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THE EXTRATERRITORIAL APPLICATION OF THE ANTIFRAUD PROVISIONS OF THE SECURITIES ACTS

It is an established rule of statutory construction that, absent a clear expression of congressional intent to the contrary, federal legislation will be presumed to apply only within the territorial limits of the United States.¹ During the early 1960's when the first transnational securities cases arose, the federal courts strictly adhered to this principle. Finding that nothing in the language or legislative history of the Securities Act of 1933² and the Securities Exchange Act of 1934³ suggested that the acts were to apply extraterritorially,⁴ the courts held that they had no subject matter jurisdiction over securities disputes which were essentially foreign in nature.⁵ However, as international securities dealings increased it became apparent that to refuse to apply United States law in all cases would dilute the antifraud provisions of the acts⁶ which were designed to protect American investors and safeguard the integrity of domestic securities markets.⁷

1. A statute is to be construed "as intended to be confined in its operation and effect to the territorial limits over which the lawmaker has general and legitimate power." *American Banana Co. v. United Fruit Co.*, 213 U.S. 347, 357 (1909); *accord*, *Steele v. Bulova Watch Co.*, 344 U.S. 280, 285 (1952); *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949); *Blackmer v. United States*, 284 U.S. 421, 437 (1932); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

2. 15 U.S.C. §§ 77a-77aa (1970).

3. *Id.* §§ 78a-78hh-1.

4. *See, e.g.*, *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975); *Ferraioli v. Cantor*, [1964-66] FED. SEC. L. REP. (CCH) ¶ 91,615, at 95,310-11 (S.D.N.Y. 1965).

5. *See Ferraioli v. Cantor*, [1964-66] FED. SEC. L. REP. (CCH) ¶ 91,615 (S.D.N.Y. 1965); *Kook v. Crang*, 182 F. Supp. 388 (S.D.N.Y. 1960).

6. The securities acts contain three general antifraud provisions: § 17(a) of the Securities Act, 15 U.S.C. § 77q(a)(1970); § 10(b) of the Exchange Act, *id.* § 78j(b), and rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1977); and § 15(c)(1) of the Exchange Act, 15 U.S.C. § 78(o)(c)(1) (1970). The operation of § 15(c)(1) is limited to over-the-counter transactions. Most transnational securities fraud cases have been brought under § 10(b) and rule 10b-5.

7. *See, e.g.*, *Des Brisay v. Goldfield Corp.*, 549 F.2d 133, 135 (9th Cir. 1977); *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206 (2d Cir.), *rev'd in part on other grounds en banc*, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969); *Venture Fund (Int'l) N.V. v. Willkie Farr & Gallagher*, 418 F.Supp. 550, 554 (S.D.N.Y. 1976). Similarly, courts began to

This Note will assess the current extraterritorial scope of the American securities laws. After a review of the major cases which have dealt with transnational securities fraud, the Third Circuit's recent decision in *SEC v. Kasser*⁸ will be examined. A jurisdictional framework will then be suggested for determining those instances in which the courts may properly invoke the protection of the securities acts.

I

THE EARLY CASES

The extraterritorial application of the securities acts turns upon whether the federal courts have subject matter jurisdiction over transnational securities dealings. In determining whether such jurisdiction has been granted by Congress, the courts first look to the language of the statute. The Exchange Act and the Securities Act, however, do not clearly address this issue.⁹ The courts, therefore, have sought guidance from the jurisdictional principles of international law. Although these principles do not limit the power of Congress to extend legislation extraterritorially,¹⁰ the courts consider international law as setting the

apply other statutes extraterritorially in order to effect their legislative purposes. See Note, *Extraterritorial Application of United States Laws: A Conflict of Laws Approach*, 28 STAN. L. REV. 1005, 1009-10 (1976).

8. 548 F.2d 109 (3d Cir. 1977).

9. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir.), cert. denied, 423 U.S. 1018 (1975); *Venture Fund (Int'l) N.V. v. Willkie Farr & Gallagher*, 418 F. Supp. 550, 554 (S.D.N.Y. 1976). Cf. *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334 (2d Cir. 1972) (Exchange Act).

The jurisdictional reach of the two acts is coextensive. *Recaman v. Barish*, 408 F. Supp. 1189, 1194 (E.D. Pa. 1975). With regard to the Exchange Act, only § 27, 15 U.S.C. § 78aa (1970), explicitly deals with jurisdiction. This section merely provides that "[t]he district courts . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder"

The only express limitation on the extraterritorial application of the Exchange Act appears in § 30(b), 15 U.S.C. § 78dd (1970), which provides in part that "[t]he provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States" Although often invoked by defendants as exempting their transaction from the coverage of the act, the section has been construed as exempting only those who conduct an actual business in securities, namely brokers, dealers, and banks. See *Schoenbaum v. Firstbrook*, 405 F.2d 200, 207 (2d Cir.), rev'd in part on other grounds en banc, 405 F.2d 215 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969); *Roth v. Fund of Funds, Ltd.*, 405 F.2d 421, 422 (2d Cir. 1968) (per curiam), cert. denied, 394 U.S. 975 (1969).

10. "[I]f Congress has expressly prescribed a rule with respect to conduct outside the United States, even one going beyond the scope recognized by foreign relations law, a United States court would be bound to follow the Congressional direction unless this would violate the due process clause of the Fifth Amendment." *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334 (2d Cir. 1972).

boundaries beyond which they are powerless to go in the absence of clear legislative intent to the contrary.¹¹

Of the five generally recognized jurisdictional bases,¹² the courts have employed only the territorial principle in transnational securities cases.¹³ The opinions have discussed two variations of this principle. The first, the subjective territorial principle, hereinafter referred to as the conduct doctrine, bases jurisdiction on conduct within the territorial limits of the state.¹⁴ The situs of the effects flowing from that activity is irrelevant to the inquiry.¹⁵ On the other hand, the second variation, the objective territorial principle, hereinafter referred to as the effects doctrine, grants jurisdiction over acts which cause foreseeable and substantial effects within the territory regardless of where those acts occurred.¹⁶

The courts have placed varying emphasis on these two jurisdictional principles. Several courts have apparently required that both domestic

11. "[A]n act of congress [sic] ought never to be construed to violate the law of nations if any other possible construction remains" *Murray v. Schooner Charming Betsy*, 6 U.S. (2 Cranch) 115, 118 (1804); *accord*, *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949); *United States v. Aluminum Co. of America*, 148 F.2d 416, 443 (2d Cir. 1945).

12. In addition to the territorial principle, there are the nationality, protective, universality, and passive personality principles. A detailed examination of these principles is beyond the scope of this Note; for a discussion of these principles, see Sahovic & Bishop, *The Authority of the State: Its Range with Respect to Persons and Places*, in *MANUAL OF PUBLIC INTERNATIONAL LAW* 311 (M. Sørensen ed. 1968); *Research in International Law, Jurisdiction with Respect to Crime*, 29 AM. J. INT'L L. 443 (Supp. 1935).

13. The only other jurisdictional theory discussed in the opinions is the nationality principle which, as the name implies, bases jurisdiction solely on the nationality of the alleged violator. *See* *Research in International Law*, *supra* note 12, at 519. The nationality principle has been uniformly rejected as a basis for applying the securities acts to transnational securities fraud. *See* *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1016 (2d Cir. 1975); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 992 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975); *F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co.*, 400 F. Supp. 1219, 1223 (S.D.N.Y. 1975).

14. "A state has jurisdiction to prescribe a rule of law . . . 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" *RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES* § 17(a) (1965).

15. *RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES* § 17, Comment a (1965).

16. This principle was explained in an often quoted statement by Mr. Justice Holmes: Acts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a State in punishing the cause of the harm as if [the actor] had been present at the [time of the detrimental] effect, if the State should succeed in getting him within its power.

Stassheim v. Daily, 221 U.S. 280, 285 (1911). An alternative formulation of this principle is that a state may consider a crime as having been committed in its territory "if one of the constituent elements of the offence, and more especially its effects, have taken place there." *The S.S. Lotus*, [1927] P.C.I.J. ser. A, No. 9, at 23. *See also* *United States v. Aluminum Co. of America*, 148 F.2d 416, 443 (2d Cir. 1945); *RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES* § 18 (1965).

conduct and effect be found.¹⁷ Others have purported to apply the tests alternatively.¹⁸ Despite these seemingly different approaches, there is a common element running through all of the earlier cases: each case in which jurisdiction was upheld, regardless of the court's supposed alternative or concurrent application of the effects and conduct doctrines, involved some measure of domestic impact.¹⁹ None of the early cases rested jurisdiction solely on intranational activity. In fact, those courts which have claimed to have relied exclusively on conduct have often gone to great lengths to note the domestic effects of the transaction.²⁰

In some instances the domestic conduct involved in a transaction and its impact on American interests are intertwined.²¹ Such was the case in *Roth v. Fund of Funds, Ltd.*,²² where the court held section 16(b) of the

17. "The Securities Exchange Act is applicable to securities transactions where (1) there is some significant connection in the violations [*sic*] with the United States, and (2) the effects of the violations are detrimental to American investors." *Selzer v. Bank of Bermuda Ltd.*, 385 F. Supp. 415, 418 (S.D.N.Y. 1974) (emphasis added). "[I]t would appear that § 10(b) of the 1934 Act, and § 17(a) of the 1933 Act, cover at least charges of fraudulent conduct in the United States resulting in sales of securities abroad which have a substantial detrimental effect upon the interests of American investors." *United States v. Clark*, 359 F. Supp. 131, 134 (S.D.N.Y. 1973). "[I]t is clear that sufficient conduct took place within the U.S. to allow applicability of § 10(b) beyond the U.S. and that the transaction in question has a significant impact on American securities markets." *Selas of America (Nederland) N.V. v. Selas Corp. of America*, 365 F. Supp. 1382, 1386 (E.D. Pa. 1973).

18. See, e.g., *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515 (8th Cir. 1973); *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir.), *rev'd in part on other grounds en banc*, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

19. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975), and *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975), were the first cases which applied the conduct doctrine without relying in part on the domestic impact of the transaction. See notes 49-65 *infra* and accompanying text. But see notes 66-68 *infra* and accompanying text. *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977), was the first decision to employ pure conduct analysis in the context of a transaction which had no domestic impact. See notes 69-89 *infra* and accompanying text.

20. *SEC v. Gulf Intercontinental Finance Corp.*, 223 F. Supp. 987 (S.D. Fla. 1963), is one of the clearest examples of a court straining to find domestic impact while simultaneously discounting the need to do so. The case involved a public offer to Canadians of the securities of a Canadian corporation. After reviewing the defendants' domestic conduct, the court properly concluded that "the scheme to defraud . . . operated and was executed in the United States . . . as well as in Canada." *Id.* at 994. It was further noted that application of the securities laws appeared proper anytime it was necessary to use facilities of interstate commerce to carry out the fraud—a conduct test which was more than met by the facts of this case. Nevertheless, the court seemed compelled to find some domestic impact. Taking judicial notice of the fact that some of the Canadian newspapers which carried advertisements of the offering were sold in the United States, the court reasoned that the American public had no doubt been exposed to the offer. This in itself was deemed sufficient to invoke the protection of American law. *Id.* at 994-95.

21. The most common example involves fraudulent trading on a domestic stock exchange. See, e.g., *Des Brisay v. Goldfield Corp.*, 549 F.2d 133 (9th Cir. 1977); *Straub v. Vaisman & Co.*, 540 F.2d 591 (3d Cir. 1976).

22. 405 F.2d 421 (2d Cir. 1968) (*per curiam*), *cert. denied*, 394 U.S. 975 (1969).

Exchange Act²³ applicable to a Canadian corporation which had purchased and sold securities on the New York Stock Exchange.²⁴ Since all of the transactions constituting the alleged violation had occurred in the United States, the elements of the conduct doctrine were clearly satisfied.²⁵ Although most of the Second Circuit's opinion merely retraced the district court's conduct-based analysis,²⁶ the role of domestic impact in the jurisdictional calculus was apparent. Implicit in the decision was the belief that allowing such dealings by a foreigner would impinge on the integrity of American securities markets. Indeed, the court noted "that the effect of this kind of insider trading is quite as great as when the trader is an American."²⁷

Although the courts have seemed reluctant to ground jurisdiction solely on domestic conduct, the effects doctrine has long been applied as an independent jurisdictional base. In *Schoenbaum v. Firstbrook*²⁸ the court permitted an American stockholder of a Canadian corporation to bring a derivative suit under section 10(b)²⁹ and rule 10b-5³⁰ against the directors of the corporation for allegedly causing it to issue treasury shares at an inadequate price.³¹ Finding that the Exchange Act was designed to pro-

23. 15 U.S.C. § 78p(b) (1970). Section 16(b) permits an issuer of a security to recover any profit realized through purchases and sales of that security within a six month period by any officer or director of the issuer or by a beneficial owner of more than 10% of any class of equity security of the issuer.

24. This derivative action was brought on behalf of Dreyfus Corporation against The Fund of Funds Ltd., a Canadian mutual investment company which owned over 10% of the Dreyfus common stock. The president of the defendant corporation or his representative placed the nine purchase and six sell orders in question through telephone calls from Geneva, Switzerland to a broker in New York City who executed the orders. 279 F. Supp. 935, 936 (S.D.N.Y. 1968).

25. See note 14 *supra*.

26. The defendant argued that it fell within the exemption of § 30(b) of the Exchange Act. See note 9 *supra*. The district court held that this section exempted only activities on foreign exchanges and was therefore inapplicable since "the wrong complained of occurred in the United States." 279 F. Supp. at 937. *Kook v. Crang*, 182 F. Supp. 388 (S.D.N.Y. 1960), was distinguished on the basis that all the transactions in that case occurred in Canada. 279 F. Supp. at 937. The first portion of the Second Circuit's opinion employs substantially identical analysis. See 405 F.2d at 422.

27. *Id.*

28. 405 F.2d 200 (2d Cir.), *rev'd in part on other grounds en banc*, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

29. 15 U.S.C. § 78j(b) (1970).

30. 17 C.F.R. § 240.10b-5 (1977).

31. The complaint alleged that the directors of Banff Oil Ltd., a Canadian corporation, had conspired with the directors of Aquitane of Canada, a wholly owned subsidiary of a French concern, and the directors of Paribas Corp., a Delaware corporation wholly owned by a French bank, to defraud Banff by causing it to issue treasury shares at market price. The plaintiff charged that the defendants knew, on the basis of inside information concerning a recent oil discovery, that the market price was below the shares' actual value. 405 F.2d at 204-06.

tect the domestic securities markets and American investors who traded in these markets,³² the court held the act applicable to foreign transactions "when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors."³³ Although the plaintiff neither pleaded nor proved individual injury, the court reasoned that the fraud deprived the corporation of fair compensation for its shares, thereby reducing shareholders' equity which would in turn lower the market price of the shares on the domestic exchange.³⁴ This attenuated impact alone was deemed sufficiently serious to warrant invoking the protection of the Exchange Act.³⁵

Basing jurisdiction solely on domestic impact, as the court did in *Schoenbaum*, carries with it the possibility of applying the securities acts to all securities trading throughout the world where an American investor is involved.³⁶ Recognizing the doctrine's potential for abuse, the court in *Leasco Data Processing Equipment Corp. v. Maxwell*³⁷ stated that the holding in *Schoenbaum* was not to be extended beyond its facts.³⁸ Since the transaction in *Leasco*, unlike that in *Schoenbaum*, did not directly involve any American security, jurisdiction would have to be based on the defendants' domestic conduct.³⁹ Finding that the activities in the United States were "an essential link" in inducing the purchase, the court held that no principle of international law would bar the application of the

32. "We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities." *Id.* at 206.

33. *Id.* at 208. See Research in International Law, *supra* note 12, at 579.

34. 405 F.2d at 208-09. According to the complaint, the corporation had received \$10 million less than the actual value of the treasury shares issued. *Id.* at 205.

35. *Id.* at 209.

36. The Restatement, which the courts have relied upon in defining the effects doctrine, might limit the principle's application somewhat. Section 18(b) requires that the effect be "substantial" and "a direct and foreseeable result of the conduct outside the territory." RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 18(b) (1965). However, these concepts are too vague to limit the scope of the effects doctrine with any degree of certainty.

37. 468 F.2d 1326 (2d Cir. 1972). *Leasco*, an American corporation whose shares were traded on the New York Stock Exchange, charged that defendant Robert Maxwell, a British citizen, had fraudulently induced *Leasco* to purchase the stock of a British corporation on the London Exchange. *Id.* at 1330.

38. *Id.* at 1334.

39. The alleged violation in *Schoenbaum* involved stock registered on an American exchange, whereas the fraud in *Leasco* involved securities registered only on a foreign exchange. Noting this difference, the court doubted whether the Exchange Act would be applicable if all of the fraudulent conduct alleged had taken place abroad simply because the transaction had an adverse effect on an American corporation whose stock was traded on a domestic exchange. "When no fraud has been practiced in this country and the purchase or sale has not been made here, we would be hard pressed to find justification for going beyond *Schoenbaum*." *Id.*

Exchange Act.⁴⁰ But rather than ending the analysis here, which would have been appropriate under a pure conduct approach, the court went on to examine the effect of the fraud on American interests to determine if Congress would have intended American law to apply under these circumstances.⁴¹ Thus the ultimate finding of jurisdiction under the court's purported conduct approach turned not on the defendants' activity but on the fraud's domestic impact.

Similarly, the courts in *Travis v. Anthes Imperial Ltd.*⁴² and *SEC v. United Financial Group, Inc.*⁴³ relied upon the effects doctrine to support their conduct-based analyses. In *Travis*, the court spoke in terms of the defendants' domestic conduct in upholding jurisdiction over the plaintiffs' first claim;⁴⁴ yet jurisdiction over the plaintiffs' second claim, which arose out of the same transaction, was based on the domestic impact of the fraud.⁴⁵ The loss suffered by American investors as a result of the fraudulent transaction undoubtedly influenced the court's decision on the

40. Alternatively, the court held that the conduct doctrine would be satisfied "if defendants' fraudulent acts in the United States significantly whetted [the plaintiffs'] interest" in the transaction. *Id.* at 1335.

41. The court specifically stated that the case dealt "with the problem considered in the Restatement's § 17," yet one page later the court extensively analyzed the effects of the transaction—a consideration which is irrelevant under the conduct doctrine. *Id.* at 1334-35. If the conduct doctrine had truly been followed it would have been unnecessary to deal with the defendants' arguments that § 10(b) was inapplicable where the transaction: (1) involved foreign securities not traded on an American exchange; or (2) involved a non-American purchaser. The court rejected the first argument since the effect on an American investor was the same regardless of the nature of the security. *Id.* at 1335-36. As to the defendants' second argument, although the purchaser of record was a foreign corporation, because of the involvement of the purchaser's American parent in the transaction, the court felt that "it would be elevating form over substance to hold that this entails a conclusion that the purchases did not have a sufficient effect in the United States to make § 10(b) apply." *Id.* at 1338 (emphasis added).

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

43. 474 F.2d 354 (9th Cir. 1973).

44. The suit was brought by American stockholders of the defendant Canadian corporation. The plaintiffs alleged that they had been fraudulently induced to retain their shares during a favorable tender offer to Canadian shareholders and were later forced to accept a less attractive offer from the defendants. Count I of the plaintiffs' amended complaint set forth two separate claims: (1) misrepresentation and nondisclosure; and (2) self dealing. 473 F.2d at 519-20.

The conduct deemed sufficient to uphold jurisdiction over count one consisted mainly of the use of the mails and other facilities of interstate commerce. *Id.* at 524-26. The court also noted that the defendants had visited the United States to close the second and less favorable tender offer. *Id.* at 526. It is questionable whether the activity related to this visit should have been considered at all. The sale was closed after the true intentions of the defendants were known and thus this domestic conduct cannot properly be said to have been part of the scheme to defraud. The closing of the second tender offer did not further the scheme but merely fixed the loss sustained by the plaintiffs from a fraud which had already been consummated. As to the question of jurisdiction, such post-violation conduct should be irrelevant. See note 63 *infra*.

45. 473 F.2d at 528.

first claim.⁴⁶ The defendants in *United Financial* had engaged in sufficient domestic activity to justify under international law the application of the Exchange Act.⁴⁷ Nevertheless, the court spent most of its time searching for some effect on American interests which, coupled with the domestic conduct, would provide a basis for asserting jurisdiction.⁴⁸

II

BERSCH AND IIT

The interplay between the effects and conduct doctrines was clarified and a new jurisdictional calculus established in the companion cases of *Bersch v. Drexel Firestone, Inc.*⁴⁹ and *IIT v. Vencap, Ltd.*⁵⁰ In *Bersch* a United States citizen brought a class action suit against a Canadian mutual fund on behalf of all American and foreign plaintiffs.⁵¹ Paralleling his analysis in *Leasco*,⁵² Judge Friendly stated that although the defendants' domestic activities clearly satisfied the conduct doctrine under international law standards, "it would be . . . erroneous to assume that the legislature always means to go to the full extent permitted."⁵³ In

46. The court revealed its partial reliance on the effects doctrine through its repeated citation of those portions of the *Leasco* opinion in which the domestic impact of the fraud in that case was examined. See *id.* at 526.

47. The fraud had been directed from the United States and facilities of interstate commerce were used in furtherance of the scheme. 474 F.2d at 356.

48. *Id.* at 356-57. The court strained to find significant domestic impact. Stating that "[t]he relative number of American citizen shareholders vis-a-vis alien shareholders is not determinative of whether United States courts may assert jurisdiction," the court placed great emphasis on the impact the fraud had on the three American investors whose total holdings were under \$10,000. *Id.*

49. 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

50. 519 F.2d 1001 (2d Cir. 1975).

51. The suit arose out of the sale of common stock by I.O.S., Ltd., a financial service organization involved in the management of mutual funds which was organized under Canadian law. The complaint alleged that the underwriters had misrepresented I.O.S. as suitable for public ownership and that the prospectus had failed to disclose, among other things, illegal activities by I.O.S. and its officers. 519 F.2d at 981.

52. *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334-37 (2d Cir. 1972).

53. 519 F.2d at 985 (quoting *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334 (2d Cir. 1972)). The district court judge found that: (1) the defendants held numerous meetings in New York "to initiate, organize and structure the offering"; (2) a New York law firm and a New York accounting firm were retained by the defendants; (3) parts of the prospectus were drafted and reviewed in New York; and (4) accounts for the proceeds of the offering were opened with a New York bank. *Id.* at 985 n.24. The court had "no doubt that the activities within the United States . . . were sufficient to authorize the United States to impose a rule with respect to consequences flowing from them wherever they might appear, under the principle stated in Restatement (2d) of the Foreign Relations Law of the United States § 17 . . ." *Id.* at 985. However, the question was not one of the court's power, but of the propriety of exercising that power. *Id.*

hypothesizing what Congress would have considered the proper extraterritorial scope of the securities laws, the court established a three-tiered test. The test, in essence, applies the conduct and effects doctrines concurrently, requiring a lesser degree of intranational conduct when the domestic impact is great, and a lesser degree of effect when there is substantial domestic activity. Dividing the class of plaintiffs into three categories—resident Americans, Americans living abroad, and foreigners outside the United States⁵⁴—the court held that the antifraud provisions of the federal securities laws applied “to losses from sales of securities to Americans resident in the United States whether or not acts . . . of material importance occurred in this country”⁵⁵ The impact on American interests in such a case was so great that “merely preparatory activities in the United States” would trigger the application of the securities laws.⁵⁶ Since “Congress surely did not mean the securities laws to protect the many thousands of Americans residing in foreign countries against securities frauds by foreigners acting there,”⁵⁷ jurisdiction over suits by this class of plaintiffs would be found only if “acts . . . of material importance in the United States have significantly contributed” to the investor’s loss.⁵⁸ Here the American interest and thus the domestic impact was less; therefore, greater conduct was required. With regard to foreign investors, the court for the first time applied a pure conduct test stating that American law would not govern unless domestic activity “directly caused” the plaintiff’s loss.⁵⁹

The dimensions of the third standard in *Bersch*—the pure conduct test—were further refined in *IIT*, a case involving a suit by an international investment trust organized under the laws of Luxembourg against a Bahamian corporation.⁶⁰ Jurisdiction, the court held, could be based solely on domestic conduct—but not just any domestic conduct.⁶¹ Acknowledging that its holding went beyond any prior case,⁶² the court stated that its ruling was limited to those instances in which the “fraudu-

54. See note 67 *infra* for a discussion of the equal protection problems involved in such a classification.

55. 519 F.2d at 993.

56. *Id.* at 992.

57. *Id.*

58. *Id.* at 993.

59. *Id.*

60. IIT, one of the many mutual funds of the former I.O.S. empire, brought an action for fraud against Vencap, Ltd., a venture capital firm. Vencap had been organized by Richard Pistell, a United States citizen residing in the Bahamas who was the central figure in the alleged fraud. *IIT v. Vencap, Ltd.*, 519 F.2d at 1004-05.

61. *Id.* at 1017-18.

62. *IIT v. Vencap, Ltd.*, 519 F.2d at 1018; *accord*, *Bersch v. Drexel Firestone, Inc.*, 519 F.2d at 987.

lent acts themselves" took place in the United States and did not extend to those cases involving "mere preparatory activities . . . where the bulk of the activity was performed in foreign countries" ⁶³ This distinction, the court believed, would prevent the United States from being used as a base from which to perpetrate fraud on foreigners,⁶⁴ while at the same time preventing the application of American law to every transaction involving some conduct in the United States.⁶⁵

The application of the conduct doctrine in *Bersch* and *IIT* does not appear too expansive since both cases involved transactions in which American investors had suffered financial loss.⁶⁶ Indeed, in *Bersch* the jurisdictional reach of the conduct doctrine may not have been great enough. It seems unfair, if not a denial of equal protection, to allow American investors to bring suit while denying that right to identically situated foreigners.⁶⁷ Similarly a finding of jurisdiction in *IIT* appears

63. *IIT v. Vencap, Ltd.*, 519 F.2d at 1018. The court explained: Admittedly the distinction is a fine one. But . . . the line has to be drawn somewhere if the securities laws are not to apply in every instance where something has happened in the United States, however large the gap between the something and a consummated fraud and however negligible the effect in the United States or on its citizens.

Id.

This distinction made the manner in which the fraud was characterized critical. The court hypothesized five theories of fraud under which the plaintiffs might be proceeding: (1) the defendants had misrepresented the benefits which "preferential capital investors" would receive; (2) the preferred stock was by itself a "device, scheme or artifice to defraud"; (3) Vencap's organizer and IIT's management had conspired to defraud IIT fundholders; (4) the defendants had explicitly represented Vencap to be a bona fide venture capital enterprise; and (5) IIT was suing derivatively as a stockholder of Vencap for injury done to it. *Id.* at 1011-14. Under the first three theories only the conduct prior to the sale was relevant to the determination of jurisdiction. The only pre-sale activity in the United States was the exchange of drafts of a purchase agreement which merely formalized a deal which had been worked out in the Bahamas. This activity was deemed insufficient. On the other hand, under theories four and five post-sale activity was relevant. Pistell's extensive operations in his New York office after the sale were deemed to be not only "evidence of the misrepresentation but the cause of the damage." *Id.* at 1018. Thus jurisdiction could be found under these two theories.

64. *Id.* at 1017.

65. *Id.* at 1019.

66. Although the fraud in both *IIT* and *Bersch* had some domestic impact, neither of the opinions, unlike earlier cases, relied upon this impact to buttress the finding of jurisdiction.

67. Friendly's three classifications raise constitutional problems. Distinguishing between American citizens abroad and foreigners outside the United States as the second and third categories do, and between Americans resident in the United States and foreigners living in America as the first classification seems to do, probably violates the equal protection clause of the fifth amendment. See *Bolling v. Sharpe*, 347 U.S. 497, 499 (1954). Alienage is a suspect classification. See, e.g., *In re Griffiths*, 413 U.S. 717 (1973); *Sugarman v. Dougall*, 413 U.S. 634 (1973). The constitutional implications of *Bersch* are discussed in Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 569 (1976); Note, *Subject Matter Jurisdiction in Transnational Securities Fraud Cases*, 17 B.C. IND. & COM. L. REV. 413, 433 (1976). The constitutional problems of *Leasco's* apparent

proper since it would protect legitimate American interests. Only by permitting the plaintiff corporation to recover could its American stockholders be made whole.⁶⁸ However, in the context of a transaction involving no American investors and stock not registered on a national exchange, the application of the securities laws solely on the basis of domestic conduct becomes more questionable. The Third Circuit's most recent decision in this area involved just such a case.

III

SEC V. KASSER

The dispute in *SEC v. Kasser*⁶⁹ revolved around the development of a forestry complex in Manitoba by the Manitoba Development Fund, a Canadian corporation created by the provincial government to oversee the venture. The option to develop the complex had been granted to Churchill Forest Industries, a Canadian corporation, and River Sawmills Company, a Delaware corporation. Both companies were secretly owned and controlled by Alexander Kasser, an American citizen.⁷⁰ The principal financing for the project was to be provided through equity contributions by Churchill and River and by loans from the Development Fund in exchange for debentures issued by Churchill and River. Each loan was to be matched by specified equity contributions by the two corporations. The essence of the Commission's complaint was that Kasser, through an elaborate series of bank transfers, funneled the Development Fund's loan disbursements and income from the project into the purported equity investments.⁷¹

Conceding that the fraud had no direct impact on American investors or domestic securities markets,⁷² the SEC asserted that the antifraud provi-

application of different standards based on nationality are examined in Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1376-77 (1973).

68. IIT, the plaintiff corporation, had approximately 300 American fundholders. Assuming, as the court did, that the American fundholders invested proportionately more than their foreign counterparts, the loss suffered by United States citizens could have totaled \$15,000. The court, however, discounted this impact by emphasizing the *relative* American impact; United States fundholders constituted only 0.2% of the total number of investors and suffered only 0.5% of the loss. 519 F.2d at 1016-17. Thus the court found the impact insufficient as an independent jurisdictional base. Moreover, the effects of the transaction were not invoked to support the conduct-based analysis. Compare the approach of the court in *United Financial*, note 48 *supra*.

69. 548 F.2d 109 (3d Cir. 1977).

70. *SEC v. Kasser*, 391 F. Supp. 1167, 1169, 1171 (D.N.J. 1975).

71. 548 F.2d at 111. By the time the scheme was discovered over \$38 million had been advanced by the Development Fund to Churchill in exchange for debentures with a total face value of \$40.7 million. River had issued \$9.6 million worth of debentures and had received about \$7.9 million from the Development Fund. 391 F. Supp. at 1171-72.

72. *Id.* at 1173 & n.1. The sole victim of the fraud was the Development Fund, a

sions of the securities acts applied to schemes devised in the United States by Americans who utilized the facilities of interstate commerce to further their objectives.⁷³ The district court twice held the defendants' intranational conduct insufficient to sustain jurisdiction over what it considered an essentially foreign transaction.⁷⁴

On appeal the Third Circuit reversed. Writing for the court, Judge Adams stated that "[t]he federal securities laws . . . grant jurisdiction . . . where at least some activity designed to further a fraudulent scheme occurs within this country."⁷⁵ The domestic conduct of the defendants was found to be not merely preparatory to fraudulent acts committed abroad but "much more substantial than the United States-based activities in *IIT*."⁷⁶

Canadian corporation. None of the securities were traded on a domestic exchange and none were held by American citizens. 548 F.2d at 113; 391 F. Supp. at 1177.

73. *Id.* at 1173.

74. In its first opinion, the district court held that it had no jurisdiction over what it considered "essentially foreign transactions without impact in this country." *Id.* at 1177. "It is beyond dispute that the principal objective [of the Exchange Act] is protection of American purchasers who are exposed to fraudulent offers or sales of securities in interstate commerce." *Id.* at 1175. The court distinguished *United Financial*, *Leasco*, *Schoenbaum*, *Travis*, and *Roth* on the ground that those cases involved a measure of domestic impact. *Gulf International* was deemed inapplicable since it involved offers made in the United States. *Id.* at 1175-76.

Six weeks later, the Second Circuit handed down its decisions in *Bersch* and *IIT*. The SEC amended its complaint and once again sought relief. After reviewing the Second Circuit's recent decisions, the district court found that the amended complaint was also insufficient to confer subject matter jurisdiction. Emphasizing that the holding of *IIT* was limited to cases in which the fraudulent acts were performed in the United States, the court distinguished *Kasser* stating that "the alleged fraud was consummated in Canada where the Manitoba Development Fund (MDF) transferred funds to defendants in exchange for debentures." SEC v. *Kasser*, Civil Action No. 74-90, slip op. at 4 (D.N.J. Nov. 17, 1975). Moreover, the court found that:

[t]he activities conducted in the United States were more in the nature of preparatory activities than was the case in *IIT*. *Kasser* involves a situation where the gap is large "between the [local acts] and a consummated fraud," and where the "effect in the United States or on its citizens" is miniscule.

Id. (quoting *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1018 (2d Cir. 1975)). The court then quoted a hypothetical posed in *Bersch* which it found "strikingly similar" to the facts of *Kasser*:

"Assuming that there were no American purchasers and that the underwriting related, for example, to a large foreign country rather than with the United States . . . we do not believe the activities in the United States . . . would justify an American court in taking jurisdiction in a suit for damages by foreign plaintiffs."

Id. at 5 (quoting *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 986-87 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975)).

75. 548 F.2d at 114.

76. *Id.* at 115. The district court noted the following domestic activities: (1) meetings in the United States as part of the negotiations; (2) use of the New York office of a foreign bank as a conduit for a small portion of the funds; (3) execution of one key contract; (4) incorporation of the defendant companies in the United States; and (5) use of facilities of interstate commerce to further the scheme. 391 F. Supp. at 1176. The circuit court added the following conduct to the list: (1) maintenance of books and records in the United States; (2)

Although the court made the pretense that it was merely applying well established law,⁷⁷ the opinion represents a significant extension of prior cases in three respects. First, *Kasser* is the only case in which jurisdiction was based on the conduct doctrine in the complete absence of domestic impact. Second, the court apparently required much less domestic conduct in suits involving foreign losses than that demanded in *Bersch* and *IIT*. And finally, the opinion announced new policy justifications for the application of the securities laws in the transnational setting—policies upon which further extraterritorial expansion can be based.

Although *Bersch* and *IIT* held the securities laws applicable to cases involving foreign loss only when the fraudulent act itself was committed in this country,⁷⁸ the circuit court found it unnecessary to address the district court's finding that the fraud had taken place in Canada.⁷⁹ Judge Adams sidestepped this previously pivotal issue in the following somewhat opaque passage:⁸⁰

Not only do we believe that the sum total of the defendants' intranational actions was *substantial*, but we also question whether it can be convincingly maintained that such acts within the United States did not *directly cause* any extraterritorial losses. Rather, it is evident that the defendants' conduct occurring within the borders of this nation was *essential* to the plan to defraud the Fund.⁸¹

The court seemed satisfied that the United States based conduct was "substantial," the standard applied in *Bersch* only to cases involving losses to American citizens abroad.⁸² Alternatively, jurisdiction could be asserted if the domestic acts were "essential" to the fraud, the degree of contact deemed sufficient in *Leasco*, a suit in which recovery was sought for the losses sustained by an American corporation.⁸³

In addition to lowering the amount of activity required to invoke conduct-based jurisdiction, the court set forth three policy considerations

drafting of agreements executed outside the United States; and (3) transmittal of proceeds to and from the United States. 548 F.2d at 111.

77. The court attempted to mold the holdings of *Straub v. Vaisman & Co.*, 540 F.2d 591 (3d Cir. 1976), and *Leasco* to support its decision. 548 F.2d at 112-13, 115 n.26. A proper reading of these cases in fact suggests that jurisdiction should have been denied in *Kasser*. *Straub* involved a suit by a foreign plaintiff who had purchased the stock of an American corporation on an American exchange. 540 F.2d at 595. *Leasco* was cited for the proposition that "'significant' intranational conduct [is] 'sufficient' for subject-matter jurisdiction." 548 F.2d at 115 n.26. However, *Leasco* involved an American, not a foreign purchaser. 468 F.2d at 1337-38.

78. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d at 993; *IIT v. Vencap, Ltd.*, 519 F.2d at 1018.

79. Civil Action No. 74-90, slip op. at 4 (D.N.J. Nov. 17, 1975).

80. Interestingly, this is the only confusing passage of an otherwise clear opinion.

81. 548 F.2d at 115 (emphasis added).

82. 519 F.2d at 993. See notes 57-58 *supra* and accompanying text.

83. 468 F.2d at 1335. See notes 37-40 *supra* and accompanying text.

which, given a liberal reading, would justify the application of American law when there was *any* conduct in the United States. Adopting dicta in *Bersch*,⁸⁴ the court found that to deny jurisdiction would, "in effect, create a haven for . . . defrauders and manipulators."⁸⁵ In the most colorful passage of the opinion, the court explained: "We are reluctant to conclude that Congress intended to allow the United States to become a 'Barbary Coast,' as it were, harboring international securities 'pirates.'"⁸⁶

The court was also concerned that a holding of no jurisdiction would induce reciprocal responses on the part of other nations and create a base from which foreigners could export fraud to American investors. Upholding jurisdiction, on the other hand, might "encourage other nations to take appropriate steps against parties who seek to perpetrate fraud in the United States."⁸⁷

The final policy justification asserted was that the "antifraud provisions of the 1933 and 1934 Acts were designed to insure high standards of conduct in securities transactions within this country in addition to protecting domestic markets and investors from the effects of fraud."⁸⁸ Continuing with this explosively expansive language, the court reasoned that these goals would be furthered by enabling "the SEC to police vigorously the conduct of securities dealings within the United States."⁸⁹

IV

TOWARD A JURISDICTIONAL FRAMEWORK

The antifraud provisions of the securities acts were designed to protect American investors and safeguard the integrity of domestic securities exchanges.⁹⁰ Whenever either of these interests is substantially threatened, American antifraud standards should be applied vigorously regardless of the domestic or foreign nature of the transaction. Although foreign laws may set a somewhat lower standard, there is little chance that the application of the securities acts to transactions involving actual fraudulent misrepresentations would subject foreign citizens to inconsistent standards of conduct. Even in the case of intentional nondisclosure, it is questionable whether United States courts should defer to a less refined foreign standard where American interests are involved.

84. 519 F.2d at 987.

85. 548 F.2d at 116.

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. See note 7 *supra*.

Even if American and foreign standards differed materially, other nations would nevertheless favor United States adjudication in some instances. Where a foreign nation cannot obtain personal jurisdiction, it would no doubt prefer the perpetrator of a fraud to be prosecuted under the more stringent American standard rather than have him escape prosecution entirely.⁹¹ Similarly there should be no objection to injunctive actions. Nations contemplating prosecution would welcome suits by the SEC to freeze the assets of those allegedly involved in transnational securities fraud. If no such means were available to prevent the dissipation of the proceeds from a fraud, any foreign judgment which might be obtained could well be an empty one.

Although it has been argued that the extraterritorial application of American law might offend foreign nations by subjecting their citizens to multiple liability if United States judgments were not recognized abroad and by forcing foreign defendants to litigate in distant forums, the requirement of personal jurisdiction will minimize any such risks. The potential defendant will often be subject to service of process in only one country—probably the country in which it will be most convenient for him to litigate. Where such problems do materialize, the doctrines of forum non conveniens and comity—not subject matter jurisdiction—should be invoked to remedy them.

One factor mitigating against the extraterritorial application of the securities acts is judicial economy. Would Congress, if it had considered the issue, have wished the limited resources of American courts and law enforcement agencies to be devoted to frauds which are predominantly foreign in nature?⁹²

The fact that the stock involved in the fraud was registered on a domestic exchange in itself justifies the application of American standards, regardless of the nationalities of the parties involved and the situs of the conduct. Here the impact on American markets is direct and substantial, and it is likely that all parties involved in the transaction expected United States law to govern. Transactions in securities not registered on domestic exchanges can have a similar impact on American markets when the sales are made under the facade of United States law.

91. The problem of obtaining personal jurisdiction is, of course, not limited to foreign courts. For example, in *SEC v. Kasser*, the main culprit, Alexander Kasser, had not been served with process. 391 F. Supp. at 1169. Foreign prosecution may also be blocked by the failure to obtain sufficient evidence where the bulk of the activities took place outside of that country. Canada has experienced difficulty in subpoenaing witnesses for its investigation of the *Kasser* fraud. See *In re Letters of Request to Examine Witnesses from the Court of Queen's Bench for Manitoba, Canada*, 59 F.R.D. 625 (N.D. Cal.), *aff'd*, 488 F.2d 511 (9th Cir. 1973).

92. 519 F.2d at 985.

Schemes involving stock which is falsely represented as being registered on a United States exchange, or otherwise subject to American regulation, impair the attractiveness of domestic markets almost as much as fraudulent transactions in securities which are in fact so registered. Thus the federal courts should assert jurisdiction in such cases.⁹³ Similarly investors might be misled by the use of American banks and accounting firms during the course of the transaction. Although the incidental use of the resources of the American financial community does not justify invoking United States law, when these relationships were touted to give the transaction an aura of American approval the provisions of the securities acts should be invoked. The integrity of American financial institutions must be maintained if the reputation of domestic markets is to be preserved.

The question of when to invoke United States law to protect American investors is more difficult. Certainly the antifraud provisions of the acts should govern the domestic sale of any security to an American resident. But when the transaction occurs abroad, it is unlikely that the parties would expect any dispute arising from the sale to be adjudicated in American courts under American law. Unless no other forum were available, the federal courts would be wise to defer to foreign courts in the interests of judicial economy.

Fraud involving domestic conduct, but no domestic impact, should generally be adjudicated in foreign courts. Such pure conduct cases would arise when the United States situs of the activity was merely fortuitous or when the transaction's ties with the United States were not used to induce others into believing that the sale was governed by American law. In the absence of domestic effect, only when foreign prosecution is unlikely—for example, if the foreign nation can not obtain personal jurisdiction or gather sufficient evidence—will the interest in conserving scarce judicial resources be outweighed.

93. In *Wandschneider v. Industrial Incomes Incorporated of North America*, [1972] FED. SEC. L. REP. (CCH) ¶ 93,422 (S.D.N.Y. 1972), the prospectus emphasized that the issuer was registered with and subject to regulation by the SEC, was a member of NASD, and had regularly filed audited financial statements with the SEC. Only near the end of the prospectus was it mentioned that the stock involved in this issuing was not registered under the Securities Act of 1933. *Id.* at 92,059. The German nationals who purchased the stock undoubtedly believed that the sale was subject to the high American standards of honesty and fair dealing. Permitting this type of fraud would destroy foreign investors' confidence in the American markets. In *Finch v. Marathon Securities Corp.*, 316 F. Supp. 1345 (S.D.N.Y. 1970), the purchase agreement stated that the sale was governed by the Investment Company Act of 1940, the Securities Act of 1933, and the Exchange Act of 1934, to the extent that the transaction was within the purview of the acts. *Id.* at 1347-48. Here too the sale was cloaked with the aura of American regulation; therefore, United States law should have been applied.

Thus, although the policy justifications posited by the *Kasser* court are overly broad, the result is the correct one. Under a liberal reading of the policies set forth in *Kasser*, federal courts would be compelled to hear all securities disputes involving some conduct in the United States: a Japanese and a German businessman meeting in New York to conduct business in foreign securities would be subject to the securities acts and could adjudicate their disputes in American courts.⁹⁴ The facts of *Kasser*, however, justified the court's finding of jurisdiction. Canada was experiencing difficulty in obtaining witnesses for its investigation, which suggested that successful Canadian prosecution was unlikely.⁹⁵ Moreover, a substantial part of the proceeds of the fraud was apparently transmitted to the United States.⁹⁶ Prompt action by the SEC would prevent the dissipation of these funds. Under these circumstances the American courts had the duty to hear the case and ensure that the investor is protected.

CONCLUSION

The federal courts have continually expanded the extraterritorial scope of the securities acts. Although the early cases seemed reluctant to base jurisdiction solely on conduct, more recent decisions have applied the conduct and effects doctrines alternatively. Generally the securities acts should be applied to all securities fraud having an impact on domestic markets or American investors—regardless of the foreign or domestic nature of the transaction. If the sale involves only domestic conduct, American courts should usually defer to foreign forums except when foreign prosecution is unlikely because of the lack of evidence or personal jurisdiction, or when any foreign judgment would be nugatory because the proceeds of the fraud are beyond the reach of the foreign court.

Judson J. Wambold

94. Judge Friendly posited this hypothetical in *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326, 1338 (2d Cir. 1972).

95. See note 91 *supra*.

96. Brief of the Securities and Exchange Commission at 17, *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977).

