Extraterritorial Application of United States Securities Law: A Matrix Analysis*

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I. INTRODUCTION

Securities sold exclusively to nonresident aliens in compliance with Securities and Exchange Commission (SEC) administrative guidelines[1] are exempt from registration[2] under the Securities Act of 1933, as amended (Securities Act).[3] Despite this exemption, the antifraud provisions[4] of the Securities Act and the Securities Exchange Act of 1934, as amended (Exchange Act)[5] may apply.[6] These provisions apply ex-

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* This article is dedicated to my teacher, Professor Louis Loss, whose ideas and writings have benefitted the author, and all other members of the securities profession.

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1. SEC Securities Act Release No. 4708, 29 Fed. Reg. 9828 (1964).

2. An offering sold exclusively to foreign investors is exempt from registration with the SEC. For an analysis of the administrative release and no-action letters delineating the mechanics of qualifying for the exemption see Morgenstern, *Real Estate Securities and the Foreign Investor—Some Problems and a Proposal*, 11 SEC. REG. L.J. 332 (1984).

3. 15 U.S.C. §§ 77a-77bbbb (1982).

4. The primary antifraud provisions are those of section 10(b) of the Exchange Act, 15 U.S.C. § 78(j) (1982); and rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1975).

5. 15 U.S.C. §§ 78(a)-78kk.

6. Much has been written about the extraterritorial application of the securities laws. *See, e.g.*, Hacker & Rotunda, *The Extraterritorial Regulation of Foreign Business Under the U.S. Securities Laws*, 59 N.C.L. REV. 643 (1981); Johnson, *Application of Federal Securities Laws to International Securities Transactions*, 45 ALB. L. REV. 890 (1981); Loomis & Grant, *The U.S. Securities and Exchange Commission Financial Institutions Outside the U.S. and Extraterritorial Application of the U.S. Securities Laws*, 1 J. COMP. CORP. L. SEC. REG. 3 (1978); Mizrack, *Recent Developments in the Extraterritorial Application of Section 10(b) of the Securities and Exchange Act of 1934*, 30 BUS. LAW 367 (1975); Sandberg, *The Extraterritorial Reach of American Economic Regulation: The Case of Securities Law*, 17 HARV. INT'L L.J. 315 (1976); Comment, *Offshore Mutual Funds: Extraterritorial Application of the Securities Exchange Act of 1934*, 13 B.C. INDUS. & COM. L. REV. 1225 (1972); Note, *Extraterritorial Application of the Securities Exchange Act of 1934*, 69 COLUM. L. REV. 94 (1969); Note,

traterritorially only when United States courts have subject matter jurisdiction[7] over the transaction under principles of international law.[8]

Jurisdiction—Extraterritorial Application of United States Securities Laws, 10 COLUM. J. TRANSNAT'L L. 150 (1971); Note, *The Extraterritorial Application of the Anti-Fraud Provisions of the Securities Acts*, 11 CORNELL INT'L L.J. 137 (1978); Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553 (1976); Note, *Extraterritorial Application of the Federal Securities Laws: The Need for Reassessment*, 14 J. INT'L L. & ECON. 529 (1980); Note, *The International Character of Securities Credit: A Regulatory Problem*, 2 LAW & POL'Y INT'L BUS. 147 (1970); Note, *Extraterritorial Application of United States Securities Laws*, 42 MO. L. REV. 158 (1977); Comment, *An Interest Analysis Approach to Extraterritorial Application of Rule 10b-5*, 52 TEX. L. REV. 983 (1974); Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363 (1973); Note, *Securities Regulation—Transnational Reach of Federal Securities Laws—Federal Courts Lack Jurisdiction Over Rule 10b-5 Claims Brought by Foreigner Where the Alleged Deception Occurs Abroad*, 19 VA. J. INT'L L. 935 (1979); Comment, *Extraterritorial Effect of the Registration Requirements of the Securities Act of 1933*, 24 VILL. L. REV. 729 (1979); *Extraterritorial Application of the Securities Acts*, 1974 WASH. U. L.Q. 859.

For articles discussing the extraterritorial application of the federal securities laws under the proposed Federal Securities Code see Buschman, *Antifraud and the Water's Edge: Transnational Transactions, Rule 10b-5, and the Federal Securities Code*, 7 SEC. REG. L.J. 232 (1979); Curtis, *The Extraterritorial Application of the Federal Securities Code: A Further Analysis*, 9 CONN. L. REV. 67 (1976); Karmel, *The Extraterritorial Application of the Federal Securities Code*, 7 CONN. L. REV. 669 (1975); Lifton, *The Extraterritorial Reach of the Federal Securities Code: An Analysis of Section 1905*, 32 VAND. L. REV. 495 (1979); Loss, *Extraterritoriality in the Federal Securities Code*, 20 HARV. INT'L L.J. 305 (1979); and Note, *Extraterritorial Application of the Federal Securities Code: An Examination of the Role of International Law in American Courts*, 11 VAND. J. TRANSNAT'L L. 711 (1978).

7. In addition to subject matter jurisdiction, the United States must have in personam jurisdiction over the defendants, an issue not addressed in this Article. For cases dealing with the sensitive issues of personal jurisdiction in the context of an international transaction, see Garner v. Enright, 71 F.R.D. 656 (E.D.N.Y. 1976), Wagman v. Astle, 380 F. Supp. 497 (S.D.N.Y. 1974), Alco Standard Corp. v. Benalal, 345 F. Supp. 14 (E.D. Pa. 1972), and Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1339-44 (2d Cir. 1972).

8. *See* Kook v. Crang, 182 F. Supp. 388 (S.D.N.Y. 1960) (when an order was placed and payment received in Canada for stock of a Canadian corporation traded on the Toronto Stock Exchange, incidental use of United States mail and telephone did not give a United States court jurisdiction over alleged violations of section 7(c) of the Exchange Act or Regulation T of the Federal Reserve Board rules); Wagman v. Astle, 380 F. Supp. 497 (S.D.N.Y. 1974) (no jurisdiction to recover short-swing profits under section 16(b) of the Exchange Act where Canadian defendants traded in Canadian securities on Canadian exchanges and in private Canadian sales and the transaction had no foreseeable effect on protected United States interests); Roth v. Fund of Funds, 405 F.2d 221 (2d Cir. 1968) (per curiam), *cert. denied*, 394 U.S. 975 (1969) (section 16(b) liability exists when foreigners executed transactions on United States securities exchanges); Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp., 303 F. Supp. 1354 (S.D.N.Y. 1969) (no jurisdiction under Regulations G and T of the Federal Reserve Board margin rules to regulate the activities of foreign lending institutions); United States v. Weisscredit Banca Commerciale e D'Investimenti, 325 F. Supp. 1384 (S.D.N.Y. 1971) (jurisdiction upheld over Swiss bank for violation of Regulation T and section 7 of the Exchange Act for broker/dealer conduct within the United States when a foreign bank acts as a broker/dealer within the United States); Ufitec, S.A. v. Carter, 20 Cal. 3d 238, 571 P.2d 990, 142 Cal. Rptr. 279 (1977) (jurisdiction upheld over Swiss Bank for violations of Regulation T for domestic conduct, since the exemption of section 30(b) of the

International law recognizes five bases for subject matter jurisdiction: (1) the nationality principle;[9] (2) the protective principle;[10] (3) the universality principle;[11] (4) the passive personality principle;[12] and (5) the territorial principle.[13] United States jurisdiction in transna-

Exchange Act "is determined by the activity's location rather than by the actor's nationality; SEC v. OSEC Petroleum, S.A., [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,915 (D.D.C. 1974) (jurisdiction upheld over foreign defendants for violation of section 13(d) of the Exchange Act when securities were registered under section 12 of the Exchange Act); and United States v. Clark, 359 F. Supp. 131 (S.D.N.Y. 1973) (jurisdiction upheld for criminal violation of section 17(a) of the Securities Act when European investors purchased debentures in a Netherland Antilles corporation and warrants convertible into stock traded on the American Stock Exchange because the sale would detrimentally affect interests of American investors). For a discussion of Roth v. Fund of Funds see Note, *Jurisdiction—Extraterritorial Application of United States Securities Laws*, *supra* note 6, at 150.

9. RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 10 (1965) [hereinafter cited as RESTATEMENT]. The nationality principle provides for a nation's jurisdiction over the conduct of its citizens regardless of whether such conduct occurs within or without its territorial boundaries.

10. *Id.* § 33. The protective principle permits a state to exercise jurisdiction and prescribe rules of law to govern extraterritorial conduct that can threaten the state's governmental operations or national security.

11. *Id.* § 34. The universality principle provides that a state that has custody of a person who has committed an act necessarily has the power to exercise jurisdiction over that person.

12. *Id.* § 30. The passive personality principle is not recognized by the United States. It permits a nation to exercise jurisdiction over conduct injuring its citizens, regardless of where the injurious act occurred. *See Research in International Law: Jurisdiction with Respect to Crime*, 29 AM. J. INT'L L. 435, 445, 579 (Dickinson ed. Supp. 1935).

13. RESTATEMENT, *supra* note 9, at § 10. The territorial principle provides that nations have jurisdiction to punish crimes committed within their territorial limits, regardless of the nationality or residence of the actor. The territorial principle is further divided into two distinct concepts: the subjective territorial principle and the objective territorial principle. As to the subjective territorial principle, section 17 of the RESTATEMENT provides:

> A state has jurisdiction to prescribe a rule of law
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> (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
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> (b) relating to a thing located, or a status or other interest localized, in its territory.

As to the objective territorial principle, section 18 of the RESTATEMENT provides:

> 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
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> (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
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> (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.

tional securities cases has been decided almost exclusively by reference to the territorial principle.[14]

Case law development of subject matter jurisdiction in the United States has focused on the relationship among four variables to determine whether United States courts will assert or deny jurisdiction: (1) the nationality or residence of the plaintiff; (2) the nationality or residence of the defendant; (3) the country in which the critical fraudulent conduct occurred; and (4) the country in which the effect of the fraudulent conduct was manifested. Neither the nationality or residence of the litigants, nor the location of the fraudulent conduct or the country affected by the fraud can establish United States jurisdiction by itself. A determination, however, as to whether each of the variables is predominantly United States or foreign generally reveals if the antifraud provisions should be applied. The purpose of this Article is to propose a matrix model that uses those four variables to assist in the determination of jurisdiction. In addition, this Article will propose a standard nomenclature to aid that analysis.

Assuming that each variable will only be categorized as either "United States" or "foreign," the following matrix illustrates the sixteen possible combinations of these variables (the "jurisdictional matrix"):

The subjective territorial principle is also known as the "conduct doctrine" and the objective territorial principle as the "effects doctrine." Jurisdiction exists under the conduct doctrine in the territory where the act occurred, even if the effect of the act is not manifested within the same territory. The effects doctrine establishes jurisdiction in a territory where conduct had a foreseeable and substantial effect, regardless of where the conduct occurred. A finding that the territorial principle permits jurisdiction does not mean that a nation must exercise jurisdiction—only that under international legal principles the nation has the right and the power to exercise jurisdiction. For analysis of the territorial principle see Johnson, *supra* note 6, at 903-25; Case Comment, IIT v. Cornfeld, 6 BROOKLYN J. INT'L L. 157, 161-65 (1980).

14. Norton, *Extraterritorial Jurisdiction of U.S. Antitrust and Securities Laws*, 28 INT'L & COMP. L.Q. 575, 579 (1979).

Nationality or Residence of Plaintiff	Nationality or Residence of Defendant	Country in which Conduct Occurred	Country in which Effect Occurred
1 United States	United States	A. United States	United States
		B. United States	Foreign
		C. Foreign	United States
		D. Foreign	Foreign
2 United States	Foreign	A. United States	United States
		B. United States	Foreign
		C. Foreign	United States
		D. Foreign	Foreign
3 Foreign	United States	A. United States	United States
		B. United States	Foreign
		C. Foreign	United States
		D. Foreign	Foreign
4 Foreign	Foreign	A. United States	United States
		B. United States	Foreign
		C. Foreign	United States
		D. Foreign	Foreign

The combinations are divided into four basic groups determined by reference to the nationality or residence of the litigants. When the plaintiff is American, the transaction is denominated Transaction 1 if the defendant is American, but Transaction 2 if the defendant is foreign. When the plaintiff is foreign, the transaction is denominated Transaction 3 if the defendant is American, but Transaction 4 if the defendant is foreign.

Within each Transaction group are four subgroups, established by reference to the country in which the conduct occurs or effect of the fraud is manifested. Thus, when the conduct and effect both occur in the United States, the subgroup classification is A. United States conduct with foreign effect is B. When the conduct is foreign and the effect is in the United States, then the subgroup classification is C. The final classification is D, which indicates that both conduct and effect are foreign.

A two variable code identifies which of the sixteen combinations is involved in litigation. Transaction 3 (foreign plaintiff, United States defendant) with a conduct/effect subgroup of B (United States conduct, foreign effect) is known as a "3B Transaction." Use of the matrix nomenclature specifies which of the sixteen possible transaction combinations is involved.

Transactions 1A and 4D represent the extremes of the matrix. A pure case of 1A (where plaintiff, defendant, conduct, and effect are all American) is not a transnational situation, and does not raise the issue of the extraterritorial application of United States law. A pure case of 4D (where plaintiff, defendant, conduct, and effect are all foreign) may involve a transnational securities problem if the litigants, conduct, and effect involve more than one country, but should not result in application of United States law. Each of the remaining fourteen combinations, however, may justify the exercise of jurisdiction in the United States (and elsewhere) under international legal principles.

The thesis of this Article is that the jurisdictional sufficiency of conduct and effect is directly related to the nationality and residence of the litigants. In Transactions 1 and 2, where the injured party is American, a fraudulent transaction necessarily involves at least a modest United States effect, although not one necessarily cognizable for purposes of subject matter jurisdiction. Even a modicum of United States conduct (beyond the statutory minimum use of the means of interstate commerce) may be sufficient to sustain jurisdiction. Transaction 3 involves injury to a foreign party by an American. Because the injured party is foreign, the effect will generally, although not always, be foreign. If jurisdiction exists, it will usually be based upon the domestic conduct of the American. Finally, in Transaction 4, where both victim and perpetrator of the fraud are foreign, only an extraordinary showing of United States conduct will establish jurisdiction.

Without the benefit of analysis and characterization, few transnational securities transactions can be neatly or quickly identified in terms of the matrix model. When a foreign investor purchases securities in London and meets in both London and New York with a United States issuer, the transaction could be 3B (foreign plaintiff, United States defendant, United States conduct, and foreign effect) or 3D (foreign plaintiff, United States defendant, foreign conduct, and foreign effect) since conduct occurs in both the United States and England. A major focus of judicial inquiry lies in comparing and contrasting conduct and effect involving the United States and other countries and concluding (for a variety of analytical reasons) that the conduct or effect should be characterized as either United States or foreign even though both domestic and foreign elements are involved. The same analysis also applies to the nationality of the real parties in interest in the litigation where the litigant of record may be of a different nationality than the beneficial litigants or alter egos of the litigants. The categorization of the nationality of the litigants and the foreign or domestic nature of the conduct and effect, in turn, establishes the relevant standards to analyze whether jurisdiction exists.

The process by which the judiciary evaluates competing national interests in its search for a suitable tribunal for an international dispute is complex, fascinating, and continually evolving. The goal of the following discussion, which subjects existing law to a matrix analysis, is to encourage the adoption of standard nomenclature, terminology, and analysis by the judiciary. Uniform interpretation of the applicable standards for subject matter jurisdiction would permit issuers to plan international securities transactions with greater confidence, knowing that like conduct will be governed uniformly, at least in the United States.

II. CASE LAW DEVELOPMENT OF THE EXTRATERRITORIAL APPLICATION OF THE FEDERAL SECURITIES LAWS

Development of the extraterritorial application of the securities laws has been principally fashioned by the Second Circuit.[15] Follow-

15. *See* IIT v. Cornfeld, 619 F.2d 909 (2d Cir. 1980) (foreign investors who purchase securities in the United States are entitled to the protection of the federal securities laws); Fidenas A.G. v. Compagnie Internationale Pour L'Informatique CII Honeywell Bull S.A., 606 F.2d 5 (2d Cir. 1979) (no jurisdiction where all parties were foreign and the core of the alleged fraud occurred in Switzerland); Arthur Lipper Corp. v. SEC, 547 F.2d 171 (2d Cir. 1976) (jurisdiction upheld over broker/dealer who sold securities to an offshore mutual fund); IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975) (fraud to foreign investors results in jurisdiction when United States conduct is material, but will not arise if domestic conduct is "merely preparatory" to commission of the fraud); Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975) (jurisdiction for international securities transactions can exist for United States citizens and residents, nonresident United States citizens, and foreign investors, although varying degrees of conduct are required to sustain jurisdiction based upon the nationality and residence of the injured party); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972) (when material misrepresentations are made in the United States, jurisdiction exists even when the actual sale of securities occurs in England); SEC v. N. Am. Research & Dev. Corp., 280 F. Supp. 106 (S.D.N.Y. 1968), *aff'd in part and vacated in part on other grounds*, 424 F.2d 63 (2d Cir. 1970) (no registration exemption for stock offering made to dealers outside the United States who purchase with a view to redistribute the stock into the United States); Roth v. Fund of Funds, Ltd., 405 F.2d 421 (2d Cir. 1968); and Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969) (antifraud provisions apply extraterritorially when necessary to protect United States securities exchanges, domestic securities markets, or American investors); SEC v. Vesco, [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,837 (S.D.N.Y. 1982) (federal securities law jurisdiction exists where many of the acts essential to the commission of the fraud against the largely foreign investors occurred in the United States and involved substantial use of the United States mail and telephone); Fund of Funds v. Arthur Andersen & Co., 545 F. Supp. 1314 (S.D.N.Y. 1982) (jurisdiction exists where the transaction involved

"weighty United States contacts"); Armstrong v. McAlpin, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,323 (S.D.N.Y. 1978) (consideration of subject matter jurisdiction postponed pending further discovery); Ogdeninvest, A. G. v. Hessiche Landesbank—Girozentrale, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,555 (S.D.N.Y. 1978) (no jurisdiction where plaintiff and defendant were foreign corporations and no allegations that defendant committed fraudulent acts within the United States with regard to plaintiff were made); Sun First Nat'l Bank v. Miller, 77 F.R.D. 430 (S.D.N.Y. 1978) (consideration of subject matter jurisdiction postponed for further discovery of whether sale by English defendants of a repurchase agreement backed by United States Treasury bills satisfied either the *Leasco* or *Bersch* tests); Garner v. Enright, 71 F.R.D. 656 (E.D.N.Y. 1976) (personal jurisdiction sustained as to domestic defendants and found insufficient as to foreign defendants in an action brought by the liquidators of a Bahamian bank); Fund of Funds, Ltd. v. Vesco, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,644 (S.D.N.Y. 1976) (jurisdiction upheld in a sale of notes between a Canadian and Costa Rican corporation where defendants performed activities materially important to the fraud within the United States); Venture Fund (Int'l) N.V. v. Willkie Farr & Gallagher, 418 F. Supp. 550, 556 (S.D.N.Y. 1976) (consideration of subject matter jurisdiction postponed and motion to dismiss denied since conflicting versions of facts made it impossible to determine whether defendants' actions "were peripheral, 'merely preparatory,' or more significant."); F.O.F. Proprietary Funds Ltd. v. Arthur Young & Co., 400 F. Supp. 1219 (S.D.N.Y. 1975) (no jurisdiction when a Canadian corporation purchased convertible guaranteed debentures issued and guaranteed by United States corporations but plaintiff failed to allege any culpable, rather than merely preparatory, acts by defendant within the United States); Wagman v. Astle, 380 F. Supp. 497 (S.D.N.Y. 1974) (lack of personal jurisdiction precluded consideration of subject matter jurisdiction); SEC v. Capital Growth Co., S.A. (Costa Rica), 391 F. Supp. 593 (S.D.N.Y. 1974) (jurisdiction upheld in an SEC injunctive action where sales of offshore mutual funds stressed investment in United States securities, and the use of interstate mail to sell the funds constituted acts forming an essential part of the fraudulent activity); Selzer v. Bank of Bermuda, Ltd., 385 F. Supp. 415 (S.D.N.Y. 1974) (jurisdiction upheld where a personal trust created by a Canadian citizen with a Bermuda bank for the benefit of a United States citizen was formed to, and did, invest in American securities); United States v. Clark, 359 F. Supp. 131 (S.D.N.Y. 1973) (jurisdiction upheld in a criminal indictment under section 17(a) of the Securities Act where defendants sold debentures of a Netherlands Antilles corporation and warrants convertible into common stock of an American Stock Exchange company to European investors because a sale abroad could have a substantial detrimental effect on American investors); Wandschneider v. Indus. Incomes Inc. of N. Am., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,422 (S.D.N.Y. 1972) (jurisdiction upheld where German nationals purchased nonvoting stock in a New York corporation that managed a mutual fund, and the sale closed in the United States); Inv. Properties Int'l, Ltd. v. I.O.S. Ltd., [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,011 (S.D.N.Y. 1971) (motion for preliminary injunction denied, and issue of subject matter jurisdiction deferred, in intercompany disputes involving loans, stock in a private company, stock traded on foreign stock exchanges sold exclusively to non-United States citizens and residents, condominiums sold with a pooled rental agreement and conceded to be an investment contract, and a pledge of securities); Manus v. The Bank of Bermuda, Ltd., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,299 (S.D.N.Y. 1971) (court noted probable lack of subject matter jurisdiction when a Canadian plaintiff sued a Bermuda bank for an allegedly unauthorized purchase of unregistered common stock of a New York corporation and the principal transaction occurred in England); United States v. Weisscredit Banca Commerciale e D'Investimenti, 325 F. Supp. 1384 (S.D.N.Y. 1971); Finch v. Marathon Sec. Corp., 316 F. Supp. 1345 (S.D.N.Y. 1970) (despite some United States involvement, no jurisdiction when the substance of the allegedly fraudulent conduct occurred in England, the parties ing the seminal case of *Schoenbaum v. Firstbrook*,[16] opinions by the court in *Leasco Data Processing Equipment Corp. v. Maxwell*,[17] *Bersch v. Drexel Firestone, Inc.*,[18] *IIT v. Vencap, Ltd.*,[19] and *IIT v. Cornfeld*[20] have established a complex jurisdictional calculus for determining subject matter jurisdiction for transnational securities litigation. With the notable exceptions of the Third Circuit's opinion in *SEC v. Kasser*[21] and the Eighth Circuit's opinion in *Continental Grain v. Pacific Oilseeds, Inc.*[22] the Third,[23] Fifth,[24] Eighth,[25] and Ninth Circuits[26] have substan-

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were predominantly foreign, the stock was of a foreign corporation not registered on a national securities exchange, and there was no showing of a United States injury); Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp., 303 F. Supp. 1354 (S.D.N.Y. 1969) (no jurisdiction to extend sections 14(d) and (e) of the Exchange Act and Regulations G and T promulgated under section 7 of the Exchange Act to govern loan made by German and English lenders to finance a tender offer for a New York Stock Exchange company); Sinva, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 48 F.R.D. 385 (S.D.N.Y. 1969) (no jurisdiction for commodities futures transactions made between foreigners in Europe and executed on the London Stock Exchange); Ferraioli v. Cantor, [1964-1966 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,615 (S.D.N.Y. 1965) (no jurisdiction over a private sale in Canada of the controlling shares of a New York Stock Exchange corporation in an isolated transaction); and Kook v. Crang, 182 F. Supp. 388 (S.D.N.Y. 1960).

16. 405 F.2d 200 (2d Cir. 1968), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc) *cert. denied*, 395 U.S. 906 (1969).

17. 468 F.2d 1326 (2d Cir. 1972).

18. 519 F.2d 974 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975).

19. 519 F.2d 1001 (2d Cir. 1975).

20. 619 F.2d 909 (2d Cir. 1980).

21. 548 F.2d 109 (3d Cir. 1977), *cert. denied*, 431 U.S. 938 (1977).

22. 592 F.2d 409 (8th Cir. 1979).

23. *See* SEC v. Kasser, 548 F.2d 109 (3d Cir. 1977) *cert. denied*, 431 U.S. 938 (1977) (jurisdiction exists when significant conduct forming essential part of defendant's fraud toward Canadian investor occurred in the United States, even with no domestic effect) and Straub v. Vaisman & Co., 540 F.2d 591 (3rd Cir. 1976) (jurisdiction upheld where a nonresident foreign national was defrauded by a domestic broker through a scheme conceived in the United States and involving stock in an American corporation traded on the over-the-counter market). For commentary on *Kasser* indicating the Third Circuit's departure from the standards of the Second Circuit *see* Note, *The Extraterritorial Application of the Antifraud Provisions of the Securities Acts*, 11 CORNELL INT'L L.J. 137 (1978); Comment, *Jurisdiction in Transnational Securities Fraud Cases—Securities and Exchange Commission v. Kasser*, 7 DEN. J. INT'L L. & POL'Y 279 (1978); Note, *Securities Regulations—Extraterritorial Application of the Antifraud Provisions*, 11 VAND. J. TRANSNAT'L L. 173 (1978); Guritzky, *Transnational Application of Anti-Fraud Provisions of the Federal Securities Laws Expanded (SEC v. Kasser, 3d Cir. 1977)*, 8 SETON HALL L. REV. 795 (1977).

See also Recaman v. Barish, 408 F. Supp. 1189 (E.D. Pa. 1975) (no jurisdiction when a Colombian plaintiff sued a foreign investment trust organized under the laws of the Bahama Islands formed to invest in United States real estate when domestic investors were prohibited from owning the securities and no domestic effect was alleged other than a generalized statement that defendant's fraud adversely affected United States real estate type securities); Selas of Am. (Nederland) v. Selas Corp. of Am., 365 F. Supp. 1382 (E.D. Pa. 1973) (jurisdiction upheld when an American Stock Exchange company sold stock in a foreign subsidiary to a Dutch corporation owned by employees of the subsidiary, including an American, when tially accepted the analytical leadership of the Second Circuit.

the agreement was reached in the United States, the allegedly fraudulent acts occurred in the United States, and the result could impact on defendant's earnings, thereby causing a significant impact on the American market); Alco Standard Corp. v. Benalal, 345 F. Supp. 14 (E.D. Pa. 1972) (jurisdiction upheld when a New York Stock Exchange company plaintiff purchased stock in five privately owned Spanish companies, which it paid for with its common stock, and when negotiations were conducted and the stock purchase agreement executed in the United States).

24. *See* United States v. Cook, 573 F.2d 281 (5th Cir. 1978), *cert. denied*, 439 U.S. 836 (1978) (jurisdiction upheld when a domestic promoter sold fractional undivided working interests in United States oil and gas wells to European investors and investors defrauded, in part, in the United States). *See also* Garner v. Pearson, 374 F. Supp. 591 (M.D. Fla. 1974) (jurisdiction sustained where fraudulent acts occurred in Florida, interstate mails were used, and domestic investors were affected by a fraudulent sale of bank time deposits); Ferland v. Orange Groves of Florida, 377 F. Supp. 690 (M.D. Fla. 1974) (jurisdiction upheld without discussion in a class action brought by Canadian residents who purchased one-acre lots in a Florida orange grove through the Montreal sales offices of Florida corporations); SEC v. Gulf Intercontinental Fin. Corp., 223 F. Supp. 987 (S.D. Fla. 1963) (jurisdiction sustained in an SEC injunction action where Canadian citizens purchased Canadian notes issued for the benefit of a United States corporation, but defendants used interstate mails and placed offers in Canadian newspapers, and some of the newspapers were circulated in southern Florida where many Canadian citizens vacation).

25. *See* Continental Grain Austl. Pty. Ltd. v. Pac. Oilseeds, 592 F.2d 409 (8th Cir. 1979) (jurisdiction upheld where an Australian company purchased all of the stock of an Australian company and a scheme of fraudulent nondisclosure was organized and completed in the United States, even though the agreement was executed outside of the United States and there was no effect on domestic securities markets or investors); and Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973) (jurisdiction upheld when a Canadian corporation made a tender offer for Canadian stock to Canadian residents only, United States residents were fraudulently induced to retain their shares, and the fraudulent inducements involved United States contacts, even though contact was primarily limited to the use of interstate mail or telephone for communications initiated by United States citizens).

For an incisive criticism of the avowedly expansionist policy approach to securities jurisdiction adopted in *Continental Grain* and *SEC v. Kasser*, the Third Circuit case upon which the Eighth Circuit relied, see Note, Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.: *An Unjustifiable Expansion of Subject Matter Jurisdiction in a Transnational Securities Fraud Case*, 2 Nw. J. INT'L L. & BUS. 264 (1980).

26. *See* Grunenthal GmbH v. Hotz, 721 F.2d 421 (9th Cir. 1983) (jurisdiction upheld when a German company purchased common stock from a Mexican company, the purchase agreement was executed in the United States for convenience reasons, and the transaction had no effect either on United States investors or securities markets); Des Brisay v. Goldfield Corp., 549 F.2d 133 (9th Cir. 1977) (jurisdiction upheld when an American Stock Exchange Company paid for the stock and assets of a Canadian corporation with its own common stock in a transaction that violated United States securities laws and caused the collapse of the domestic market of the company, thereby adversely affecting domestic investors); and SEC v. United Fin. Group, Inc., 474 F.2d 354 (9th Cir. 1973) (when misrepresentations and fraudulent conduct involved interstate mails, jurisdiction was upheld even though United States shareholders represented a tiny fraction of all shareholders). *See also* Ufitec v. Carter, 20 Cal. 3d 238, 571 P.2d 990, 142 Cal. Rptr. 279 (1977).

A. *Schoenbaum v. Firstbrook*[27]

In *Schoenbaum*, the earliest of the major Second Circuit cases, the court examined the basis for and limitations upon the extraterritorial application of the federal securities laws. The court sustained jurisdiction based upon the objective territorial principle, or the effects test.[28]

An American shareholder of Banff Oil, Ltd., a Canadian corporation (Banff), alleged violations of Rule 10b-5[29] in a shareholder's derivative action. The complaint alleged that treasury shares were sold in Canada at an artificially low price to defendants Aquitaine of Canada, Ltd., and Paribas Corporation. Banff common stock was registered with the SEC and traded on the Toronto and American stock exchanges.

The court first dealt with the well-settled principles of statutory construction which provide that American law presumptively governs only within the territorial limits of the United States,[30] unless there is evidence of clear congressional intent to extend legislation beyond national borders.[31] The Second Circuit did not cite, nor does there appear to be, any legislative history discussing the extraterritorial application of the federal securities laws.[32] In the absence of any ex-

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27. 405 F.2d 200 (2d Cir.), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969). For discussion of the substantive securities issues involved see Comment, Schoenbaum v. Firstbrook: *The "New Fraud" Expands Federal Corporation Law*, 55 VA. L. REV. 1103 (1969).

28. 405 F.2d at 208-09.

29. 405 F.2d at 218; *see* 17 C.F.R. § 240.10b-5 (1983).

30. 405 F.2d at 206. For a fuller analysis of the presumption against the extraterritorial application of federal law, see Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1335 (2d Cir. 1972).

31. Blackmer v. United States, 284 U.S. 421 (1932); Foley Bros. v. Filardo, 336 U.S. 281 (1949). *See also* Steele v. Bulova Watch Co., 344 U.S. 280 (1952) (United States patent law given extraterritorial application after finding sufficient congressional intent to rebut the presumption of territoriality). *See generally* Grundman, *The New Imperialism—The Extraterritorial Application of United States Law*, 14 INT'L LAW. 257 (1980); Norton, *supra* note 14.

32. In *Bersch*, decided some seven years later, the Second Circuit conceded that there was no legislative history because Congress had not considered the problem of the extraterritorial application of the securities law:

> We freely acknowledge that if we were asked to point to language in the statutes, or even in the legislative history, that compelled these conclusions, we would be unable to respond. The Congress that passed these extraordinary pieces of legislation in the midst of the depression could hardly have been expected to foresee the development of offshore funds thirty years later. We recognize also that reasonable men might conclude that the coverage was greater, or less, than . . . this day decided. Our conclusions rest on case law and commentary concerning the application of the securities laws and other statutes to situations with foreign elements and *on our best judgment as to what Congress would have wished if these problems had occurred to it*.

pression of congressional intent on this issue, the Second Circuit concluded that Congress must have intended to apply the federal securities laws extraterritorially when necessary to effectuate the expressed statutory purposes of protecting American investors and of maintaining "fair and honest markets" in securities transactions.[33]

The court next rejected the suggestion that section 30(b)[34] of the Exchange Act reflects legislative intent to apply the securities laws solely to domestic transactions. The court held that the only limitation imposed thereby is to exempt from federal registration those securities transactions conducted outside of the United States when such conduct is part of a "business in securities."[35] Having overcome the presumption against extraterritorial application of domestic law, the Second Circuit considered the case on its merits.

Neither the trial court nor the appellate court found any domestic conduct. The trial court similarly found no domestic effect and denied

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519 F.2d at 993 (emphasis added).

33. 405 F.2d at 206. The Second Circuit additionally relied on Strassheim v. Daily, 221 U.S. 280, 285 (1911), where the Supreme Court held that:

> 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.

Strassheim represents an early acceptance of the effects doctrine. Since the effects doctrine frequently is employed when the actor is outside the jurisdiction where the effects doctrine is jurisdictionally appropriate, its use may serve to overcome the presumption against extraterritorial application precisely because the doctrine inherently contemplates extraterritorial application of domestic law.

34. 15 U.S.C. § 78dd(b). The section provides that:

> The 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, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.

Section 30(a), 15 U.S.C. § 78dd(a) provides:

> (a) It shall be unlawful for any broker or dealer, directly or indirectly, to make use of the mails or of any means or instrumentality of interstate commerce for the purpose of effecting on an exchange not within or subject to the jurisdiction of the United States . . . in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate . . . to prevent the evasion of this chapter.

The implications of section 30 to the extraterritorial application of the federal securities laws are also discussed in Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d at 1336. For a detailed analysis of section 30(b), see Goldman & Magrino, *Some Foreign Aspects of Securities Regulation: Towards a Reevaluation of Section 30(b) of the Securities Exchange Act of 1934*, 55 VA. L. REV. 1015 (1969); Toth, *Registration and Regulation of Foreign Securities Businesses*, 12 INT'L LAW. 159 (1978).

35. 405 F.2d at 207.

jurisdiction.[36] The Second Circuit, however, held that there was significant United States effect and therefore granted jurisdiction.[37] The contrary jurisdictional conclusions result primarily from different perceptions of which matrix combination was involved.

The trial court regarded the American shareholder as standing in the litigation shoes of Banff.[38] Since Banff was a foreign corporation, the transaction was 4D. Plaintiff and defendant were foreign, the fraudulent sale occurred in Canada, and the effect of the fraud, if any, was manifested upon the Canadian corporation. All four variables were foreign and subject matter jurisdiction did not exist.

The Second Circuit disregarded the derivative characteristics of the suit and focused instead on the actual parties to the litigation. The plaintiff was an American, the defendant was foreign, and the sale occurred in Canada. The fraudulent sale adversely affected both the foreign corporation and its American shareholders, as well as the integrity of the American securities markets upon which Banff's shares were traded. Therefore, the effect could be classified as domestic since there was at least as much of a domestic as a foreign effect. Identification of the true party in interest as the American shareholder rather than the Canadian corporation affected both the base group designation of plaintiff's nationality (2 versus 4) and the subgroup classification of the location of the effect (C versus D). As viewed by the appellate court the transaction was 2C, and jurisdiction existed.

The court concluded that Congress intended the Exchange Act to apply extraterritorially to "protect domestic investors who have purchased foreign securities on American exchanges"[39] and also to protect "the domestic securities market from the effects of improper foreign transactions in American securities."[40] The decision established a minimum standard for application of United States federal securities laws to international transactions. If the actual injured party is American, if the transaction adversely affects domestic securities markets, and if the affected security is registered on a national securities exchange, then applying the securities laws extraterritorially is consonant with congressional intent and international law.[41]

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36. Schoenbaum v. Firstbrook, 268 F. Supp. 385, 393 (S.D.N.Y. 1967).
37. 405 F.2d at 208-09.
38. 268 F. Supp. at 390.
39. 405 F.2d at 206.
40. *Id.*
41. In the words of the court:

the district court has subject matter jurisdiction over violations of the Securities Exchange Act although the transactions which are alleged to violate the Act take

Schoenbaum illustrates the importance of the matrix as an analytical mode and the significant differences that arise from characterizing any individual variable as United States or foreign. When jurisdiction is sought solely on the basis of the effects doctrine, many transactions would support jurisdiction if Party *A* sues Party *B*, but will not sustain jurisdiction if Party *B* sues Party *A* for fraudulent conduct arising from the same situation. As an example, although there is jurisdiction for a lawsuit by a Banff shareholder as a 2C transaction, the matrix shows that a reversal of litigation roles falls into a different category. Thus, if Aquitaine sued Banff alleging that Aquitaine had overpaid for the treasury shares in a sale occurring in Canada induced by inadequate disclosure, the litigation would have involved a foreign plaintiff (Aquitaine), a foreign defendant (Banff), foreign conduct (Canadian sale), and foreign effect (injury to Aquitaine). The transaction would be characterized as 4D, with the result of no jurisdiction.

If the Second Circuit's analysis in *Schoenbaum* is used for the same example and the court looks through Banff as defendant to Banff's United States shareholders as defendants, then the transaction must be recharacterized. Under this analysis the plaintiff (Aquitaine) and the conduct (Canadian sale) are foreign and the defendants (Banff's United States shareholders) are domestic. The effect, however, is that the United States defendants are enriched by the fraudulent conduct. Since the effect is not adverse to United States interests, the effect is not classifiable as domestic but is designated as foreign (*i.e.*, not United States). The transaction is 3D and does not result in jurisdiction. When the nationality of plaintiff and defendant are reversed the base group classification changes—in this example from Transaction 2 to Transaction 3. For transactions where jurisdiction exists only pursuant to the effects doctrine, this will inevitably have the consequence of eliminating jurisdiction.

B. *Leasco Data Processing Equipment Corp. v. Maxwell*[42]

In *Leasco* the Second Circuit circumscribed the holding in *Schoenbaum*, thereby narrowing the application of the effects test. The

> place outside the United States, *at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors*.

Id. at 208 (emphasis added).

42. 468 F.2d 1326 (2d Cir. 1972). See Note, *Extraterritorial Application of Section 10(b) and Rule 10b-5*, 34 OHIO ST. L.J. 342 (1973).

court, however, granted jurisdiction based on the conduct test and clarified the parameters of the subjective territorial principle.

A British corporation, Pergamon Press Limited (Pergamon), persuaded an American corporation, Leasco Data Processing Equipment Corporation (Leasco), to purchase shares of Pergamon traded on the London Stock Exchange. The purchase was ultimately made by Leasco's wholly-owned Netherlands Antilles subsidiary (Leasco N.V.), which subsequently sued Pergamon for violation of Rule 10b-5.[43] Leasco alleged that the purchase was induced by misrepresentations which were communicated by mail and telephone, and in person, and which occurred in the United States and England.[44]

The defendants encouraged the court to engage in a stringent effects test, and analyze the transaction based on the nationality of the named litigants.[45] Viewed from this perspective, the plaintiff was Leasco N.V. (foreign), the defendant was Pergamon, a British corporation (foreign), the effect was suffered by Leasco N.V. (foreign), and the fraudulent conduct was the sale of shares in England (foreign). Defendants argued that there should be no extraterritorial application of Rule 10b-5 when a foreign investor buys a security of a foreign issuer not registered with the SEC and the sale occurs abroad.[46] This concurs with a matrix analysis that when all four matrix variables are foreign, then the transaction is 4D and there is no United States jurisdiction. Consideration of whether benefit of the federal securities laws is available to foreign investors was deferred, however, because Leasco N.V. was ultimately "accepted by both sides as the *alter ego* of the American."[47] As a result of the foregoing analysis, the Second Circuit analyzed jurisdiction as if the litigation involved a domestic plaintiff and a foreign defendant. The threshold determination, therefore, was that the base group of the case was Transaction 2, and the remaining issue was whether the subclassification was A, B, C, or D.

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43. Technically, Leasco sued Pergamon. When defendants properly objected that without Leasco N.V. as a party to the litigation there was no actual purchaser of securities and therefore no party with standing to allege violations of Rule 10b-5, plaintiff's counsel stipulated that the complaint would be amended to join Leasco N.V. as party plaintiff. 468 F.2d at 1337.

44. *Id.* at 1331.

45. *Id.* at 1335.

46. *Id.* at 1336.

47. *Id.* at 1338. Judge Friendly, on behalf of the court, specifically did not decide what effect, if any, would result when a United States citizen deliberately purchased securities in a foreign country through a foreign entity. "Whatever may be the rule where the defrauded American investor chooses, deliberately and unilaterally, to have the purchase consummated abroad by a foreigner, here the situation was quite different." *Id.*

Injury was incurred by an American corporation (Leasco) and its domestic shareholders. Since the fraudulent sale was to an American, the minimum standards of international law under the objective territorial principle for adverse domestic effect would have been satisfied provided that the adverse effect was intended by the wrongdoer. The danger with such an analysis is that jurisdiction would lie under the effects test in favor of a corporation whose shares were registered with the SEC no matter where the fraudulent transaction occurred and without regard to the relative interests of competing national forum.[48] This expansionist approach was rejected and the *Schoenbaum* holding narrowed. The Second Circuit held that absent a minimum amount of United States conduct, jurisdiction cannot arise based solely upon the effects doctrine when the effects are limited to those of the instant case.[49]

It is imperative to note that the court did not deny that there was some adverse United States effect. The injury to an American plaintiff (Transactions 1 or 2), however, when considered in terms of the legislative intent to protect United States securities markets, was too indirect and attenuated to be designated as domestic effect.[50] The characterization of effect as foreign represents an abbreviated analysis that the American effect is not substantial or direct enough to be designated as domestic, rather than a conclusion that there is no United States effect. *Leasco* therefore involves either Transaction 2B or 2D, of which only Transaction 2B results in jurisdiction.

Although jurisdiction was not supportable based solely upon the effects test, jurisdiction could result from sufficient United States conduct. Leasco and Pergamon held several key meetings in the United states and material misrepresentations were communicated in, and to,

48. As the Second Circuit framed the limitation:

> If all the misrepresentations here alleged had occurred in England, we would entertain most serious doubt whether, despite . . . *Schoenbaum*, § 10(b) would be applicable simply because of the adverse effect of the fraudulently induced purchases in England of securities of an English corporation, not traded in an organized American securities market, upon an American corporation whose stock is listed on the New York Stock Exchange and its shareholders. . . . [T]he language of § 10(b) . . . is much too inconclusive to lead us to believe that Congress meant to impose rules governing conduct throughout the world in every instance where an American company bought or sold a security. 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. at 1334.

49. *Id.*

50. *Id.*

the United States.[51] That amount of conduct, by itself, is sufficient to satisfy the minimum standards under international law for jurisdiction under the subjective territorial principle.[52] The level of United States conduct additionally distinguishes *Schoenbaum* from *Leasco*, since *Schoenbaum* involved wholly foreign conduct. The issue persists, however, whether Congress intended to apply its laws extraterritorially to the full limits permitted by international law. Even where international standards have been satisfied, the federal courts must still choose to assert jurisdiction to effectuate congressional policy and the purposes of the federal securities laws.[53]

The court rejected the conduct analysis provided for by a conflict of laws approach.[54] Under the analogous conflict of laws provisions, a wrong (or fraud) occurs where "the last event necessary to make an actor liable for an alleged tort takes place."[55] Using the conflict of laws theory, the conduct in *Leasco* would be designated as foreign because the purchase of shares was ultimately executed in England. Using matrix nomenclature and a conflict of laws approach, the Leasco transaction is 2D (domestic plaintiff, foreign defendant, foreign conduct, and foreign effect) which would not sustain United States jurisdiction.

Instead, the Second Circuit held that jurisdiction premised upon a conduct analysis should be determined by a comparison of domestic and foreign conduct. The roles that United States and foreign conduct played in the fraud must be contrasted, and the sequence, location, quantity, and quality of the fraudulent conduct considered. Fraud and misrepresentation require a more "extensive and sophisticated analysis"[56] than that provided by the conflict of laws principles. The opinion emphasized that the location of the execution of the transaction, the London Stock Exchange, is less determinative analytically than the mosaic of fraudulent conduct and misrepresentations that induced the foreign purchase.[57] Because substantial misrepresentations were made in the United States, which significantly affected Leasco's decision to

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51. *Id.* at 1335.

52. *Id.*

53. As Judge Friendly stated the issue: "Up to this point we have established only that, because of the extensive acts alleged to have been performed in the United States, considerations of foreign relations laws do not preclude our reading § 10(b) as applicable here. The question remains whether we should." *Id.*

54. *Id.* at 1337.

55. RESTATEMENT OF THE CONFLICT OF LAWS § 377 (1934).

56. 468 F.2d at 1337. *See* RESTATEMENT (SECOND) OF THE CONFLICT OF LAWS § 148 (1971).

57. 468 F.2d at 1337.

purchase the Pergamon shares, the defendant's conduct should be designated as United States conduct for jurisdictional determinations.[58] Employing the Second Circuit's standards, *Leasco* is a 2B transaction (domestic plaintiff, foreign defendant, domestic conduct, and foreign effect) for which jurisdiction lies.

Leasco revealed the delicate policy considerations involved when securities sales transcend national borders. The Herculean task of the judiciary is to examine the total conduct and effect in the United States and other nations and assess the relative impact to the several nations involved. When substantial fraud-inducing conduct occurs in the United States and the injured party is American, *Leasco* indicates that the conduct should be classified as domestic and lead to jurisdiction.

C. *Bersch v. Drexel Firestone, Inc.*[59]

Bersch and its companion case, *IIT v. Vencap, Ltd.*,[60] were milestone cases that examined several matrix combinations and directly responded for the first time to the applicable jurisdictional standards governing foreign plaintiffs. *Bersch* enunciated cascading standards for the conduct test—requiring less United States conduct to sustain juris-

58. The Second Circuit stated that:

> It was understood from the outset that all the transactions would be executed in England. Still we must ask ourselves whether, if Congress had thought about the point, it would not have wished to protect an American investor if a foreigner comes to the United States and fraudulently induces him to purchase foreign securities abroad—a purpose which its words can fairly be held to embrace. While as earlier stated, we doubt that impact on an American company and its shareholders would suffice to make the statute applicable if the misconduct had occurred solely in England, *we think it tips the scales in favor of applicability when substantial misrepresentations were made in the United States.*

Id. (emphasis added).

59. 519 F.2d 974 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975). For commentary on the *Bersch* case see Note, *Securities—Second Circuit Clarifies the Extraterritorial Application of American Securities Laws*, 44 FORDHAM L. REV. 674 (1975); Comment, *Securities Regulation—Securities Fraud—Federal Subject Matter Jurisdiction*, 28 VAND. L. REV. 1382 (1975); Comment, *Subject Matter Jurisdiction in Transnational Security Fraud Cases*, 17 B.C. INDUS. & COM. L. REV. 413 (1976); Tenney, *Securities*, 42 BROOKLYN L. REV. 1197, 1209-34 (1976); Note, *Securities Law Subject Matter Jurisdiction in Transnational Securities Fraud*, 9 N.Y.U. J. INT'L L. & POL'Y 113 (1976); Comment, *Securities Regulation—Subject Matter Jurisdiction Under Securities Exchange Act of 1934, § 10(b)*, 11 TEX. INT'L L.J. 173 (1976); Comment, *Extraterritorial Application of § 10(b) of the Securities Exchange Act of 1934—The Implications of* Bersch v. Drexel Firestone, Inc. *and* IIT v. Vencap, Ltd., 33 WASH. & LEE L. REV. 397 (1976); and Casenote, *Securities Law—Extraterritorial Applicability of the Securities Exchange Act of 1934*, 22 WAYNE L. REV. 997 (1976).

60. 519 F.2d 1001 (2d Cir. 1975); *see* Recent Cases, *Extraterritorial Application of United States Securities Laws, supra* note 6. For a discussion of *Vencap* see *infra* text accompanying notes 75-84.

diction in favor of a resident American plaintiff than for a nonresident American, and less United States conduct to sustain jurisdiction in favor of either a resident or nonresident American plaintiff than any foreign investor.[61] Unlike prior opinions, *Bersch* specifically distinguishes transactions by reference to the nationality or residence of the litigants, and delineates alternative jurisdictional standards based upon classifications corresponding to the matrix transaction classifications.[62] The Second Circuit's holding in *Bersch*, more notably than in any other case, demonstrates the necessity for, the sophistication of, and the limitations upon, the jurisdictional matrix as an analytical aid.

The litigation stemmed from three simultaneous common stock offerings made by the group of foreign companies headed by I.O.S. Ltd. (IOS)[63] and its organizer, Bernard Cornfeld.[64] The largest offering was a primary distribution underwritten by the Drexel group[65] exclusively to foreign nationals residing abroad (the Primary Offering). One secondary offering was conducted wholly within Canada[66] and an additional secondary offering was made by an IOS subsidiary and was limited to foreign investors with longstanding relationships with IOS (the Overseas Offering).[67]

The three offerings, although technically independent, had common elements, including substantially identical prospectuses.[68] All financial statements were prepared by defendant Arthur Andersen & Co. None of the stock was to be registered on an American stock exchange. Finally, numerous offering activities occurred in the United States, in-

61. 519 F.2d at 992.

62. *Id.* at 993.

63. IOS was an international financial service organization which sold and managed mutual funds. During 1975 as many as fifteen IOS related cases were pending in the federal court for the Southern District of New York. Note, *Securities Law—Subject Matter Jurisdiction in Transnational Securities Fraud*, 9 N.Y.U. J. INT'L L. & POL'Y 113, 113 n.2 (1976).

64. For full discussions of the intrigue behind this international financier and successful con man see B. CANTOR, THE BERNIE CORNFELD STORY (1970); and C. RAW, B. PAGE & G. HODGSON, DO YOU SINCERELY WANT TO BE RICH?: THE FULL STORY OF BERNARD CORNFELD AND IOS (1971).

65. The Drexel Group consisted of two United States investment firms, Drexel Firestone, Inc. and Smith Barney & Co., and four foreign investment firms whose principal offices were outside of the United States: Banque Rothschild, Hill Samuel & Co. Limited, Guinness Mahon & Co. Limited, and Pierson Heldring & Pierson. 519 F.2d at 979.

66. *Id.* at 980.

67. The prospectus for both the primary and overseas offerings stated that the shares "are not being offered in the United States of America or any of its territories or possessions or any area subject to its jurisdiction." *Id.*

68. *Id.*

cluding meetings of lawyers, accountants, and underwriters.[69]

Following a brief stabilization period, the shares quickly became worthless. Although the shares were to be sold only to foreign investors, a United States citizen, Howard Bersch, purchased some of the securities in the Overseas Offering and subsequently brought a class action on behalf of investors in all three offerings.[70] Because the offerings were intended exclusively for foreign investors, the overwhelming majority of members of the alleged class were citizens and residents of Europe, Asia, and South America.

Based upon the extensive domestic conduct related to the fraud by way of legal, accounting, and underwriting activity, the Second Circuit was satisfied that the threshold jurisdiction standards of international law under the subjective territorial principle had been satisfied.[71] A finding that the minimum standards have been met, however, is only a predicate for further analysis. Defendants were potentially subject to litigation in several countries. Each potential tribunal had a nexus to the fraud, different legal standards for liability and damages, and unique domestic policy reasons for asserting or denying jurisdiction. Furthermore, a class action purporting to bind unnamed and unnameable foreign investors might not bind either the class or defendants.[72] These twin procedural problems, as well as a reluctance to expand the aegis of United States law, may explain the court's restrictive jurisdictional analysis. While not insensitive to the rights of foreign investors to have access to United States law and the federal court system, the holding nonetheless recognizes that Congress did not intend to unnecessarily extend the federal securities laws over predominantly foreign transactions.[73]

The court established jurisdictional standards predicated upon the

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69. *Id.* at 985 n. 4.

70. *Id.* at 981.

71. *Id.* at 992.

72. Affidavits introduced indicated that a judgment in favor of defendants would not bar subsequent litigation in at least five European countries. This "near certainty" that a foreign court would not recognize or enforce a United States judgment led the Court to dismiss from the class action all purchasers who were not United States citizens or residents. *Id.* at 996.

73. The court stated:

> When, as here, a court is confronted with transactions that on any view are predominantly foreign, it must seek to determine whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to them rather than leave the problem to foreign countries.

Id. at 985.

nationality[74] and residence of the litigants, and then on the quantity and quality of domestic conduct and effect.[75] As the number of foreign variables increases for matrix purposes, there must be a concomitant increase in the amount of United States conduct and in its causal nexus with the fraud before conduct can be classified as United States conduct.

The Second Circuit held:

> [T]hat the anti-fraud provisions of the federal securities laws:
>
> (1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and
>
> (2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but
>
> (3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses.[76]

When the plaintiff is a United States citizen and resident, then neither the nationality of the defendant nor the country of the conduct is relevant, provided that the statutory minimum conduct required to invoke the protection of the federal securities laws has been satisfied. The fraudulent sale necessarily has a direct, domestic effect on American investors. In terms of the matrix, subject matter jurisdiction therefore exists for transactions 1A, 1C, 2A, and 2C.

When the plaintiff is a United States citizen but a foreign resident, a fraudulent sale causes no cognizable domestic effect. Although there is clearly an adverse effect to the individual investor, there is no effect to American investors as a class nor to domestic securities markets. Jurisdiction, accordingly, is less easily obtained and arises only if a "materially importan[t]" act "significantly contribut[ing]" to the fraud

74. Refusal to find subject matter jurisdiction as to an alien when jurisdiction would exist for an American may constitute a denial of due process under the equal protection guarantee of the fifth amendment of the Constitution. *See* Case Comment, *supra* note 13, at 170; Note, *Subject Matter Jurisdiction in Transnational Securities Fraud Cases*, 17 B.C. INDUS. & COM. L. REV. 413, 433 (1976); Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 569 (1976). *See also* Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1376-77 (1973).

75. Different standards may apply in actions seeking equitable relief. 519 F.2d at 986 n.26, 988.

76. *Id.* at 993.

occurred in the United States.[77] Thus, the analysis switches from the effects doctrine to the conduct doctrine, solely because of the difference in residence, but not nationality, of the plaintiff. In terms of the matrix, only Transactions 1A, 1B, 2A, or 2B sustain jurisdiction for a nonresident American.

When a foreigner purchases a security outside of the United States, subject matter jurisdiction exists only when the sales are classifiable for matrix purposes as 3A, 3B, 4A, or 4B. Jurisdiction requires both material United States conduct and a direct causal relationship between the United States acts and the foreign loss. A fraudulent sale to a foreign investor causes no loss to domestic investors, and therefore no cognizable adverse American effect.[78]

Bersch established a dynamic continuum for the jurisdictional adequacy of conduct and effect. There are different standards for denominating a transaction as involving United States conduct and therefore falling into A or C for matrix purposes for Transactions 1, 2, 3, and 4, and different standards within Transactions 1 and 2 depending upon the residence of the United States plaintiff. An American resident plaintiff (Transaction 1 or 2) must establish only the statutory minimum required under the federal securities laws in order to sustain jurisdiction. A nonresident American seeking United States jurisdiction (also Transaction 1 or 2) must demonstrate "materially important" United States conduct which "significantly" contributed to the fraud. Both the amount of conduct and its relationship to the fraud represent more stringent standards than required of the United States resident. A foreign investor who purchases a security abroad (Transaction 3 or 4) must establish significant domestic conduct and satisfy a stricter causal relationship than an American plaintiff. Jurisdiction results for

77. *Id.*

78. It is possible, however unlikely, that the sale of certain securities to foreign investors could impair the reputation, integrity, or liquidity of the American securities markets, thereby justifying jurisdiction under the effects test. Where fraudulent conduct occurred abroad, the effects doctrine will support jurisdiction only as to those purchasers or sellers of securities "in whom the United States has an interest." A general allegation that domestic investors, or the economy, have sustained adverse effects is insufficient as a jurisdictional predicate. In *Bersch*, plaintiffs alleged broad, adverse effects upon the American securities markets resulting from the precipitous collapse of the price of the IOS shares. The financial debacle deteriorated investor confidence in American underwriters and securities generally and diminished interest in offshore mutual funds which invested in domestic securities. While the court agreed that the failure of IOS had an "unfortunate financial effect" in the United States, the effect was of such a diffuse and generalized nature that it, by itself, could not justify jurisdiction as to foreign plaintiffs. *Id.* at 988.

a foreign plaintiff only if the domestic act "directly" caused the loss.[79] Thus, as the relationship of the plaintiff to the United States changes from American citizen and resident, to nonresident American, to foreigner, the standards required for United States conduct to suffice as a jurisdictional predicate increase.

The critical analysis in *Bersch* is whether an act (or culpable failure to act) of material importance[80] occurred in the United States. The Second Circuit's analysis reflects a division of fraudulent conduct into acts of preparation and acts of perpetration, consistent with the subsequent use of such terms by the Second Circuit in *Vencap*. The distinction would appear to be that acts of preparation are those which position the actor to commit the fraudulent act while acts of perpetration are those which constitute the fraudulent act itself: the sale, the misrepresentation, or the failure to disclose.

The preparation/perpetration dichotomy distinguishes the caliber of domestic conduct required to sustain jurisdiction for a nonresident American plaintiff in contrast to a foreign plaintiff. "While merely preparatory activities in the United States are not enough to trigger application of the securities laws for injury to foreigners located abroad, they are sufficient when the injury is to Americans so resident."[81]

In *Bersch*, domestic conduct involved legal, accounting, underwriting, and financing activity.[82] The court held that such acts were merely preparatory to the offering work performed in Europe. The majority of the offering work, including all final preparation of materials, was performed abroad. The fraud occurred when the misleading prospectus, the final production of which occurred overseas for all three offerings, was delivered to the purchasers.[83] Thus, no fraud occurred in the United States and no jurisdiction arose.

If this distinction is applied literally, then a fraudulent securities sale made by a domestic issuer to roommates in Paris, one a French

79. The court expressly reserved judgment on subject matter jurisdiction when losses to foreigners resulted from sales made to them within the United States. Thus, *Bersch* does not answer whether jurisdiction exists as to 3B or 4B transactions. *Id.* at 988 n.31.

80. The utility of the concept of an "act of material importance" is significantly diminished because the term is used nowhere else in the *Bersch* opinion. Elsewhere, conduct is categorized by the litigants and the court variously as: "certain United States activity," "activity," "preliminary," "ancillary," "final form of culpable nonfeasance," "action and inaction," "essential," and "significant." The failure to employ consistent terminology renders the opinion unnecessarily ambiguous.

81. 519 F.2d at 992.

82. *Id.* at 985 n.24.

83. *Id.* at 987.

citizen and the other a United States citizen, where domestic conduct was "merely preparatory," results in no United States jurisdiction for the foreign investor but jurisdiction for the nonresident American. If a fraudulent sale occurs in France, without United States effect, the transaction is either subclassification B or D since the transaction involves foreign effect and either domestic or foreign conduct. For the nonresident American plaintiff, merely preparatory activity is adequate to classify the transaction as B, while for the foreign roommate the transaction would be a D transaction. B transactions support jurisdiction while D transactions do not. While such a result may be viewed with dismay for those proponents of expansive United States jurisdiction, the result is practical. The French roommate will have jurisdiction in France and can pursue remedies under French law. The American can pursue litigation in either France or the United States.

While the perpetration/preparation dichotomy has analytical appeal, it also has inherent dangers. The distinction may induce courts to buttress conclusions by merely labelling behavior by reference to the dichotomy rather than analyzing behavior meticulously. The dichotomy, like the matrix itself, is a beginning rather than an end to analysis.

D. *IIT v. Vencap, Ltd.*[84]

In *Vencap* the court could not establish the existence of subject matter jurisdiction because the trial court's factual findings were incomplete.[85] The opinion, however, confirms three major principles for the extraterritorial application of United States securities law. First, the nationality principle, as an independent jurisdictional base, will not sustain federal jurisdiction. Second, jurisdiction will normally be decided based upon the nationality of an entity rather than its owners, unless analysis of the owner's nationality reveals a compelling reason to the contrary. Third, the preparation/perpetration dichotomy enunciated in *Bersch* expresses the cardinal distinction for granting or denying jurisdiction over foreign investors based upon the subjective territorial principle.[86]

Several foreign entities and Richard Pistell, a nonresident American, were sued for an alleged fraud in connection with the sale of securities of Vencap Limited (Vencap), a Bahamian venture capital firm. IIT, a Luxembourg investment trust, invested $3,000,000 in Vencap af-

84. 519 F.2d 1001 (2d Cir. 1975).
85. *Id.* at 1004.
86. *Id.* at 1018.

ter meetings held in London, the Bahamas, and the United States. Purchase documents and a Memorandum of Understanding were drafted and reviewed in the Bahamas and New York, and the actual purchase closed in the Bahamas. Plaintiffs[87] alleged that Pistell then improperly obtained funds from Vencap.

Plaintiffs urged that United States jurisdiction should result from the American citizenship of defendant Pistell. The Second Circuit, however, repudiated the nationality principle as an independent jurisdictional basis for violations of the federal securities acts. The court held that the United States had no jurisdiction over the actions of its nationals abroad, unless there was a relationship between those actions and either domestic conduct or effect.[88]

If the nationality principle formed the basis of United States jurisdictional law, then one-half of the matrix would be unnecessary. The United States nationality of defendant would be outcome-dispositive and result in United States jurisdiction for Transactions 1 and 3, each of which involves American defendants. Only Transactions 2 and 4 would remain subject to analysis. Because the court rejected the nationality principle as being independently determinative, a defendant's nationality remains only a single factor which, in conjunction with other matrix variables, shapes the governing jurisdiction standards for a particular transaction.

The Second Circuit then concluded that jurisdiction could not arise under the effects test when there was no "significant effect in the United States."[89] The immediate effect of the fraud in *Vencap* was upon IIT, a foreign investor. Plaintiffs urged the court to adopt a "pierce-the-corporate-nationality" test to consider the adverse effect resulting from the fraud upon IIT's American shareholders. The overwhelming majority (99.5%) of IIT's shareholders, however, were foreign.[90] The court held that when the effect is so predominately foreign, then it is inadequate to sustain U.S. jurisdiction.[91] For matrix

87. The litigation was brought by IIT and three citizens of Luxembourg appointed by the District Court of Luxembourg as the liquidators of IIT. *Id.* at 1003.

88. Id. at 1016. Judge Friendly, on behalf of the court, stated that "It is simply unimaginable that Congress would have wished the antifraud provisions of the securities laws to apply if, for example, Pistell while in London had done all the acts here charged and had defrauded only European investors." *Id.*

89. *Id.*

90. *Id.*

91. Judge Friendly stated the issue as follows:

> And even though *Schoenbaum* does not necessarily set the outmost reaches for subject matter jurisdiction with respect to foreign activities having effect within the United States, the losses from this $3,000,000 investment to these 300 American

purposes, this relative proportion of foreign versus domestic effect indicates that the proper subclassification is D and not B.

The remaining issue was whether domestic activity was sufficiently material to sustain jurisdiction under the conduct test. United States conduct consisted primarily of reviewing and drafting agreements in New York. The factual record, however, was unclear as to the relative significance of the drafting and negotiating in New York compared with the preparatory conduct in the Bahamas and elsewhere. Because both the *Bersch* and *Vencap* opinions stress the distinctions between acts of preparation and perpetration, it is imperative that the factual record fully reflect all of the foreign and domestic conduct. The court emphasized the importance of ascertaining the "exact means by which an alleged fraud has been accomplished. . . ."[92]

The court held that the perpetration/preparation dichotomy governs all defendants, domestic as well as foreign.[93] While the demarcation may be artificial, the Second Circuit felt that discriminations must exist or the United States would resolve every dispute tangentially involving domestic conduct, without regard to the impact of the activity on the United States or its citizens.[94]

Translated into matrix terminology, the *Vencap* holding indicates that both Transactions 3B and 4B give rise to jurisdiction, while Transactions 3D and 4D do not. In order for domestic conduct in transac-

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> investors, owning only some .5% of a foreign investment trust which reported net assets of $263,000,000 as of December 31, 1971, and the shares of which apparently were not intended to be offered to American residents or citizens, is not the "substantial" effect within the territory of which the Restatement of Foreign Relations Law § 18(b)(ii) speaks.

Id. at 1017.

92. *Id.* at 1009.

93. For a trenchant analysis of Judge Friendly's approach in *Bersch* and *Vencap*, particularly critical of the preparation/perpetration dichotomy see Note, *supra* note 63, at 135-36.

94. In the words of the court:

> We do not think that Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners. . . . Our ruling on this basis of jurisdiction is limited to the perpetration of fraudulent acts themselves and does not extend to mere preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries, such as in *Bersch*. Admittedly the distinction is a fine one. But the position we are taking here itself extends the application of the securities laws to transnational transactions beyond prior decisions and 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 the consummated fraud and however negligible the effect in the United States or on its citizens.

519 F.2d at 1018.

tions 3 and 4 to be subclassified as B, the activity must constitute the actual perpetration of the fraud. Preparatory activities, no matter how extensive or material to the commission of the fraud, will not serve as a basis for jurisdiction.

While these distinctions may appear harsh and unnecessarily restrictive to the foreign investor, they reflect a sensitivity to the differences between the conduct and effects tests as bases for jurisdiction. When foreign investors are injured, the United States customarily suffers no adverse effect. Federal jurisdiction, therefore, can only arise from application of the conduct test. The nation where the defrauded foreign investor resides, however, has probably sustained an adverse effect because of the injury to its citizen and may assert effects-based jurisdiction. Depending upon the facts, the nation may also assert jurisdiction under the conduct test. Because injury to foreign investors involves an alternative (and probably more convenient) forum with substantial nexus to the fraud, access to United States courts is less important. The applicable standards for granting United States jurisdiction to foreign investors should, therefore, be more stringent than that for injured American investors. By establishing a higher standard, the federal judiciary will avoid duplicating jurisdiction.

The preparation/perpetration dichotomy is somewhat contrived and difficult to apply. It possesses the virtue, however, of limiting the reach of American law and permitting other nations to exercise jurisdiction over transnational securities transactions. The value of using a matrix analysis, in conjunction with the dichotomy, is that the appropriate legal standard for the sufficiency of conduct and effect is immediately apparent. The higher standards for conduct and effect as jurisdictional predicates for Transactions 3 and 4 implicitly acknowledges that other nations may appropriately exercise jurisdiction over those transactions. Because of that recognition, the test enunciated in *Vencap* for balancing the relative importance of domestic to foreign conduct and effect represents a subtle, but sophisticated, method of weighing the interests of competing international forums. As the interests of other nations become predominant and the probability increases that another country will exercise jurisdiction over the transaction, application of the Second Circuit's test makes it increasingly improbable that the United States will exercise jurisdiction.

E. *IIT v. Cornfeld* [95]

In the most recent major Second Circuit case, *Cornfeld*, the court granted jurisdiction even though the litigation involved "substantial foreign elements."[96] The opinion illuminates the *Bersch* holding and introduces several new concepts to the jurisdictional analysis.

Cornfeld was yet another case involving the IOS group. The allegedly injured party, as in *Vencap*, was IIT which was managed by a Luxembourg company, IIT Management Company S.A., an IOS affiliate. The liquidators of IIT brought a shareholders' derivative action alleging that the purchase of securities in companies controlled by an American, John King, constituted an attempt by IOS and IIT Management Company to defraud IIT and its predominantly foreign shareholders.[97]

The plaintiffs alleged that several American companies were principals, aiders, or abettors of the fraud in their respective roles as brokers, accountants, or underwriters.[98] Arthur Lipper and Arthur Lipper Corp. (collectively, "Lipper") were charged as principals, aiders, and abettors for their role in facilitating the purchase of securities. The international accounting firm of Arthur Andersen & Ço. and several American underwriters were charged as aiders and abettors for their respective roles in preparing inadequate financial statements appearing in the offering circulars and of selling the securities.[99]

Fraud was charged in connection with three separate securities transactions effected by various King companies. IIT purchased subordinated convertible debentures (Debenture Purchase) issued by a Netherlands Antilles corporation, King Resources Capital Corporation, N.V. (Netherlands Antilles Subsidiary), a wholly-owned subsidiary of King Resources Company (King). King was an American corporation whose shares were traded publicly in the United States. The debentures were guaranteed by King and were convertible into King's common stock. The purchase was made in the Eurodollar

95. 619 F.2d 909 (2d Cir. 1980). *See* Recent Decisions, *Transnational Reach of Federal Securities Laws—Federal Courts Lack Jurisdiction Over Rule 10b-5 Claims Brought by Foreigners where the Alleged Deception Occurs Abroad*, 19 VA. J. INT'L L. 935 (1980).

96. 619 F.2d at 912.

97. As of the date of litigation, IIT had 218 shareholders residing in the United States of whom an unknown number were citizens. Of a total of 144,496 fundholders in 154 countries, approximately 1/8 of 1% were American. *Id.* at 913.

98. John King and his companies were not named as parties defendant because protective stays were issued by the courts handling their respective bankruptcy proceedings. *Id.* at 914.

99. *Id.* at 915.

aftermarket following a foreign offering conducted virtually simultaneously with a domestic offering of King debentures.[100]

IIT's second acquisition was a substantial purchase of King's common stock (Stock Purchase). The Stock Purchase was handled by Lipper as the broker and the securities were bought in the United States over-the-counter market.[101]

The last of the ill-fated transactions was the purchase of a convertible note (Private Note Purchase) from The Colorado corporation, a private company largely owned by John King. The purchase of the Private Note was consummated in the United States.[102]

The appellate court identified the real parties in interest differently than the trial court. The district court focused on the derivative nature of the claim and concluded that where foreign management defrauded a foreign investment trust whose fundholders were foreign, and Americans merely aided and abetted such fraud, then the actual fraud and deception were necessarily committed outside of the United States.[103] Thus viewed, *Cornfeld* is a 4D transaction (foreign plaintiffs, defendant, conduct, and effect) which does not give rise to jurisdiction.

The Second Circuit regarded the predominantly foreign fundholders as the real parties in interest, and the American aiders and abettors as the true defendants.[104] This alteration converts the action from foreign shareholders suing foreign management (Transaction 4) to foreign shareholders suing American defendants (Transaction 3). This emphasis results in a different base group classification with lower standards for the jurisdictional sufficiency of domestic conduct. It also results in a different analysis of what fraudulent conduct was involved, where it occurred, its materiality, and its causal relationship to the fraud.

Both the district and appellate courts agreed that the transactions involved injury primarily to foreign parties (whether to predominantly foreign shareholders or to the foreign corporation).[105] Mere generalized adverse effects resulting to the domestic securities market were

100. *Id.* at 914. IIT also alleged that it purchased $50,000 of the subordinated debentures in the United States. *Id.*

101. *Id.*

102. *Id.* at 918.

103. *Id.* at 914. The District Court concluded that "[s]ince virtually all the fundholders were foreign nationals residing in foreign countries, the deception, if it could be proved, *must* have occurred outside of the United States." IIT v. Cornfeld, 462 F. Supp. 209, 224 (S.D.N.Y. 1978).

104. 619 F.2d at 918.

105. 462 F. Supp. at 223; 619 F.2d at 917.

therefore insufficient to sustain jurisdiction under the effects test.[106] The Second Circuit, however, identified a new variable which may influence the existence of jurisdiction—the nationality of the issuer. Although there is no legislative history to support this position, the court posited that Congress would more willingly extend American law to govern securities fraudulently sold by domestic, rather than foreign, issuers.[107]

The court then analyzed the three transactions by reference to the conduct test and concluded that jurisdiction existed over each of them.[108] Treating the case as if plaintiffs were shareholders defrauded by American principals, aiders, and abettors (Transaction 3), the Stock Purchase and Private Note Purchase easily sustained United States jurisdiction. The Debenture Purchase, however, yielded jurisdiction only after thoughtful and creative analysis, which relies heavily on the jurisdictional relevance of the issuer's nationality.[109]

The Stock Purchase and the Private Note Purchase are 3B transactions. Foreign plaintiffs sue United States defendants, and although there is no cognizable domestic effect, conduct critical to the fraud (preparation of the prospectus and sale of the security) occurred in the

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106. 619 F.2d at 917.

107. In the words of the Second Circuit:

> We think Congress would have been considerably more interested in assuring against the fraudulent issuance of securities constituting obligations of American rather than purely foreign business. Our statement in *Vencap*, *supra*, 519 F.2d at 1017: "We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners" applies with even greater force when, as here, the securities are essentially American. Our very next sentence, id., "This country would surely look askance if one of our neighbors stood by silently and permitted misrepresented securities to be poured into the United States" reads with particular strength on a situation where the securities are essentially of the pourer's own nationals. . . . None of this amounts to saying that if fraud had been committed in the United States in connection with the issuance of the debentures, American courts would look away.

Id. at 920.

Although it is by no means certain, one interpretation of this judicial thesis is that when an American security is fraudulently sold, even though there is no direct effect on domestic investors or markets, there is an indirect and undesirable impact upon the integrity of the domestic system. While the impact, without more, is neither necessary nor sufficient to sustain jurisdiction, a court may be influenced to accept jurisdiction over the fraudulent sale of United States securities where the same matrix combination of plaintiff, defendant, conduct, and effect would not result in jurisdiction when the security is foreign. Rather than modifying the matrix base groups, this position establishes specific criteria for subgroup classification involving the effects test.

108. *Id.* at 920-21.

109. *Id.*

United States. If foreigners buy securities in the United States, they may be protected by the federal securities laws, an issue left unresolved in *Bersch*.[110] Foreigners who purchase securities in the United States do not, however, automatically gain access to the federal court system, even when the security is issued by a domestic issuer. When both factors occur concurrently, however, they are strong predicates for jurisdiction.[111]

A United States purchase of a security by a foreigner does not necessarily confer jurisdiction. Transactions 3A, 3B, 4A, and 4B potentially involve a United States sale. In 3A and 3B, where the defendant is American, the sale alone should be sufficient to sustain jurisdiction regardless of whether the sale is effected privately or on a securities exchange. Personal jurisdiction can be obtained in the United States over the defendant, and possibly nowhere else. No matter what conduct may have occurred elsewhere, the fact that the sale occurred domestically should suffice for jurisdiction as to a United States defendant.

Transactions 4A and 4B, however, in which a foreign plaintiff sues a foreign defendant for a fraudulent securities sale effected in the United States, may not support jurisdiction, a conclusion reached in *Leasco* and elsewhere.[112] An adverse American effect is unlikely in Transaction 4. A private sale between foreign parties cannot directly affect the market or American investors, involves no domestic effect, and cannot be classified as 4A. If the fraud involves securities traded on a domestic exchange, the sale may adversely affect domestic markets or investors, although this is highly unlikely. If so, a sale effected on the stock exchange could be classified as 4A. As a practical matter, however, Transaction 4A is unlikely to occur.

Jurisdiction under Transaction 4 will normally exist only for Transaction 4B and will result from the commission of acts of perpetration committed within the United States, when the United States is de-

110. The court stated that "[n]one of our cases or any others intimate that foreigners engaging in security purchases in the United States are not entitled to the protection of the anti-fraud provisions of the securities laws." *Id.* at 918. The court specifically left this issue undecided in *Bersch*, 519 F.2d at 993.

111. The Second Circuit sensibly avoided establishing an overly facile "litmus test" while recognizing the usual importance of these factors:

> Hence we do not mean to suggest that either the American nationality of the issuer or consummation of the transaction in the United States is either a necessary or a sufficient factor, . . . but rather that the presence of both these factors points strongly toward applying the anti-fraud provisions of our securities laws.

619 F.2d at 918.

112. For a discussion of *Leasco* see *supra* text accompanying notes 42-58.

liberately chosen as the location of the sale by the perpetrator of the fraud and when the location materially assists the commission of the fraud. When two foreigners close a transaction in New York merely for convenience and no other domestic conduct is involved, then the relationship of the fraud and the foreign parties is insufficient to sustain jurisdiction.[113]

Analysis of the Debenture Purchase involves complex jurisdictional issues. The debentures were sold in Europe to foreign investors. Thus, in accordance with *Bersch*, no federal jurisdiction should arise unless acts (or culpable failures to act) within the United States were the direct cause of the losses.

The fraudulent securities, although nominally foreign, were characterized by the court as American. First, the foreign subsidiaries' debentures were offered simultaneously with a significant United States offering of King debentures. The debenture offering was an "integral part"[114] of the American stock financing, in contrast to *Bersch* in which the simultaneous offerings were all foreign. Because the American and foreign offerings were interrelated, they could be integrated. Therefore, the Debenture Purchase was analyzed as involving American financing. Second, although the debentures were direct obligations of the subsidiary, their issuance depended entirely upon the financial viability of the parent American corporation. The subsidiary had no operating assets and the debentures were saleable only because they were convertible into King's common stock and guaranteed by King.[115] Thus, purchasers made investment decisions based upon the American guarantor rather than the foreign issuer. Under those circumstances, the debentures are characterized as domestic obligations. These distinctions serve to differentiate the securities in *Bersch* from those in *Cornfeld*.

The salient analysis, however, is whether United States conduct in the Debenture Purchase was merely preparatory to the fraud or constituted an act of perpetration. That differentiation necessitates an examination of the quantity and materiality of United States conduct by itself and then a comparison of such conduct to the corresponding foreign

113. In *Leasco*, the Second Circuit posited that a sale between foreigners effected in the United States where the closing location was merely a matter of convenience rather than the situs of negotiation would not give rise to subject matter jurisdiction. Judge Friendly's analysis was rejected by the Ninth Circuit in Grunenthal GmbH v. Hotz, 712 F.2d 421 (9th Cir. 1983). *See supra* note 26.

114. 619 F.2d at 919.

115. *Id.*

conduct, if any.[116] The lead underwriter of the Eurodollar offering was American, the allegedly fraudulent prospectus was drafted entirely in the United States, and all of the allegedly improper accounting work was performed domestically. All fraudulent activity, with the exception of the actual sale, was effected domestically. The role of American conduct in *Cornfeld* contrasts sharply to *Bersch*, in which American conduct was prior to, and less material than, its counterpart European conduct.

Employing this conduct analysis, the Second Circuit found that although the United States activities in *Bersch* resemble those in *Cornfeld*, "the relativity is entirely different because of the lack here of the foreign activity so dominant in *Bersch*. . . ."[117] Thus, even the identical amount and nature of domestic conduct does not determine if the subclassification is B or D. Because several nations have a legitimate jurisdictional interest in the transaction, the importance of the United States conduct must be assessed in relation to foreign conduct.[118]

Although *Bersch* and *Cornfeld* involve many similar jurisdictional variables (foreign plaintiff, domestic defendant, purchases abroad, and effect abroad), the Second Circuit successfully distinguishes the cases. Because the conduct of the fraud was both domestic and foreign, either transaction could be identified as 3B or 3D. Whereas in *Bersch* the domestic conduct was preparatory and the foreign conduct was the final and critical conduct, the preparatory domestic conduct in *Cornfeld* had no foreign counterpart and was consequently the sole and direct cause of the loss. Through this relativistic conduct analysis, *Bersch* emerges as a 3D transaction which will not sustain jurisdiction while *Cornfeld* is a 3B transaction supporting jurisdiction.

III. CONCLUSION

The jurisdictional tests developed by the Second Circuit have been

116. As the court stated: "Determination whether American activities 'directly' caused losses to foreigners depends not only on how much was done in the United States but also on how much (here how little) was done abroad." *Id.* at 920-21.

117. *Id.* at 920.

118. While the court observes that the other countries where aspects of the fraud occurred or had an effect might have an interest in the litigation, it concludes that since the United States antifraud statutes are as strict or stricter than comparable provisions of the laws of other nations, those countries would not be disturbed by application of American law. *Id.* It is doubtful, however, that the court would have reached a different conclusion if American law were less strict than competing foreign law, or that it would have suggested that jurisdiction should rest exclusively with the country with the highest standards.

criticized as nationalistic and insensitive to transnational policy considerations.[119] This criticism is misplaced. Although the opinions may not be explicitly responsive to the competing interests of other forums,[120] the decisions make sophisticated and subtle distinctions based on the nationality of the litigants and the countries affected by the fraud which implicitly accommodate the competing interests of potential forums. The Second Circuit tests represent a statesmanlike approach to the problem of extraterritorial application of the federal securities laws.

The matrix proposed in this Article is a tool which clarifies the variables involved in the jurisdictional analysis and the different legal standards which are used when a court has identified which matrix combination is involved. Recognition of the matrix and adoption of a standard nomenclature for discussion and analysis will encourage more uniform analysis and development of the principles for subject matter jurisdiction of transnational securities transactions.

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119. For an article highly critical of the Second Circuit's failure to consider the competing interest and balancing test suggested by section 40 of the RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES see Note, *supra* note 63, at 139-46.

120. Section 40 of the RESTATEMENT provides:

> Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as
>
> (a) vital national interests of each of the states,
>
> (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,
>
> (c) the extent to which the required conduct is to take place in the territory of the other state,
>
> (d) the nationality of the person, and
>
> (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

RESTATEMENT, *supra* note 9, § 40.