particularly geared to the needs of foreigners was in the exemption of certain foreign issuers from the registration requirements of § 12 of the Exchange Act, following the 1964 amendment to the Exchange Act which required wholesale registration of issues trading in the public markets.¹⁴² The promulgation of rules with regard to foreign margin

142. See text accompanying notes 12-18 *supra*.

transactions was accomplished by the Federal Reserve Board rather than the SEC.¹⁴³ Recently the SEC has demonstrated a greater willingness to consider the adoption of rules particularly addressed to foreign entities engaged in the securities business. Comments have been solicited concerning appropriate policies and regulations for foreign broker-dealers and foreign investment companies.¹⁴⁴ The manner in which these requests for comments are followed up could show how the Commission would implement § 1604(d).

The SEC usually has been prompted to formulate rules in the international arena because another government agency, and particularly the Department of the Treasury, has insisted upon action. To the extent exemptive rules have been adopted their underlying purpose has been to implement monetary policy.¹⁴⁵ When expressing its view in the prosecution of cases or in *amicus curiae* briefs the SEC has taken an aggressively expansive view of its jurisdiction over transnational matters.¹⁴⁶

History therefore would suggest that the SEC would not be any more receptive to adopting exemptive rules to § 1604(c) of the Code than it has been in adopting rules under § 30(b) of the Exchange Act. The wisdom of giving the SEC broad rule-making power without a clearer standard than "the limits of international law" is therefore a matter which should be seriously debated before the Code is enacted. It is only where legislative intent concerning extraterritoriality is apparent, as in §§ 7(f) and 12(g) of the Exchange Act, that precise and satisfactory rules have been developed. Any adoption of rules by the SEC or a failure by the agency to adopt any rules could have a significant impact upon the foreign relations of the United States as well as upon international monetary affairs.

B. *The Interests of Other Agencies*

Transnational and international securities questions are too important and too delicate to be entrusted to the SEC to the extent envisioned by the Code. The Department of the Treasury and the State Department should have at least an equal voice with the SEC in formulating the extent to which foreign securities businesses,

143. See text accompanying notes 98-101 & 126 *supra*.

144. SEC Exchange Act Release No. 10634 (Feb. 8, 1974); SEC Investment Co. Act Release No. 8596 (Dec. 2, 1974).

145. See, e.g., Securities Act Release No. 4951 (Feb. 25, 1969).

146. See, e.g., SEC v. United Financial Group, Inc., 474 F.2d 354 (9th Cir. 1973); Brief for SEC as Amicus Curiae on Rehearing, Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968).

foreign issuers, and foreign securities transactions should be governed by United States law.

With the development and growth of multinational corporations and the increasing flow of capital between nations, international securities law is likely to become a viable branch of international law. The conduct and financing of multinational corporations may well have to be regulated by a consortium of countries in order to be rational or effective.¹⁴⁷ Whether such regulation can best be done by treaty, by organizations like the European Economic Community, or by agencies of the United Nations remains a question to be answered by future events. Whether the SEC would be able to adapt to an international securities market is also an open question.¹⁴⁸

The SEC has traditionally viewed its mission as that of investor protection. Whether that view represents a proper reading of the securities laws is a question beyond the scope of this article. In the international arena investor protection is a consideration of some importance but not nearly so much importance as monetary and diplomatic considerations. The experience, expertise, and point of view which the SEC possesses with respect to the domestic securities markets should certainly be brought to bear upon the formulation of rules governing the transnational and international securities markets. However, the Department of the Treasury and the Department of State should also be brought into the decision-making process.

One analogy to the type of inter-agency solution which should be found to the complicated problems here posed is seen in the margin regulations under the Exchange Act. These regulations are promulgated and interpreted by the Federal Reserve Board, although largely enforced by the SEC. The substantive decisions which must be made to determine the loan values which may be ascribed to margin securities and the scope of the margin regulations in various gray areas are too intimately tied to the Federal Reserve Board's general monetary policies to be given to the SEC. Accordingly, these decisions are made by the Federal Reserve Board. However, the SEC is in a bet-

147. U.N. Dep't of Economic and Social Affairs, *Multinational Corporations in World Development*, U.N. Doc. ST/ECA/190 (1973). See Dale, *The Rising Influence of International Lenders*, N.Y. Times, Feb. 2, 1975, § 4, at 4, col. 3.

148. See generally Cohen, *Toward an International Securities Market*, 5 LAW & POLICY IN INT'L BUS. 357 (1973). The national securities exchanges have experienced severe growing pains in their efforts to adjust to the concept of a central marketplace. See *The Central Market System: A Case of Future Shock*, 258 BNA SEC. REG. L. REP. (Special Supp., June 26, 1974). There is no reason to assume the SEC would be any less jealous of its regulatory prerogatives if compelled to adjust to an international marketplace.

ter position than the Federal Reserve Board to enforce effectively the margin regulations, and it is charged with such enforcement responsibility.

Many significant activities in the transnational and international securities markets, however, are not considered by the Code. The regulation of these activities is left to the SEC's discretion, even though other agencies are now involved in the regulation of such activities. One example of current interest is the area of tender offers by foreigners for shares of United States corporations. As the Code is now drafted it would be the task of the SEC to decide whether such tenders should be subject to the same law as domestic tenders or as foreign tenders for shares of foreign corporations which occur in the United States. Congress, however, has directed that a comprehensive study of foreign direct and portfolio investments in the United States be conducted jointly by the Departments of Commerce and Treasury, and not the SEC.¹⁴⁹ It is the view of this author that the grant of discretion to the SEC made by § 1604(c), under the circumstances, is too broad.

IV. A PROPOSAL FOR REFORM

A. *Defining the National Interest*

Section 1604 of the Code is based primarily upon decisions in litigated cases, most of which involve allegations of fraud. The language employed is a codification of what judges have stated were factors which they considered in determining whether to give extraterritorial application to the securities laws. In most of these cases, numerous alternative theories of jurisdiction were suggested and a variety of relevant factors was analyzed. Therefore, it is frequently difficult to ascertain what jurisdictional standards or what facts were the most influential. For example, although the nationality principle of jurisdiction is frequently stated to be of little importance, a good argument can be made that the courts were in many cases primarily

149. FOREIGN INVESTMENT STUDY ACT OF 1974, Pub. L. No. 93-479. Another example is the participation of U.S. issuers and dealers in the Eurobond market. Since the interest equalization tax, Pub. L. No. 88-563, was effectively repealed by Exec. Order No. 1176, 39 Fed. Reg. 3807 (1974), the SEC has not promulgated any regulations concerning the new conditions under which such activities are being conducted. See *The Singer Co.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,979 (Aug. 2, 1974).

influenced by the nationality of the litigants.¹⁵⁰ The complexities and ambiguities in the Code must be attributed to the decisions in the cases the Code attempts to codify.

The judiciary is concerned with adjudicating cases and controversies, not with formulating or implementing public policy. However, in today's marketplace the extent to which the securities laws ought to be applied extraterritorially should not be left to the haphazard and parochial process of case-by-case decision. If the Code is going to deal with problems of extraterritoriality, as it should, and if the SEC is going to be given rule-making authority in this area, which is highly likely, the national interest should be better defined than has heretofore been done. This article suggests that the Code gives the most liberal possible reading to the relevant cases. Congress should not make such a decision based only upon precedents where fraud was charged.

The national interest involved has numerous components. One is foreign policy. Another is monetary policy. The type of regulation to which foreign issuers will be subject in raising capital or investing in the United States will have an effect on such activities. Similarly, the type of regulation to which United States issuers will be subject in raising capital or investing abroad will have an impact upon such activities.¹⁵¹ Given this nation's philosophical disinclination for capital controls, the regulatory climate is important in determining where capital will be raised and invested.¹⁵²

One rationale frequently ascribed to extraterritorial application of the securities laws is the importance of preserving the integrity of the United States securities markets in order to promote the free flow of capital to American corporations. The same rationale is applicable to the objective of promoting foreign investment in the United States in order to create a favorable balance of payments.¹⁵³ By the same token, since investment by Americans abroad is inimical to the nation's balance of payments, perhaps domestic investors in foreign securities should not be vigorously protected. Arguments against ex-

150. See text accompanying notes 80-96 *supra*.

151. Cf. SWANN, *THE ECONOMICS OF THE COMMON MARKET* 79 (Penguin ed. 1972).

152. See U.S. TREASURY DEP'T, *PUBLIC POLICY FOR AMERICAN CAPITAL MARKETS* (1974), reprinted in 239 BNA SEC. REG. & L. REP. at D-18.

153. The policy of stimulating foreign investment in the United States to correct the country's negative balance of payments emanated from the "Fowler Report." REPORT TO THE PRESIDENT OF THE UNITED STATES FROM THE TASK FORCE ON PROMOTING INCREASED FOREIGN INVESTMENT IN UNITED STATES SECURITIES AND INCREASED FOREIGN FINANCING FOR UNITED STATES CORPORATIONS OPERATING ABROAD (1964).

tratorritoriality also can be based upon giving American corporations an ability to compete on favorable terms with foreign corporations in their activities abroad¹⁵⁴ and in promoting comity between nations.

Regardless of what short-term policies may be in the nation's interest now, the Code should express long-term policies. In the international arena, the harmonious development and coordination of economic activities in different countries require mutual respect and toleration of different national, legal, and economic systems, as well as concern for international law. There is a kind of cultural and political arrogance in taking the position that the federal securities laws are civilized and that different laws or standards which may prevail in the corporations and securities laws of other countries are not as good.

B. *An Analogy to Antitrust Repealer*

A federal statute will not be construed to violate international law if any other possible construction remains.¹⁵⁵ Since the traditional basis of a state's jurisdiction is territorial,¹⁵⁶ federal legislation is presumed to be confined in its operation and effect to the territorial limits of the United States.¹⁵⁷ The Second Circuit made short shrift of these principles in *Schoenbaum v. Firstbrook* before declaring that "the usual presumption against extraterritorial application of legislation" does not show "Congressional intent to preclude application of the Exchange Act to transactions . . . effected outside the United States, when extraterritorial application of the Act is necessary to protect American investors."¹⁵⁸ The Code perpetuates the presumption in favor of extraterritoriality contained in the *Schoenbaum* opinion.

It is important to note, however, that powers incidental to sovereignty, in the international sense, are inherent in the executive and were never delegated to Congress by the states.¹⁵⁹ This is the reason that Congress cannot enact legislation which is contrary to international law. The SEC, being a creature of the legislative branch,

154. For example, the Federal Reserve Board does not regulate overseas lending by foreign branches of American banks except insofar as loans are made by such branches to Americans. Regulation M, 12 C.F.R. § 213 *et seq.* (1974). *But see* 12 U.S.C. § 632 (1971), giving jurisdiction to federal courts in actions involving foreign and international banking.

155. *The Charming Betsy*, 6 U.S. (2 Branch) 64, 118 (1804).

156. *Case of S.S. Lotus* [1927] P.C.I.J., ser. A., No. 9, at 18; *The Appolon*, 22 U.S. (9 Wheat.) 362, 370 (1824). *See* Reporter's note to RESTATEMENT § 30.

157. *American Banana Co. v. United Fruit Co.*, 213 U.S. 347, 357 (1909).

158. A fuller quotation of the court's holding is set forth in the text accompanying note 55 *supra*.

159. *United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936).

is similarly prohibited from adopting or applying regulations contrary to international law. The Code's provisions are directed to be construed "within the limits of international law." However, there is a presumption in favor of extraterritorial application with respect to fraudulent and manipulative acts,¹⁶⁰ and there is no presumption against extraterritoriality articulated except with respect to acts occurring wholly outside the United States, transactions between foreign broker-dealers and foreigners, and distributions abroad by nonresident broker-dealers.¹⁶¹

There is concededly a conflict between the remedial purposes of the federal securities laws and the restrictive limitations of international law.¹⁶² The Code's resolution of this conflict is not entirely satisfactory because there is not a sufficient distinction drawn between extraterritorial application of the disclosure provisions and the regulatory provisions of the securities laws. It is suggested that there should be a presumption against the extraterritorial application of those Code provisions which would regulate the internal affairs of foreign issuers, bankers, broker-dealers, or investment companies.

There are numerous cases involving the possible extraterritorial application of federal laws regulating commerce. These cases have brought forth an abundance of contradictory precedents.¹⁶³ In addition to the teaching of such decisions under federal statutes other than the securities laws, cases resolving a conflict between the federal securities laws and possibly contrary domestic legislation may be instructive.

In the antitrust arena an implied repealer of the antitrust laws is permitted only to the extent necessary to make the securities laws work.¹⁶⁴ Because of vigorous criticisms by the Department of Justice and private litigants of the SEC's failure to foster competition in the securities industry, the SEC has become increasingly inclined in its rule-making procedures to take competition into account.¹⁶⁵

160. Reporter's Revision § 1604(a)(2).

161. Reporter's Revision § 1604(b).

162. Cf. *Lauritzen v. Larsen*, 345 U.S. 571 (1953); *Vermilya-Brown Co. v. Connell*, 335 U.S. 377, 385 (1948).

163. The extraterritorial application of federal labor, antitrust, and other statutes was discussed by the author in Karmel, *The Applicability of the Margin Regulations to Foreign Financial Institutions*, 4 INT'L LAW. 496, 526-33 (1970).

164. *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 127 (1973); *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963); *Gordon v. New York Stock Exchange*, 498 F.2d 1303 (2d Cir. 1974).

165. SEC Exchange Act Release No. 11203 (Jan. 23, 1975) (adoption of negotiated commission rates).

By way of analogy, the Code could well provide that the securities laws should be applied extraterritorially only if necessary to make the Code work. This would probably limit the SEC's jurisdiction to regulate foreign entities to situations where such regulation is necessary in order to prevent an evasion of federal law. Admittedly, this proposal represents a fundamentally different point of view from that of the expansion of SEC jurisdiction to protect either American investors or the domestic securities markets. For example, the application of the financial responsibility and investor protection rules under the Exchange Act to foreign broker-dealers which choose to solicit United States customers might be necessary to protect such customers from damage in the event of the financial collapse of the foreign broker-dealer. However, such regulation is hardly necessary to make the securities laws work. On the other hand, the widespread borrowing from foreign financial institutions by United States citizens and corporations which occurred in the late 1960's constituted an evasion of United States margin regulations. The passage of § 7(f) of the Exchange Act and the promulgation of Regulation X probably were necessary in order to make the Exchange Act margin requirements work.

In *Scherk v. Alberto-Culver Co.*¹⁶⁶ the Supreme Court refused to give extraterritorial application to the Exchange Act to void an arbitration clause in a contract for an international business transaction between a Delaware corporation and a German corporation. If the allegedly fraudulent transaction had been between two citizens of the United States, the arbitration agreement probably would have been void by reason of the federal securities laws.¹⁶⁷ However, the Court believed that an international agreement involves considerations and policies significantly different from those found controlling in domestic contracts. A parochial application of federal law would damage the fabric of international commerce and trade.

Although *Scherk* was more of a conflicts of law than subject matter jurisdiction case, it is a Supreme Court decision and it is more recent than the cases relied upon in support of § 1604 of the Code. *Scherk's* outlook is much more accommodating toward considerations of foreign policy than the Code.

166. 417 U.S. 506 (1974).

167. *Wilko v. Swan*, 346 U.S. 427 (1953); SECURITIES ACT § 14, 15 U.S.C. § 77n (1971).

C. *The Needs of the International Market*

This article has discussed extraterritoriality in terms of both international and transnational securities transactions. The international capital market is the market for securities offered outside the country of the issuer—for example, the Eurobond market. A transnational market is one which touches or involves more than one nation. Although international law may require that the Code not be applied extraterritorially in certain situations, a court hearing a dispute over a transnational transaction must make a choice of law decision as to what law to apply if federal law is inapplicable.¹⁶⁸

Most of the fact patterns to which § 1604 of the Code is addressed involve transnational problems. However, the multinational corporation, which has become such a significant influence in international economic affairs, may well require an international rather than a transnational market-place for securities.¹⁶⁹ The goal of international economic integration is advocated by a consensus of enlightened economists. The achievement of this goal requires a free flow of capital and technological knowledge between nations. Despite capital and other controls inhibiting such access, multinational businesses have managed to hurdle obstacles between countries in the pursuit of their economic interests.¹⁷⁰

The United States has traditionally favored free international trade and capital flows. In order to integrate and expand the international economy there must be a stable supply of long-term international risk capital. The impact of securities regulation on these and similar economic and political goals should be taken into consideration in the drafting of Code provisions on extraterritoriality. The absence of appropriate regulation over the international and transnational securities markets would be detrimental to those marketplaces, as demonstrated by the collapse of I.O.S. and the ensuing loss of investor confidence.¹⁷¹ On the other hand, it does not necessarily

168. Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1392-93 (1973).

169. See Cohen, *Toward an International Securities Market*, 5 LAW & POLICY IN INT'L BUS. 357 (1973); Dale, *The Rising Influence of International Lenders*, N.Y. Times, Feb. 2, 1975, § 4, at 4, col. 3.

170. Miller, *Access To Do Business Across International Boundaries*, TULANE LAW REV. 795 (1968).

171. N.Y. Times, Dec. 2, 1972, at 49, col. 7; N.Y. Times, Nov. 30, 1972, at 63, col. 7. This was not considered a sufficient basis for jurisdiction in *Bersch v. Drexel Firestone, Inc.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,080 at 97,797-98 (2d Cir. 1975).

follow that regulatory vacuums should be filled by the SEC rather than by comparable foreign agencies or international bodies.

V. CONCLUSION

Many difficult questions concerning the extraterritorial reach of the federal securities laws have not been discussed in Congress. There is no legislative history for § 30(b) of the Exchange Act. The most significant developments in this area have been in court decisions, many of them involving egregiously fraudulent schemes. Before legislation like § 1604 of the Code is adopted, the national and foreign policy considerations upon which such a statute is based should be articulated. Further, the Code provisions should be re-evaluated in the light of certain cases which postdate its drafting, particularly the Supreme Court's holding in *Scherk v. Alberto-Culver Co.* and the lower court cases previously discussed dealing with personal jurisdiction.

The SEC's authority to create exemptions from the Code in the sphere of international relations and monetary policy should be carefully examined. Such authority should be subject to the authority of the Departments of State and the Treasury to formulate policy. The objectives of harmony in international relations and of a sound international securities market should be taken into account in fashioning rules under the Code which have an extraterritorial effect.