

Fordham International Law Journal

Volume 16, Issue 1

1992

Article 5

Alfadda v. Fenn: Shifting the Standard for Applying U.S. Statutes to Predominantly Non-U.S. Transactions

Tara Ann Carroll*

*

Copyright ©1992 by the authors. *Fordham International Law Journal* is produced by The Berkeley Electronic Press (bepress). <http://ir.lawnet.fordham.edu/ilj>

Alfadda v. Fenn: Shifting the Standard for Applying U.S. Statutes to Predominantly Non-U.S. Transactions

Tara Ann Carroll

Abstract

This Comment argues that the Second Circuit, in *Alfadda v. Fenn*, properly held that the district court had subject matter jurisdiction over a controversy involving few U.S. activities and actors because the actors engaged in significant conduct in the United States. Part I examines the principles and pertinent case law governing the extraterritorial application of the civil RICO statute. Part II describes the facts and procedural history of *Alfadda v. Fenn*, detailing the district court's denial of subject matter jurisdiction and the Second Circuit's subsequent reversal. Part III argues that the Second Circuit correctly applied the existing legal precedents by granting federal subject matter jurisdiction over this case and examines the implications of the decision. It also argues that, given the competing interests at stake, U.S. courts should grant jurisdiction over predominantly non-U.S. transactions only where, as here, the evidence demonstrates substantial conduct or a substantial effect within the United States. This Comment concludes that Congress should amend RICO and clearly delineate its extraterritorial application so that courts need no longer speculate about congressional intent. This Comment argues that the Second Circuit, in *Alfadda v. Fenn*, properly held that the district court had subject matter jurisdiction over a controversy involving few U.S. activities and actors because the actors engaged in significant conduct in the United States. Part I examines the principles and pertinent case law governing the extraterritorial application of the civil RICO statute. Part II describes the facts and procedural history of *Alfadda v. Fenn*, detailing the district court's denial of subject matter jurisdiction and the Second Circuit's subsequent reversal. Part III argues that the Second Circuit correctly applied the existing legal precedents by granting federal subject matter jurisdiction over this case and examines the implications of the decision. It also argues that, given the competing interests at stake, U.S. courts should grant jurisdiction over predominantly non-U.S. transactions only where, as here, the evidence demonstrates substantial conduct or a substantial effect within the United States. This Comment concludes that Congress should amend RICO and clearly delineate its extraterritorial application so that courts need no longer speculate about congressional intent.

COMMENTS

ALFADDA v. FENN: SHIFTING THE STANDARD FOR APPLYING U.S. STATUTES TO PREDOMINANTLY NON-U.S. TRANSACTIONS

INTRODUCTION

The U.S. Congress passed the Racketeering Influenced and Corrupt Organizations Act (“RICO” or the “Act”)¹ in the 1970s to enable the federal government and private litigants to redress harms caused by patterns of illegal activity.² Although Congress primarily intended to eradicate organized crime through RICO, the Act also has been applied to racketeering activity in the civil context.³ Application of the statute presents no problems when the alleged activity occurs entirely within the United States or when all the parties are U.S. citizens.⁴ A jurisdictional difficulty arises, however, when the illegal activity occurs substantially outside the United States or the actors are predominantly non-U.S. citizens.⁵

1. 18 U.S.C. §§ 1961-1968 (1988 & Supp. II 1991) [hereinafter RICO or the Act]. The statute defines “racketeering activity” as any act or threat involving murder, kidnaping, gambling, arson, robbery, bribery, extortion, dealing in obscene matter, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year.

Id. § 1961(1).

2. See H.R. REP. No. 1549, 91st Cong., 2d Sess. (1970), reprinted in 1970 U.S.C.C.A.N. 4007, 4010 (further explaining RICO). The statute defines a “pattern of racketeering activity” as

requir[ing] at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity.

18 U.S.C. § 1961(5).

3. See, e.g., *Sedima, S.P.R.L. v. IMREX Co.*, 473 U.S. 479, 495 (1985) (stating that it is unlawful for any person, not just participants in organized crime, to violate RICO). The difference between the civil and the criminal provisions of the Act lies in the punishment. 18 U.S.C. §§ 1963-1964. Criminal penalties are set forth in 18 U.S.C. § 1963 and civil remedies are set forth in 18 U.S.C. § 1964.

4. See, e.g., *Haviland v. Goldman, Sachs & Co.*, 947 F.2d 601 (2d Cir. 1991) (applying RICO to wholly U.S.-based transaction involving only U.S. citizens), cert. denied sub nom. *J. Aron & Co. v. Haviland*, 112 S. Ct. 1995 (1992).

5. See *Alfadda v. Fenn*, 935 F.2d 475 (2d Cir.) (involving RICO claims with primarily non-U.S. parties), cert. denied, 112 S. Ct. 638 (1991); *United States v. Parness*,

In *Alfadda v. Fenn*,⁶ the U.S. Court of Appeals for the Second Circuit expanded the extraterritorial application of RICO by granting subject matter jurisdiction over a case involving primarily non-U.S. actors and a transaction substantially completed outside the United States.⁷ *Alfadda* is particularly important because it addresses the extraterritorial application of the RICO statute, while most earlier cases addressed the extraterritoriality of the Securities and Exchange Act of 1934 ("SEA")⁸ or the Commodities Exchange Act ("CEA").⁹ In addition, *Alfadda* marks the first time a U.S. court has granted U.S. subject matter jurisdiction over a RICO claim using the "conduct" test¹⁰ and the "effects" test¹¹ employed in SEA and CEA litigation.¹² By expanding the SEA and CEA precedents to RICO claims, the Second Circuit furthered the overall goal of RICO, which is to eradicate ongoing illegal or fraudulent

503 F.2d 430 (2d Cir. 1974) (same), *cert. denied*, 419 U.S. 1105 (1975); *Philan Ins. Ltd. v. Frank B. Hall & Co.*, 748 F. Supp. 190 (S.D.N.Y. 1990) (same).

6. 935 F.2d 475.

7. *Id.*

8. 15 U.S.C. § 78 (1988 & Supp. II 1991); *see, e.g.*, *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983) (involving SEA violation); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979) (same); *SEC v. Kasser*, 548 F.2d 109 (3d Cir.) (same), *cert. denied sub nom. Churchill Forest Indus. Ltd. v. SEC*, 431 U.S. 938 (1977); *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975) (same); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.) (same), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972) (same and stating that purpose of Securities and Exchange Act [hereinafter SEA] is to protect against fraud in sale and purchase of securities regardless of whether or not traded on U.S. markets).

9. 7 U.S.C. §§ 1-26 (1988); *see Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d 1103 (7th Cir.) (involving CEA violation), *cert. denied*, 469 U.S. 871 (1984); *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041 (2d Cir. 1983) (same). *Tamari* states that the purpose of the Commodities Exchange Act [hereinafter CEA] is to ensure fair dealing on commodities exchanges, for the protection of the market and of those who would be injured by unreasonable fluctuations in commodities prices. 730 F.2d at 1106.

10. *See, e.g., Leasco*, 468 F.2d at 1334 (holding that when significant conduct occurs within United States and Congress has not clearly forbidden extraterritorial application, statute may be applied extraterritorially).

11. *Id.* at 1340 (stating that when acts of individual performed outside state cause effects within state, jurisdiction should be granted for cause of action arising from those effects).

12. *See United States v. Parness*, 503 F.2d 430 (2d Cir. 1974) (granting U.S. jurisdiction over RICO claim without applying conduct and effects tests), *cert. denied*, 419 U.S. 1105 (1975); *but see Philan Ins. Ltd. v. Frank B. Hall & Co.*, 748 F. Supp. 190 (S.D.N.Y. 1990) (applying conduct and effects tests but denying jurisdiction).

ventures, as distinct from individual illegal or fraudulent acts.¹³

This Comment argues that the Second Circuit, in *Alfadda v. Fenn*, properly held that the district court had subject matter jurisdiction over a controversy involving few U.S. activities and actors because the actors engaged in significant conduct in the United States. Part I examines the principles and pertinent case law governing the extraterritorial application of the civil RICO statute. Part II describes the facts and procedural history of *Alfadda v. Fenn*, detailing the district court's denial of subject matter jurisdiction and the Second Circuit's subsequent reversal. Part III argues that the Second Circuit correctly applied the existing legal precedents by granting federal subject matter jurisdiction over this case and examines the implications of the decision. It also argues that, given the competing interests at stake, U.S. courts should grant jurisdiction over predominantly non-U.S. transactions only where, as here, the evidence demonstrates substantial conduct or a substantial effect within the United States. This Comment concludes that Congress should amend RICO and clearly delineate its extraterritorial application so that courts need no longer speculate about congressional intent.

I. EXTRATERRITORIAL APPLICATION OF RICO

Neither the text nor the legislative history of RICO indicates congressional intent regarding the statute's application to activities that occur primarily outside U.S. borders.¹⁴ As a result, courts have construed the statute and have established a standard for applying it to RICO violations that involve non-U.S. conduct and non-U.S. actors.¹⁵ Because most cases regarding the extraterritoriality of federal law have involved SEA violations, the standards established by those cases have been

13. See 18 U.S.C. §§ 1962-1964 (1988 & Supp. II 1991) (setting forth prohibited activities, criminal penalties, and civil remedies); H.R. REP. NO. 1549, 91st Cong., 2d Sess. (1970), reprinted in 1970 U.S.C.C.A.N. 4007, 4010 (further explaining RICO).

14. See 18 U.S.C. §§ 1961-1968 (lacking any mention of extraterritoriality); H.R. REP. NO. 1549, 91st Cong., 2d Sess., reprinted in 1970 U.S.C.C.A.N. 4007 (same).

15. See, e.g., *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir.) (setting forth standard for extraterritorial application of RICO), cert. denied, 112 S. Ct. 638 (1991); *Parness*, 503 F.2d at 439 (affirming that court can apply RICO extraterritorially); *Philan*, 748 F. Supp. at 194-95 (setting forth standard for extraterritorial application of RICO).

applied by analogy to the RICO litigation.¹⁶

A. *The Statutory Language and Legislative History of RICO*

In passing the RICO statute, Congress sought to punish not any single type of activity, but to penalize individuals and enterprises engaging in ongoing patterns of illegal activity.¹⁷ Neither the statute nor its legislative history sets forth the method for applying RICO to transactions completed substantially outside the United States.¹⁸ Thus, when U.S. courts began hearing cases of international RICO violations involving non-U.S. actors and conduct outside the United States, the courts had to interpret the statute to decide its applicability to these cases.¹⁹

16. See, e.g., *Alfadda*, 935 F.2d at 479 (using analogy to apply SEA cases to RICO claim); *Philan*, 748 F. Supp. at 194 n.4 (same).

17. See 18 U.S.C. § 1962 (1988 & Supp. II 1991). The statute provides that it is unlawful for a person, through patterns of illegal activity, to gain control of any enterprise that is involved in interstate or international commerce. *Id.* The statute provides that

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. . . .

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section.

Id.; see also H.R. REP. NO. 1549, 91st Cong., 2d Sess. (1970), reprinted in 1970 U.S.C.C.A.N. 4007, 4010 (further explaining RICO). The statute defines "enterprise" as "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. § 1961(4).

18. See 18 U.S.C. §§ 1961-1968 (1988 & Supp. II 1991) (lacking any mention of extraterritoriality); see also H.R. REP. NO. 1549, 91st Cong., 2d Sess., reprinted in 1970 U.S.C.C.A.N. 4007 (same).

19. See, e.g., *Alfadda*, 935 F.2d 475 (interpreting extraterritorial force of RICO).

To interpret any statute, courts must follow accepted rules of statutory construction.²⁰ One such rule is the presumption against extraterritorial application of U.S. law.²¹ This rule provides that, in the absence of contrary intent, U.S. statutes apply only within the United States.²² Courts have widely held, however, that when Congress has not explicitly expressed its intent, courts may infer an intent as to the case under consideration.²³

When attempting to infer congressional intent, a court first must examine the statute's plain language²⁴ to decide the scope of the statute's application.²⁵ RICO expressly provides that its purpose is to penalize, civilly and criminally, individuals who earn money through illegal enterprises.²⁶ The statute, however, does not directly authorize or forbid extraterritorial application.²⁷

When the plain language of a statute is inconclusive, the court must look to the statute's legislative history to decide the congressional intent.²⁸ Unfortunately, the legislative history of RICO also is silent as to the extraterritorial application of the statute.²⁹ Because neither the statute itself nor the legislative

20. See generally 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION (5th ed. 1992) (explaining basic rules of statutory construction).

21. See, e.g., *Foley Bros. v. Filardo*, 336 U.S. 281, 285 (1949) (referring to "canon of construction which teaches that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States").

22. *Id.*

23. See, e.g., *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1044-45 (2d Cir. 1983) (stating that courts must sometimes determine congressional intent); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 (2d Cir.) (same), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975).

24. See 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 46.01 (5th ed. 1992) (explaining plain meaning rule, which refers to actual wording of statute, understood for its explicit meaning, without reference to outside sources or inference).

25. *Id.*; see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201 (1976) (noting that language of statute controls when sufficiently clear in its context).

26. See 18 U.S.C. § 1962 (1988 & Supp. II 1991), *supra* note 17 (reproducing most of statute's language).

27. See generally 18 U.S.C. §§ 1961-1968.

28. See, e.g., *United States v. James*, 478 U.S. 597 (1986) (noting that legislative history can be legitimate guide to statutory purpose); *Blum v. Stenson*, 465 U.S. 886 (1984) (stating that courts will first look to statutory language and then to legislative history if statutory language is unclear).

29. See generally H.R. REP. NO. 1549, 91st Cong., 2d Sess., *reprinted in* 1970 U.S.C.C.A.N. 4007 (lacking any mention of extraterritoriality).

history of the statute indicates congressional intent regarding the Act's extraterritorial application, the courts have had to fashion a standard for applying RICO to transactions that occur predominantly outside the United States and which involve few, if any, U.S. citizens.³⁰

B. *Judicial Interpretations of the Extraterritoriality of Federal Securities Laws*

Because few cases have dealt with the extraterritorial application of RICO,³¹ courts have applied legal precedents that involve the extraterritorial application of the Securities and Exchange Act of 1934.³² Because many RICO violations are based on some kind of securities fraud,³³ courts find the two

30. *See, e.g.*, *Alfadda v. Fenni*, 935 F.2d 475, 476-78 (2d Cir.) (applying RICO to primarily non-U.S. conduct by non-U.S. citizens), *cert. denied*, 112 S. Ct. 638 (1991).

31. *See Alfadda v. Fenn*, 751 F. Supp. 1114, 1116-19 (S.D.N.Y. 1990) (noting lack of extraterritorial RICO precedent), *rev'd*, 935 F.2d 475 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991). Litigants have filed approximately 16 extraterritorial RICO cases in U.S. courts, six of which were dismissed on jurisdictional grounds. *See Philan Ins. Ltd. v. Frank B. Hall & Co.*, 748 F. Supp. 190 (S.D.N.Y. 1990) (finding no jurisdiction over non-U.S. defendants); *Michelson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 669 F. Supp. 1244 (S.D.N.Y. 1987) (same); *Soltex Polymer Corp. v. Fortex Indus., Inc.*, 590 F. Supp. 1453 (E.D.N.Y. 1984) (same), *aff'd*, 832 F.2d 1325 (2d Cir. 1987); *Huang v. Sentinel Gov't Sec.*, 657 F. Supp. 485 (S.D.N.Y. 1987) (same); *Ancilla Domini Health Servs., Inc. v. Communications Assocs., Inc.*, No. 84-C-2771, 1985 WL 4054 (N.D. Ill. Nov. 5, 1985) (same); *Nordic Bank PLC v. Trend Group, Ltd.*, 619 F. Supp. 542 (S.D.N.Y. 1985) (same).

In another five cases, litigants established jurisdiction but their RICO claims were stayed or dismissed. *See Republic of Philippines v. Marcos*, 818 F.2d 1473 (9th Cir. 1987) (holding RICO claims barred by act of state and political question doctrines), *cert. denied*, 490 U.S. 1035 (1989); *S.A. Mineracao da Trindade-Samitri v. Utah Int'l, Inc.*, 745 F.2d 190 (2d Cir. 1984) (staying RICO claims pending arbitration of other claims); *FMC Corp. v. Varonos*, No. 87-C-9640, 1988 WL 116825 (N.D. Ill. Oct. 20, 1988) (finding RICO claims insufficient), *aff'd*, 892 F.2d 1308 (7th Cir. 1990); *Selman v. American Sports Underwriters, Inc.*, 697 F. Supp. 225 (W.D. Va. 1988) (same); *Chisholm & Co. v. Bank of Jamaica*, 643 F. Supp. 1393 (S.D. Fla. 1986) (same).

Courts have maintained RICO causes of action against non-U.S. defendants only five times. *See Alfadda*, 935 F.2d 475 (denying non-U.S. defendant's motion to dismiss); *In re All Terrain Vehicles Litig.*, No. 88-237, 1989 WL 30948 (E.D. Pa. Feb. 23, 1989) (same, but not addressing conduct and effects tests); *Chamarac Properties, N.V. v. Pike*, No. 86-Civ.-7919, 1987 WL 20023 (S.D.N.Y. Oct. 30, 1987) (same); *State of North Carolina ex rel. Long v. Alexander & Alexander Servs., Inc.*, 680 F. Supp. 746 (E.D.N.C. 1988) (same); *Shulton, Inc. v. Optel Corp.*, No. CIV.A.95-2925, 1986 WL 15617 (D.N.J. Sept. 29, 1986) (same).

32. 15 U.S.C. § 78 (1988 & Supp. II 1991); *see Alfadda*, 935 F.2d at 478-79 (explaining that SEA cases are applied by analogy to RICO claims).

33. *See, e.g.*, *Akin v. Q-L Inv., Inc.*, 959 F.2d 521 (5th Cir. 1992); *Alfadda*, 935

areas of law similar enough to justify the use of SEA cases as precedent.³⁴ The transnational character of the securities industry has resulted in a significant amount of litigation regarding the extraterritoriality of federal securities laws, and the extraterritoriality of these laws is considered analogous to the extraterritoriality of RICO.³⁵

The SEA, like RICO, lacks an express indication of congressional intent regarding extraterritorial application in both its text and its legislative history.³⁶ As a result, courts have formulated two tests by which to decide the propriety of federal court jurisdiction over a particular claim:³⁷ the "conduct" test³⁸ and the "effects" test.³⁹ If either test is satisfied, the court may grant subject matter jurisdiction.⁴⁰

F.2d 475; *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990), *cert. denied*, 111 S. Ct. 250 (1990); *Street v. J.C. Bradford & Co.*, 886 F.2d 1472 (6th Cir. 1989); *Snook v. Trust Co. of Ga. Bank of Savannah, N.A.*, 859 F.2d 865 (11th Cir. 1988); *Durham v. Business Management Assoc.*, 847 F.2d 1505 (11th Cir. 1988); *Girard v. Drexel Burnham Lambert, Inc.*, 805 F.2d 607 (5th Cir. 1986).

34. *See, e.g.*, *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041 (2d Cir. 1983) (using analogy to apply SEA cases to CEA claim); *cf. Alfadda*, 935 F.2d at 479 (using analogy to apply SEA cases to RICO claim).

35. *See, e.g.*, *Alfadda*, 751 F. Supp. at 1116-17 (listing nine Second Circuit cases on issue); *see also* H.R. REP. NO. 910, 100th Cong., 2d Sess. (1988), *reprinted in* 1988 U.S.C.C.A.N. 6043, 6065-68 (observing increase of securities violations committed through off-shore entities).

36. *See* 15 U.S.C. § 78 (1988 & Supp. II 1991).

37. *See Psimenos*, 722 F.2d 1041 (applying conduct test); *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983) (same); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979) (same); *SEC v. Kasser*, 548 F.2d 109 (3d Cir.) (same), *cert. denied sub nom. Churchill Forest Indus. v. SEC*, 431 U.S. 938 (1977); *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975) (applying conduct and effects tests); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.) (same), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972) (applying conduct test).

38. *See, e.g.*, *Leasco*, 468 F.2d at 1334 (holding that when significant conduct occurs within United States and Congress has not clearly forbidden extraterritorial application, statute may be applied extraterritorially).

39. *Id.* at 1341 (holding that when acts of individual performed outside United States cause effects within United States, jurisdiction should be granted for cause of action arising from those effects).

40. *See Continental*, 592 F.2d at 417 (noting that jurisdiction requires either substantial conduct or substantial effect within United States, but not both); *see also Psimenos*, 722 F.2d at 1045 (holding that once jurisdiction is granted under one test, it is unnecessary to apply other test).

1. The Conduct Test

The conduct test requires that significant acts, furthering a fraudulent scheme, occur in the United States before jurisdiction can be granted.⁴¹ Between 1968 and 1975, the U.S. Court of Appeals for the Second Circuit decided the first three cases involving the conduct test.⁴² Judge Henry J. Friendly wrote detailed and scholarly opinions in all three cases.⁴³ These three cases have become the most significant precedents in this area and have been cited by most courts that address the extra-territorial effect of federal securities laws.⁴⁴

a. Early Second Circuit Precedents

The U.S. Court of Appeals for the Second Circuit first applied the conduct test in *Leasco Data Processing Equip. Corp. v. Maxwell*.⁴⁵ In *Leasco*, British defendants fraudulently induced British plaintiff corporations to purchase stock in a British corporation.⁴⁶ Although these securities were never traded on a U.S. market,⁴⁷ the court found that defendants had made substantial misrepresentations in the United States.⁴⁸ Defendants' U.S. conduct included meetings with plaintiffs in New York, numerous telephone calls between New York and London, and use of the U.S. mails.⁴⁹ This conduct was adjudged sufficient

41. See, e.g., *Bersch*, 519 F.2d at 992-93 (explaining requirements of conduct test).

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

43. *Vencap*, 519 F.2d 1001; *Bersch*, 519 F.2d 974; *Leasco*, 468 F.2d 1326. When examining the development of the conduct test, it is important to remember that the test is almost entirely based on the decisions of one judge.

44. See, e.g., *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir.) (quoting *Vencap*, 519 F.2d at 1018), *cert. denied*, 112 S. Ct. 638 (1991); *Consolidated Gold Fields PLC v. Minorco, S.A.*, 871 F.2d 252, 262 (2d Cir.) (quoting *Bersch*, 519 F.2d at 985), *cert. dismissed*, 492 U.S. 939 (1989); *Psimenos*, 722 F.2d at 1045 (citing *Leasco*, 468 F.2d at 1337); *Continental*, 592 F.2d at 413 (recognizing Judge Friendly's U.S. Court of Appeals for the Second Circuit as "the Mother Court" of securities law).

45. 468 F.2d 1326 (2d Cir. 1972).

46. *Id.* at 1330.

47. *Id.* at 1334.

48. *Id.* at 1334-35. The court stated that the misrepresentations regarded the financial soundness of defendants' companies and that plaintiffs relied on those misrepresentations when contemplating a joint venture with those companies. *Id.* at 1331-32.

49. *Id.* at 1330-33.

to grant federal jurisdiction over plaintiffs' claims.⁵⁰

The *Leasco* court recognized that congressional intent indicated that federal laws could be applied extraterritorially in certain circumstances.⁵¹ In *Leasco*, the court applied the standard set forth in the *Restatement (Second) of the Foreign Relations Law of the United States*⁵² to the issue of extraterritoriality.⁵³ The court acknowledged that if no fraud had been committed within the United States, it would be difficult to justify a grant of jurisdiction.⁵⁴ The court held, however, that the defendants' substantial misrepresentation made in the United States, coupled with an adverse impact on a U.S. company, were sufficient to establish jurisdiction.⁵⁵

The elements of the conduct test were outlined by the U.S. Court of Appeals for the Second Circuit in *Bersch v. Drexel Firestone, Inc.*⁵⁶ According to Judge Friendly, the conduct test requires that "acts (or culpable failures to act) of material importance" must occur within the United States before a court

50. *Id.* at 1339.

51. *Id.* Addressing congressional intent, the court stated that

[s]ince Congress thus meant § 10(b) to protect against fraud in the sale or purchase of securities whether or not these were traded on organized United States markets, we cannot perceive any reason why it should have wished to limit the protection to securities of American issuers. The New Yorker who is the object of fraudulent misrepresentations in New York is as much injured if the securities are of a mine in Saskatchewan as in Nevada.

Id. at 1336.

52. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 (1962) [hereinafter RESTATEMENT (SECOND)]. The *Restatement (Second)* provides 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.

Id. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402 (1986) [hereinafter RESTATEMENT (THIRD)] also recognizes the conduct test. The RESTATEMENT (THIRD) provides that "[s]ubject to [the reasonableness standard of] § 403, a state has jurisdiction to prescribe law with respect to (1)(a) conduct that, wholly or in substantial part, takes place within its territory." *Id.* § 402(1)(a).

53. *Leasco*, 468 F.2d at 1334.

54. *Id.* at 1334; see *supra* notes 46-49 and accompanying text (describing defendants' conduct).

55. *Leasco*, 468 F.2d at 1337.

56. 519 F.2d 974 (2d Cir.), *cert. denied sub nom.* *Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975).

may grant jurisdiction over a case.⁵⁷ *Bersch* further limited jurisdiction to cases in which the conduct within the United States was more than "merely preparatory."⁵⁸ The conduct occurring in the United States, typically fraudulent statements or misrepresentations, must directly cause the plaintiff's losses, even if the plaintiff's reliance on the defendants' misrepresentations and the resultant losses or damages occur entirely outside the United States.⁵⁹

The *Bersch* court denied jurisdiction under the conduct test.⁶⁰ It characterized the acts occurring in the United States⁶¹ as merely preparatory and therefore not substantial enough to support a grant of jurisdiction.⁶² The court stated that the acts merely constituted culpable nonfeasance and were relatively minor when compared to the acts that occurred outside the United States.⁶³

IIT v. Vencap, Ltd.,⁶⁴ decided on the same day as *Bersch*, clarified the holding of *Leasco*. *Vencap* involved a venture capital firm in which plaintiffs intended to invest.⁶⁵ The controversy arose when defendants induced plaintiffs to transfer substantial amounts of money into defendants' possession.⁶⁶ Defendants then kept the money that plaintiffs transferred rather than investing it on plaintiffs' behalf.⁶⁷ Plaintiffs claimed that they made the transfers in reliance on a false and misleading

57. *Id.* at 993 (stating that U.S. conduct was insufficient to establish jurisdiction, but that non-U.S. conduct resulted in substantial effects within United States and that jurisdiction should be granted on those grounds).

58. *Id.* at 987. The *Bersch* court found that meetings and negotiations in the United States that preceded the actual fraud were merely preparatory and therefore not substantial enough to confer jurisdiction. *Id.* at 985 n.24.

59. *See, e.g., id.* at 992-93 (stating that jurisdiction could be granted based on material U.S. conduct that directly causes plaintiff's losses even though reliance and losses occurred outside United States); *see also* RESTATEMENT (SECOND) and RESTATEMENT (THIRD) conduct tests, *supra* note 52 (reproducing language of tests in full).

60. *Bersch*, 519 F.2d at 992.

61. *See id.* at 985 n.24 (stating that U.S. conduct engaged in by defendants included preliminary meetings, use of New York law firm and accounting firm, drafting of documents in United States and use of U.S. banks).

62. *Id.* at 987.

63. *Id.*

64. 519 F.2d 1001 (2d Cir. 1975).

65. *Id.* at 1005.

66. *Id.* at 1008.

67. *Id.*

memorandum produced by the defendants.⁶⁸

In *Vencap*, at least one defendant was a U.S. citizen, a meeting regarding financial matters was held in the United States,⁶⁹ plaintiffs and defendants both retained U.S. attorneys,⁷⁰ and various documents related to the transaction at issue were drafted in the United States.⁷¹ Judge Friendly again articulated the need for a direct causal connection between the U.S. conduct and the plaintiffs' losses.⁷² Additionally, as he did in *Leasco* and implicitly in *Bersch*, Judge Friendly required that actual fraudulent conduct, not merely conduct in furtherance of a fraud, occur in the United States.⁷³ Finding these criteria satisfied, the Second Circuit granted subject matter jurisdiction.⁷⁴

b. Other Circuits Applying the Second Circuit Standard

When deciding international securities cases, other circuits adopted the fundamental elements of the conduct test articulated by the Second Circuit.⁷⁵ They did not, however, apply the test as stringently. The Ninth, Eighth, Third, and Seventh Circuit Courts of Appeals granted jurisdiction even when the acts within the United States did not constitute a violation of U.S. law.⁷⁶

68. *Id.* at 1011.

69. *Id.* at 1004. Plaintiffs were a Luxembourg trust company and three Luxembourg citizens. *Id.* at 1003.

70. *Id.* at 1005.

71. *Id.* at 1006.

72. *Id.* at 1018; see *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 34-35 (D.C. Cir. 1987) (comparing standards set by various circuits and adopting Second Circuit's as most restrictive).

73. *Vencap*, 519 F.2d at 1018 (stating that finding of jurisdiction "is limited to the perpetration of fraudulent acts themselves").

74. *Id.* at 1020-21.

75. See *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d 1103, 1106-08 (7th Cir.), *cert. denied*, 469 U.S. 871 (1984) (discussing, among others, Second Circuit precedents); *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 423 n.4 (9th Cir. 1983) (stating that lower court reviewed Second Circuit precedents); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 413-15 (8th Cir. 1979) (discussing, among others, Second Circuit precedents); *SEC v. Kasser*, 548 F.2d 109, 112 (3d Cir.) (listing, among others, Second Circuit precedents), *cert. denied sub nom. Churchill Forest Indus. v. SEC*, 431 U.S. 938 (1977).

76. See *Tamari*, 730 F.2d at 1108 (requiring only conduct material to completion of fraudulent scheme); *Grunenthal*, 712 F.2d at 426 (not requiring violation within United States); *Continental*, 592 F.2d at 418 (stating that *Kasser* extended liability to

The courts based their decisions on various rationales. The Third Circuit relied on its interpretation of congressional intent, the language of the SEA, and policy considerations.⁷⁷ The Seventh Circuit based its holding on the fundamental purposes of the CEA.⁷⁸ The Eighth Circuit examined the relationship between the defendants' conduct in the United States and the allegation of a fraudulent scheme.⁷⁹ The Ninth Circuit combined and adopted the rationales of the Third and Eighth Circuits.⁸⁰ Eventually, the Second Circuit also adopted a more liberal approach to granting jurisdiction over predominantly non-U.S. cases.⁸¹

i. The Relaxation of the Second Circuit's Test

Circuit courts have interpreted and applied the basic elements of the conduct test in a variety of ways. The Ninth, Eighth, Third, and Seventh Circuits adopted the Second Circuit's conduct test, but applied it less strictly.⁸² The following four cases represent a relaxation of the Second Circuit's standard because they do not require that the fraudulent acts occur in the United States.⁸³ Rather, the courts granted jurisdiction when U.S. conduct substantially furthered the fraudulent

cases where U.S. conduct did not constitute violation); *Kasser*, 548 F.2d at 114 (stating that accomplishment of fraud is not prerequisite to liability).

77. *Kasser*, 548 F.2d at 114, 116. Policy considerations mentioned by the court included a desire to prevent non-U.S. citizens from using the United States as a base of fraudulent operations, a desire to avoid reciprocal responses from other nations, and a desire to enhance the ability of the SEC to insure high standards of conduct in securities transactions. *Id.* at 116.

78. *Tamari*, 730 F.2d at 1108.

79. *Continental*, 592 F.2d at 420.

80. *Grunenthal*, 712 F.2d at 424-25.

81. *See Alfadda v. Fenn*, 935 F.2d 475, 478-79 (2d Cir.) (applying less stringent conduct test to RICO claim), *cert. denied*, 112 S. Ct. 638 (1991); *see also Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041 (2d Cir. 1983) (applying less stringent conduct test to CEA claim).

82. *Tamari*, 730 F.2d 1103; *Grunenthal*, 712 F.2d 421; *Continental*, 592 F.2d 409; *SEC v. Kasser*, 548 F.2d 109 (3d Cir.), *cert. denied sub nom. Churchill Forest Indus. v. SEC*, 431 U.S. 938 (1977).

83. *See Tamari*, 730 F.2d at 1108 (requiring only that conduct be material to successful completion of alleged fraud); *Grunenthal*, 712 F.2d at 425 (requiring only that conduct be significant, material and in furtherance of fraudulent scheme); *Continental*, 592 F.2d at 421 (granting jurisdiction where defendants' conduct was significant and furthered fraudulent scheme); *Kasser*, 548 F.2d at 111-12 (granting jurisdiction because significant U.S. conduct formed part of defendants' scheme).

scheme.⁸⁴

The U.S. Court of Appeals for the Ninth Circuit, in *Grunenthal GmbH v. Hotz*,⁸⁵ adopted the conduct test set forth in *Bersch*, but applied it somewhat less strictly.⁸⁶ In *Grunenthal*, plaintiff, a German corporation, alleged that defendants, two Bahamian corporations and a Mexican corporation, violated the SEA by making misrepresentations in connection with the sale of stock in one defendant corporation to plaintiff corporation.⁸⁷ The misrepresentations concerned defendants' ability to transfer the shares and defendants' intent to perform the agreement.⁸⁸ The U.S. conduct consisted of meetings in Los Angeles, California during which the parties furthered the scheme that caused plaintiff's losses.⁸⁹ The court set forth the elements of the conduct test gleaned from the earlier opinions.⁹⁰ The test, according to *Grunenthal*, requires use of "instrumentalities of interstate commerce."⁹¹ The court stressed that defendants' use of these instrumentalities constituted sig-

84. See *Tamari*, 730 F.2d at 1108 (holding that transmission of commodities orders to United States was sufficient conduct); *Grunenthal*, 712 F.2d at 425 (holding that misrepresentations made in United States constituted sufficient conduct); *Continental*, 592 F.2d at 421 (holding that use of U.S. mails and instrumentalities of interstate commerce was sufficient conduct); *Kasser*, 548 F.2d at 111-12 (holding that various U.S. conduct furthering fraudulent scheme was sufficient).

85. 712 F.2d 421.

86. See *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 992 (2d Cir.) (characterizing defendants' U.S. conduct as merely preparatory and relatively minor in comparison to conduct outside United States), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975); *cf.*, *Grunenthal*, 712 F.2d at 422-23 (describing defendants' conduct, which could be described as merely preparatory and relatively minor under *Bersch*).

87. *Grunenthal*, 712 F.2d at 422.

88. *Id.* at 423.

89. *Id.*

90. *Id.* at 424.

91. *Id.* at 423-24; see Securities and Exchange Commission Rules, 17 C.F.R. § 240.10b-5 (1991) (setting forth requirements of violation). This rule provides that it is illegal for any person to use any instrumentality of interstate commerce, or to use mails or any facility of a 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.

nificant conduct within the United States, furthering the fraudulent scheme.⁹² The court held that the requirement that the conduct must be material, rather than merely preparatory, was satisfied.⁹³

In *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*,⁹⁴ the U.S. Court of Appeals for the Eighth Circuit also applied the conduct test.⁹⁵ In *Continental*, U.S. defendants sold stock in an Australian company to an Australian citizen.⁹⁶ Defendants failed to disclose material information concerning the financial soundness of the company.⁹⁷ The court granted subject matter jurisdiction because the fraudulent failure to disclose began with communications in the United States.⁹⁸

The U.S. Court of Appeals for the Third Circuit, in *SEC v. Kasser*,⁹⁹ required only that some of the activity furthering the fraudulent scheme occur within the United States.¹⁰⁰ In *Kasser*, defendants' U.S. conduct caused losses to a Canadian corporation.¹⁰¹ The U.S. conduct included various meetings and negotiations in the United States, execution of a contract in New York, use of the U.S. wires and mails, incorporation of two defendant companies in the United States, and use of the U.S. branch of a Swiss bank as a conduit for fraudulently received funds.¹⁰² The court granted jurisdiction because the defendants furthered their fraudulent scheme through these activities within the United States.¹⁰³

Tamari v. Bache & Co. (Lebanon) S.A.L.,¹⁰⁴ decided by the U.S. Court of Appeals for the Seventh Circuit, represents a

92. *Grunenthal*, 712 F.2d at 423. Although the court did not specify, one might assume that the defendants used U.S. wires and mails in connection with a meeting in Los Angeles. *Id.*

93. *Id.* at 426.

94. 592 F.2d 409 (8th Cir. 1979).

95. *Id.* at 415-16.

96. *Id.* at 411.

97. *Id.* at 411-13.

98. *Id.* at 420.

99. 548 F.2d 109 (3d Cir.), *cert. denied sub nom. Churchill Forest Indus. v. SEC*, 431 U.S. 938 (1977).

100. *Id.* at 114.

101. *Id.* at 111.

102. *Id.*

103. *Id.* at 111-12.

104. 730 F.2d 1103 (7th Cir.), *cert. denied*, 469 U.S. 871 (1984).

particularly lenient application of the conduct test.¹⁰⁵ Although the case involved a violation of the CEA,¹⁰⁶ the court, by analogizing to the more extensively litigated securities cases, applied the conduct test.¹⁰⁷ Plaintiffs were citizens of Lebanon and defendant was a Lebanese corporation wholly owned by a U.S. corporation.¹⁰⁸ Defendant solicited and traded on plaintiffs' commodities accounts.¹⁰⁹ The violations alleged included excessive trading, misrepresentations concerning the condition of plaintiffs' accounts, and false reports given to plaintiffs by defendant.¹¹⁰ The only U.S. conduct alleged was the transmission of commodities futures orders to U.S. exchanges.¹¹¹ The *Tamari* court decided that this conduct was sufficient to confer jurisdiction because this holding would further the fundamental purpose of the CEA, which is to ensure the integrity of U.S. commodities markets.¹¹²

ii. The U.S. Court of the Appeals for the District of Columbia Applying the Early Second Circuit Standard

In *Zoelsch v. Arthur Andersen & Co.*,¹¹³ the U.S. Court of Appeals for the District of Columbia adopted the early Second Circuit standard for applying the conduct test.¹¹⁴ *Zoelsch* involved a non-U.S. plaintiff and a U.S. defendant corporation.¹¹⁵ Plaintiff and other non-U.S. citizens invested in a tax shelter plan set up by two non-U.S. companies and a U.S. company.¹¹⁶ Plaintiff alleged that defendant provided false and misleading statements to the other companies, knowing that these companies would use the information in reports distributed to plaintiff and the other investors.¹¹⁷ The *Zoelsch* court expressed doubt as to whether a U.S. court should ever grant

105. *Id.* at 1108.

106. 7 U.S.C. §§ 1-26 (1988).

107. *Tamari*, 730 F.2d at 1108.

108. *Id.*

109. *Id.* at 1105.

110. *Id.*

111. *Id.* at 1108.

112. *Id.*

113. 824 F.2d 27 (D.C. Cir. 1987).

114. *Id.* at 31.

115. *Id.* at 28.

116. *Id.* These three companies were not defendants in this action. *Id.* at 29.

117. *Id.*

jurisdiction over a case when the injured parties are non-U.S. citizens.¹¹⁸ However, noting the Second Circuit's preeminence in the field of securities law and desiring to avoid multiplicity of standards among the circuits, the District of Columbia Circuit adopted the conduct test as enunciated in *Bersch*.¹¹⁹ The court held that this test required that the fraudulent statements connected to the purchase or sale of securities originate in the United States, that the statements be made with scienter, and that the statements directly cause plaintiff's losses.¹²⁰ In other words, the *Zoelsch* court adopted the Second Circuit requirement that the U.S. conduct must establish an actionable violation of the securities laws.¹²¹ Holding that these criteria were not satisfied, the court declined to exercise jurisdiction over plaintiff's claims.¹²²

c. Second Circuit's Adoption of the More Liberal Standard

The most recent Second Circuit case applying the conduct test is *Psimenos v. E.F. Hutton & Co.*¹²³ In *Psimenos*, the court granted subject matter jurisdiction over a complaint by a non-U.S. investor against a U.S. commodities broker.¹²⁴ *Psimenos*, like *Tamari*, involved a violation of the CEA.¹²⁵ Defendant's advertisements stated that its commodities trading accounts were handled in accordance with the CEA, that defendant's money managers were experienced, and the quality of their work was thoroughly evaluated.¹²⁶ Relying on these representations, plaintiff opened an account with defendant's Athens office.¹²⁷ Although plaintiff directed defendant to seek only conservative investments, defendant used plaintiff's money to participate in several high-risk ventures.¹²⁸ As a result, plaintiff incurred substantial losses.¹²⁹ Defendant also made bogus

118. *Id.* at 32.

119. *Id.*

120. *Id.* at 33.

121. *Id.* at 31.

122. *Id.* at 34.

123. 722 F.2d 1041 (2d Cir. 1983).

124. *Id.* at 1042-43.

125. *Id.* at 1042.

126. *Id.* at 1043.

127. *Id.*

128. *Id.*

129. *Id.*

trades on plaintiff's account to generate commissions.¹³⁰ Plaintiff eventually lost in excess of US\$200,000.¹³¹

The misrepresentations made by defendant to plaintiff occurred almost entirely outside the United States.¹³² The only U.S. conduct alleged by plaintiff was that the commodities were traded on a U.S. market.¹³³ Although the activity of trading commodities on a U.S. market was, of itself, entirely legal and the plaintiff was a non-U.S. investor, the trading furthered a fraudulent scheme outside the United States.¹³⁴ The Second Circuit found that this minimal U.S. activity satisfied the conduct test and, therefore, the court granted jurisdiction.¹³⁵

2. The Effects Test

A necessary corollary to the conduct test is the effects test.¹³⁶ First applied by the U.S. Court of Appeals for the Second Circuit in *Schoenbaum v. Firstbrook*,¹³⁷ the effects test requires that non-U.S. conduct directly result in a substantial and foreseeable effect within the United States before a court may grant jurisdiction.¹³⁸ In *Schoenbaum*, the Canadian defendants

130. *Id.* at 1044.

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.* at 1046-48.

135. *Id.* The court applied the less restrictive test while not expressly overturning Judge Friendly's earlier Second Circuit precedents. *Id.*

136. See *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir.) (setting forth basic elements of effects test), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969).

137. *Id.*

138. RESTATEMENT (SECOND), *supra* note 52, § 18 recognizes the effects test; see *supra* note 52 and accompanying text (recognizing conduct test). The RESTATEMENT (SECOND) provides that

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

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

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

RESTATEMENT (SECOND), *supra* note 52, § 18. RESTATEMENT (THIRD) § 402(1)(c) also

sold stock in Canada, resulting in a fluctuation of the stock's price on the American Stock Exchange.¹³⁹ The court deemed this effect substantial enough to justify granting subject matter jurisdiction.¹⁴⁰

In *Bersch v. Drexel Firestone, Inc.*,¹⁴¹ the U.S. Court of Appeals for the Second Circuit also applied the effects test. After denying jurisdiction under the conduct test, the *Bersch* court held that the effects test had been met.¹⁴² *Bersch* involved a number of U.S. and non-U.S. investors who purchased stock in several non-U.S. companies.¹⁴³ Although the offering prospectus excluded U.S. citizens from investing,¹⁴⁴ many U.S. citizens or residents did invest.¹⁴⁵ As a result of defendants' fraudulent actions, the value of plaintiff's shares dropped so drastically that they became virtually unsaleable.¹⁴⁶ The court held that the conduct within the United States was "merely preparatory," yet the losses to the U.S. investors constituted a substantial enough effect to allow the U.S. court to exercise subject matter jurisdiction.¹⁴⁷

In *Tamari*,¹⁴⁸ the U.S. Court of Appeals for the Seventh Circuit granted jurisdiction under the conduct test, but also held that the effects test had been met.¹⁴⁹ Similar to *Schoenbaum*, the court in *Tamari* found that the facts satisfied

recognizes the effects test. RESTATEMENT (THIRD), *supra* note 52. The RESTATEMENT (THIRD) provides that

[s]ubject to [the reasonableness requirement of] § 403, a state has jurisdiction to prescribe

....

(1)(c) conduct outside its territory that has or is intended to have substantial effect within its territory.

Id.

139. *Schoenbaum*, 405 F.2d at 204-09.

140. *Id.* at 208.

141. 519 F.2d 974 (2d Cir.), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975).

142. *Id.* at 992-93.

143. *Id.* at 979-80.

144. *Id.* at 980.

145. *Id.* at 992 n.42 (stating that approximately 385 "American persons" had acquired shares).

146. *Id.* at 981.

147. *Id.* at 992.

148. 730 F.2d 1103 (7th Cir.), *cert. denied*, 469 U.S. 871 (1984); *see supra* notes 104-12 and accompanying text (discussing application of conduct test in *Tamari*).

149. *Id.* at 1108.

the effects test because of trading activity on a U.S. market.¹⁵⁰ The *Tamari* court held that because fraudulent transactions artificially influenced the markets, jurisdiction was appropriate under the effects test.¹⁵¹

More recently, the U.S. Court of Appeals for the Second Circuit applied the effects test in *Consolidated Gold Fields PLC v. Minorco, S.A.*¹⁵² In *Consolidated*, U.S. investors, representing a very small percentage of the affected shareholders, held stock valued at approximately US\$120,000,000.¹⁵³ The court held that an investment of this size would have an effect within the United States substantial enough to satisfy the requirements of the *Restatement (Third) of the Foreign Relations Law of the United States*.¹⁵⁴ While *Psimenos* represents a relaxation of the Second Circuit's standard for applying the conduct test, *Consolidated* reflects a similar relaxation of the effects test standard.¹⁵⁵

C. Judicial Interpretations of RICO's Extraterritorial Effect

Very few cases address the extraterritorial application of RICO.¹⁵⁶ *United States v. Parness*¹⁵⁷ and *Philan Insurance Ltd. v. Frank B. Hall & Co.*¹⁵⁸ are two significant extraterritorial RICO cases. *Parness* addressed RICO's extraterritoriality based on an interpretation of the Act's language and legislative history¹⁵⁹ and *Philan* followed the conduct and effects formulations set forth in *Vencap*, *Bersch*, and *Leasco*.¹⁶⁰

150. *Id.*

151. *Id.*

152. 871 F.2d 252 (2d Cir.), *cert. denied*, 492 U.S. 939 (1989); see William R. Covey, Comment, *Consolidated Gold Fields PLC v. Minorco, S.A.: The Extraterritorial Application of United States Securities Laws in International Equities Markets*, 14 *FORDHAM INT'L L.J.* 240 (1990-1991) (arguing that *Consolidated* impermissibly relaxed standard for jurisdiction under effects test).

153. *Consolidated*, 871 F.2d at 262 (stating that U.S. residents represented 2.5 percent of shareholders).

154. *Id.*

155. See *supra* notes 126-34 and accompanying text (describing conduct adjudged sufficient for jurisdiction in *Psimenos*).

156. *United States v. Parness*, 503 F.2d 430 (2d Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975); *Philan Ins. Ltd. v. Frank B. Hall & Co.*, 748 F. Supp. 190 (S.D.N.Y. 1990); see *supra* note 31 (listing 16 extraterritorial RICO cases).

157. 503 F.2d 430 (2d Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975).

158. 748 F. Supp. 190.

159. *Parness*, 503 F.2d at 438-39.

160. See *id.* at 440 (citing *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972)); *Philan*, 748 F. Supp. at 193 (citing *Bersch v. Drexel Fire-*

The U.S. Court of Appeals for the Second Circuit decided *Parness* only two years after *Leasco* and one year prior to *Bersch* and *Vencap*.¹⁶¹ Although Judge Friendly did not write for the court, he joined in its decision.¹⁶² Thus, one may assume that the circumstances within *Parness* satisfied the strict Second Circuit standard formulated by Judge Friendly.

In *Parness*, defendants faced criminal charges of conversion and transportation of stolen money across state lines.¹⁶³ In addition, a RICO claim arose from the allegation that the U.S. defendants had used the stolen money to divest the U.S. plaintiff of his interest in a non-U.S. corporation.¹⁶⁴ Defendants asserted that, because the corporation was not subject to U.S. laws, RICO should not apply to this acquisition.¹⁶⁵

In *Parness*, the court addressed defendants' contention that RICO was not intended to apply to the wrongful acquisition of a non-U.S. corporation.¹⁶⁶ The court relied on RICO's legislative history to reject this argument and granted jurisdiction.¹⁶⁷ The court referred to the civil provisions of RICO,¹⁶⁸ which were intended to protect individuals who invest in U.S. and non-U.S. ventures.¹⁶⁹ Although civil liability was not an issue in this case, the court's reference to the civil provisions of RICO is significant because the complainant was a U.S. citizen who owned a non-U.S. corporation.¹⁷⁰ Thus, the Second Circuit, through *Parness*, made it clear that RICO could be construed to have substantial extraterritorial effect.¹⁷¹

Philan, a civil RICO case, was decided by the U.S. District

stone, Inc., 519 F.2d 974, 985 (2d Cir.), cert. denied sub nom. *Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975)).

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

162. *Parness*, 503 F.2d at 432.

163. *Id.* at 433.

164. *Id.*

165. *Id.* at 439.

166. *Id.*

167. *Id.*; see H.R. REP. NO. 1549, 91st Cong., 2d Sess. (1970), reprinted in 1970 U.S.C.C.A.N. 4007, 4033 (stating that any wrongful acquisition, without exception, is prohibited).

168. 18 U.S.C. §§ 1963-1964 (1988 & Supp. II 1991).

169. *Parness*, 503 F.2d at 439.

170. *Id.* at 433.

171. *Id.* at 439.

Court for the Southern District of New York.¹⁷² *Philan* involved a scheme in which defendants arranged to take in premiums owed to plaintiff insurance companies, keep ten percent for themselves, and transfer only the remaining ninety percent to plaintiffs.¹⁷³ Defendants transmitted the misappropriated funds through and from New York and created and transmitted fraudulent records in and from New York.¹⁷⁴

In *Philan*, the court denied subject matter jurisdiction under both the conduct and effects tests.¹⁷⁵ However, because the facts do not satisfy even the more relaxed requirements for extraterritoriality, this case does not represent a departure from the recent, less stringent standard.¹⁷⁶ In *Philan*, the district court first examined plaintiffs' claims under the conduct test.¹⁷⁷ Although this conduct furthered the fraud,¹⁷⁸ the court denied subject matter jurisdiction because these actions did not directly cause plaintiffs' losses.¹⁷⁹ Turning to the effects test, the court also denied jurisdiction on that ground.¹⁸⁰ Plaintiffs argued that because defendants had violated federal law, the requirements of the effects tests had been met.¹⁸¹ Denying jurisdiction under the effects test, the court recognized that accepting plaintiffs' argument would diminish the effects test to nothing more than a determination that plaintiffs had a cognizable claim under federal law.¹⁸²

172. *Philan Ins. Ltd. v. Frank B. Hall & Co.* 748 F. Supp. 190 (S.D.N.Y. 1990).

173. *Id.* at 192.

174. *Id.*

175. *Id.* at 194-95.

176. *Id.* at 191-93; see *supra* notes 75-112 and accompanying text (discussing more relaxed standard).

177. *Philan*, 748 F. Supp. at 194.

178. See *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1018 (2d Cir. 1975) (limiting jurisdiction to perpetration of fraudulent acts themselves); cf. *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1046 (requiring only substantial conduct in furtherance of fraud).

179. *Philan*, 748 F. Supp. at 194; see *Psimenos*, 722 F.2d at 1046 (requiring that U.S. conduct directly cause plaintiff's losses); see also *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir.), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975) (same).

180. *Philan*, 748 F. Supp. at 195.

181. *Id.* at 194.

182. *Id.* at 194-95.

II. ALFADDA v. FENN

In *Alfadda v. Fenn*,¹⁸³ the U.S. Court of Appeals for the Second Circuit again addressed the extraterritorial application of RICO, but this time granted jurisdiction based on the conduct test.¹⁸⁴ *Alfadda* involved an allegedly fraudulent sale of securities to plaintiffs, a group of non-U.S. residents.¹⁸⁵ The sale was made outside the United States and the company for which the securities were issued was a non-U.S. corporation.¹⁸⁶ Plaintiffs alleged that, in contravention of the offering prospectus, defendants made a second offering that diluted plaintiffs' voting rights.¹⁸⁷ Plaintiffs contended that the U.S. court should confer jurisdiction over this case because substantial conduct leading up to the second sale of securities occurred in the United States.¹⁸⁸ The U.S. District Court for the Southern District of New York denied jurisdiction under both the conduct¹⁸⁹ and the effects tests.¹⁹⁰ However, the U.S. Court of Appeals for the Second Circuit reversed, holding that defendants' U.S. activities satisfied the conduct test.¹⁹¹

A. *Factual Background*

On February 14, 1979, defendant Radwan, a U.S. citizen, invited plaintiff Alfadda¹⁹² to purchase shares in defendant company, Saudi European Investment Corporation N.V. ("SEIC").¹⁹³ Later that year, plaintiff Alfadda purchased 1000 shares of SEIC stock for US\$1,000,000.¹⁹⁴ Several other investors also purchased substantial amounts of SEIC stock.¹⁹⁵ Ac-

183. 935 F.2d 475 (2d Cir. 1991).

184. *Id.* at 479.

185. *Id.* at 476.

186. *Id.* at 477.

187. *Id.*

188. *Id.*

189. *Alfadda v. Fenn*, 751 F. Supp. 1114, 1118 (S.D.N.Y. 1990), *rev'd*, 935 F.2d 475 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991).

190. *Id.* at 1118-19.

191. *Alfadda*, 935 F.2d at 480.

192. *Id.* at 476-77.

193. *Id.* All plaintiffs are non-U.S. residents and nationals of either Saudi Arabia or Bahrain. *Id.* SEIC is incorporated in the Netherlands Antilles. *Id.*

194. *Id.* at 477.

195. *Id.* Plaintiffs Abdulla Kanoo, Abdulaziz Kanoo and Yusif Bin Ahmed (the Kanoos) purchased 10,000 shares for US\$1,000,000; plaintiffs Ahmed Zainy and Abdullah Abbar each purchased 10,000 shares for US\$1,000,000. *Id.*

ording to the terms of the original offering prospectus, plaintiff Alfadda and the other original investors were to receive preference in any subsequent offering of SEIC stock.¹⁹⁶ In addition, the prospectus guaranteed that any subsequent offering would not dilute the voting interests of the original investors.¹⁹⁷

In 1983, defendant Radwan and defendant Fenn, a U.S. citizen and resident, planned a second offering of SEIC stock.¹⁹⁸ The chairman of the U.S.-based American Continental notified SEIC that American Continental's savings and loan subsidiary, Lincoln Savings and Loan Association ("Lincoln"), wanted to purchase fifteen percent of SEIC's voting shares.¹⁹⁹ Six days later, American Continental received a telex in Phoenix, Arizona from SEIC directing it to deposit payment for the shares in a New York bank account.²⁰⁰ Subsequently, defendants met with American Continental's chairman in Phoenix, Arizona.²⁰¹ One week after the meeting, a SEIC employee, hired by defendants to market the second offering, received a telex from defendant Fenn informing him that the US\$18,000,000 from American Continental had finally arrived.²⁰²

SEIC's offering prospectus included a clause prohibiting direct or indirect offerings in the United States.²⁰³ To circumvent this clause, American Continental created Lincoln American Investments N.V. ("Lincoln American").²⁰⁴ Lincoln American was a wholly-owned, subsidiary, off-shore shell company created solely for the purpose of purchasing shares in SEIC.²⁰⁵

In addition, plaintiffs alleged that in June of 1984, defendant Radwan telephoned another potential investor, Mr. Al-

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.*

200. *Id.*

201. *Id.* at 477 n.6. Defendant Fenn said that the meeting was unrelated to SEIC, but that he could not remember the topics discussed. *Id.* This is significant because if the meeting concerned SEIC it would be additional U.S. conduct in furtherance of the fraud on plaintiffs. *Id.*

202. *Id.* at 477.

203. *Id.*

204. *Id.*

205. *Id.* at 479. Lincoln American is incorporated in the Netherlands Antilles.

Id.

Turki, in Houston, Texas²⁰⁶ to notify him of Lincoln American's purchase and to suggest that, if Mr. Al-Turki bought a large amount of stock, then Mr. Al-Turki, defendants Radwan and Fenn and another original investor would control SEIC.²⁰⁷ Plaintiffs alleged that the SEIC employee hired to market the second offering telexed Mr. Al-Turki on June 22 to ask if Mr. Al-Turki intended to invest.²⁰⁸ Mr. Al-Turki replied by telex that he would purchase 150,000 shares for US\$15,000,000.²⁰⁹ On June 26, SEIC accepted Mr. Al-Turki's offer by telex, and directed him to deposit payment in its New York bank account.²¹⁰

The parties did not dispute that the sales to Lincoln American and Mr. Al-Turki caused losses to plaintiffs by diluting their voting rights.²¹¹ The only controversy concerned the significance of defendants' conduct within the United States.²¹² There were several significant U.S. activities in *Alfadda v. Fenn*. Most importantly, defendants Radwan and Fenn were both U.S. citizens.²¹³

Plaintiffs alleged additional U.S. conduct that defendants did not dispute. The second offering was planned and completed almost entirely within the United States.²¹⁴ The SEIC employee, a U.S. citizen, prepared and marketed the second offering.²¹⁵ Shares were sold in the United States to Lincoln American²¹⁶ and to Mr. Al-Turki, whose company had offices in the United States.²¹⁷ Furthermore, defendants repeatedly used U.S. mail, wire, and telephone services to arrange the second sale.²¹⁸ The stock certificates issued in that sale were

206. *Id.* at 478 n.7. Al-Turki is a resident of Saudi Arabia and he owns a Saudi company with offices in Houston. *Id.*

207. *Id.* at 477.

208. *Id.*

209. *Id.* at 478.

210. *Id.*

211. *Id.* at 477.

212. *Id.* at 477 n.4.

213. *Alfadda v. Fenn*, 751 F. Supp. 1114, 1115 (S.D.N.Y. 1990), *rev'd*, 935 F.2d 475 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991).

214. *Alfadda*, 935 F.2d at 477.

215. *Alfadda*, 751 F. Supp. at 1116.

216. *Id.*

217. *Alfadda*, 935 F.2d at 477 n.7.

218. *Alfadda*, 751 F. Supp. at 1116.

printed in New York.²¹⁹ Meetings prior to the sale were held at several U.S. locations.²²⁰ Of particular significance are the deposits made in U.S. banks of monies used to purchase shares in the second offering.²²¹

Plaintiffs also claimed that this second offering was made in contravention of the original offering prospectus.²²² Defendants contended, however, that the fraud was complete upon the delivery of the original prospectus to plaintiffs.²²³ Because that delivery occurred outside the United States, defendants asserted that the U.S. activity was inconsequential in this case.²²⁴

*B. Opinion of the U.S. District Court for the Southern
District of New York*

Following the sales to Lincoln American and Mr. Al-Turki, plaintiffs brought a suit for damages against defendants in the U.S. District Court for the Southern District of New York.²²⁵ Count I of the complaint alleged RICO violations.²²⁶ Count II alleged violations of the SEA, Rule 10b-5 of the Securities and Exchange Commission Rules,²²⁷ common law fraud, breach of fiduciary duty, and rescission of contract.²²⁸ Defendants moved for dismissal of the complaint for lack of subject matter jurisdiction or, in the alternative, on the grounds of *forum non conveniens*.²²⁹ Defendants also moved to have the complaint dismissed for failure to plead fraud with particularity.²³⁰

219. *Id.*

220. *Id.*

221. *Id.*

222. *Alfadda v. Fenn*, 935 F.2d 475, 477 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991).

223. *Id.* at 478.

224. *Id.* at 477 n.4.

225. *Alfadda*, 751 F. Supp. at 1115. The original complaint was filed on September 20, 1989. *Id.* On June 29, 1990, following limited discovery on the jurisdictional issue, plaintiffs filed an amended complaint. *Id.*

226. *Id.* at 1115. Count I was joined by all plaintiffs. *Id.*

227. 17 C.F.R. § 240.10b-5 (1991); *see supra* note 91 (reproducing language of Rule 10b-5).

228. *Alfadda*, 751 F. Supp. at 1115. Count II was joined by all plaintiffs except *Alfadda*. *Id.*

229. *Id.*

230. *Id.* The district court dismissed the suit for lack of subject matter jurisdiction. *Id.* As a result, it did not address defendants' motions to dismiss for failure to

Stating that there was a great deal more authority on the extraterritorial application of the securities laws than on RICO, the district court addressed the SEA violations before the RICO violation.²³¹ Applying the conduct test, the court found that the U.S. conduct in this case was even less significant than that declared insufficient in *Bersch*.²³² The court held that the fraud was complete once the plaintiffs paid for their SEIC shares in reliance on the original prospectus.²³³ Therefore, according to the district court, the subsequent U.S. activity leading up to the sales to Lincoln American and Mr. Al-Turki was of no legal significance.²³⁴

Having declined to grant jurisdiction under the conduct test, the district court then applied the effects test.²³⁵ The court found that plaintiffs were not U.S. investors, nor were the stocks ever traded on a U.S. exchange.²³⁶ As a result, the court held that there was no domestic effect substantial enough to justify a grant of jurisdiction.²³⁷

In addressing the RICO claims contained in Count I, the court again denied jurisdiction.²³⁸ Noting the dearth of extraterritorial RICO precedent,²³⁹ the court applied the standard conduct and effects analysis.²⁴⁰ It concluded that the U.S. activities, such as the use of U.S. communication and transportation systems, were "subsidiary" to the actual fraud, which oc-

plead fraud with particularity and to dismiss on the grounds of *forum non conveniens*. *Id.* at 1122-23.

231. *Id.* at 1116.

232. *Id.* at 1118. The conduct found insufficient in *Bersch* included numerous meetings in New York attended by U.S. citizens, the involvement of U.S. law firms and accountants, the drafting of documents in New York, telephone calls from New York to Geneva, and the use of U.S. bank accounts. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 n.24 (2d Cir.), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975). This conduct was adjudged to be merely preparatory and ancillary to the work later done in Europe. *Id.* at 985 n.24, 987.

233. *Alfadda*, 751 F. Supp. at 1118.

234. *Id.*

235. *Id.*

236. *Id.* at 1119.

237. *Id.* at 1118-19.

238. *Id.* at 1122.

239. *Id.* at 1119; *see* *United States v. Parness*, 503 F.2d 430 (2d Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975); *see also supra* notes 156-82 and accompanying text (discussing extraterritorial RICO cases).

240. *Alfadda*, 751 F. Supp. at 1119.

curred entirely outside the United States.²⁴¹ The court then held that when the pattern of activity is not part of the underlying fraud “but an after-the-event working out of an already completed fraud,” a court should not grant subject matter jurisdiction.²⁴²

The district court also held that the U.S. conduct did not directly cause plaintiffs’ losses.²⁴³ These losses, according to the court, were a direct result of the fraudulent statements contained in the original offering prospectus, which had no connection to the United States.²⁴⁴ This analysis represented an extremely strict application of the conduct test.²⁴⁵

C. *Opinion of the U.S. Court of Appeals for the Second Circuit*

Plaintiffs appealed to the U.S. Court of Appeals for the Second Circuit.²⁴⁶ They based their appeal on the theory that the U.S. conduct resulting in the sales to Lincoln American and Mr. Al-Turki constituted a necessary part of the alleged securities fraud.²⁴⁷ The plaintiffs contended that, in fact, these sales consummated the fraud.²⁴⁸ Reversing the district court’s dismissal of the complaint, the U.S. Court of Appeals for the Second Circuit held that the acts within the United States were necessary elements of the fraud and, as such, could serve as the basis for subject matter jurisdiction.²⁴⁹

Addressing the general issue of the extraterritorial application of the RICO statute, the court quoted from *United States v. Parness*.²⁵⁰ In *Parness*, the Second Circuit held that restricting the application of RICO to wholly domestic enterprises would frustrate “the salutary purposes of the Act.”²⁵¹ Having af-

241. *Id.* at 1121. The court emphasized its position by stating that “[t]he tail should not wag the dog.” *Id.*

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.*

246. *Alfadda v. Fenn*, 935 F.2d 475, 476 (2d Cir.), *cert. denied*, 112 S. Ct. 628 (1991).

247. *Id.* at 478-79.

248. *Id.* at 478.

249. *Id.* at 480.

250. *Id.* at 479 (quoting *United States v. Parness*, 503 F.2d 430 (2d Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975)); see *supra* notes 161-74 and accompanying text (discussing *Parness*).

251. *Parness*, 503 F.2d at 439.

firmed the possibility that RICO could reach beyond the borders of the United States, the *Alfadda* court granted jurisdiction based on its analysis of the facts, in light of the accepted conduct and effects tests.²⁵²

The appellate court based its reversal of the district court on its belief that the fraud was still incomplete upon delivery of the original prospectus to plaintiffs.²⁵³ Rather, the court of appeals considered the negotiations with and the sales to Lincoln American and Mr. Al-Turki, which occurred primarily in the United States, necessary elements of the fraud.²⁵⁴ In support of this assertion, the court stressed that RICO violations are based, above all, on patterns of illegal activity.²⁵⁵ The appellate court viewed the original sale and the subsequent sales as part of the same pattern of activity that resulted, ultimately, in losses to the plaintiffs.²⁵⁶

The court of appeals also stressed procedural considerations. It noted that, because *Alfadda* was before the district court on a motion to dismiss, the district court was required to accept all of the plaintiffs' factual allegations as true.²⁵⁷ The court of appeals stated that if the district court had followed this procedural rule, it would have found sufficient conduct to grant jurisdiction.²⁵⁸ For the foregoing reasons, the court of appeals reversed the judgment of the district court and remanded the case for further proceedings.²⁵⁹

III. THE SECOND CIRCUIT CORRECTLY GRANTED SUBJECT MATTER JURISDICTION OVER THE PLAINTIFFS' CLAIMS

In *Alfadda*, the U.S. Court of Appeals for the Second Cir-

252. *Alfadda*, 935 F.2d at 479.

253. *Id.* at 478-79.

254. *Id.*

255. *Id.* at 479; see *Agency Holding Corp. v. Malley-Duff & Assoc.*, 483 U.S. 143, 154 (1987). In *Agency Holding*, the Court stated that "the heart of any RICO complaint is the allegation of a pattern of racketeering activity." *Id.*

256. *Alfadda*, 935 F.2d at 478-79.

257. *Id.* at 478; see 5A CHARLES A. WRIGHT & ARTHUR R. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 1350, at 220 (2d ed. 1990) (explaining that uncontroverted factual allegations in body of complaint must be taken as true on disposition of motion to dismiss for lack of subject matter jurisdiction).

258. *Alfadda*, 935 F.2d at 478.

259. *Id.* at 480.

cuit properly granted subject matter jurisdiction.²⁶⁰ The court applied a slightly more relaxed version of the early Second Circuit SEA cases to this civil RICO claim.²⁶¹ Although the court did not require that the U.S. conduct itself constitute an actionable violation, it did require that the conduct be substantial and directly cause plaintiffs' losses.²⁶²

The result in *Alfadda* is consistent with the need to preserve the integrity of the United States and the principles of predictability of application, international comity, and the desire to limit the burden on the federal judiciary. Allowing the various circuit courts to set their own standards, however, will serve only to confuse the issue. For that reason, Congress should establish a uniform standard for the extraterritorial application of federal statutes and thereby prevent the need for the judicial activism which has dominated this area of the law.

A. *The Second Circuit Correctly Applied Judicial Precedents*

The Second Circuit correctly applied the judicial precedents to the facts of *Alfadda*. Defendants' actions in the United States were varied and substantial.²⁶³ All the U.S. conduct directly resulted in the dilution of plaintiffs' voting rights and therefore caused losses to the plaintiffs.²⁶⁴ Plaintiffs proved that defendants used U.S. wires and mails and conducted meetings in the United States.²⁶⁵

1. Jurisdiction Was Appropriately Denied Under the Effects Test

The Second Circuit addressed the effects test in a cursory manner in the *Alfadda* opinion.²⁶⁶ The district court, however, had applied this test, reaching an appropriate outcome.²⁶⁷ The district court denied jurisdiction under the effects test because the plaintiffs were not U.S. investors and the securities

260. *Id.* at 479-80.

261. *See id.* at 478 (adopting more relaxed standard); *cf. supra* notes 45-74 and accompanying text (discussing early Second Circuit precedents).

262. *Alfadda*, 935 F.2d at 478.

263. *Alfadda v. Fenn*, 751 F. Supp. 1114, 1115-16 (S.D.N.Y. 1990), *rev'd*, 935 F.2d 475 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991).

264. *Alfadda*, 935 F.2d at 477-79.

265. *See id.* at 477-78 (describing defendants' U.S. conduct).

266. *Id.* at 478.

267. *Alfadda*, 751 F. Supp. at 1118-19.

involved were not traded on a U.S. market.²⁶⁸ As a result, there was no substantial effect on the U.S. economy or on any U.S. citizen. If the court had granted jurisdiction under the effects test, it would have impermissibly relaxed the standard for extraterritoriality.²⁶⁹

2. Jurisdiction Was Appropriately Granted Under the Conduct Test

The Second Circuit granted subject matter jurisdiction in *Alfadda* based on its analysis and application of the conduct test.²⁷⁰ The Second Circuit held that the conduct test was satisfied because defendants' U.S. activities were more than merely preparatory and these activities directly caused plaintiffs' losses.²⁷¹ Defendants' U.S. conduct included negotiations and meetings in the United States, use of the U.S. wires and mails and, ultimately, the sale of securities to Lincoln American and Mr. Al-Turki.²⁷² This conduct could not be characterized as merely preparatory because it was necessary to the consummation of the fraud.²⁷³ But for the conduct of the defendants within the United States and the resultant sales to Lincoln American and Mr. Al-Turki, plaintiffs would have suffered no losses.²⁷⁴ Thus, the Second Circuit was correct in granting jurisdiction over plaintiffs' claims based on defendants' substantial activities within the United States.

B. *Implications of Alfadda v. Fenn*

The current conduct test employed by the Second Circuit represents a significant change from the test enunciated by the same court many years ago in *Vencap*, *Bersch*, and *Leasco*.²⁷⁵ As

268. *Id.* at 1119.

269. *See Consolidated Gold Fields PLC v. Minorco, S.A.*, 871 F.2d 252, 262-63 (2d Cir.) (setting forth standard for jurisdiction under effects test), *cert. dismissed*, 492 U.S. 939 (1989).

270. *Alfadda*, 751 F. Supp. at 1118-19.

271. *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991).

272. *Id.* at 477-78.

273. *Id.*

274. *Id.*

275. *See IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1018 (2d Cir. 1975) (holding that jurisdiction may be granted only when perpetration of fraudulent acts occurs within United States); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 987 (2d Cir.) (denying jurisdiction where acts are preparatory), *cert. denied sub nom. Bersch v. Arthur Ander-*

explained earlier, several circuits applied the test less stringently than did the Second Circuit, often preserving all the elements of the test except for the requirement that the U.S. conduct itself constitute a violation.²⁷⁶ In keeping with the more liberal formulation of the conduct test, the Second Circuit decided *Psimenos*, which specifically repudiated the requirement that the domestic activity itself constitute a violation in CEA cases.²⁷⁷ The more recent rule, set forth in *Psimenos*, and followed in *Alfadda*, preserves the most important elements of *Vencap*, *Bersch*, and *Leasco*.²⁷⁸ The new standard requires substantial and material conduct which actually furthers the fraudulent scheme and directly causes the plaintiffs' losses.²⁷⁹ Though less restrictive than the earlier rule, this new standard sufficiently balances the competing interests in any predominantly non-U.S. securities transaction that involves some amount of U.S. conduct.²⁸⁰

While *Psimenos* set the standard for granting jurisdiction over CEA claims, the decision in *Alfadda* expanded RICO's extraterritorial effect beyond the earlier RICO cases, *United States v. Parness* and *Philan Insurance Ltd. v. Frank B. Hall & Co.*²⁸¹ *Par-*

sen & Co., 423 U.S. 1018 (1975); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334-35 (2d Cir. 1972) (stating that jurisdiction would be granted only if U.S. conduct was fraudulent); see also *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987) (stating that early Second Circuit rule requires that U.S. conduct comprise all elements necessary to establish violation of § 10(b) and Rule 10b-5).

276. See *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d 1103, 1108 (7th Cir.) (granting jurisdiction where only U.S. conduct was transmission of fraudulent commodities orders to U.S. exchange), *cert. denied*, 469 U.S. 871 (1984); *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 426 (9th Cir. 1983) (requiring no violation within United States); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 418 (8th Cir. 1979) (adopting *Kasser* holding that extended jurisdiction to cases where U.S. conduct did not constitute Rule 10b-5 violation); *SEC v. Kasser*, 548 F.2d 109, 114 (3d Cir.) (stating that accomplishment of fraud is not prerequisite to liability), *cert. denied sub nom. Churchill Forest Indus. v. SEC*, 431 U.S. 938 (1977).

277. See *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1046 (2d Cir. 1983) (explaining that district court erred in requiring that U.S. conduct itself be illegal).

278. See *Alfadda*, 935 F.2d at 478 (preserving requirements of materiality and direct causation); *Psimenos*, 722 F.2d at 1046 (same).

279. *Alfadda*, 935 F.2d at 478; *Psimenos*, 722 F.2d at 1046.

280. See *infra* notes 289-335 and accompanying text (describing policy considerations).

281. *United States v. Parness*, 503 F.2d 430 (2d Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975); *Philan Ins. Ltd. v. Frank B. Hall & Co.*, 748 F. Supp. 190 (S.D.N.Y. 1990); see *supra* notes 156-82 and accompanying text (discussing *Parness* and *Philan*).

ness did not involve a RICO claim grounded in securities fraud, so it is not directly analogous to *Alfadda*.²⁸² Nor did *Parness* address the conduct and effects tests.²⁸³ The *Parness* court focused solely on whether RICO applied to the wrongful acquisition of non-U.S. businesses.²⁸⁴ *Philan* is a district court case in which the court denied jurisdiction because the U.S. conduct did not meet even the more relaxed standard, so its precedential value is limited.²⁸⁵ However, *Philan* and *Parness* are worthy of mention because they illustrate how vital and necessary clear standards on the issue of RICO's extraterritoriality have become.²⁸⁶

Alfadda is thus a significant decision because it is the first case to apply the conduct and effects tests and grant jurisdiction over a RICO claim based on a transnational securities fraud where the U.S. conduct itself did not comprise all the elements necessary to complete the fraud. *Alfadda* applied the conduct and effects tests to the extraterritorial application of the RICO statute and granted jurisdiction, while most earlier cases dealt solely with the extraterritoriality of the Securities and Exchange Act of 1934²⁸⁷ and the Commodities Exchange Act.²⁸⁸ The expansion of broad extraterritorial application to another federal statute may prompt Congress to address the issue.

282. See *Parness*, 503 F.2d at 433 (stating that RICO claim was based on criminal charges of conversion and interstate transportation of stolen property rather than securities violation).

283. See generally *Parness*, 503 F.2d 430 (granting jurisdiction solely on language and legislative history of statute without applying conduct and effects tests).

284. *Id.* at 438-39.

285. *Philan*, 748 F. Supp. 190.

286. See *Parness*, 503 F.2d at 438-39 (finding that RICO could be construed to apply extraterritorially); *Philan*, 748 F. Supp. at 194-95 (applying conduct and effects standard of extraterritoriality to RICO claim).

287. 15 U.S.C. § 78 (1988 & Supp. II 1991); see, e.g., *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983) (involving SEA violation); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979) (same); *SEC v. Kasser*, 548 F.2d 109 (3d Cir.) (same), *cert. denied sub nom. Churchill Forest Indus. v. SEC*, 431 U.S. 938 (1977); *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975) (same); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.) (same), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972) (same).

288. 7 U.S.C. §§ 1-26 (1988); see, e.g., *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d 1103 (7th Cir.), *cert. denied*, 469 U.S. 871 (1984) (involving CEA violation); *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041 (2d Cir. 1983) (same).

Another implication of this decision is the possibility that it will further encourage international business transactions. Scrupulous business people contemplating transnational ventures will be secure in the knowledge that RICO will protect them from fraud and criminal activity. The increasingly international character of modern business transactions makes this kind of security an important consideration.

C. Policy Considerations Support Broad Extraterritorial Application of RICO

Several policy considerations support the argument that RICO should be given broad extraterritorial effect. First, and perhaps most important, is the fact that aggressive application of RICO to transnational schemes will help to preserve the integrity of the United States. Second, broad construction of RICO will enhance predictability of the Act's application. Third, such application will not violate principles of international comity. Fourth, a liberal construction will not result in an undue burden on the federal judiciary.

1. Broad Application Will Preserve U.S. Integrity

The United States, as a world leader, has a responsibility to help prevent international fraudulent schemes.²⁸⁹ The increasingly transnational character of the securities industry makes it quite common for non-U.S. transactions to have some connection with the United States.²⁹⁰ To prevent non-U.S. parties from acting within U.S. territory to advance their illegal schemes, RICO and the U.S. federal securities laws must reach those actors whose activities include U.S. conduct or result in U.S. effects. Substantial extraterritorial application will also protect non-U.S. parties from fraudulent schemes perpetrated by U.S. citizens.

If U.S. laws were applied only domestically, the global span of many RICO schemes would allow defendants to evade prosecution.²⁹¹ This evasion would impair the ability of the

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

290. See generally *Internationalization Report Sent to Congress by SEC Staff*, 19 SEC. REG. & L. REP. (BNA) No. 32, at 1187 (Aug. 7, 1987) (discussing increasing internationalization of securities markets).

291. Cf. ALAN V. LOWE, EXTRATERRITORIAL JURISDICTION 5 (1983) (stating that limiting reach of antitrust laws would permit defendants to evade those laws).

United States to protect its citizens from fraud.²⁹² This significant national interest justifies broad applicability of RICO to non-U.S. transactions that include U.S. conduct or U.S. effects.²⁹³

Most circuits addressing the extraterritorial application of securities regulations have alluded to a desire to prevent the United States from being used as a "base of operations" for fraudulent activity.²⁹⁴ These courts agree that the best way to avoid this result is to give the securities regulations substantial extraterritorial effect. The same can be said for RICO, which targets patterns of illegal or fraudulent activities as opposed to single instances. Defendants should not be permitted to escape liability for fraudulent conduct in the United States simply because the resultant losses occur entirely outside the United States and the parties adversely affected are non-U.S. citizens. Actions within the United States that further a fraudulent scheme, regardless of the location of their effects, are within the purview of U.S. federal regulation.²⁹⁵

292. See *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206 (2d Cir.) (stating that Congress intended SEA to have extraterritorial application to protect U.S. investors), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969).

293. See Hon. Kenneth W. Dam, *Economic and Political Aspects of Extraterritoriality*, 19 INT'L LAW. 887, 888-89 (1985). Judge Dam states that

the legal regime of antitrust and securities and commodities market regulation could be undermined if transactions across borders were beyond the reach of our legal system. National security might be eroded if we could reach only the initial consignee of a sensitive export and had no right to impose foreign end-use or end-user restrictions.

Id.

294. See, e.g., *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1046 (2d Cir. 1983) (stating that "Congress did not want United States commodities markets to be used as a base to consummate schemes concocted abroad"); see also *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 425 (9th Cir. 1983) (stating that denial of jurisdiction "could make it convenient for foreign citizens and corporations to use [the United States] and its lawyers, accountants and underwriters to further fraudulent securities schemes"); *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir.) (denial of jurisdiction might encourage "those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations"), *cert. denied sub nom. Churchill Forest Indus. v. SEC*, 431 U.S. 938 (1977); cf. *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975) (asserting that Congress did not want "to allow the United States to be used as base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners").

295. See generally *Alfadda v. Fenn*, 935 F.2d 475 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991).

2. Broad Application Will Enhance Predictability

As long as U.S. courts are willing to grant subject matter jurisdiction over a broad range of international transactions, non-U.S. citizens conducting business within the United States will be on notice that their actions could make them vulnerable to suit in a U.S. court.²⁹⁶ The RICO statute itself repeatedly makes reference to interstate and international commerce.²⁹⁷ These references put individuals on notice that transactions which cross national boundaries will be regulated by the statute. Non-U.S. citizens who voluntarily establish contacts within the United States should foresee the possibility that U.S. law will apply to their transactions.²⁹⁸ This foreseeability will likely result in non-U.S. citizens being careful to respect U.S. laws and will make it fair for U.S. courts to exercise jurisdiction over their activities.²⁹⁹

3. Broad Application Will Not Violate Principles of International Comity

The policy of international comity, or the respect of one nation for the official acts of another, supports a broad extra-territorial application of the RICO statute.³⁰⁰ Under RICO, some element of interstate or international commerce must be present before the statute can apply either within the United States or outside its borders.³⁰¹ These jurisdictional limitations decrease the likelihood that U.S. litigation will infringe

296. *See Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 414 (1984) (stating that U.S. jurisdiction over non-U.S. corporation is fair when controversy arises out of defendant's contacts with United States).

297. 18 U.S.C. § 1962(a),(b),(c) (1988 & Supp. II 1991).

298. *See, e.g., Helicopteros*, 466 U.S. at 414 (holding that defendant's contacts with forum will form basis of U.S. jurisdiction over defendant).

299. *Id.*

300. *See Societe Nationale Industrielle Aerospatiale v. United States District Court for the Southern District of Iowa*, 482 U.S. 522, 543-44 n.27 (1987). The U.S. Supreme Court defines international comity as "the spirit of cooperation in which a domestic tribunal approaches the resolution of cases touching the laws and interests of other sovereign states." *Id.* at 543 n.27. Black's Law Dictionary defines "comity of nations" as "[t]he recognition which one nation allows within its territory to the legislative, executive, or judicial 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." BLACK'S LAW DICTIONARY 267 (6th ed. 1990).

301. *See* 18 U.S.C. § 1962 (requiring connection with interstate or foreign commerce).

on the interests of another sovereign.³⁰² Given the pervasive nature of fraud,³⁰³ it is probable that many violations falling under the statute will involve non-U.S. actors engaged in U.S. conduct.³⁰⁴

It is unlikely that other countries would object to aggressive attempts by the United States to control fraudulent activity by non-U.S. actors within U.S. borders.³⁰⁵ In past securities fraud cases, non-U.S. governments have not challenged broad U.S. jurisdiction.³⁰⁶ Because RICO, like the securities regulations, targets activity that is forbidden in most countries,³⁰⁷ liberal jurisdiction in RICO cases will not interfere with international comity.

4. Broad Application Will Not Unduly Burden the Federal Judiciary

Granting federal jurisdiction over controversies not previously heard by the federal courts often raises the "floodgates" argument.³⁰⁸ Those who set forth this argument are concerned that the federal judiciary will become further overburdened if a new line of cases is introduced into the fed-

302. *Id.*

303. *See* 1984 U.S. DEP'T OF JUSTICE ANN. REP. TO THE ATT'Y GEN. 42 (stating that many RICO suits against legitimate businesses involve allegations of fraud). Statistics place losses due to fraud at more than US\$200,000,000,000 annually. *Id.*

304. *FMC Corp. v. Varonos*, No. 87-C-9640, 1988 WL 116825 (N.D. Ill. Oct. 28, 1988), *aff'd*, 892 F.2d 1308 (7th Cir. 1990) (recognizing strong public policy interest in granting U.S. jurisdiction over claims involving non-U.S. nationals who furthered fraudulent schemes by communications to United States).

305. RESTATEMENT (THIRD), *supra* note 52, § 416 reporter's note 3 (noting that securities laws, unlike antitrust regulations, do not prohibit conduct which other nations favor or require). Plaintiffs have also filed a suit in the Netherlands Antilles, but because that country's securities regulation laws are still in a developmental stage, plaintiffs' suit is more likely to succeed under U.S. jurisdiction. Petitioner's Brief for Writ of Certiorari at 10, *Alfadda v. Fenn*, 935 F.2d 475 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991) (No. 91-641); HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION*, pt. IV, § 9A.02(4)(f) (1991).

306. RESTATEMENT (THIRD), *supra* note 52, § 416 cmt. b.

307. *See* 18 U.S.C. § 1961(1) (1988 & Supp. II 1991). A pattern of acts which may constitute a RICO violation include murder, kidnaping, gambling, arson, robbery, bribery, extortion, narcotics dealing, counterfeiting, white slave trafficking and various forms of fraud. *Id.*

308. This argument generally discourages extension of the federal courts' power to hear new types of cases on the theory that any extension may result in a "flood" of such cases into the federal forum.

eral court system.³⁰⁹ The “floodgates” argument is often valid because there are so few federal judges in comparison to the number of cases they must hear.³¹⁰ For several reasons, however, this concern is not sufficiently grave to justify limiting federal jurisdiction over these RICO claims.³¹¹

First, no historical data exists to support the “floodgates” argument in this area of the law.³¹² Since the issue of extraterritorial application was first presented to the federal judiciary twenty years ago, the courts have developed increasingly relaxed standards, thereby permitting more cases to be heard.³¹³ Even so, the federal courts have not been overrun by predominantly non-U.S. securities transactions cases.³¹⁴

Second, the federal judiciary itself crafts the standard for subject matter jurisdiction in extraterritorial securities cases.³¹⁵ Congress does not force the judiciary to adjudicate these largely non-U.S. RICO controversies.³¹⁶ Rather, the judiciary has freely expanded its jurisdiction from wholly domestic violations to violations that include very limited domestic elements.³¹⁷

Third, the structure of the U.S. federal government, particularly that of the federal judiciary, allows for liberal extension of federal jurisdiction.³¹⁸ Congress, in passing RICO and

309. See *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 32 (D.C. Cir. 1987) (arguing that United States has limited interest in adjudicating transnational securities cases involving primarily non-U.S. actors merely on basis of small amount of U.S. conduct).

310. See *Report of the Proceedings of the Judicial Conference of the United States*, Sept. 12, 1990, at 3-7 (reporting that, in the year ending June 30, 1990, 72 three-judge court of appeals panels heard 787 cases and 575 district court judges heard 319 cases).

311. See *supra* note 31 (listing extraterritorial RICO cases).

312. See *supra* note 31 (listing extraterritorial RICO cases).

313. See, e.g., *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.) (setting forth strict standard), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975); cf. *Alfadda v. Fenn*, 935 F.2d 475 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991) (adopting more relaxed standard); *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983) (same).

314. See *supra* note 31 (listing extraterritorial RICO cases).

315. See, e.g., *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1016 (2d Cir. 1975) (stating that courts often must interpret Congressional intent).

316. 18 U.S.C. §§ 1961-1968 (1988 & Supp. II 1991).

317. See *generally Alfadda*, 935 F.2d 475 (granting jurisdiction over predominantly non-U.S. transaction).

318. MALCOLM E. JEWELL & SAMUEL S. PATTERSON, *THE LEGISLATIVE PROCESS IN THE UNITED STATES* 476-77 (3d ed. 1977) (explaining that courts may interpret legislation and legislature may correct inaccurate interpretations).

other securities statutes, made no mention of its intent regarding the extraterritorial application of these regulations.³¹⁹ As is usually the case, the courts were left to interpret the statutes and "fill in the blanks."³²⁰ Under the U.S. government's tripartite system of checks and balances, Congress may intervene by amending the statute to clarify the congressional intent if it believes the courts have wrongly interpreted the statute.³²¹

Finally, the appellate system serves as an additional control.³²² The U.S. Supreme Court is aware of the standards set by the circuits in this area.³²³ Once the lower courts have clearly framed the legal conflict, the Supreme Court will be free to choose the standard that best serves the purpose of the regulations.³²⁴ Once again, if the Supreme Court missteps, Congress may speak on the issue.³²⁵

C. *Judicial Activism and the Need for Legislation*

As explained earlier, Congress did not address the issue of extraterritorial application in the RICO statute.³²⁶ As a result, the courts have engaged in judicial activism³²⁷ to determine

319. See generally H.R. REP. NO. 1549, 91st Cong., 2d Sess., reprinted in 1970 U.S.C.C.A.N. 4007 (lacking any mention of extraterritoriality).

320. See James C. Rehnquist, *The Power That Shall Be Vested in a Precedent: Stare Decisis, the Constitution and the Supreme Court*, 66 B.U. L. REV. 345 (1986) (discussing need for courts to interpret statutes and fill in blanks left by Congress); Mark I. Steinberg, *Implied Private Rights of Action Under Federal Law*, 55 NOTRE DAME L. REV. 33, 41 (1979) (explaining that legislation is often ambiguous); Richard B. Stewart & Cass R. Sunstein, *Public Programs and Private Rights*, 95 HARV. L. REV. 1195, 1231 (1982) (same).

321. Rehnquist, *supra* note 320, at 369-70.

322. *Id.*

323. *Alfadda v. Fenn*, 935 F.2d 475 (2d Cir.), *cert. denied*, 112 S. Ct. 638 (1991); *Consolidated Gold Fields PLC v. Minorco, S.A.*, 871 F.2d 252 (2d Cir.), *cert. dismissed*, 492 U.S. 939 (1989); *SEC v. Kasser*, 548 F.2d 109 (3d Cir.), *cert. denied sub nom. Churchill Forest Indus. v. SEC*, 431 U.S. 938 (1977); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975); *United States v. Parness*, 503 F.2d 430 (2d Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975); *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir.), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub. nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969).

324. Rehnquist, *supra* note 320, at 369-70.

325. *Id.*

326. See 18 U.S.C. §§ 1961-68 (1988 & Supp. II 1991) (lacking any mention of extraterritoriality); see also H.R. REP. NO. 1549, 91st Cong., 2d Sess., reprinted in 1970 U.S.C.C.A.N. 4007 (same).

327. See Daniel O. Conkle, *Toward a General Theory of the Establishment Clause*, 82 NW. U. L. REV. 1115, 1121 (1988) (defining judicial activism as use of judicial power

the proper extraterritorial scope of RICO.³²⁸ Some courts and commentators criticize this exercise of independent discretion, arguing that courts should not exercise that discretion to create new laws.³²⁹ These opponents believe that courts should only interpret existing legislation because courts are ill-equipped to legislate accurately in these complex international areas.³³⁰

The judiciary, however, has had no choice but to legislate in these extraterritorial securities cases.³³¹ Absent a directive from Congress, the courts are forced to articulate rules governing transnational RICO litigation.³³² In the interest of uniformity, Congress should set forth a standard for the extraterritorial application of RICO.³³³ The legislature is better suited than the courts to address this issue, especially because extraterritorial application of any statute has an impact on international affairs.³³⁴ International matters require a great deal of flexibility due to the changing nature of politics and econom-

to override or frustrate decisions of legislative or executive officials); BLACK'S LAW DICTIONARY 847 (6th ed. 1990). Black's Law Dictionary defines "judicial activism" as

[j]udicial philosophy which motivates judges to depart from strict adherence to judicial precedent in favor of progressive and new social policies which are not always consistent with the restraint expected of appellate judges. It is commonly marked by decisions calling for social engineering and occasionally these decisions represent intrusions into legislative and executive matters.

Id.

328. See *SEC v. Kasser*, 548 F.2d 109, 114 n.21 (3d Cir.) (noting lack of legislative guidance regarding proper transnational scope of U.S. jurisdiction under § 10(b)), *cert. denied sub nom. Churchill Forest Indus. v. SEC*, 431 U.S. 938 (1979); see also *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 29-30 (D.C. Cir. 1987) (noting same and consequent need for judicial determination).

329. See *Zoelsch*, 824 F.2d at 32 (arguing that courts should not speculate about congressional intent regarding scope of U.S. jurisdiction over transnational securities fraud).

330. *Id.*

331. *Kasser*, 548 F.2d at 114 n.21; *Zoelsch*, 824 F.2d at 29-30.

332. See *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017-18 (2d Cir. 1975) (indicating that courts must devise test for scope of proper extraterritorial application of U.S. securities laws).

333. Cf. *Zoelsch*, 824 F.2d at 33 (calling for congressional action regarding extraterritorial scope of SEA).

334. See, e.g., *Laker Airways Ltd. v. Sabena, Belgian World Airlines*, 731 F.2d 909, 949 (D.C. Cir. 1984) (stating that courts are not qualified to evaluate purely political factors); see also *United States v. Munoz-Flores*, 495 U.S. 385, 393-94 (1990) (explaining that political question doctrine is designed to restrain judiciary from inappropriately interfering with business of other branches).

ics.³³⁵ The debates preceding any legislative decision are necessarily more complete than those debates preceding a judicial decision. A larger number of parties are involved and their opinions considered. The result is that legislation is more precisely drafted than judicial opinions and addresses a larger number of concerns.

CONCLUSION

The U.S. judiciary should be vigilant in applying federal law to predominantly non-U.S. transactions whenever some substantial conduct or effect occurs within the United States. This vigilance will advance predictability in the application of the statute to non-U.S. actors. It will not have an adverse impact on international comity nor will it result in a greater burden on the federal judiciary. Finally, broad application will serve to protect the integrity of the United States in international circles. Given the fact that the United States has a significant interest in preventing fraudulent schemes which involve U.S. conduct or result in a U.S. effect, the courts should be willing to grant jurisdiction liberally when either of these elements is present. However, Congress should amend the RICO statute to express more clearly its intent regarding the extra-territorial application of this law.

*Tara Ann Carroll**

335. *See Mathews v. Diaz*, 426 U.S. 67, 81 (1976) (explaining that legislature or executive should address international matters).

* J.D. Candidate, 1993, Fordham University.