

Fordham International Law Journal

Volume 6, Issue 2

1982

Article 3

Expanding the Jurisdictional Basis for Transnational Securities Fraud Cases: A Minimal Conduct Approach

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Abstract

This Note examines subject matter jurisdiction in transnational securities fraud cases. The approaches adopted by the circuit courts and the Draft Restatement are critically analyzed, and the language and purpose of the Act are reviewed. A new test for determining subject matter jurisdiction in a United States forum is proposed, which will result in a greater protection of American and foreign investors who purchase and sell securities abroad.

EXPANDING THE JURISDICTIONAL BASIS FOR TRANSNATIONAL SECURITIES FRAUD CASES: A MINIMAL CONDUCT APPROACH

INTRODUCTION

The increase in international securities transactions in recent years¹ has been accompanied by a growing number of transnational securities fraud schemes.² The Securities and Exchange Commission (SEC) has utilized the Securities Exchange Act of 1934³ (Act) to counter international securities fraud, but the courts have yet to develop jurisdictional principles which meet with widespread acceptance in this country.⁴ The American Law Institute's *Restate-*

1. See Loomis & Grant, *The U.S. Securities and Exchange Commission, Financial Institutions Outside the U.S. and Extraterritorial Application of the U.S. Securities Laws*, 1 J. COMP. CORP. L. & SEC. REG. 3, 24 n.1 (1978).

2. See, e.g., *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980); *Fidenas A.G. v. Compagnie Int'l*, 606 F.2d 5 (2d Cir. 1979); *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979); *United States v. Cook*, 573 F.2d 281 (5th Cir. 1978); *Des Brisay v. Goldfield Corp.*, 549 F.2d 133 (9th Cir. 1977); *SEC v. Kasser*, 548 F.2d 109 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972); *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

3. 15 U.S.C. §§ 78a-78kk (1976).

4. Transnational securities fraud problems have been frequently analyzed in legal periodicals. See, e.g., Beard, *International Securities Regulation—Absorption of the Shock*, 10 INT'L LAW. 635 (1976); Goldman & Magrino, *Some Foreign Aspects of Securities Regulation: Towards a Reevaluation of Section 30(b) of the Securities Exchange Act of 1934*, 55 VA. L. REV. 1015 (1969); Johnson, *Application of Federal Securities Laws to International Securities Transactions*, 1980 FORDHAM CORP. L. INST. 89; Karmel, *Extraterritorial Application of the Federal Securities Code*, 7 CONN. L. REV. 669 (1975); Mizrack, *Recent Developments in the Extraterritorial Application of Section 10(b) of the Securities Exchange Act of 1934*, 30 BUS. LAW. 367 (1975); Norton, *Extraterritorial Jurisdiction of U.S. Antitrust and Securities Laws*, 28 INT'L & COMP. L.Q. 575 (1979); Note, *Offshore Mutual Funds: Extraterritorial Application of the Securities Exchange Act of 1934*, 13 B.C. INDUS. & COM. L. REV. 1225 (1972); Note, *Extraterritorial Application of the Securities Exchange Act of 1934*, 69 COLUM. L. REV. 94 (1969); Note, *The Extraterritorial Application of the Antifraud Provisions of the Securities Acts*, 11 CORNELL INT'L L.J. 137 (1978); Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553 (1976); Note, *The International Character of Securities Credit: A Regulatory Problem*, 2 LAW & POL'Y INT'L BUS. 147, 155-64 (1970); Comment, *Securities Law—Subject Matter Jurisdiction in Transnational Securities Fraud—Bersch v. Drexel Firestone, Inc.—IIT v. Vencap, Ltd.*, 9 N.Y.U. J. INT'L L. & POL. 113 (1976); Note, *Extra Territorial Application of Section 10(b) and Rule 10b-5*, 34 OHIO ST. L.J. 342 (1973); Note, *Extraterritorial Application of United States Laws: A Conflict of Laws Approach*, 28 STAN. L. REV. 1005 (1976); Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363 (1973); Note, *Extraterritorial Application of the Federal Securities Code: An Examination of the Role of International Law in American Courts*, 11 VAND. J. TRANSNAT'L L. 711 (1978).

ment (Revised) of Foreign Relations Law of the United States⁵ (Draft Restatement) represents the latest attempt to define a sufficient basis for subject matter jurisdiction⁶ when a securities fraud is transnational in character.⁷ The circuit courts of appeals which have considered the issue have formulated different approaches to jurisdiction.⁸ The *Draft Restatement* reflects yet another approach.⁹

This Note focuses on the jurisdictional problems raised by fraudulent securities schemes involving minimum conduct within the United States.¹⁰ In such schemes, the majority of the fraudulent conduct, as well as the detrimental effects on American and foreign investors, takes place in a foreign country. A United States court must then decide whether it has subject matter jurisdiction; it must determine whether the defendant's fraudulent conduct, both here and abroad, may be adjudicated in an American, rather than a foreign, forum.

This Note examines subject matter jurisdiction in transnational securities fraud cases. The approaches adopted by the circuit courts and the *Draft Restatement* are critically analyzed, and the language and purpose of the Act are reviewed. A new test for determining subject matter jurisdiction in a United States forum is proposed, which will result in greater protection of American and foreign investors who purchase and sell securities abroad.

5. RESTATEMENT (REVISED) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (Tent. Draft No. 2, 1981) [hereinafter cited as DRAFT RESTATEMENT].

6. In this Note, the terms "subject matter jurisdiction" and "jurisdiction" will be used interchangeably.

7. DRAFT RESTATEMENT, *supra* note 5, § 416.

8. See *Grunenthal GmbH v. Hotz*, 511 F. Supp. 582, 588 (C.D. Cal. 1981). Compare *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979) (jurisdiction over transnational securities case where at least *some* activity in furtherance of fraudulent scheme occurs within the United States) with *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.) (antifraud provisions of the Act apply to losses from sales to Americans residing abroad only if acts of *material* importance have *significantly* contributed thereto; losses to foreigners residing abroad require direct causation by acts in the United States), *cert. denied*, 423 U.S. 1018 (1975).

9. See *infra* notes 64-75 and accompanying text.

10. This Note is not concerned with situations in which the effects of a fraudulent scheme are felt within the United States and used, either alone or in conjunction with conduct, as a jurisdictional basis. See *infra* note 29. This Note does not examine the use of citizenship of a plaintiff or defendant as a basis for jurisdiction.

I. THE STATUTORY LANGUAGE

The primary antifraud provisions are found in section 10(b)¹¹ of the Act and rule 10b-5,¹² promulgated thereunder by the SEC. Both contain similar language prohibiting fraudulent schemes which make use of interstate commerce facilities. Section 10 of the Act provides in relevant part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

...
 (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.¹³

The section does not set out its jurisdictional scope. Furthermore, the legislative history does not reveal congressional intent regarding extraterritorial application.¹⁴ Although the Act specifically applies to foreign commerce,¹⁵ courts are without congressional guidance when confronted with a fraudulent securities scheme in which contacts with the American forum are minimal.

11. 15 U.S.C. § 78j (1976).

12. 17 C.F.R. § 240.10b-5 (1982). The rule provides in relevant part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

13. 15 U.S.C. § 78j (1976).

14. See *SEC v. Kasser*, 548 F.2d 109, 114 n.21 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977). The SEC has not offered any guidance by exercising its rulemaking powers. *IIT v. Cornfeld*, 619 F.2d 909, 912 n.2 (2d Cir. 1980).

15. 15 U.S.C. § 78c(a)(17) (1976).

II. THE SECOND CIRCUIT AND THE RESTATEMENTS

A. The Second Circuit

The Second Circuit, in *Schoenbaum v. Firstbrook*,¹⁶ was the first court of appeals to interpret the Act and apply the antifraud provisions to a transnational securities fraud.¹⁷ In *Schoenbaum*, an American shareholder of Banff Oil, Ltd., a Canadian corporation, brought a shareholder's derivative action for losses incurred from sales of the corporation's treasury stock to the defendants, which were also foreign corporations.¹⁸ An alleged conspiracy between Banff directors and the corporate purchasers of the stock caused Banff to sell the stock at a market price which the defendants, who had inside information, knew to be artificially low.¹⁹ An offer to purchase the stock was mailed by the defendant's New York office, although the actual sale took place in Canada.²⁰ Other uses of the mails included communications with the United States Treasury Department regarding tax rulings and with the American Stock Exchange regarding the listing of additional shares.²¹

Although the majority of the alleged fraudulent conduct occurred outside the United States, the *Schoenbaum* court held that subject matter jurisdiction existed "at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors."²² This early decision construed the antifraud provisions to apply extraterritorially in order to protect "domestic investors who have purchased foreign securities on American exchanges and to protect the

16. 405 F.2d 200 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

17. *Id.* at 206. Prior district court cases were also divided over the scope of the antifraud provisions. See *Ferraioli v. Cantor*, 259 F. Supp. 842 (S.D.N.Y. 1966) (securities laws only apply to domestic acts which are the predicate for subject matter jurisdiction); *SEC v. Gulf Intercontinental Fin. Corp.*, 223 F. Supp. 987 (S.D. Fla. 1963) (jurisdiction over claim where offer was made entirely outside of United States yet necessarily required use of the mails or interstate commerce facilities); *Kook v. Crang*, 182 F. Supp. 388 (S.D.N.Y. 1960) (use of mails and telephones within the United States does not provide jurisdiction for transactions predominantly foreign in nature).

18. 405 F.2d at 204.

19. *Id.* at 205. Banff common stock was registered with the American Stock Exchange and the SEC. *Id.* at 206.

20. *Id.* at 205.

21. *Id.* at 210. These negotiations with officials delayed the sale. *Id.*

22. *Id.* at 208.

domestic securities market from the effects of improper foreign transactions in American securities."²³

In determining what constituted sufficient use of interstate commerce facilities, the court found that preliminary negotiations in the United States in connection with the fraudulent scheme and the mailing of a purchase offer from New York to Canada were independently sufficient acts to bring the transaction within the scope of section 10(b).²⁴ The *Schoenbaum* decision established subject matter jurisdiction over a transaction where there was domestic conduct in furtherance of an allegedly fraudulent scheme and the effects of that conduct were felt within the United States.²⁵

Subsequently, the Second Circuit relied on the *Restatement (Second) of Foreign Relations Law of the United States*²⁶ (*Second Restatement*) in its attempt to define the jurisdictional boundaries of the antifraud provisions.²⁷ Section 17 of the *Second Restatement* sets forth the conduct principle, which permits a state to regulate conduct occurring at least in part within its territory.²⁸ A compan-

23. *Id.* at 206. The Second Circuit followed the reasoning of the Supreme Court which justified a state punishing a person who acted outside of the state's territorial limits, but who caused intentional detrimental effects within the territory, provided that the state obtained personal jurisdiction over him. *Id.* (citing *Strasheim v. Daily*, 221 U.S. 280, 285 (1911)).

24. 405 F.2d at 210. The court inferred that the preliminary negotiations with the Treasury Department and the American Stock Exchange necessarily involved use of interstate commerce facilities. *Id.* (citing *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195, 204 (5th Cir. 1960) (an interstate securities fraud case in which use of the mails constituted an important step in the execution of the fraud and served as a jurisdictional predicate), *cert. denied*, 365 U.S. 814 (1961)). The *Schoenbaum* court, however, found that the conduct was not fraudulent and the plaintiff had therefore failed to state a cause of action. 405 F.2d at 211.

25. *See* 405 F.2d at 208; *see also* *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334 (2d Cir. 1972) (refusal to go beyond *Schoenbaum* where no fraud was practiced in the United States and the sale took place abroad); *United States v. Clark*, 359 F. Supp. 131, 134 (S.D.N.Y. 1973) ("fraudulent conduct in the United States resulting in sales of securities abroad which have a substantial detrimental effect upon the interests of American investors" encompassed by § 10(b)).

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

27. 519 F.2d 974, 985 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

28. SECOND RESTATEMENT, *supra* note 26, § 17. The section, which is entitled "Jurisdiction to Prescribe with Respect to Conduct, Thing, Status, or Other Interest within Territory," states that:

A state has jurisdiction to prescribe a rule of law

(a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and

(b) relating to a thing located, or a status or other interest localized, in its territory.

ion provision, the effects principle, provides that a state may regulate conduct outside its territory which has foreseeable detrimental effects within its territory.²⁹

The Second Circuit, in its most important decision on the issue, *Bersch v. Drexel Firestone, Inc.*,³⁰ held that the conduct and effects principles are mutually exclusive and either may serve as a basis for jurisdiction.³¹ The court attempted to define the extraterritorial application of section 10(b) and rule 10b-5.³²

In *Bersch*, an American citizen brought a class action on behalf of both American and foreign shareholders of I.O.S., Ltd. (IOS), a Canadian investment organization whose main office was in Switzerland.³³ The class consisted of three groups: Americans

Id. Section 17 does not require that the conduct take place entirely within the prescribing state's territory. Conduct in furtherance of a transnational securities fraud scheme, therefore, need only partially take place within the United States for its courts to have jurisdiction. *See infra* notes 48-63 and accompanying text.

29. SECOND RESTATEMENT, *supra* note 26, § 18. The section, which is entitled "Jurisdiction to Prescribe with Respect to Effect within Territory," states that:

A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if either

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

(b) (i) the conduct and its effect are constituent elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems.

Id. In contrast to the conduct principle, the wording of § 18 specifically details the type of effect that is a predicate for jurisdiction. Under the effects principle, the effect must be "substantial" or a "constituent element of a crime or tort." *Id.* The qualifications suggest that § 18 was intended for conservative application.

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

31. See *id.* at 993, which formulates three fact situations in which the conduct and effects principles are applied alternatively. Prior cases had implied that the two principles were independent bases for jurisdiction although they had not specifically stated such a holding. See *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 524 (8th Cir. 1973) (jurisdiction where there has been significant conduct in the United States with respect to the alleged violations); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1338-39 (2d Cir. 1972) (although some domestic effects present, conduct formed the jurisdictional basis). *But see* *United States v. Clark*, 359 F. Supp. 131, 134 (S.D.N.Y. 1973) (substantial detrimental effects on American investors needed); *Finch v. Marathon Sec. Corp.*, 316 F. Supp. 1345, 1349 (S.D.N.Y. 1970) (absent effects in the United States, minor domestic conduct insufficient for jurisdiction).

32. 519 F.2d at 993.

33. *Id.* at 977-78. The class consisted of thousands of plaintiffs, the majority of whom were citizens and residents of numerous countries throughout the world. *Id.*

residing in the United States, Americans residing abroad and foreigners who had purchased their securities abroad.³⁴ Two of the six defendant underwriters of the IOS offering were American, as was the IOS accounting firm.³⁵ All of the defendants were charged with material misrepresentations and omissions in connection with the IOS prospectus.³⁶ The plaintiffs alleged that they were unable to ascertain the true value of IOS stock, which subsequently collapsed in price as a result of fraud by IOS directors.³⁷ While the offering itself was specifically intended to be made entirely outside the United States, mainly to employees, present clients and investors of long standing with IOS, some stock ultimately reached United States investors through the mails.³⁸

Judge Friendly set forth a tripartite test for determining whether a court may assert subject matter jurisdiction in a transnational securities fraud action:

American 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.³⁹

The court held that there was jurisdiction over the claims of Americans residing in the United States who had been mailed prospectuses in this country.⁴⁰ The court based this decision on the

34. *Id.* at 993. The court did not address the question of sales within the United States to foreigners. *Id.*

35. *Id.* at 979-80.

36. *Id.* at 981. This conduct constitutes a violation of the antifraud provisions of § 10(b) of the Act. *See supra* notes 12-13 and accompanying text.

37. 519 F.2d at 981.

38. *Id.* at 980, 990-91. Although there were actually three separate offerings, the court found them to be integrated to such an extent that the defendants who made the offerings could be considered collectively for subject matter jurisdiction. *Id.* at 992 n.43.

39. *Id.* at 993 (emphasis added).

40. *Id.* at 991.

effects of the fraud within the United States, without the need to consider conduct.⁴¹ In the case of investors residing abroad, the absence of such effects forced the court to examine conduct.⁴² The only conduct in the United States that contributed to the defrauding of Americans and foreigners residing abroad was preparation by the defendant accounting firm of a financial statement which was used in the prospectus.⁴³ The court stated that while preparatory acts would not serve as a jurisdictional predicate under the securities laws for injury to foreigners located abroad, such acts would suffice when Americans residing abroad were injured.⁴⁴ The preparatory activities in the United States did not directly cause the losses to foreigners and therefore the court held that there was no subject matter jurisdiction over their part of the claim.⁴⁵

In the absence of any domestic effects, the Second Circuit in *Bersch* held that the conduct in the United States must be "material" and "significantly" contribute to the fraud in order for a court to have subject matter jurisdiction over a claim by an American plaintiff who resides abroad.⁴⁶ A foreigner residing abroad, however, must prove that his losses are directly attributable to conduct in the United States.⁴⁷ This reasoning requires a court to examine the quality of the conduct in order to ascertain whether it is "material" or "significant." For example, by focusing on whether conduct is preparatory, a court analyzes the quality of that conduct.

41. *Id.*

42. *Id.*

43. *Id.* One commentator has suggested that use of American names as underwriters, accountants and lawyers could serve as a basis for subject matter jurisdiction in order to prevent defrauders from abusing American resources and prestige. See Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 570 (1976).

44. 519 F.2d at 992.

45. *Id.* at 987.

46. *Id.* at 993.

47. *Id.* The underlying reason for not hearing all transnational securities claims is found in the language of the *Bersch* court: "When . . . a court is confronted with transactions that on any view are predominantly foreign, it must seek to determine whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to them rather than leave the problem to foreign countries." *Id.* at 985. This concern of overburdening the federal courts may be valid. However, it is not so strong an argument as to deny a plaintiff his right to a remedy, especially if this is the only country in which personal jurisdiction may be obtained over the defendant. See *infra* text accompanying notes 144-49.

B. *The Second Restatement*

The *Bersch* court specifically relied on the conduct principle of the *Second Restatement*.⁴⁸ The *Second Restatement*, however, does not contain any restrictive adjectives such as "material" or "significant."⁴⁹ The only qualifications are that (1) the conduct must be within the territory of the country prescribing the law against it; and (2) the proscribed conduct must relate "to a thing located, or a status or other interest localized, in [the enacting nation's] territory."⁵⁰

A claim arising under section 10(b) and rule 10b-5 necessarily involves a certain amount of conduct within the United States because both provisions require use of interstate commerce facilities.⁵¹ The *Second Restatement* does not specify the amount of conduct that must take place within the United States.⁵² Therefore, even a minimal amount of conduct, such as the use of interstate commerce facilities in promoting the fraudulent scheme, should be sufficient to satisfy the first qualification to the conduct principle.⁵³

The second qualification to the conduct principle, that the proscribed conduct must relate to "interests localized" in the United States,⁵⁴ is also satisfied by the use of interstate commerce facilities as required by the Act. The Supreme Court has long recognized the power of the federal government under the mail fraud statute⁵⁵ to protect the public from mail fraud schemes.⁵⁶ The use of the mails, or any interstate commerce facility, serves as a basis for jurisdiction, enabling the federal courts to assume jurisdiction over a cause

48. 519 F.2d at 985. The court was reluctant to apply its jurisdictional power to the fullest extent possible absent specific authorization by the legislature. *Id.* See *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334 (2d Cir. 1972).

49. See *supra* note 28.

50. *Id.*

51. See *supra* notes 11, 13 and accompanying text.

52. See *supra* note 28.

53. See *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 526 (8th Cir. 1973) ("[I]t is not material who initiated the communications. Instead, the real question is whether the mails or instrumentalities of interstate commerce were used to mislead the plaintiffs."); see also *SEC v. Gulf Intercontinental Fin. Corp.*, 223 F. Supp. 987 (S.D. Fla. 1963) (ads placed in Canadian newspapers which are then offered for sale in the United States constitute offers made within the United States).

54. See *supra* note 28.

55. 18 U.S.C. § 1341 (1976).

56. See *Durland v. United States*, 161 U.S. 306 (1896).

of action which might normally be brought in a state court.⁵⁷ In proscribing conduct which uses interstate commerce facilities in furtherance of a fraud, the federal government is not solely interested in protecting investors.⁵⁸ Use of a state court might adequately protect investors.⁵⁹ The United States is also concerned with its role as regulator of interstate commerce facilities.⁶⁰

The United States government has a direct interest in the use of the postal system, interstate commerce facilities and national securities exchanges. The Second Circuit stated the necessity of preventing the use of the United States as a base from which fraudulent securities schemes might be peddled abroad.⁶¹ If interstate commerce facilities are used to further fraudulent schemes, then it

57. See *Parr v. United States*, 363 U.S. 370, 385 (1960) (fraud cause of action within federal jurisdiction when mails were used to execute the fraudulent scheme). The use of interstate banking channels to clear checks obtained in a fraud scheme results in federal jurisdiction over the scheme. *United States v. Sheridan*, 329 U.S. 379 (1946); *Kann v. United States*, 323 U.S. 88 (1944).

58. See *Durland v. United States*, 161 U.S. 306, 314 (1896) (dual purpose of the mail fraud statute is to protect the public from mail fraud schemes and to prevent use of the Post Office as a vehicle for carrying them into effect).

59. State courts, however, lack subject matter jurisdiction under the Act. Section 27 of the Act gives the federal courts exclusive jurisdiction over all "actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." 15 U.S.C. § 78aa (1976).

60. See *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195, 202 (5th Cir. 1960) (broad purpose of § 10(b) "to keep the channels of interstate commerce, the mail, and national securities exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation"), *cert. denied*, 365 U.S. 814 (1961).

Section 10(b) proscribes conduct when "necessary or appropriate in the public interest." 15 U.S.C. § 78j (1976). In transnational securities regulation, this interest includes considerations of foreign and monetary policy. Regulation of securities transactions, both in this country and abroad, has an effect on the ability of American corporations to raise capital. Preservation of the integrity associated with American securities markets is important "to promote the free flow of capital" to these corporations thereby creating a favorable balance of payments. Karmel, *supra* note 4, at 705.

Another interest of the federal government is to provide a uniform system of regulation over securities markets and investors. See 15 U.S.C. § 78b (1976).

61. *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975). The case was decided the same day as *Bersch*, both cases having arisen out of the same fraudulent scheme. In *Vencap*, a Luxembourg investment trust brought suit against a Bahamian corporation and individuals for, among other things, fraud and conversion. The court found that effects on Americans were insufficient to form a jurisdictional basis because Americans were only .2% of the total number of fundholders and had invested at most .5% of the total funds. *Id.* at 1016-17. There existed an abundance of activity within the United States, including preparation of a document which formed the basis of the fraudulent conduct. *Id.* at 1016. Judge Friendly stated: "We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners." *Id.* at 1017. See Note, *Extraterritorial Application of United States Securities*

appears that the United States is remiss in preventing schemes from being formed within its borders, thereby exposing investors abroad to potential economic harm.⁶² Thus, the second requirement of the conduct principle is fulfilled. The specific wording of the *Second Restatement* permits a court to assume jurisdiction over a cause of action where conduct within the United States, not necessarily significant or material, furthers a fraudulent scheme.⁶³

C. *The Draft Restatement*

The position of the Second Circuit in *Bersch*, which used a quality analysis approach to determine whether the conduct was "significant," has been strengthened by the *Draft Restatement*. A special section concerning jurisdiction over transnational securities transactions has been created.⁶⁴ This section requires an examination of the interests of the United States in applying American laws to an international transaction, as well as an examination of the interests of a foreign state in applying its own laws.⁶⁵ The *Draft*

Laws (IIT v. Vencap, Ltd.), 42 Mo. L. REV. 158, 167 (1977) (jurisdictional principles should serve a descriptive rather than a normative function in policy analysis).

62. Lenient regulation of fraud may encourage other countries to engage in similar practice. Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 421 (8th Cir. 1979); SEC v. Kasser, 548 F.2d 109, 116 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977).

63. See *supra* note 28.

64. DRAFT RESTATEMENT, *supra* note 5, § 416. The section, which is entitled "Jurisdiction over Securities Transactions," provides in part:

(2) As regards transactions in securities not on a securities market in the United States, but where

(a) securities of the same issuer are traded on a securities market in the United States; or

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

(c) the party subject to the regulation is a United States national or resident, or the persons sought to be protected are residents of the United States, the authority of the United States to exercise jurisdiction to prescribe depends on its reasonableness in the light of evaluation under § 403(2).

65. These interests are considered when determining whether it is reasonable to exercise jurisdiction. Section 403(2) of the *Draft Restatement* provides:

(2) Whether the exercise of jurisdiction is unreasonable is judged by evaluating all the relevant factors, including:

(a) the extent to which the activity (i) takes place within the regulating state, or (ii) has substantial, direct, and foreseeable effect upon or in the regulating state;

(b) the links, such as the nationality, residence, or economic activity, between the regulating state and the persons principally responsible for the activity

Restatement approach evolved from the quality analysis reasoning utilized by the Second Circuit.⁶⁶ The *Bersch* test also considered the interests of the United States in assuming jurisdiction when determining whether the conduct within the United States was "sufficiently significant."⁶⁷

Under the *Draft Restatement*, jurisdiction to prescribe a law regulating transnational securities fraud depends on whether it is "reasonable," in light of certain enumerated factors, for an American court to assume jurisdiction.⁶⁸ These factors include: the quality of the conduct in the state, the interests of the state in regulating conduct or effects of a scheme, the interests of a foreign state in asserting jurisdiction, and the expectations of the parties involved that the conduct will be subject to regulation by the United States.⁶⁹

The comments to the *Draft Restatement* state that the primary purpose of the securities laws is to protect domestic markets and investors.⁷⁰ These comments further note that the antifraud provisions should be applied more liberally than other provisions of the Act, such as the "requirements of registration or disclosure [which are] not immediately directed at preventing fraud."⁷¹ The *Draft Restatement*, however, fails to use minimal conduct within the

to be regulated, or between that state and those whom the law or regulation is designed to protect;

(c) the character of the activity to be regulated, the importance of the regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted;

(d) the existence of justified expectations that might be protected or hurt by the regulation in question;

(e) the importance of regulation to the international, political, legal or economic system;

(f) the extent to which such regulation is consistent with the traditions of the international system;

(g) the extent to which another state may have an interest in regulating the activity;

(h) the likelihood of conflict with regulation by other states.

Id. § 403.

66. *Id.* § 416 reporter's note 1.

67. *Id.* See *supra* text accompanying note 39.

68. DRAFT RESTATEMENT, *supra* note 5, § 416.

69. *Id.* § 403(2). For a list of the interests, see *supra* note 65. These enumerated factors are not meant to be exhaustive. DRAFT RESTATEMENT, *supra* note 5, § 403 comment b, § 416 reporter's note 5.

70. DRAFT RESTATEMENT, *supra* note 5, § 416 comment a.

71. *Id.* See *infra* notes 136-42 and accompanying text.

United States as a basis for jurisdiction.⁷² Conduct, such as preliminary negotiations in the United States, "would be one factor to be evaluated along with other factors."⁷³

This approach goes further than the Second Circuit, which requires more than preparatory activity in the United States when the actual defrauding occurs abroad.⁷⁴ Examination of the other factors required by the *Draft Restatement*, however, would preclude the foreign plaintiff, in the majority of cases, from asserting his claim in an American court.⁷⁵

III. AN EXPANSIVE APPROACH USING CONDUCT AS A JURISDICTIONAL BASIS

The Third and Eighth Circuits have taken a more expansive view of subject matter jurisdiction than the Second Circuit and the *Draft Restatement*. These circuits require a lesser degree of conduct in the United States in connection with the fraudulent scheme in order for a plaintiff to assert a section 10(b) and rule 10b-5 claim.⁷⁶ In determining a basis for subject matter jurisdiction these two courts have specifically examined the amount of conduct within the United States, rather than whether such conduct is "significant."⁷⁷

72. DRAFT RESTATEMENT, *supra* note 5, § 403(2). All of the relevant factors must be evaluated in determining whether it is reasonable to exercise jurisdiction. *Id.*

73. *Id.* § 416 reporter's note 3.

74. See *supra* notes 44-45 and accompanying text.

75. Minimal domestic conduct or effects would imply that it is unreasonable for the United States to assert jurisdiction. Minimal conduct in the United States implies that an assertion of jurisdiction by an American court would be more likely to offend foreign sovereignty. Moreover, the costs in time and money of bringing suit in a United States court might deter an American court from asserting jurisdiction. See *supra* note 47. Vigorous enforcement of the antifraud provisions when there is some connection with the United States, such as minimal conduct, provides a greater deterrence to defrauders, thereby protecting investors abroad.

76. Compare *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979) and *SEC v. Kasser*, 548 F.2d 109 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977) (only *some* activity within the United States in furtherance of the fraudulent scheme is required for subject matter jurisdiction) with *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.) (requirement of *material* conduct *significantly* contributing to the fraud for American plaintiffs who reside abroad, and requirement of *direct causation* of losses from domestic acts for foreigners residing outside the United States), *cert. denied*, 423 U.S. 1018 (1975).

77. The Second Circuit in *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972), used the phrase "essential link" to describe conduct occurring in the United States which induced a purchase in London. *Id.* at 1335.

A. *The Third Circuit*

The Third Circuit in, *SEC v. Kasser*,⁷⁸ analyzed the problem of subject matter jurisdiction by examining the quantity of conduct in the United States and whether it furthered the fraudulent scheme. In *Kasser*, a Canadian development fund⁷⁹ was, by misrepresentations,⁸⁰ induced into acquiring debentures of two corporations owned by the defendants.⁸¹ Activity in the United States in connection with the scheme included: (1) various negotiations; (2) the execution of one investment contract; (3) use of interstate commerce facilities; (4) incorporation or maintenance of business offices; and (5) use of a foreign bank's offices in New York as a conduit for money received from the fund.⁸² The court held that subject matter jurisdiction exists in transnational securities fraud cases "where at least *some* activity designed to further a fraudulent scheme occurs within this country."⁸³

The *Kasser* court emphasized the quantity, rather than the quality, of conduct within the United States. Nevertheless, the court noted its position was consistent with that of the Second Circuit.⁸⁴ While basing its decision on conduct occurring within the

78. 548 F.2d 109 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977).

79. The SEC brought the action seeking injunctive relief on behalf of the Manitoba Development Fund, owned by the Province of Manitoba, Canada. *Id.* at 110-12. This fact implies Canadian approval of the suit in the United States, thereby decreasing the likelihood of Canadian sovereignty being offended by an American court.

80. Misrepresentations of a material fact are a violation of rule 10b-5. *See supra* text accompanying note 13.

81. 548 F.2d at 111.

82. *Id.* Other activities noted by the circuit court, but not used by the district court, included maintenance of business records, drafting of contracts executed abroad and transmittal of proceeds within the United States. *Id.*

83. *Id.* at 114 (emphasis added).

84. *Id.* at 115. This quantitative approach is reflected in the court's comparison of the conduct involved in *Kasser* with that found in *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975). The *Kasser* court felt that the "sum total" of the defendant's actions within the United States was "more substantial" than in *Vencap*, possibly directly causing extraterritorial losses. 548 F.2d at 115.

The Third Circuit was apparently unwilling to let its decision stand solely on a qualitative theory of subject matter jurisdiction. Instead, the court in *Kasser* reconciled its holding with language used by the Second Circuit. *Id.* The *Kasser* court may have been reluctant to move too far from the approach of the Second Circuit, a court which is recognized as having a certain amount of expertise in securities law. *Id.* at 115 n.29 (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting, referring to the Second Circuit as "the Mother Court" of securities law)).

United States, the court also gave policy reasons for asserting jurisdiction. “[T]o deny such jurisdiction may embolden those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations”⁸⁵ [A] holding of no jurisdiction might induce reciprocal responses on the part of other nations.”⁸⁶ Finally, to grant jurisdiction would allow the SEC to police vigorously in order to maintain “high standards of conduct in securities transactions within this country . . . [and to protect] domestic markets and investors from the effects of [securities] fraud [committed outside the United States].”⁸⁷ These policy reasons are better effectuated by use of an expansive concept of subject matter jurisdiction, one which requires only *some* conduct to take place within the United States.⁸⁸

B. *The Eighth Circuit*

The Eighth Circuit subsequently addressed the problem of subject matter jurisdiction in *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*⁸⁹ Although the degree of domestic conduct present⁹⁰ was less than that in *Kasser*,⁹¹ the Eighth Circuit found that *Kasser* was an extension of the boundaries of subject matter jurisdiction.⁹² Quoting *Kasser*, the Eighth Circuit held that

The *Kasser* court had no need to reconcile its holding with the Second Circuit. A qualitative approach to jurisdiction, in which a minimal amount of conduct occurs in the United States, is justified. See *infra* notes 111-49 and accompanying text.

85. 548 F.2d at 116.

86. *Id.* Similarly, the court hoped that a finding of jurisdiction would “encourage other nations to take appropriate steps against parties who seek to perpetrate frauds in the United States.” *Id.*

87. *Id.* It was also noted that jurisdiction should be determined according to the literal wording of the statute. Section 10(b) and rule 10b-5 are primarily concerned with preventing fraudulent conduct and should therefore be broadly interpreted to include fraudulent schemes that are not consummated. *Id.* at 114.

88. Basing jurisdiction on some domestic conduct is a broad interpretation of jurisdiction which is consistent with other broad constructions of the Act. For example, the definition of “interstate commerce” includes trade, commerce, transportation or communications with any “foreign country.” 15 U.S.C. § 78c(a)(17) (1976).

89. 592 F.2d 409 (8th Cir. 1979).

90. The conduct consisted, for the most part, of preliminary communications among the defrauders through the use of interstate commerce facilities. *Id.* at 415.

91. See *supra* notes 79-82 and accompanying text.

92. 592 F.2d at 418. Prior opinions from the Southern District of New York had interpreted *Bersch* and *Vencap* as requiring “that the domestic conduct constitute the elements of a rule 10b-5 violation.” *Id.* (citing *F.O.F. Propriety Funds, Ltd. v. Arthur Young & Co.*, 400 F. Supp. 1219, 1222-23 (S.D.N.Y. 1975)). See *Venture Fund (Int’l) N.V. v. Willkie*

subject matter jurisdiction exists "where at least some activity designed to further a fraudulent scheme occurs within this country."⁹³

Continental Grain, an Australian corporation, was a wholly-owned subsidiary of a Delaware corporation.⁹⁴ Continental Grain purchased all the stock of Pacific Seeds Pty. Ltd., also an Australian corporation, from three vendors.⁹⁵ Two of the vendors were named as defendants, one an individual residing in California, the other an American corporation.⁹⁶ The third vendor, Australian Chemical Holdings, Ltd.,⁹⁷ an Australian corporation, was not made a party to the action.⁹⁸ The third defendant, an American corporation, had a licensing agreement to supply Pacific Oilseeds with hybrid seedstock.⁹⁹ The continued availability of this seedstock under terms of the licensing agreement constituted the primary asset of Pacific Seeds.¹⁰⁰ Continental Grain alleged that the defendants had agreed not to disclose the intended reclamation of the seedstock by the licensor upon termination of the licensing agreement.¹⁰¹

Conduct in the United States included transpacific telephone calls and letters through which the managing director of Australian Chemical, who acted as agent for the sellers, and the two American defendant-vendors agreed to conceal the termination of the licensing agreement.¹⁰² The defendants never had any direct contact with Continental Grain.¹⁰³ The contract for the sale of Pacific Seeds

Farr & Gallagher, 418 F. Supp. 550, 555 (S.D.N.Y. 1976); *Finch v. Marathon Sec. Corp.*, 316 F. Supp. 1345, 1348 (S.D.N.Y. 1970).

93. 592 F.2d at 418-19 (quoting *Kasser*, 548 F.2d at 114). The Eighth Circuit has been criticized for this interpretation of *Kasser*. See Note, *Continental Grain v. Pacific Oilseeds: Unjustifiable Expansion*, 2 Nw. J. INT'L L. & Bus. 264 (1980); Note, *A Policy Approach to Subject Matter Jurisdiction in Transnational Securities Fraud Cases: Continental Grain (Australia) Party, Ltd. v. Pacific Oilseeds, Inc.*, 17 WILLAMETTE L. REV. 263 (1980).

94. 592 F.2d at 411.

95. *Id.*

96. *Id.* Pacific Oilseeds, Inc. (POI), a California corporation, owned 48% of Pacific Seeds stock. *Id.* Claassen, a California resident and president of POI, owned 1% of the stock in question. *Id.*

97. Australian Chemical owned 51% of the stock of Pacific Seeds. *Id.*

98. *Id.* at 414. One possible reason may have been that joinder of Australian Chemical to the action would have defeated diversity jurisdiction. *Id.* at 414 n.5.

99. *Id.* at 411. This licensor, Northrup, King & Co., a Minnesota corporation, had a 10-year license agreement to supply Pacific Seeds with hybrid seedstock. *Id.*

100. *Id.* It was the intent of Northrup, however, to reclaim all seedstock within Pacific Seeds' possession upon termination of the contract. *Id.*

101. *Id.* Claassen telephoned a representative of Northrup to urge Northrup not to "spoil the deal" with Continental Grain by revealing Northrup's intended reclamation. *Id.*

102. *Id.* at 411-12.

103. *Id.* at 412. The agent for the vendors handled all the negotiations in Australia.

stock was executed in California, but the closing occurred in Australia.¹⁰⁴

The court rejected the view that use of interstate commerce facilities by the defendants was “merely preparatory.”¹⁰⁵ The court found that letters and telephone calls within the United States were necessary for furtherance of the fraudulent scheme,¹⁰⁶ and indeed, “constituted the organization and completion of the fraud.”¹⁰⁷

While the Eighth Circuit maintained that the domestic conduct involved was “significant,”¹⁰⁸ thus reconciling its view with the Second Circuit,¹⁰⁹ the facts point to an opposite conclusion.¹¹⁰ Because the defrauding occurred abroad, with little conduct in this country, the Eighth Circuit’s holding can be interpreted to mean that a minimal amount of conduct is sufficient as a basis for subject matter jurisdiction.

IV. ANALYSIS

Subject matter jurisdiction based on minimum conduct within the United States, although not specifically stated by the Third and Eighth Circuits, is supported by use of the term “some” conduct. Furthermore, this use of minimum conduct as a jurisdictional basis is a justifiable position.

A. Policy Considerations

Although the legislative history of the Act fails to disclose congressional intent,¹¹¹ the language of the Act provides some guid-

104. *Id.* The closing was held outside the United States for tax reasons. *Id.* at 412-13.

105. *Id.* at 420.

106. *Id.* Proceeds from the sale were transmitted through interstate commerce facilities and representatives of POI were flown to Australia for the closing and then back to the United States. *Id.*

107. *Id.* The court did not explain how the fraud could be “completed” in the United States when all the negotiations and the closing were carried out in Australia.

108. *Id.*

109. *See supra* notes 28, 39 and accompanying text.

110. In spite of the court’s finding that the domestic conduct was not preparatory, the conduct still appears to be minimal. A close analysis of the facts shows: (1) the conduct in the United States consisted of the planning of the fraud; (2) the actual defrauding took place in Australia where the defendants’ agent failed to disclose to representatives of Continental Grain the intended reclamation of the seedstock upon termination of the licensing agreement; and (3) the final closing occurred in Australia. Therefore, the conduct in the United States appears to be merely preparatory. *See* 592 F.2d at 411-12.

111. *See supra* note 14.

ance in determining its jurisdictional scope.¹¹² This language supports an expansive view of jurisdiction under the antifraud provisions.

Section 10(b) states that “[i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or any facility of any national securities exchange.”¹¹³ to execute a fraudulent securities scheme. The statute does not contain any limiting adjectives or qualifiers.¹¹⁴

The antifraud provisions of the Act have always been broadly construed to afford investors the greatest possible protection.¹¹⁵ Minimal conduct as a basis for subject matter jurisdiction is permissible under the wording of the statute and, in fact, better effectuates the remedial purposes of the Act.¹¹⁶

The deterrent effect¹¹⁷ linked with vigorous enforcement of the antifraud provisions¹¹⁸ is a justifiable preservation of United States integrity. The circuit courts¹¹⁹ agree that strong enforcement discourages those who wish to make the United States a “Barbary Coast” from which fraudulent securities schemes may be peddled abroad.¹²⁰

112. 15 U.S.C. § 78j; *see supra* text accompanying note 13. The language of § 10(b) is similar to that found in rule 10b-5. *See supra* notes 11-13 and accompanying text.

113. 15 U.S.C. § 78j (1976).

114. On the contrary, the wording is quite liberal in prohibiting the direct or indirect use of interstate commerce facilities. *See supra* text accompanying note 13 for the relevant language of § 10(b).

115. The antifraud provisions of § 10(b) are “to be construed ‘not technically and restrictively, but flexibly to effectuate [their] remedial purposes.’” *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972) (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)).

116. A greater number of injured plaintiffs, who might not otherwise be able to obtain relief in another jurisdiction, are afforded a chance to have their suit heard in at least one forum where the requirement of “some” or minimal conduct in furtherance of a fraudulent scheme has occurred. *See infra* notes 144-49 and accompanying text.

117. *See supra* note 85 and accompanying text.

118. *See supra* notes 11-13 and accompanying text.

119. *See Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 420-21 (8th Cir. 1979); *United States v. Cook*, 573 F.2d 281, 284 (5th Cir. 1978); *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977); *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017-18 (2d Cir. 1975); *Grunenthal GmbH v. Hotz*, 511 F. Supp. 582, 587 (C.D. Cal. 1981).

120. *Kasser*, 548 F.2d at 116.

Unrestrained use of section 10(b) would prevent any fraudulent schemes from deriving their beginnings in the United States.¹²¹ Strict regulation of minimal conduct in the United States in connection with a fraudulent securities scheme provides a greater deterrence. Potential defrauders are put on notice that the highest degree of honesty and fairness is to be maintained in securities transactions, and that securities fraud, even though only in an embryonic stage, will not be tolerated in the United States.

Vigorous enforcement of the antifraud provisions of the Act may result in other nations relying on the United States for regulation of international securities fraud.¹²² Restrained application of the antifraud provisions by the United States may also cause other nations to ease their own prosecution of securities fraud.¹²³ Rather than relying on regulation by other sovereigns, American courts should encourage the SEC to become an enforcement model for other nations.¹²⁴ Thus, the highest standards of conduct will be maintained in both domestic and transnational securities transactions.

By the very nature of a transnational claim, any regulation imposed on a party in the United States will necessarily affect the party in another jurisdiction.¹²⁵ If the United States maintains it has the right to regulate conduct within its territory, then other states, which may have stronger claims because of the occurrence of con-

121. Vigorous enforcement of the antifraud provisions would elevate the general standard of conduct in securities transactions. *Continental Grain*, 592 F.2d at 421; *Kasser*, 548 F.2d at 116.

122. The implication of this possible situation might prove to be a burden on United States judicial and law enforcement resources. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975). *See supra* note 47.

123. *Kasser*, 548 F.2d at 116 ("[A] holding of no jurisdiction might induce reciprocal responses on the part of other nations.").

124. *Id.* One commentator, however, has suggested that limited use of the antifraud provisions in transnational cases will encourage other nations to develop their own regulatory systems to protect investors. As these nations apply their own laws, the need for the United States to regulate transnational fraud would decrease. *See Note, Offshore Mutual Funds: Extraterritorial Application of the Securities Exchange Act of 1934*, 13 B.C. INDUS. & COM. L. REV. 1225, 1254-55 (1972).

125. A transnational transaction involves conduct in more than one country. A foreign nation may have its own antifraud provisions which it may choose to apply absent, or in spite of, an American judgment.

The United States has cooperated with foreign countries to avoid conflicts in and duplication of transnational fraud cases. *See Beard, International Securities Regulation—Absorption of the Shock*, 10 INT'L LAW. 635, 648-51 (1976).

duct in their territory, may resent the assertion of jurisdiction by courts in the United States.¹²⁶

This concern for the sovereignty of other states, where there also exists conduct in furtherance of the fraudulent scheme or the fraud itself occurs, is reflected in the doctrine of comity.¹²⁷ While the United States is not under an obligation to respect a foreign court's concurrent jurisdiction over a claim,¹²⁸ failure to do so may be offensive to the other state. Such a failure may result in the foreign state's refusal to give effect to a judgment by an American court, which the foreign state believes has a lesser claim to jurisdiction.¹²⁹ Thus, an approach to subject matter jurisdiction which only considers conduct in the United States may offend another state's sovereignty.¹³⁰

While another country may consider exercise of its own sovereign rights to be superior to that of the United States in a transnational securities fraud case, the United States does have a right to assert subject matter jurisdiction because of the occurrence of some part of the conduct within its own territory. In order for section 10(b) and rule 10b-5 to apply, the facilities of interstate commerce must have been used in furtherance of the scheme.¹³¹ It follows that

126. See *infra* notes 133-42 and accompanying text.

127. "[Comity] is the recognition which one nation allows within its territory to the . . . acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws." *Hilton v. Guyot*, 159 U.S. 113, 164 (1895).

128. See Comment, *An Interest Analysis Approach to Extraterritorial Application of Rule 10b-5*, 52 TEX. L. REV. 983, 984 (1974) (respect for international law is meant to prevent retaliation, unenforceable judgments, multiple trials and inconsistent liabilities).

129. See *Loomis & Grant*, *supra* note 1, at 16-18 (discussing the problems of secrecy inherent in Swiss banking laws).

130. However, an approach which looks for minimal conduct within the United States as a jurisdictional basis over a securities fraud is consistent with decisions involving conduct taking place entirely within this country. *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 421 (8th Cir. 1979). See *Kerbs v. Fall River Indus.*, 502 F.2d 731 (10th Cir. 1974); *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968).

In cases involving strictly interstate conduct, for example the use of telephones entirely within one state in furtherance of a fraudulent scheme, the federal courts have been willing to assume jurisdiction even though the court of the state in which the conduct occurred has a stronger claim to subject matter jurisdiction. See *Weiss v. United States*, 308 U.S. 321, 327 (1939). See also *Dupuy v. Dupuy*, 511 F.2d 641, 643 (5th Cir. 1975) ("[I]t seems somewhat anomalous to assume . . . that on the one hand, Congress and the SEC meant to erect a comprehensive statutory scheme for the prevention of securities fraud, and on the other, intended to narrowly circumscribe its scope of operation.").

131. See *supra* notes 11-13 and accompanying text.

if the United States is to preserve its position as regulator of these facilities, it should strictly control all domestic conduct which promotes the fraud so that potential defrauders may be deterred.¹³²

Although exercise of jurisdiction based solely on conduct in the United States may be offensive to the sovereignty of another state,¹³³ it is equally true that the laws of the United States have been violated. Any use of United States interstate commerce facilities as part of an overall fraudulent securities scheme affects an interest localized in this country.¹³⁴ The federal government, therefore, has the right to prohibit fraud promoted by use of its instrumentalities.¹³⁵

In this respect, the antifraud provisions may be distinguished from the registration¹³⁶ and margin requirements¹³⁷ found elsewhere in the securities laws. The assertion of jurisdiction by an American court over a transnational fraud claim hardly interferes with the economic policies of the foreign countries. Rather, the American court is merely providing a remedy for an accepted wrong.¹³⁸

Similarly, the antifraud provisions may be distinguished from the antitrust laws.¹³⁹ Extraterritorial application of American antitrust laws has been criticized primarily because of the interference with the foreign country's economy and internal policy.¹⁴⁰ Applica-

132. See *supra* text accompanying notes 117-21.

133. See Note, *Extra Territorial Application of Section 10(b) and Rule 10b-5*, 34 OHIO ST. L.J. 342, 352 (1973).

134. The "interstate commerce facilities use" theory has been advocated by the SEC. See Brief for the SEC (*amicus curiae*) at 18, *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

The theory is that the United States has a direct interest in the use to which the facilities of interstate commerce are put, and that, because of its plenary power over the use of the facilities of interstate commerce, Congress may outlaw any use, however incidental, which is connected with fraudulent purposes. *SEC v. United Fin. Group, Inc.*, 474 F.2d 354, 357 n.6 (9th Cir. 1973). Although no court has specifically adopted the theory, the SEC has not abandoned the argument. *Loomis & Grant*, *supra* note 1, at 11.

135. See Comment, *supra* note 128, at 984.

136. See, e.g., 15 U.S.C. § 78l (1976); Securities Act of 1933, § 5, 15 U.S.C. § 77e (1976).

137. 15 U.S.C. § 78g (1976). See Widmer, *The U.S. Securities Laws—Banking Law of the World? (A Reply to Messrs. Loomis and Grant)*, 1 J. COMP. CORP. L. & SEC. REG. 39, 40 (1978).

138. See *IIT v. Cornfeld*, 619 F.2d 909, 921 (2d Cir. 1980).

139. See 15 U.S.C. §§ 1-2 (1976).

140. See *Timberlane Lumber Co. v. Bank of Am.*, 549 F.2d 597, 609 (9th Cir. 1976); *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 443 (2d Cir. 1945). See also Comment,

tion of section 10(b) and rule 10b-5 in a transnational fraud case, however, causes minimal impact on the economy of a foreign country.¹⁴¹ Capital formation in foreign countries actually may be encouraged because there will be less risk of fraud upon American investors.¹⁴²

The problem of competing claims to sovereignty has been approached from various perspectives in recent years. The established jurisdictional principles, such as the conduct principle, and the now developing interest analysis approach of the *Draft Restatement*, have sought to provide a solution to the problem without violating the sovereignty of a foreign state. The interest analysis approach strives to permit the exercise of jurisdiction without causing resentment in other countries, even though the United States may permissibly be exercising its sovereign right to jurisdiction.¹⁴³

B. A Hypothetical Study

Use of the conduct principle of the *Second Restatement*¹⁴⁴ is preferable to the developing interest analysis of the *Draft Restatement*.¹⁴⁵ There are situations which may be envisaged in which the United States would not have jurisdiction under the interest analysis approach although it would have jurisdiction under the conduct principle.

Consider the following hypothetical. While in the United States, A and B, two foreigners, conspire to defraud C, also a foreigner, of his stock. The stock in question is that of a foreign corporation which only does business in Europe where C resides. Conduct in the United States consists of letters exchanged by A and B which contain preliminary drafts of a contract for the sale of the stock and suggestions as to the final means to be used in defrauding C. The actual defrauding, the final drafting and the signing of the

Defining Jurisdictional Limits in International Antitrust: Should the EEC Adopt the Timberlane Approach?, 5 *FORDHAM INT'L L.J.* 469 (1982).

141. Criticism of extraterritorial application of the antitrust provisions has focused on use of the effects principle as a jurisdictional basis. See *DRAFT RESTATEMENT*, *supra* note 5, § 403 reporter's note 1.

142. See Bloomenthal, *Extraterritorial Application of United States Securities Laws—Recent Developments*, 2 *SEC. & FED. CORP. L. REP.* 114, 116 (1980). But see Widmer, *supra* note 137, at 39 (burden of judging whether a transaction is fraudulent is on the investor).

143. See Comment, *supra* note 128, at 984.

144. See *supra* note 28.

145. See *supra* notes 64-75 and accompanying text.

contract by *C* take place in Europe. *C* then sues *A* and *B* in the United States.

Under the established conduct principle, the United States would have jurisdiction over a section 10(b) cause of action because some conduct, even though minimal, has occurred in this country and furthered a fraudulent scheme. Moreover, this conduct promoted the fraud through use of interstate commerce facilities.¹⁴⁶ The Second Circuit would dismiss such a claim on the grounds that the conduct was merely preparatory.¹⁴⁷ The *Draft Restatement* would refuse jurisdiction because of the preponderance of foreign interests over American interests in hearing the claim.¹⁴⁸ Only the minimum conduct principle utilized, but not enunciated, by the Third and Eighth Circuits protects *C*, the injured party who is seeking relief, by providing a forum.¹⁴⁹

CONCLUSION

The approaches taken by the circuit courts and the *Draft Restatement* are possible solutions to a complicated problem of jurisdiction. None of the approaches provides a clear and definitive test for the courts to apply when confronted with a case involving minimal conduct within the United States and a plaintiff who resides abroad.

The Second Circuit requires that the conduct be "significant" in the case of an American plaintiff residing abroad, while a foreign plaintiff must show that the losses are directly attributable to the domestic conduct.¹⁵⁰ The facts must be analyzed in each case. The quality of the conduct is then examined in order to determine whether it is of a type that will provide a basis for subject matter jurisdiction. This qualitative determination is subjective and may result in inconsistent decisions where the facts are similar.¹⁵¹

146. See *supra* notes 51-53 and accompanying text.

147. See *supra* text accompanying notes 44-45.

148. See *supra* notes 64-75 and accompanying text.

149. The discrepancy in views is even more pronounced if *C* is unable to obtain personal jurisdiction over *A* and *B* in a foreign jurisdiction or it is not possible to extradite *A* and *B* under a treaty.

150. See *supra* text accompanying note 39.

151. A question that arises following determination of subject matter jurisdiction is whether the American forum should decline to adjudicate the case. See Comment, *Securities Law—Subject Matter Jurisdiction in Transnational Securities Fraud—Bersch v. Drexel Firestone, Inc.—IIT v. Vencap, Ltd.*, 9 N.Y.U. J. INT'L L. & POL. 113 (1976), in which the

Furthermore, the deterrent value of the antifraud provisions is undermined. Only a broad application of section 10(b) will prevent a defrauder from escaping justice and deter others from using the United States as a base for fraudulent transactions in securities.

The interest analysis approach of the *Draft Restatement* will also result in inconsistent decisions based on a subjective determination of factors such as the quality of the domestic conduct. Moreover, although the established conduct principle does not so require, the *Draft Restatement* considers the interests of a foreign state in determining subject matter jurisdiction. The United States should have jurisdiction over the subject matter of a case based upon conduct in this country. The interests of other states and the alternative of bringing suit in a foreign country should not interfere with the right of the United States to regulate conduct within its territory.

The Third and Eighth Circuits have provided greater deterrence by requiring only minimal conduct in the United States. These courts have exhibited a reluctance, however, to depart from the language of the Second Circuit. Rather than reconciling their holdings with the Second Circuit, courts should strive for a broad interpretation of the Act. Minimal domestic conduct as a basis for subject matter jurisdiction designates the United States as a model of enforcement which other nations may emulate. It will, furthermore, allow more defrauded investors the opportunity to obtain relief and will elevate the standards of conduct associated with international securities transactions.

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author suggests this is the more difficult question. One escape for a court is dismissal on the grounds of *forum non conveniens*. This doctrine assumes subject matter jurisdiction, but allows dismissal based on considerations of convenience, fairness to the parties and witnesses, and burden on the forum. See A. EHRENZWEIG & E. JAYME, PRIVATE INTERNATIONAL LAW § 180-1 (1973) (enunciation of factors to be considered by the court); see also Note, *Forum Non Conveniens: Standards for the Dismissal of Actions From United States Federal Courts to Foreign Tribunals*, 5 FORDHAM INT'L L.J. 533 (1982).