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Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject-Matter Jurisdiction.

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MULTINATIONAL ENFORCEMENT OF U.S. SECURITIES LAWS: THE NEED FOR THE CLEAR AND RESTRAINED SCOPE OF EXTRATERRITORIAL SUBJECT-MATTER JURISDICTION

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Despite the usual presumption for the territorial application of securities laws, U.S. courts have applied domestic antifraud provisions extraterritorially to transactions in other countries, justifying its actions as necessary to protect U.S. investors and the integrity of U.S. markets. The current approaches of U.S. courts, however, have some problematic features. The scope of federal jurisdiction is inconsistent and expansive, and this results in conflicts with other countries and the potential for redundant and unnecessarily costly systems of overlapping regulations. Because courts are not well suited to analyze the various delicate issues related to the application of antifraud rules, this Article affirms the proposition that Congress should grapple with the issue of extraterritoriality and provide the judiciary with clear guidance as to the proper reach of the antifraud provisions. Moreover, believing that the current effects and conduct tests of the courts give us practical approaches to decide the reasonable scope of extraterritoriality, this Article makes some recommendations for the scope of extraterritorial subject-matter jurisdiction by suggesting modified and narrowed effects and conduct tests.

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INTRODUCTION

As securities markets have become increasingly globalized in recent years, the growth of transactions in cross-border securities raises an issue of the regulation of transnational securities fraud. Although surging capital across jurisdictional boundaries seems to suggest that national borders are artificial constructs, this circumstance does not comport with regulatory reality. It is an internationally recognized principle that the power to prescribe and enforce securities laws is territorial,[1] and most modern securities markets are regulated on a national basis.[2] The securities regulations of most countries, in fact, reach only some transactions and not others, and the same may be said of U.S. securities laws.[3] Viewed differently, however, securities laws are hardly territorial at all because no country formulates the content of its securities laws without considering the practices of its sister countries and the extraterritorial effects of their laws.[4] In regard to the limits of a nation's power to unilaterally regulate conduct that occurs outside of its borders, there is general agreement that laws may have some extraterritorial reach.[5]

Enforcement of U.S. securities laws against securities fraud produces special problems when persons alleged to have violated the laws are foreign or when securities transactions that are

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1. *See, e.g.*, James D. Cox, *Choice of Law Rules for International Securities Transactions?*, 66 U. CIN. L. REV. 1179, 1181-82 (1998); James D. Cox, *Premises for Reforming the Regulation of Securities Offerings: An Essay*, 63 LAW & CONTEMP. PROBS. 11, 28 (2000) [hereinafter Cox, *Reforming the Regulation of Securities Offerings*].

2. *See, e.g.*, Marc I. Steinberg & Lee E. Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity*, 20 MICH. J. INT'L L. 207, 208 (1999).

3. *See, e.g.*, LARRY D. SODERQUIST & THERESA A. GABALDON, SECURITIES LAW 170 (1998).

4. *See, e.g.*, James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition*, 55 LAW & CONTEMP. PROBS. 157, 157 (1992); James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200, 1201 (1999) [hereinafter Cox, *Regulatory Duopoly*].

5. *See, e.g.*, JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 1202 (2d ed. 1997) [hereinafter COX, SECURITIES REGULATION].

allegedly tainted with fraud are foreign in nature.[6] While the U.S. Securities and Exchange Commission (the "SEC" or "Commission") has taken a number of steps to define the scope of disclosure requirements with respect to foreign companies and conduct that occurs primarily abroad,[7] the extraterritorial reach of the antifraud provisions remains a matter for the courts to resolve.[8] Despite the usual presumption for the territorial application of securities laws,[9] U.S. courts have applied domestic antifraud provisions extraterritorially to transactions in other countries, justifying its actions as necessary to protect U.S. investors and the integrity of U.S. markets.[10] The current

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6. *See, e.g.*, 2 J. WILLIAM HICKS, INTERNATIONAL SECURITIES REGULATION 12-6 (Indiana Univ. School of Law-Bloomington 2001) (on file with author) [hereinafter HICKS, INTERNATIONAL SECURITIES REGULATION]. Generally, enforcement of U.S. securities laws can take at least four different forms:

> (1) private litigation where defrauded persons seek damages, rescission of contracts, and/or equitable relief; (2) SEC enforcement actions against registered companies or registered market intermediaries, such as broker-dealers, in administrative proceedings or against any person involved in fraudulent activities in judicial proceedings; (3) criminal actions by the U.S. Department of Justice in a U.S. federal court; and (4) SRO actions to sanction members for violations of SRO rules which have been approved by the SEC.

Id. at 12-8.

7. The SEC has provided a separate integrated disclosure system for foreign private issuers that accommodates the desires of non-U.S. companies to raise capital in the United States. *New Accounting Rules Facilitate SEC Filings by Foreign Registrants* (stating that in order "[t]o facilitate the growth in the number of foreign companies gaining access to U.S. markets, the SEC provides a separate integrated disclosure system for foreign private issuers."), *at* http://www.foreigncompanylisting.com/sec.html (last visited Oct. 1, 2003). Also, the SEC adopted a more restrained approach through Regulation S for offers and sales taking place outside the United States. 17 C.F.R. §§ 230.901-.905 (2003).

8. *See* COX, SECURITIES REGULATION, *supra* note 5, at 1201.

9. The principle of international law calls for such territorial application of securities laws. *See* Cox, *Reforming the Regulation of Securities Offerings*, *supra* note 1, at 28 n.72 (stating that "[t]he territorial principle of international law calls for determining jurisdiction to prescribe and enforce by reference to the place where the act or offense occurs.").

10. *See* Michael J. Calhoun, Comment, *Tension on the High Seas of Transnational Securities Fraud: Broadening the Scope of United States Jurisdiction*, 30 LOY. U. CHI. L.J. 679, 680 (1999); PHILIP R. WOOD, INTERNATIONAL LOANS, BONDS, AND SECURITIES REGULATION 361 (1995) ("There is nothing new about the

approaches of U.S. courts, however, have some problematic features. The scope of federal jurisdiction is inconsistent and expansive, and this results in conflicts with other countries and the potential for redundant and unnecessarily costly systems of overlapping regulations. Given the possibility of being sued based on the extraterritorial application of U.S. antifraud provisions, participants in cross-border transactions need an identifiable standard to guide their actions.

Based on these problematic features of the current extraterritorial subject-matter jurisdiction, this Article reassesses the current approaches of U.S. courts and seeks to determine what U.S. policy should be toward the regulation of cross-border securities fraud. Part I examines the current antifraud provisions of U.S. securities laws and subject-matter jurisdiction of U.S. courts. Part II addresses the propriety of the extraterritoriality of U.S. securities laws and articulates the problems with the current extraterritorial subject-matter jurisdiction. Part III examines the procedural devices currently available for confining the broad reach of subject-matter jurisdiction. Part IV makes recommendations for reform of extraterritorial subject-matter jurisdiction.

I. THE CURRENT REGULATION OF TRANSNATIONAL SECURITIES FRAUD

A. Antifraud Provisions Under the Securities Act and the Exchange Act

The Securities Act of 1933 (the "Securities Act")[11] contains three antifraud provisions.[12] Sections 11 and 12(a)(2) provide

application of domestic laws to foreign transactions in the economic field. Antitrust law, exchange control regulations, and economic sanctions are cases in point.").

11. The Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2000) [hereinafter Securities Act].

12. 15 U.S.C. §§ 77k ("Civil Liabilities on Account of False Registration Statement"), 77*l*(a)(2) ("Civil Liabilities Arising in Connection with

purchasers of securities with a private cause of action for damages.[13] Section 11 provides a civil remedy in the case of a registration statement that contains "an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading."[14] Section 12(a)(2) provides that any person who offers or sells a security, by "means of a prospectus or oral communication" that includes a material misstatement or omission, is liable to her purchaser for rescission or damages.[15] The SEC has authority under section 17 to seek equitable relief against persons who offer or sell securities by means of misleading statements.[16] While the Securities Exchange Act of 1934 (the "Exchange Act")[17] provides many statutory sections regulating fraud,[18] the most important one is section 10(b) and Rule 10b-5.[19] Rule 10b-5 is applicable to purchases and sales of securities of all issuers, whether or not they have registered under section 12 of the Exchange Act.[20] "It applies to all securities transactions in the primary and secondary markets where the jurisdictional means . . . are present."[21]

Prospectuses and Communications"), 77q ("Fraudulent Interstate Transactions").

13. 15 U.S.C. §§ 77k, 77*l*(a)(2).

14. 15 U.S.C. § 77k.

15. 15 U.S.C. § 77*l*(a)(2).

16. 15 U.S.C. § 77q.

17. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78mm (2000) [hereinafter Exchange Act].

18. Section 15(c) of the Exchange Act is aimed at broker-dealers, and section 16(b) regulates officers, directors, and more than 10 percent holders of equity securities of a registered company. *See* 15 U.S.C. §§ 78*o*(c), 78p(b). Other provisions are designed to protect specified transactions: section 9 (trading on national stock exchanges); section 14(a) and Rule 14a-9 (soliciting of proxies); and section 14(e) and Rules 14e-1, 14e-2, 14e-3, and 14e-4 (tender offers). *See* 15 U.S.C. §§ 78i, 78n; 17 C.F.R. §§ 240.14a-9, 14e-1, 14e-2, 14e-3, and 14e-4 (2003).

19. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

20. 17 C.F.R. § 240.10b-5.

21. HICKS, INTERNATIONAL SECURITIES REGULATION, *supra* note 6, at 12-8.

B. Subject-Matter Jurisdiction and Judicial Approaches to Foreign Transactions

In relation to the application of the antifraud provisions of the federal securities laws to securities transactions with transnational aspects, Rule 10b-5 plays an important role.[22] Among the antifraud provisions under the Securities Act, sections 11 and 12(a)(2) of the Securities Act, which are applicable only to fraud in the registration statement and to prospectuses pursuant to a public offering respectively, no longer apply to transnational transactions exempt under Regulation S.[23] However, since Rule 10b-5 under section 10(b) of the Exchange Act covers all transactions in the primary and secondary markets where the jurisdictional means (*e.g.*, the mails or instruments of interstate commerce or communication) are present, transactions exempt from section 5 under Regulation S still remain subject to Rule 10b-5.[24] The question remains, therefore, how far the reach of Rule 10b-5 extends to cover overseas transactions. Since, unlike Regulation S, the SEC has not clarified the reach of Rule 10b-5 outside the United States, the extent of the reach of Rule 10b-5 has

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22. *See* Harold S. Bloomenthal & Samuel Wolff, *Transnational Aspect of U.S. Securities Laws, in* 10C International Capital Markets and Securities Regulation 5-166 (Harold S. Bloomenthal & Samuel Wolff eds., 1982 & Supp. June 2000) [hereinafter Bloomenthal & Wolff, *Transnational Aspect*].

23. 17 C.F.R. §§ 230.901-.905. "Regulation S limits the extraterritorial application of the Securities Act by eliminating the registration requirements for many offshore transactions and by providing greater predictability with regard to the application of U.S. securities laws to offshore offerings." Uri Geiger, *The Case for the Harmonization of Securities Disclosure Rules in the Global Market*, 1997 COLUM. BUS. L. REV. 241, 256 (1997).

24. Rule 10b-5 states:

> Employment of manipulative and deceptive devices. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

been left to the courts.[25] Federal courts have sought to articulate the extraterritorial coverage of the federal securities laws on a case-by-case basis.[26] After grappling with the issue, federal courts have sought to articulate the scope of coverage of the federal securities laws. They have applied their own blend of international law and their perception of the intent of Congress.[27]

The courts have applied two primary tests, which are sometimes referred to as the "effects" test and the "conduct" test. The effects test determines whether subject-matter jurisdiction exists based solely on the effects of the transaction on American investors or securities markets regardless of where the transaction actually took place.[28] Under the effects test, courts look to whether alleged securities fraud occurring in foreign countries has caused "foreseeable and substantial harm to interests in the United States."[29] Generally, courts determine whether or not conduct outside the United States has a significant effect in the United States on a case-by-case basis, and they tend to construe the effects test in a relatively conservative manner.[30]

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25. *See* Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT'L L. & BUS. 207, 215–16 (1996) [hereinafter Choi & Guzman, *Dangerous Extraterritoriality*] (stating that U.S. courts have grappled with the reach of 10b's extraterritorial application on a case-by-case basis).

26. Since the area is an evolving one, attempts to synthesize the law are tentative. Bloomenthal & Wolff, *Transnational Aspect*, *supra* note 22, at 5-166.

27. *See* Calhoun, *supra* note 10, at 688–89 (stating that statutory language and legislative history can be evidence of Congress's intent to cast away the presumption against extraterritoriality if principles of international comity are not violated).

28. *E.g.*, Calhoun, *supra* note 10, at 692; Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969) (holding that section 10(b) of the Securities Exchange Act of 1934 grants subject matter jurisdiction to U.S. courts because extraterritorial transactions are injurious to U.S. investors).

29. Tamari v. Bache & Co. S.A.L., 730 F.2d 1103, 1108 (7th Cir. 1984).

30. It is perhaps because American investors own at least a small part of so many predominantly foreign companies, that courts are usually wary of allowing a claim to proceed based solely on this fact. *See* Joshua G. Urquhart, Comment, *Transnational Securities Fraud Regulation: Problems and Solutions*, 1 CHI. J. INT'L L. 471, 475 (2000). For example, when American stakes in a foreign investment trust amount to only 0.5% of the total investment, the impact of the

The conduct test determines whether United States securities laws enable courts to claim subject-matter jurisdiction based upon the location of the conduct.[31] The conduct test is based on the principle of foreign relations law, which stipulates that a country can assert jurisdiction over significant conduct within its territory.[32] Under the conduct test, which is primarily a territorial-based rule, jurisdiction is conferred on events based on their location.[33] The conduct test allows the U.S. judiciary to exert more extraterritorial power over transnational securities transactions, than does the effects test, because, even absent an effect on U.S. investors, courts will sustain a claim if domestic conduct contributes to the commission of fraud overseas.[34] Under the conduct test, although U.S. investors or U.S. investment markets suffered no deleterious effects, federal courts have jurisdiction where the conduct of the defendant in the United States had some significance.[35]

While the effects and conduct tests have been used separately by courts to assess subject-matter jurisdiction where the facts require one test over the other, courts do not apply the conduct test with the same degree of uniformity.[36] In addition, some courts have effectively combined the two tests.[37] The Second

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alleged fraud was not substantial if someone in Europe defrauds the trust fund. *See* IIT v. Vencap, Ltd., 519 F.2d 1001, 1016–17 (2d Cir. 1975).

31. Pismenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir. 1983); Leasco Data Processing Equipment Corporation v. Maxwell, 468 F.2d 1326 (2d Cir. 1972); *see* MCG, Inc. v. Great Western Energy Corp., 896 F.2d 170, 174 (5th Cir. 1990) (holding that there must be an element of fraud or misrepresentation infused in the transaction in order for U.S. courts to gain jurisdiction over transactional conduct that occurs in the United States).

32. SODERQUIST & GABALDON, *supra* note 3, at 178.

33. *See* Choi & Guzman, *Dangerous Extraterritoriality*, *supra* note 25, at 216. Therefore, the issuer and investor can avoid the jurisdiction of a country simply by moving their transaction abroad. *Id.*

34. Urquhart, *supra* note 30, at 475.

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

36. *See* HICKS, INTERNATIONAL SECURITIES REGULATION, *supra* note 6, at 12-20 to 12-24.

37. *Id.* at 12-24. Professors Choi and Guzman have also noted:

> One difficulty with the conduct test is that of defining what actions count as "conduct" for purposes of determining territoriality. In a securities

Circuit addressed the issue of the conduct test and the effects test in combined form in *Bersch v. Drexel Firestone, Inc.*[38] In *Bersch*, Judge Friendly held that the antifraud provisions of the securities laws apply in the following instances: (1) losses from sales of securities to Americans residing in the United States even if no significant acts (or culpable failures to act) occurred in the United States; (2) sales of securities to Americans residing abroad if, but only if, acts (or culpable failures to act) of material importance in the United States contributed significantly to their losses; and (3) sales of securities to foreigners outside the United States if acts (or culpable failures to act) within the United States directly caused their losses.[39] Thus, "merely preparatory" acts are insufficient to trigger jurisdiction when the injury is to foreigners located abroad, but may be sufficient when the injury is to resident Americans.[40] The strict approach taken by the Second Circuit in *Bersch* was later adopted by the District of Columbia Circuit in *Zoelsch v. Arthur Anderson & Co.*[41]

Other circuits, including the Third, Eighth and Ninth, however, have adopted a broader standard for the assertion of jurisdiction.[42] For example, the Third Circuit modified the strict approach taken by the Second Circuit into a loose one. In *S.E.C. v. Kasser*,[43] the court held that jurisdiction exists "where at least some activity designed to further a fraudulent scheme occurs

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transaction, for example, many actions may lead up to the ultimate transaction; telephone calls may cross jurisdictional boundaries, attorneys may conduct cross-border investigations, and funds may flow internationally. A workable conduct test, therefore, must specify the amount and type of conduct that is necessary in order to trigger jurisdiction. U.S. circuit courts are split on exactly how much conduct is necessary.

Choi & Guzman, *Dangerous Extraterritoriality*, *supra* note 25, at 216–17.

38. 519 F.2d 974 (2d. Cir. 1975).

39. *Id.* at 993.

40. *Id.* at 992.

41. 824 F.2d 27, 30–32 (D.C. Cir. 1987) (holding that the D.C. Circuit Court would follow the Second Circuit's approach articulated in *Bersch*).

42. *See* Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 420 (8th Cir. 1979) (granting jurisdiction where defendants' conduct "furthered the fraudulent scheme" and was "significant with respect to the alleged violation"); Grunenthal GmbH v. Hotz, 712 F.2d 421, 424–25 (9th Cir. 1983) (adopting the Eighth Circuit's test in *Continental Grain*).

43. 548 F.2d 109 (3d Cir. 1977).

within this country."[44] Therefore, under this broader form of the conduct test, even preparatory acts such as making initial phone calls and soliciting potential foreign investors in the United States may trigger jurisdiction.[45]

II. PROBLEMS WITH EXTRATERRITORIAL SUBJECT-MATTER JURISDICTION

A. The Propriety of the Extraterritorial Application of U.S. Securities Laws

As was observed in Part I, U.S. courts have applied domestic antifraud provisions extraterritorially to transactions in other countries. While the purposes of extraterritorial application of U.S. securities laws are rarely stated clearly,[46] a conventional goal is commonly put forth in defense of the extraterritorial reach of the laws: to protect U.S. investors and to safeguard the integrity of U.S. markets.[47] Traditionally, the SEC has imposed the U.S.

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44. *Id.* at 114.

45. Choi & Guzman, *Dangerous Extraterritoriality, supra* note 25, at 217.

46. *See* RAVI C. TENNEKOON, THE LAW & REGULATION OF INTERNATIONAL FINANCE 380 (1991) (stating that it is difficult to predict when U.S. courts will apply the provisions of U.S. securities laws extraterritorially); Choi & Guzman, *Dangerous Extraterritoriality, supra* note 25, at 219. The sparse legislative history that addresses the extraterritorial reach of the federal securities laws is indicative of the fact that Congress did not foresee the expansive globalization of securities markets when it passed the securities laws. *See* Paul Hamilton, Note, *The Extraterritorial Reach of the United States Securities Laws Towards Initial Public Offerings Conducted over the Internet*, 13 ST. JOHN'S J. LEGAL COMMENT. 343, 361 (1998).

47. *See* George C. Nnona, *International Insider Trading: Reassessing the Propriety and Feasibility of the U.S. Regulatory Approach*, 27 N.C. J. INT'L L. & COM. REG. 185, 196 (2001); Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968) (stating that antifraud provisions are for "protection of investors"). Also, in Securities Act Release No. 4708, the SEC stated:

> [T]he Commission has traditionally taken the position that the registration requirements of Section 5 of the Act are primarily intended to protect American investors. Accordingly, the Commission has not taken any action for failure to register securities of United States corporations distributed abroad to foreign nationals . . . [I]t is immaterial whether the offering

securities regime so as to protect U.S. resident investors from making damaging securities decisions due to poor information.[48]

There are other policy arguments that show the strong grounds for the extraterritorial application of antifraud rules in the context of transnational fraudulent activities. First, the expansion of the jurisdictional reach of federal securities laws is needed for the deterrence of securities fraud in global markets. As securities markets are integrated, internationalization increases the potential for fraudulent activity in connection with cross-border securities transactions.[49] In order to ensure that the United States does not become a "haven for such defrauders and manipulators" of foreign securities,[50] extraterritorial application of the antifraud rules is inevitable. Second, by vigorously

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originates from within or outside the United States, whether domestic or foreign broker-dealers are involved and whether the actual mechanics of the distribution are effected within the United States, so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States.

Registration of Foreign Offerings by Domestic Issuers; Registration of Underwriters of Foreign Offerings as Broker-Dealers, Securities Act Release No. 4708, [1982 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 1,361 (July 9, 1964) [hereinafter Release No. 4708], *available at* 1964 WL 67885, at *1.

48. *See* Travis v. Anthes Imperial Ltd., 473 F.2d 515, 522 (8th Cir. 1973) (stating that the purpose of antifraud provisions is to "protect investors from deceptive schemes"); Assoc. Sec. Corp. v. S.E.C., 293 F.2d 738, 740 (10th Cir. 1961) (stating that the purpose of securities laws is to "protect investors"); Straley v. Universal Uranium & Milling Corp., 289 F.2d 370, 372 (9th Cir. 1961) (stating that Congress's intention in enacting the Securities Act was to protect innocent purchasers of securities, and that its provisions must be interpreted in light of that intent and purpose). This has been the position of most academic commentators as well. *See, e.g.*, J. William Hicks, *Protection of Individual Investors under U.S. Securities Laws: The Impact of International Regulatory Competition*, 1 IND. J. GLOBAL LEGAL STUD. 431, 432-33 (1994) (articulating reasons for continuing regulatory practices that will protect the interests of ordinary individual investors).

49. *See* Stephen J. Choi & Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market*, 65 FORDHAM L. REV. 1855, 1857 (1997) [hereinafter Choi & Guzman, *National Laws*] (noting, for example, that corporate insiders may seek to trade in countries where insider trading rules are non-existent or rarely enforced).

50. S.E.C. v. Kasser, 548 F.2d 109, 116 (3d Cir. 1977), *cert. denied*, 431 U.S. 938 (1977).

policing transnational securities fraud, other nations will be encouraged to work similarly to enforce their own securities fraud rules to prevent cross-border fraudulent activities.[51] Finally, as to the concerns for a breach of comity and conflicts with the sovereignty of other countries, commentators have noted that enforcement of the antifraud provisions does not seriously interfere with the economic or regulatory policies of a foreign country.[52] Generally, the extraterritoriality of U.S. antitrust laws often presents conflict-of-law problems because the laws expose a particular "economic doctrine" with distinct political conditions which cannot be harmonized with a foreign country's economic policies.[53] Unlike antitrust law, however, the antifraud provisions of U.S. securities laws have a minimal impact on another country's economy because no foreign nation will want to preserve the ability of its nationals to engage in fraudulent transactions.[54]

In response to the arguments favoring the expansion of the extraterritorial reach of U.S. securities laws, counter arguments have been made. First, the extraterritorial application of U.S. securities laws may give rise to a breach of international comity[55]

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51. Louise Corso, Note, *Section 10(b) and Transnational Securities Fraud: A Legislative Proposal to Establish a Standard for Extraterritorial Subject Matter Jurisdiction*, 23 GEO. WASH. J. INT'L L. & ECON. 573, 603 (1989).

52. *See* Edward A. Taylor, Note, *Expanding the Jurisdictional Basis for Transnational Securities Fraud Cases: A Minimal Conduct Approach*, 6 FORDHAM INT'L L.J. 308, 328–29 (1983) (stating that section 10(b) and rule 10b-5 "causes minimal impact on the economy of a foreign country" when applied in transnational fraud cases).

53. Corso, *supra* note 51, at 603 n.215.

54. *See* SODERQUIST & GABALDON, *supra* note 3, at 172; Corso, *supra* note 51, at 603 n.215.

55. The doctrine of comity emphasizes restraint by nations in international affairs. *See* LASSA OPPENHEIM, INTERNATIONAL LAW 34 (H. Lauterpacht ed., 8th ed. 1955). Comity, which is a fundamental element of international choice of law, is used to explain why one state would give effect to the law of another. The Supreme Court has described the principle of comity as follows:

> [The principle of comity is] the spirit of cooperation in which a domestic tribunal approaches the resolution of cases touching the laws and interests of other sovereign states. . . . "Comity," in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its

as well as cause frequent conflicts with the sovereignty of other countries.[56] For instance, when seeking to regulate investment activity abroad, the United States cannot help but interfere with the regulatory systems of other countries and compel foreign banks and other institutions to reveal information that is otherwise protected under the laws of their countries.[57] These conflicts may cause foreign countries to pass retaliatory legislation of their own.[58] Second, even if U.S. regulators are able to obtain judgments against foreign-based parties, they may run into problems enforcing such judgments outside the United States.[59] While extradition might be possible in some

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territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protections of its laws.

Societe Nationale Industrielle Aerospatiale v. U.S. Dist. Ct. for S. Dist. of Iowa, 482 U.S. 522, 543 n.27 (1987) (quoting Hilton v. Guyot, 159 U.S. 113, 163–64 (1895)).

56. "Sovereignty" can be defined as the supreme political authority of an independent state. Included in this concept is the idea that sovereignty is fundamentally the ability of a country to enforce its own laws. *See* Felice B. Friedman et al., *Coordinating National Regulatory Standards and Enforcement Mechanisms in the Global Marketplace*, at 3, *available at* http://www.law.nwu.edu/depts/contexec/cle/srgie/index_papers.htm (last visited Sept. 19, 2003). While not every exercise of extraterritorial jurisdiction will clearly conflict with the law of another nation, every assertion of U.S. jurisdiction abroad encroaches upon the sovereignty of another national government. *See* Note, *Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction*, 98 HARV. L. REV. 1310, 1310 n.1 (1985) [hereinafter Harvard Note, *Predictability and Comity*].

57. Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 914 (1998) [hereinafter Choi & Guzman, *Portable Reciprocity*]; Nnona, *supra* note 47, at 198.

58. Jill E. Fisch, *Imprudent Power: Reconsidering U.S. Regulation of Foreign Tender Offers*, 87 NW. U. L. REV. 523, 523–24 (1993). The retaliation has taken the form of statutes designed to reverse the effect of a given U.S. statute, and the legislation has been designed to protect transactions in the home country or discriminate against U.S. business or business transactions. Various rules have also aimed at preventing the intrusion of the U.S. litigation process. *See id.* at 571 n.262, n.263, and n.264.

59. Choi & Guzman, *Portable Reciprocity*, *supra* note 57, at 914.

circumstances, it is an extreme approach.[60] Third, the extraterritorial application of the antifraud rules may lead to a situation in which transactions involving U.S. investors could trigger U.S. securities rules even in cases where the issuer involved is already complying with some other country's regulatory regime. These U.S. approaches would accordingly produce undesirable results such as redundant and unnecessarily costly systems of overlapping regulation, and would thereby impede the free flow of capital across borders.[61] Fourth, since extraterritoriality will not ensure predictability and certainty in the application of securities laws, the parties involved in transnational transactions might have difficulty in discerning the jurisdictional consequences of their actions.[62] Finally, no consensus exists among other national regulators and market participants as to what are fraudulent transactions.[63] For example, while some commentators argue for the continued prohibition of insider trading, the case for prohibition is no longer overwhelming and is at best on a par with the case for deregulating it.[64] Under these circumstances, the continued

60. Extradition would likely involve litigation in foreign courts, thereby negating or at least diluting the gains that come from invoking U.S. jurisdiction. *See* Nnona, *supra* note 47, at 198.

61. Hannah L. Buxbaum, *Conflict of Economic Laws: From Sovereignty to Substance*, 42 VA. J. INT'L L. 931, 940 (2002). Many commentators recognize that an efficient international securities market requires that nations limit the reach of their laws. *See* Fisch, *supra* note 58, at 555–56.

62. *See* Corso, *supra* note 51, at 601 (noting that jurisdictional rulings are largely determined by the predilections of the particular judge hearing the case).

63. Nnona, *supra* note 47, at 214. This is most evident from the laxity with which insider trading laws have traditionally been enforced in many of these jurisdictions. *Id.*

64. For the arguments for prohibition of insider trading, *see* ROBERT C. CLARK, CORPORATE LAW 265–68 (1986); William K. S. Wang, *Trading on Material Nonpublic Information on Impersonal Stock Markets: Who Is Harmed, and Who Can Sue Whom under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217, 1321 (1981) (concluding that insider trading should be deterred and that Congress needs to step in to ensure that insider trading is eliminated); R. J. Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 MICH. L. REV. 1051, 1053–55 (1982) (noting that as information travels up the corporate hierarchy it necessarily becomes distorted. However, eliminating the corporate

expansion of U.S. jurisdiction over transnational fraudulent transactions cannot be justified in global markets.

B. The Broad and Inconsistent Reach of Extraterritorial Subject-Matter Jurisdiction

Aside from the arguments about the propriety of the extraterritorial application of securities laws, there are other problems with the current U.S. subject-matter jurisdiction over transnational securities fraud. Because many of the significant provisions of U.S. securities laws are interrelated with the term "interstate commerce," which includes commerce or communication between any foreign country and any state,[65] an argument can be made that U.S. securities laws can apply to any transaction with "one end" in the United States.[66] Thus,

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hierarchical system, and allowing insiders to trade on information as it becomes available to them, will cause the information to stall at the level at which insiders seek to capitalize on that information); D. A. Winslow & Seth C. Anderson, *From Shoeless Joe Jackson to Ivan Boesky: A Sporting Response to Law and Economics Criticism of the Regulation of Insider Trading*, 81 KY. L.J. 295, 321 (1993) (arguing that corporate insiders should not be able to make trades based upon inside information in order to ensure market purity); Mark Klock, *Mainstream Economics and the Case for Prohibiting Insider Trading*, 10 GA. ST. U. L. REV. 297, 333–35 (1994) (arguing, in part, that the economic data does not support the proposition that prohibiting insider trading leads to economic inefficiencies). For the arguments against prohibition of insider trading, see BARRY RIDER & MICHAEL ASHE, INSIDER CRIME 3–4 (1993) (noting that in insider to purchaser or seller transactions, there is no unfairness involved because neither party is being misled because they both are privy to the same information); N. ARSHADI & T.H. EYSELL, THE LAW AND FINANCE OF CORPORATE INSIDER TRADING: THEORY AND EVIDENCE 132 (1993) (commenting that "the fairness argument fails to provide an economically justifiable reason to prohibit insider trading" as open market transactions necessarily lead to either a release of the insider information or to its non-release—in which case no one is adversely affected).

65. *See* Securities Act § 2(a)(7), 15 U.S.C. § 77b(a)(7).

66. *See* SODERQUIST & GABALDON, *supra* note 3, at 171. For example, section 5 of the Securities Act requires registration of all offers of securities, by U.S. or non-U.S. companies, if the means of "interstate commerce" or the mails are used in the United States, unless an exemption is available. *See* 15 U.S.C. § 77e. Also, the principal fraud provision, such as Rule 10b-5 of the Exchange Act, is applied to all securities transactions in primary and secondary markets where

theoretically and in practice, the reach of U.S. securities laws is very far. Although the impact of the federal securities laws is primarily limited by the self-restraint of the SEC and of U.S. courts,[67] the potentially broad reach of the law has been significantly criticized and denounced as a form of legal and economic imperialism.[68]

Faced with the possibility of the broad reach of U.S. securities laws, Regulation S was adopted by the SEC to clarify the extraterritorial application of the registration provisions of the Securities Act, and has partly accomplished the goal of finding clear jurisdictional rules.[69] One of the consequences of the law prior to Regulation S was that U.S. investors found it difficult to invest in issues made by foreign issuers,[70] because these foreign issuers feared that the presence of a U.S. investor would trigger

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mails or instruments of "interstate commerce" or communication are present. *See* 17 C.F.R. § 240.10b-5.

67. *See* HAROLD S. BLOOMENTHAL, 1 SECURITIES LAW HANDBOOK 1000 (2002).

68. Donald H. J. Hermann, *Extraterritorial Criminal Jurisdiction in Securities Laws Regulation*, 16 CUMB. L. REV. 207, 228 (1986) (commenting that U.S. courts should restrain themselves from exercising jurisdiction "over parties who have a reasonable basis for their belief that their conduct is in compliance with the law of a foreign nation."); Gregory K. Matson, Note, *Restricting the Jurisdiction of American Courts Over Transnational Securities Fraud*, 79 GEO. L.J. 141, 162 (1990) (stating that U.S. courts' extraterritorial jurisdiction is unrestrained and undermines the predictability and reasonableness necessary for effective legal rules); Fisch, *supra* note 58, at 523–24 (noting that the expansive jurisdiction which U.S. courts practice over essentially foreign transactions has proven costly, as other countries have passed retaliatory legislation).

69. *See* Choi & Guzman, *Dangerous Extraterritoriality*, *supra* note 25, at 208.

70. Prior to the adoption of Regulation S, offshore transactions were governed by the Securities Act Release No. 4708 and a significant, sprawling body of no-action letters. Release 4708 attempted to limit the reach of U.S. law by exempting from the registration requirements offerings that were sold in a manner reasonably designed to preclude distribution or redistribution in the United States or to nationals of the United States. Rather than relying on this body of fact-specific no-action letters, however, most companies were compelled to seek an individualized determination of the SEC's staff that their particular offerings would not be deemed to occur in the United States. Therefore, SEC no-action letters failed to give shape to the policy. Release No. 4708, *supra* note 47.

the expansive U.S. registration requirements.[71] Another concern was the uncertainty as to when or under what circumstances securities sold in an offering to non-U.S. persons could be resold to either a person in the United States or a U.S. person outside the United States.[72] By providing guidance on which securities transactions conducted outside the United States could come under the reach of section 5, Regulation S reduced these uncertainties.[73]

Also, in adopting Regulation S, the SEC proposed a shift in jurisdictional focus away from protection of U.S. investors, wherever located, to the protection of the integrity of U.S. capital markets.[74] While this new approach still maintains the goal of protecting certain investors from being poorly informed, it reformulates the class of persons protected to consist of all investors in U.S. market, wherever their residence, but only if they purchase in U.S. markets.[75] Thus, the SEC is embracing a territorial approach to the extraterritorial application of the Securities Act.[76] No longer would the SEC view the protections of

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71. Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927, 941 (1994). In effect, Americans abroad have become pariahs in foreign markets because of the shadow of U.S. securities laws—the "ugly Americans" of their time. *See* William J. Carney, *Jurisdictional Choice in Securities Regulation*, 41 VA. J. INT'L L. 717, 721–22 (2001).

72. *See* Testy, *supra* note 71, at 941.

73. To address the broad jurisdictional reach of the registration requirements of the Securities Act, Regulation S provides both an issuer safe harbor and a resale safe harbor from the registration requirements of section 5 for certain offshore transactions. 17 C.F.R. §§ 230.901–.905.

74. *See* Offshore Offers and Sales, Securities Act Release No. 6779, [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,242, at 89,136 (June 10, 1988), *available at* 1988 WL 239804.

75. Merritt B. Fox, *The Political Economy of Statutory Reach: U.S. Disclosure Rules in a Globalizing Market for Securities*, 97 MICH. L. REV. 696, 701 (1998).

76. Securities Act Release No. 6863, [1989–1990 Transfer Binder] Fed. Sec. L. Rep (CCH) ¶ 84,524, at 80,664 (Apr. 24, 1990) [hereinafter Release No. 6863], *available at* 1990 WL 311658. While the SEC has not yet moved actual U.S. practice significantly toward exclusive reliance on this approach, the mere articulation of the capital market protection goal puts such exclusive reliance on the agenda for discussion and raises the possibility that the SEC will make this move in the future. Professors Choi and Guzman, for example, have recently endorsed just such exclusive reliance on the transaction location approach. *See*

section 5 as an American birthright, but rather as a protection provided to those participating in U.S. capital markets.[77] For registration purposes, provided that the requirements set forth in Regulation S are satisfied, the SEC now chooses to rely upon the laws in the jurisdictions in which the transactions occur rather than upon the U.S. Securities Act. Thus, the SEC has stated: "The territorial approach recognizes the primacy of the laws in which a market is located. As investors choose their markets, they choose the laws and regulations applicable in such markets."[78] By establishing a territorial approach to jurisdiction, therefore, Regulation S presents domestic issuers with the possibility of selling securities freely offshore while avoiding the registration requirements of the Securities Act.[79] Regulation S also reserves a significant role for itself in bringing about comity and cooperation among various regulatory regimes in global markets.[80]

Unlike Regulation S, however, the antifraud provisions still have a great reach in the context of transnational securities fraud. Since the SEC has not clarified the extraterritorial reach of antifraud rules, the extent of the reach of the rules has been left to courts, and courts have actively expanded their jurisdictional coverage.[81] Generally, the courts have not been uniform when considering the extraterritorial application of the antifraud provisions and the extraterritorial application of the registrations provisions. In Bersch, for example, the Second Circuit stated that "[i]t is elementary that the antifraud provisions of the federal

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Choi & Guzman, *Dangerous Extraterritoriality*, *supra* note 25, at 221–23; Choi & Guzman, *National Laws*, *supra* note 49, at 1894.

77. Edward F. Greene & Linda C. Quinn, *Building on the International Convergence of the Global Markets: A Model for Securities Law Reform*, 1281 PLI/CORP 11, 53 (2001).

78. Release No. 6863, *supra* note 76, at 80,665.

79. *See* Stephen J. Choi, *The Unfounded Fear of Regulation S: Empirical Evidence on Offshore Securities Offerings*, 50 DUKE L.J. 663, 665 (2000).

80. Testy, *supra* note 71, at 955. The SEC has stated: "Principles of comity and the reasonable expectations of participants in the global markets justify reliance on laws applicable in jurisdictions outside the United States to define requirements for transactions effected offshore." Thorn EMI plc, SEC No-Action Letter, *available at* 1992 WL 56547, at *6 (Mar. 18, 1992).

81. *See* Matson, *supra* note 68, at 141 (noting that the present body of securities fraud law is largely a product of the courts).

securities laws apply to many transactions which are neither within the registration requirements nor on organized American markets."[82] In fact, the reach of U.S. securities laws is interpreted most narrowly when the need for registration under those laws is at issue, and most broadly when the question presented involves liability for violation of the antifraud provisions of the laws.[83] This approach is quite sensible because no foreign nation will have a strong interest in preserving the ability of its nationals to engage in fraud,[84] and countries should be free to adopt national rules that they feel are most advantageous to them.[85]

The problem here is that the antifraud provisions are applied by the courts on an ad hoc judicial decision-making basis, not by clear rules that the legislative or executive branches have formulated.[86] Generally, if Congress intends to extend the

82. Bersch v. Drexel Firestone Inc., 519 F.2d 974, 986 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975). *See also* Consol. Gold Fields PLC v. Minorco, S.A., 871 F.2d 252, 262 (2d Cir.) *modified*, 890 F.2d 569 (2d Cir.), *cert. dismissed*, 492 U.S. 939 (1989) (noting that "the antifraud provisions of American securities laws have broader extraterritorial reach than American filing requirements."); IIT v. Cornfield, 619 F.2d 909, 921 (2d Cir. 1980) (allowing for jurisdiction because the antifraud sections of the securities laws were implicated and not the registration provisions); Charles J. Johnson Jr., *Application of the Federal Securities Laws to International Securities Transactions*, 45 ALB. L. REV. 890, 925–26 (1981) (stating that the courts and the SEC are more likely to exercise jurisdiction over cases implicating the antifraud provisions than they are with cases that involve "more technical provisions").

83. *See* SODERQUIST & GABALDON, *supra* note 3, at 172. The Second Circuit stated that "the antifraud provisions of American securities law have broader extraterritorial reach than American filing requirements." *Consol. Gold Fields PLC*, 871 F.2d at 262.

84. *See* SODERQUIST & GABALDON, *supra* note 3, at 172. Fraudulent practices discourage potential investors and issuers of new stocks or bonds, which has the effect of decreasing the liquidity of the affected stock exchange. Gunnar Schuster, *Extraterritoriality of Securities Laws: An Economic Analysis of Jurisdictional Conflicts*, 26 LAW & POL'Y INT'L BUS. 165, 172 (1994).

85. Choi & Guzman, *National Laws*, *supra* note 49, at 1894. Sovereign states are able to choose to have their laws apply extraterritorially. Andrew T. Guzman, *Choice of Law: New Foundations*, 90 GEO. L.J. 883, 926 (2002).

86. Testy, *supra* note 71, at 958. If the benefit to a country applying its law extraterritorially is substantial, the legislature can apply the law to conduct that takes place abroad, as long as it defines the precise reach of the statute. Guzman, *supra* note 85, at 926.

jurisdiction of U.S. courts beyond domestic borders, the language of a statute must provide some indicia of that intent.[87] Also, federal jurisdiction over securities claims is predicated upon specific congressional grants of jurisdiction.[88] However, since the Exchange Act provides no express guidance for the extraterritorial application of section 10(b) to foreign transactions, courts have to ascertain the congressional intent underlying the antifraud provisions of the Act.[89] Unfortunately, legislative history deals almost exclusively with domestic markets and the protection of investors in those markets, not international markets.[90] The Exchange Act does not explicitly address possible civil and criminal penalties for individuals who act within the United States but who affect foreign securities markets, or for individuals who act outside the United States but who affect U.S. securities markets.[91] Thus, each court has had to struggle with the difficult issue of the extraterritoriality of securities laws without congressional guidance, expanding or limiting its jurisdictional coverage according to its individual whims, instead of questioning the indeterminate and unrestrained reach of the tests.[92] This lack of clear guidance has resulted not only in the

87. *See* E.E.O.C. v. Arabian Am. Oil Co., 499 U.S. 244, 250–51 (1991) (holding that the extraterritorial reach of Congressional statutes should be inferred from boilerplate language within the statute).

88. *See* 15 U.S.C. §§ 77v, 78aa (granting U.S. district courts and state courts jurisdiction over offenses and suits brought in violation of the '33 Act and the '34 Act, respectively).

89. *See* Matson, *supra* note 68, at 144–45.

90. *See* Des Brisay v. Goldfield Corp., 549 F.2d 133, 135 (9th Cir. 1977) (quoting 15 U.S.C. § 78b and concluding that Congress' intent in enacting the securities laws was "to protect the integrity of domestic securities markets in a particular stock"). Since Congress in 1929 "could not have foreseen the thoroughly interconnected global marketplace" that the Exchange Act would come to regulate, "the legislative silence on the issue of the extraterritorial reach of the Act is hardly surprising." Katherine J. Fick, Comment, *Such Stuff as Laws Are Made on: Interpreting the Exchange Act to Reach Transnational Fraud*, 2001 U. CHI. LEGAL F. 441, 447–48 (2001).

91. Matson, *supra* note 68, at 141–42.

92. *Id.* at 142, 161–62. The U.S. Supreme Court also has not granted certiorari in any of the major cases addressing the determination of extraterritorial subject matter jurisdiction. *See, e.g.*, United States v. Cook, 573 F.2d 281 (5th Cir. 1978), *cert. denied*, 439 U.S. 836 (1978); S.E.C. v. Kasser, 548

tendency of U.S. courts to give the antifraud rules too broad a scope, but also in inconsistent standards for the determination of subject-matter jurisdiction. As a result, parties involved in transnational transactions cannot reasonably predict the jurisdictional consequences of their actions.[93] Although it can hardly be doubted that the United States is eminently qualified to assume a leadership role in international securities regulation, the decisions of U.S. courts could catalyze international discord and injury to U.S. markets.[94]

Furthermore, along with the excessive and inconsistent scope of extraterritorial application, the current effects and conduct tests have their own problems.[95] For example, the main problem with the conduct test in the context of global markets is defining what actions count as "conduct" for the purposes of determining territoriality.[96] U.S. courts are divided on the nature of the conduct that must occur in the United States to sustain the assumption of jurisdiction.[97] Also, when a fraudulent securities transaction is perpetrated extraterritorially through the Internet, the conduct test often cannot be met because no acts directly causing the loss have been committed within the United States.[98] One problem with the effects test is that, given the state of

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F.2d 109 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977); Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975); Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *modified on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969).

93. Corso, *supra* note 51, at 576.

94. HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW, § 27:24; MICHAEL J. KAUFMAN, SECURITIES LITIGATION: DAMAGES § 27:2 (2002).

95. *See* Corso, *supra* note 51, at 576 (stating that Congress needs to pass legislation that will bring stability and predictability to the practice of applying U.S. securities' laws extraterritorially).

96. Choi & Guzman, *Portable Reciprocity*, *supra* note 57, at 913.

97. *See id.* There is sharp disagreement among the circuit courts about the precise degree of domestic conduct to allow a federal court to exercise jurisdiction. Calhoun, *supra* note 10, at 681. *See also* HICKS, INTERNATIONAL SECURITIES REGULATION, *supra* note 6, at 12-21 to 12-22.

98. *See* Michael A. Collora & David M. Osborne, *Extraterritorial Jurisdiction in Cyberspace*, *at* http://dwyercollora.com/articles/mc_extra.asp (last visited Sept. 19, 2003).

information technology today, the potential reach of the effects test could be too broad.[99] Also, since it is unclear to what extent the effects test is applicable, participants involved in transnational transactions do not know what constitutes a substantial effect or what behavior abroad might affect U.S. securities.[100]

III. THE CURRENT PROCEDURAL CONTROLS OF SUBJECT-MATTER JURISDICTION

The risk of being sued through the extraterritorial application of U.S. securities laws is a serious one because of the burdens it often imposes on foreign defendants.[101] In response to the extraterritorial reach of U.S. jurisdiction, foreign parties may raise certain kinds of judicial and private procedural defense.[102] However, while these kinds of defense may control U.S. courts' discretionary and extensive jurisdiction to some degree, they can also be obstacles to the effective regulation of transnational securities fraud.

A. Forum Selection and Choice of Law Provisions

U.S. courts may have difficulty in gaining subject-matter jurisdiction over transnational securities fraud when private

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99. One commentator argues that there is nothing in the effect test used by U.S. courts to prevent its application, proposing a situation as follows:

> An American citizen can visit a free internet website, run from a server stationed in Egypt, and effect stock transactions which ultimately prove detrimental to his interests. Although he visited the web site without any invitation or prior notice to the owner (the website being open to all comers), the U.S. courts can sustain their jurisdiction under the effect test by arguing that the harm to the citizen is a harm to U.S. interests.

See Nnona, *supra* note 47, at 197–98.

100. John D. Kelly, Note, *Let There Be Fraud (Abroad): A Proposal for a New U.S. Jurisprudence with Regard to the Extraterritorial Application of the Anti-Fraud Provisions of the 1933 and 1934 Securities Acts*, 28 LAW & POL'Y INT'L BUS. 477, 493 (1997).

101. Robert S. De Leon, *Some Procedural Defenses for Foreign Defendants in American Securities Litigation*, 26 J. CORP. L. 717, 718 (2001).

102. These procedural defenses include forum selection, choice of law provisions, *forum non conveniens*, and international comity. *Id.* at 718, 731.

parties have attempted to settle jurisdictional issues and choice-of-law matters by pre-dispute contract provisions.[103] "Cases of this type raise the issue of private ordering"—a forum selection or arbitration clause in a contract in which the plaintiff identifies a forum outside the United States as the place for resolving any dispute between the parties.[104]

Since section 14 of the Securities Act and section 29 of the Exchange Act expressly declare "void" any agreement to waive the substantive protections of their respective statutes, the validity of choice-of-law agreements between U.S. investors and foreign issuers is affected by these provisions.[105] Also, due to the U.S. securities laws' character as public law, courts tend to apply their own national law, rather than the law of a foreign nation, so as to protect public interests that go beyond those of the litigants.[106] However, many courts have found an exception to these positions by enforcing pre-dispute agreements where there are significant foreign elements in a transaction that is subject to the Securities Act or the Exchange Act.[107] In *Scherk v. Alberto-*

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103. *See* HICKS, INTERNATIONAL SECURITIES REGULATION, *supra* note 6, at 12-39.

104. *See id.* at 12-40.

105. *See* Securities Act § 14, 15 U.S.C. § 77n; Exchange Act § 29, 15 U.S.C. § 78cc.

106. *See* COX, SECURITIES REGULATION, *supra* note 5, at 1236–37. In regard to the securities regulations' character as public law, see Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence*, 20 CARDOZO L. REV. 227, 245–63 (1998). After analyzing the relation between corporate law and securities law, Licht concludes that "the wide penumbra in each field should not obstruct the observation that these fields have a solid, determinable core consisting of private and public law, respectively." *Id.* at 263.

107. *See* HICKS, INTERNATIONAL SECURITIES REGULATION, *supra* note 6, at 12-40. *See also, e.g.*, Stamm v. Barclays Bank, 153 F.3d 30, 33 (2d Cir. 1998) (upholding the validity of a choice clause, which mandated that any dispute litigated in England was to be governed by English law); Lipcon v. Underwriters At Lloyd's, London, 148 F.3d 1285, 1296–97 (11th Cir. 1998) (noting that the court "will declare unenforceable choice clauses only when the remedies available in the chosen forum are so inadequate that enforcement would be fundamentally unfair."); Richards v. Lloyd's of London, 135 F.3d 1289, 1293 (9th Cir. 1998) (upholding a choice clause and noting that failure to recognize choice clause in favor of U.S. jurisdiction based on the securities acts would lead to an unbounded reach of the U.S. securities laws); AVC Nederland B.V. v. Atrium

Culver Co., the Supreme Court enforced an arbitration agreement in a securities case arising out of an international contract.[108] The Court stated that contractual provisions specifying the law to be applied to resolve any future disputes are an "indispensable precondition to achievement of the orderliness and predictability essential to international business transactions."[109] Put differently, considerations that go against applying foreign securities laws chosen by the parties to govern their disputes rather than U.S. laws are different in an international context.[110] Thus, in *Bonny v. Society of Lloyd's*,[111] the Court stated:

> We conclude that the available remedies and potential damage recoveries suffice to deter deception of American investors and to induce the disclosure of material information to investors. It is true that enforcement of the Lloyd's clauses will deprive plaintiffs of their specific rights under § 12(1) and § 12(2) of the Securities Act of 1933. However, the fact that an international transaction may be subject to laws and remedies different or less favorable than those of the United States is not alone a valid basis to deny enforcement of forum selection, arbitration and choice of law clauses.... Given the international nature of the transactions involved here, and the availability of remedies under British law that do not offend the policies behind the securities laws, the parties' forum selection and choice of law provisions contained in the agreements should be given effect....[112]

Inv. P'ship, 740 F.2d 148, 160 (2d Cir. 1984) (upholding a motion to dismiss which was predicated upon the fact that the parties agreed that disputes would be decided by a Dutch court implementing Dutch law); Scherk v. Alberto-Culver Co., 417 U.S. 506, 519-20 (1974) (upholding a pre-dispute forum-selecting arbitration clause partly on grounds that trade and commerce in world markets requires U.S. courts to refrain from exercising their jurisdiction in certain instances); The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 15 (1972) (stating that "in the light of present-day commercial realities and expanding international trade we conclude that the forum clause should control absent a strong showing that it should be set aside.").

108. 417 U.S. 506 (1974).

109. *Id.* at 516.

110. De Leon, *supra* note 101, at 728.

111. 3 F.3d 156 (7th Cir. 1993).

112. *Id.* at 162.

When cases involve sophisticated business professionals who are engaged in activities that have only an attenuated connection to the United States, the choice-of-law and choice-of-forum clauses would be given effect.[113] However, when identifying a significant "public" interest in the outcome of these forum selection cases, the courts may find that these types of private decisions are "contrary to the policies of the federal securities laws and, therefore, refuse to enforce them."[114] For example, if an inexperienced private U.S. investor is adversely affected by pre-dispute agreements, U.S. courts are more likely to disregard any choice-of-law clause by applying the public policy reservation embodied in U.S. law, and use the traditional effects and conduct tests for U.S. subject-matter jurisdiction over securities transactions.[115]

B. Forum Non Conveniens

In the context of disputes over transnational securities fraud, the doctrine of *forum non conveniens* could offer foreign defendants a procedural device to avoid U.S. jurisdiction.[116] The doctrine of *forum non conveniens* empowers a court vested with jurisdiction to decline to exercise that jurisdiction over a particular dispute when the chosen forum is so inconvenient that it would be unfair to conduct the litigation in that place.[117] Chief Judge Breyer stated:

> To insist that American courts hear cases where the balance of convenience and the interests of justice require that they be brought elsewhere will simply encourage an international forum-shopping that would increase the likelihood that decisions made in one country will cause (through lack of

113. Schuster, *supra* note 84, at 170.

114. HICKS, INTERNATIONAL SECURITIES REGULATION, *supra* note 6, at 12-40.

115. Schuster, *supra* note 84, at 170.

116. *See* HICKS, INTERNATIONAL SECURITIES REGULATION, *supra* note 6, at 12-39.

117. Howe v. Goldcorp Invs., Ltd., 946 F.2d 944, 947 (1st Cir. 1991); Gulf Oil Corp. v. Gilbert, 330 U.S. 501, 507 (1947) ("The principle of forum non conveniens is simply that a court may resist imposition upon its jurisdiction even when jurisdiction is authorized by the letter of a general venue statute.").

> awareness or understanding) adverse effects in another, eroding uniformity or thwarting the aims of law and policy.[118]

Given such a view, if an adequate alternative forum for action is available in another country, the action may be dismissed without prejudice based on a balancing of several private and public factors concerning each forum.[119] However, because of these numerous factors for deciding the application of the doctrine and the discretionary nature of the doctrine itself, it is very difficult to predict the application of *forum non conveniens*. While there is some case law that has dismissed securities actions against foreign issuers on pure *forum non conveniens* grounds,[120] courts are often reluctant to dismiss such actions on these grounds.[121] By directing litigation, in which American interests are low, into the courts of the country with the greatest interest, *forum non conveniens* often reduces the court's workload and protects the American taxpayers' pocketbooks.[122]

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118. Howe, 946 F.2d at 950.

119. The Supreme Court set forth the following factors. The private factors include: (1) "relative ease of access to sources of proof;" (2) "availability of compulsory process for attendance of unwilling, and the costs of obtaining attendance of willing, witnesses;" and (3) all of the issues that make trial of a case "easy, expeditious and inexpensive." *Gulf Oil Corp.*, 330 U.S. at 508. The public factors include: (1) "the administrative difficulties flowing from court congestion;" (2) "local interest in having localized controversies decided at home;" (3) "the interest in having the trial of a diversity case in a forum that is at home with the law that must govern the action;" and (4) "the unfairness of burdening citizens in an unrelated forum with jury duty." Piper Aircraft Co. v. Reyno, 454 U.S. 235, 241 n.6 (1981).

120. *See, e.g.*, Alfadda v. Fenn, 159 F.3d 41, 45–49 (2d Cir. 1998) (holding that the district court had not abused its discretion when it dismissed the complaint on forum non conveniens grounds).

121. *See, e.g.*, DiRienzo v. Philip Servs. Corp., 232 F.3d 49, 67 (2d Cir. 2000) (stating that courts " must defer to plaintiff's choice because unless the balance strongly favors defendant, plaintiffs' choice of forum 'should rarely be disturbed.'"); Allstate Life Ins. v. Linter Group, Ltd., 994 F.2d 996, 1001 (2d Cir. 1993) (noting that absent certain public and private interest factors, there is a presumption "in favor of plaintiff's choice of forum."); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1344 (2d Cir. 1972) (stating that "extreme circumstances" should exist before a court dismisses a claim on forum non conveniens grounds).

122. De Leon, *supra* note 101, at 730.

C. International Comity

Comity can be referred to as the deference that the courts of the United States will pay to another nation's laws or judgments.[123] One court stated that "[t]he decision of a foreign tribunal is to be accorded comity where that court properly exercised jurisdiction and where its ruling does not violate the public policies of the forum state."[124] Another court defined the doctrine of comity as "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws."[125]

A case may be dismissed on grounds of international comity, at the discretion of the court, when "it is shown that the foreign court is a court of competent jurisdiction, and that the laws and public policy of the forum state and the rights of its residents will not be violated."[126] Although the doctrine of comity and the doctrine of *forum non conveniens* are often considered concurrently because both doctrines share similar principles, comity retains its vitality as an independent doctrine that may warrant dismissal of an action concerning international securities fraud in at least a narrow class of cases.[127]

D. Jurisdiction and Venue

"U.S. securities laws can be applied to persons and securities transactions only where the regulator, the arbitrator, or the court . . . has jurisdiction over the subject matter and . . . the

123. *See* Bruce D. Angiolillo, *The Power of the Federal Courts to Hear Securities Fraud Claims Arising from International Transactions*, 1136 PLI/Corp 469, 502 (1999).

124. Pogostin v. Pato Consol. Gold Dredging, Inc., No. 79 Civ. 5433 (S.D.N.Y. March 23, 1981), *available at* 1982 WL 1613, at *3 (citations omitted).

125. Allstate Life Ins. Co. v. Linter Group Ltd., 994 F.2d 996, 998-99 (2d Cir. 1993) (quoting Hilton v. Guyton, 159 U.S. 113, 164 (1895)).

126. *Id.* at 999 (citations omitted).

127. Angiolillo, *supra* note 123, at 504.

person."[128] Unlike the scope of subject-matter jurisdiction for a non-judicial forum, the scope of subject-matter jurisdiction for U.S. courts over transnational fraudulent transactions is not well established.[129] Also, even if a particular forum has subject-matter jurisdiction over a dispute, it must have jurisdiction over the person alleged to have violated an antifraud rule.[130] For personal jurisdiction, each defendant must have "minimum contacts" with the United States.[131] Minimum contacts exist when defendant is (1) doing business in the United States; (2) doing an act in the United States; or (3) causing an effect in the United States by an act done elsewhere.[132] The most successful and frequently used basis for asserting personal jurisdiction in securities actions is a situation in which a defendant has caused injury in the United States as a direct or foreseeable result of wrongdoing alleged to have occurred outside the United States and has purposefully availed itself of U.S. commerce.[133] "It is not sufficient for a plaintiff in a transnational lawsuit to prove that the foreign defendant is personally present at trial or that the defendant was properly served with a legal complaint."[134] As to the venue of the

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128. HICKS, INTERNATIONAL SECURITIES REGULATION, *supra* note 6, at 12-6.

129. The scope of subject matter jurisdiction for a non-judicial forum is well established because it rests on a contractual basis which all parties to a dispute recognize as binding. *Id.* at 12-7.

130. *Id.* at 12-3.

131. De Leon, *supra* note 101, at 719.

132. *See* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1340 (2d Cir. 1972) (applying the Restatement (Second) of Conflict Laws' § 27 factors for a court to balance when attempting to exercise jurisdiction over an absent individual).

133. De Leon, *supra* note 101, at 721; *see also, e.g.*, McNamara v. Bre-X Minerals Ltd., 46 F. Supp. 2d 628, 634–35 (E.D. Tex. 1999) (holding that the court had personal jurisdiction over non-resident defendants because they knew or should have known that their actions would give U.S. courts jurisdiction over them); Edias Software Int'l, LLC v. Basis Int'l Ltd., 947 F. Supp. 413, 420 (D. Ariz. 1996) (holding that "when intentional actions are expressly aimed at the forum state and cause foreseeable harm to the defendant [sic], jurisdiction in the forum state exists."); Leonard A. Feinberg, Inc. v. Cent. Asia Capital Corp., 936 F. Supp. 250, 256–57 (E.D. Pa. 1996) (noting that when defendants purposefully directs harmful actions at a forum "the necessary minimum contacts" exist for a court to exercise personal jurisdiction over that defendant).

134. HICKS, INTERNATIONAL SECURITIES REGULATION, *supra* note 6, at 12-4.

action, section 27 of the Exchange Act provides that a proper venue for any securities litigation may be "in any [federal judicial] district where any act or transaction constituting the alleged violation occurred . . . or where the defendant is found or [resides] or transacts business."[135] In addition to the provisions of section 27, section 1391(d) of the Judicial Code states that an alien may be sued in any district.[136] Thus, these relevant provisions make venue proper wherever personal jurisdiction exists.[137]

IV. RECOMMENDATIONS FOR REFORM OF EXTRATERRITORIAL SUBJECT-MATTER JURISDICTION

It is difficult to determine whether extraterritorial application of securities laws is desirable in the context of international securities transactions, because the arguments for both expanding and restricting extraterritoriality have a certain validity.[138] Considering the problems with the current view of the U.S. jurisdictional reach, however, there is no strong basis for maintaining the present scope of the antifraud provisions in global markets. The aggressive and inconsistent judicial response to transnational securities fraud has not ensured predictability in the application of antifraud rules, for that response has made it hard for the parties involved in transnational transactions to discern the jurisdictional consequences of their actions.[139] Also, the current U.S. approach to the extraterritoriality of antifraud rules seems to have failed to adapt to the needs of international commerce and international harmony.[140] Even though fraud is widely recognized as a tort, most industrialized countries have

135. 15 U.S.C. § 78aa.

136. *See* 28 U.S.C. § 1391(d).

137. De Leon, *supra* note 101, at 725.

138. Corso, *supra* note 51, at 604.

139. *See id.* at 601-04 (commenting that an expansive application of the securities laws jurisdictional reach will not result in predictability and clarity but will have the opposite result when trying to determine when U.S. courts will exercise jurisdiction, which will cause foreign parties to avoid even minimal contacts with the United States).

140. Norimasa Murano, *Extraterritorial Application of the Antifraud Provisions of the Securities Exchange Act of 1934*, 2 INT'L TAX & BUS. LAW. 298, 321 (1984).

significant differences in their views of what constitutes fraudulent transactions and market practices.[141] Moreover, attempts to unilaterally police ever greater portions of international markets would destroy the good will toward cooperation as well as respect for the rules, customs, and practices of foreign markets, which are essential to the growth of an international legal and financial community.[142] Since the current procedural controls of subject-matter jurisdiction have their own limits, it is more desirable to seek reforms that afford U.S. regulators the opportunity to control transnational fraud in some circumstances, but not in others.[143]

In order to avoid the problems related to the unclear scope and the excessively expansive reach of the antifraud provisions, it is necessary for regulators to find clear jurisdictional rules that strictly limit the extraterritoriality of antifraud rules and provide unambiguous means for both investors and issuers to decline to be a part of the U.S. regulatory system.[144] The exercise of subject-matter jurisdiction over transnational transactions involves significant policy implications, including international political harmony and market efficiency.[145] In determining jurisdictional coverage, for example, the legitimate concerns of other nations should be recognized so that the United States does not interfere with the ability of foreign nations to prescribe rules of conduct for its citizens.[146] Also, since the predictability and reasonableness are necessary for effective laws, especially in an international setting, the extraterritorial application of the antifraud provisions should be shaped to place foreign parties on notice as to when they face liability under U.S. laws.[147] In addition, because U.S. interests alone should not determine the proper limits on extraterritorial jurisdiction, U.S. policy must reflect the interests

141. *See id.* at 317.
142. Matson, *supra* note 68, at 166.
143. Nnona, *supra* note 47, at 245.
144. Choi & Guzman, *Dangerous Extraterritoriality*, *supra* note 25, at 208.
145. Testy, *supra* note 71, at 958.
146. Matson, *supra* note 68, at 166.
147. *Id.* at 162, 168. Predictability not only ensures basic fairness to all defendants, but also prevents retaliation by other nations. *See* Harvard Note, *Predictability and Comity*, *supra* note 56, at 1321.

of all nations involved.[148] Therefore, when applying judicial tests to cross-border transactions, courts have to balance the political sensitivities and market efficiency concerns inherent in questions of the extraterritorial application of antifraud rules.[149] However, courts are not well suited to analyze these delicate issues and balance the interests of a foreign sovereign against the interests of the United States.[150] Institutionally, courts are poorly equipped to handle concerns about U.S. policy raised by extraterritoriality because (1) courts are becoming overburdened with more frequent and complex cases as to the scope of antifraud rules[151]; (2) courts have limited access to the complex market information that is involved in transnational securities cases[152]; and (3) courts have a judicial overriding bias toward investor protection.[153] Due to these institutional constraints, courts are ill-suited to the task of

148. *See* Matson, *supra* note 68, at 163; Harvard Note, *Predictability and Comity*, *supra* note 56, at 1320. As Schuster also points out:

> There is a set of rules to protect property ownership and to provide for the definition of property rights, and these rules are essential for the protection of sovereign interests. Thus, they have been incorporated into public international law. These rules operate according to the following principles: (1) the illegality of the use of force; (2) the principle of non-intervention; (3) the principle of the equality of states; (4) the principle of the peaceful settlement of disputes; and (5) the obligation to observe a minimum standard for human rights. These rules are enshrined in Article 2 of the United Nations Charter, in international human rights covenants, and in customary public international law.

Schuster, *supra* note 84, at 177–78.

149. *See* Testy, *supra* note 71, at 929.

150. *See* Fisch, *supra* note 58, at 566; Reins. Co. of Am. v. Administratia Asigurarilor de Stat. (Admin. of State Ins.) 902 F.2d 1275, 1283 (7th Cir. 1990) (Easterbrook, J., concurring) (describing the balancing test as "an approach that calls on the district judge to throw a heap of factors on a table and then slice and dice to taste"); *In re* Uranium Antitrust Litig., 480 F.Supp. 1138, 1148 (N.D. Ill. 1979) ("Aside from the fact that the judiciary has little expertise . . . to evaluate the economic and social policies of a foreign country, . . . [i]t is simply impossible to judicially 'balance' these totally contradictory and mutually negating actions.").

151. Testy, *supra* note 71, at 928–29.

152. *See id.* at 958.

153. *See id.*

resolving the overlapping legal, economic, and political concerns involved in the application of antifraud rules.[154]

This Article accordingly affirms the proposition that Congress should grapple with the issue of extraterritoriality and provide federal courts with clear guidance as to the extraterritorial reach of the antifraud provisions.[155] In other words, the inherent difficulty of requiring courts to analyze extraterritoriality on a case-by-case basis, to consider the relevant policy implications, and to weigh the interests of the United States and a foreign sovereign requires a legislative solution.[156] Also, in light of the increase in transnational activities, it is necessary for Congress to establish a jurisdictional framework that adds stability to trading in global securities markets.[157]

As for finding a clear scope for extraterritorial subject-matter jurisdiction, it should start with the goals of the Securities Act and the Exchange Act—namely, the protection of American investors and the integrity of U.S. securities markets. That is to say, the application of the antifraud provisions of U.S. securities laws is essential to protect domestic markets and investors. If the standards that Congress provides place excessive limits on or deny existing benefits to future plaintiffs, there will be a significant danger of undermining the goals of U.S. securities laws.[158]

On the other hand, the author of this Article believes that along with the need for a clear statement of the scope of subject-matter jurisdiction, a more restrained approach for extraterritoriality is needed in an internationalized securities marketplace. Too broad a scope for subject-matter jurisdiction

154. *See id.*; *see also, e.g.*, Laker Airways Ltd. v. Sabena, 731 F.2d 909, 949 (D.C. Cir. 1984) (stating that courts are not qualified to evaluate "purely political factors"); In re *Uranium Antitrust Litig.*, 480 F.Supp. at 1148 (stating that courts do not have the expertise to evaluate the economic policies of a foreign country); Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 423 (1963) (discussing the Act of State doctrine whereby the judicial branch declined to pass on the validity of acts taken by foreign governments).

155. Corso, *supra* note 51, at 576; Testy, *supra* note 71, at 929.

156. Fisch, *supra* note 58, at 573–75.

157. Corso, *supra* note 51, at 576.

158. KAUFMAN, *supra* note 94, § 27:9.

would do harm to the establishment of the effective and cooperative scheme of transnational securities regulation that most countries seek. Thus, in determining the guiding principles and rules for applying antifraud rules extraterritorially, Congress should take the position that the protection of U.S. investors and U.S. markets must be balanced by various policy concerns. This balance can be achieved by limiting the exercise of extraterritorial jurisdiction by a U.S. court to situations in which the interests of U.S. investors and U.S. markets are sufficiently involved in foreign transactions and in which activities abroad truly impact U.S. markets.[159] Put differently, Congress should reconcile the goals of equity and efficiency with a healthy respect for the rules, customs, and practices of foreign markets.[160]

Furthermore, when providing clear standards for the scope of extraterritoriality, Congress should not ignore the merits of the current effects and conduct tests utilized by federal courts. Although the current scope of extraterritorial subject-matter jurisdiction for federal courts has not been settled, the effects and conduct tests of the courts give us practical approaches to decide a reasonable scope for extraterritoriality. Thus, as regards the scope of extraterritorial subject-matter jurisdiction, this Article recommends modified and narrowed effects and conduct tests as follows.

First, when a foreign transaction is not intended to produce effects in the United States but actually does produce certain effects in the United States, federal courts would have extraterritorial subject-matter jurisdiction over the transaction, provided that the defendants have engaged in some action or conduct within the Unites States. Since a certain investment-related action somewhere else in the world could have an adverse effect on other countries whose securities markets are technologically linked, a lot of countries would justly try to exercise their own subject-matter jurisdiction over the action. Thus, in order to limit broad and overlapping subject-matter

159. Choi & Guzman, *National Laws*, *supra* note 49, at 1894.

160. Testy, *supra* note 71, at 955, 958; Cox, *Regulatory Duopoly*, *supra* note 4, at 1200 (stating that "[i]t is fundamental to the law of nations that each country's respective laws apply only to transactions within its borders.").

jurisdiction, jurisdiction should be exercised by a country where some action has occurred and adverse effects were felt. However, federal courts would have extraterritorial subject-matter jurisdiction over a foreign transaction that was intended to produce and did in fact produce substantial effects in the United States alone, regardless of whether an action or a certain kind of conduct actually occurred in the United States.

Second, extraterritorial subject-matter jurisdiction based on the conduct test alone should not come into play as regards actions initiated by private parties. Under the current conduct test, a significant act or a certain kind of conduct in the United States will lead to the application of the antifraud rules, even if only foreign investors or markets are harmed. Foreign purchasers of securities in a foreign transaction thus far have initiated actions in U.S. courts based on the current conduct test. However, it is no longer justifiable for U.S. courts to exercise subject-matter jurisdiction extraterritorially in cases in which no U.S. investors or U.S. markets suffer losses. The person who has actually suffered losses and who resides abroad could bring a suit in the courts of the country where fraudulent transactions occurred, or in the courts of his home country. Since one of the main purposes of the antifraud rules is to compensate investors harmed by deceptive foreign transactions, U.S. courts would not have to devote precious resources to foreign parties at the expense of comity when there are no U.S. interests at stake.

There would be, of course, exceptional cases. For instance, while there may be no U.S. interests involved in foreign transactions and no effects felt in the United States, there may be concerns that the United States is being used as a haven for the export of fraudulent security devices. In that case, federal courts would have subject-matter jurisdiction over the fraud claims based on the conduct test alone. This exception to subject-matter jurisdiction, however, should be allowed only in antifraud actions brought by the SEC because such actions should be restricted to determining policy issues; they should not be open to private plaintiffs who could initiate frivolous suits. In this case, Congress would determine by legislation when exercising subject-matter jurisdiction is justified. For example, a statute could provide that U.S. courts would have subject-matter jurisdiction when a

defendant committed all elements of a violation within the United States, or when material conduct within the United States directly caused the loss—in this case, the statute could define what "material conduct" is.

Third, federal courts would have extraterritorial subject-matter jurisdiction over fraud claims including sales of securities to either a U.S. citizen residing in the United States or a foreigner residing in the United States. If the antifraud provisions of federal securities laws were applied in an instance where securities were sold to a U.S. citizen residing abroad or a foreigner residing outside the United States, the scope of extraterritorial subject-matter jurisdiction would be too broad, for U.S. investors or foreign investors who made securities transactions outside the United States would not expect the protection of U.S. securities laws. This proposal corresponds to the recent approach of the SEC, which placed more emphasis on the protection of the integrity of U.S. markets than on the protection of U.S. investors. Investors who transact abroad would expect protection from the laws of the country in which the transaction took place.

Finally, when private parties want to settle fraudulent matters by pre-dispute contract provisions, courts should withhold the exercise of this subject-matter jurisdiction. By doing this, the extraterritorial application of the antifraud rules could be minimized, and parties involved in cross-border securities transactions could predict the jurisdictional consequences of their actions. In other words, federal courts should take into account the costs and benefits of exercising their jurisdiction, withholding it in circumstances in which U.S. interests are weak and the incentive for restraint is powerful.

Even if Congress provides the judiciary with clear standards as to the extraterritorial reach of the antifraud provisions, it is the courts that finally interpret and apply the rules to the real transnational disputes. According to the above proposals, for example, even if Congress defines the term "substantial effects" or "material conduct," the content of these terms would take concrete shape only through application by the courts. Also, there are several factors U.S. courts may consider in the matter of the application of antifraud rules, and the principles of

international law could be a device to aid them in the resolution of interpretative questions since cross-border fraud involves international elements.[161] In short, in order to operate in harmony with other nations in international markets, U.S. courts must tolerate the different standards of other sovereign countries and be sensitive to the potential negative effects of excessive expansion of subject-matter jurisdiction.[162]

CONCLUSION

In regard to the regulation of transnational securities fraud, U.S. courts have applied two major tests in determining the reach of extraterritorial subject-matter jurisdiction: the effects test and the conduct test.[163] The effects test determines whether subject-matter jurisdiction exists based on the effects of transactions on U.S. investors or securities markets, regardless of where the transaction actually took place.[164] The conduct test determines whether U.S. securities laws enable courts to claim subject-matter jurisdiction based upon the situs of the conduct.[165] The conduct test thus focuses on the nature of the conduct within the United States as it relates to alleged fraud under the federal securities laws.[166] Where fraud has usually been alleged, federal courts have been quite generous towards the United States in their interpretation of U.S. securities laws. While the SEC has taken a number of steps to define the scope of disclosure requirements with respect to foreign companies and to conduct that occurs primarily abroad, the reach of the antifraud provisions remains a matter for the courts to resolve.[167]

The current scope of extraterritorial federal jurisdiction, however, is inconsistent and excessively expansive, which has resulted in conflicts with other countries as well as the potential for redundant and unnecessarily costly systems of overlapping

161. KAUFMAN, *supra* note 94, § 27:9.
162. Corso, *supra* note 51, at 600; Murano, *supra* note 140, at 321.
163. *See supra* text accompanying notes 26–44.
164. *See supra* text accompanying notes 28–30.
165. *See supra* text accompanying notes 31–35.
166. *See id.*
167. *See supra* text accompanying notes 21–25.

regulation. Also, given the possibility of being sued as a result of the extraterritorial application of U.S. antifraud provisions, participants in cross-border transactions need an identifiable standard to guide their actions. Therefore, it is necessary for U.S. courts to find clear jurisdictional rules that strictly limit the extraterritoriality of the antifraud provisions and provide unambiguous means for both investors and issuers to decline to embrace the U.S. regulatory system.

In response to the extraterritorial reach of subject-matter jurisdiction, foreign parties may raise some types of judicial and private procedural defenses.[168] However, while these defenses may exert some needed control on U.S. federal courts' discretionary and extensive jurisdiction to some degree, they could also be obstacles to the effective regulation of transnational securities fraud.[169]

Because courts are not well suited to analyze the various delicate issues related to the application of antifraud rules, this Article has explained and supported the proposition that Congress should grapple with the issue of extraterritoriality and provide the judiciary with clear guidance as to the proper reach of the antifraud provisions. Moreover, believing that the current effects and conduct tests of the courts give us practical approaches to decide the reasonable scope of extraterritoriality, this Article has made some recommendations for the scope of extraterritorial subject-matter jurisdiction by suggesting modified and narrowed effects and conduct tests. Under the recommended proposals, plaintiffs who initiate actions based on the effects test would have to be either U.S. citizens residing in the United States or foreigners residing in the United States. U.S. courts would also have extraterritorial subject-matter jurisdiction based on the conduct test, but only when an action was brought by the SEC. In short, in determining the guiding principles and rules for applying antifraud rules, Congress should take the position that the protection of U.S. investors and U.S. markets must be balanced by policy issues such as international political harmony and market efficiency.

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168. *See supra* text accompanying notes 101–37.

169. *See supra* text accompanying notes 101–102.