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Comments

Tension on the High Seas of Transnational Securities Fraud: Broadening the Scope of United States Jurisdiction

I. INTRODUCTION

Business activities pertaining to the offer, sale, or purchase of securities¹ increasingly transpire in two or more countries.² On the one hand, this globalization of the securities markets³ has a beneficial effect because it promises more efficient securities markets as well as increased diversification of investment risks.⁴ On the other hand, globalization places a heavier burden upon countries to police improper investment activity because the increase in “transnational” securities transactions produces greater opportunity to commit securities fraud.⁵ Illegal activities causing securities fraud can span two or more

1. The Securities Exchange Act of 1934 (“Exchange Act”) broadly defines the term “security” to include notes, stocks, bonds, debentures, and investment contracts. *See* 15 U.S.C. § 78c(a)(10) (West 1997 & Supp. 1999). However, “cases have not been entirely clear on the proper method of analysis for determining when an instrument is a ‘security.’” *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 688 (1985). For an extensive discussion of the definition of the term “security,” see 2 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 923-1138.19 (3d ed. rev. 1999).

2. *See Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 30 (D.C. Cir. 1987). When Congress initially enacted the federal securities laws in the 1930s, “[t]he web of international connections in the securities market was . . . not nearly as extensive or complex as it has become.” *Id.*

3. Globalization of securities markets occurs as securities transactions involve issuers of different nationalities, transactions are executed in more than one country, or securities purchasers and sellers residing in more than one country. *See* Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498, 2502 (1997).

4. *See* Stephen J. Choi & Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market*, 65 FORDHAM L. REV. 1855, 1856 (1997).

5. *See id.* at 1857; *see also infra* notes 29-44 and accompanying text (discussing the basic elements of securities fraud). Transnational law includes, “all law which regulates actions or events that transcend national frontiers.” PHILIP C. JESSUP, *TRANSNATIONAL LAW* 2 (1956). The United States, however, is limited in its ability to adjudicate issues of transnational law by both the Constitution and international principles of sovereignty. *See id.* at 35; U.S. CONST. art. III, § 2 (giving United States courts the authority to decide cases that arise under the “Constitution, the Laws of the United States, and treaties made . . . under their Authority”).

continents,⁶ and litigants can include foreign nationals and corporations.⁷ The varieties of transnational securities fraud are limitless, and only the facts of each particular case lead to the characterization of a given transaction as “transnational.”⁸

Despite the usual presumption against the extraterritorial application of United States laws,⁹ in certain instances, federal courts do have subject matter jurisdiction over cases involving transnational securities fraud.¹⁰ Under the so-called “effects” approach, a federal court has jurisdiction in a transnational securities fraud case if the alleged fraud had a negative effect on United States investors or securities markets.¹¹ Even if there is no adverse effect on American investors or securities markets, however, a United States court may still have jurisdiction if sufficient conduct pertaining to the fraud occurs in the United States.¹² When a plaintiff alleges that only some of a defendant’s activities pertaining to the fraud occurred in the United States, a question arises as to whether the conduct is extensive enough to allow a United States federal court to preside over the case.¹³

The jurisdictional provisions of the Securities Exchange Act of 1934 (“Exchange Act”) and its legislative history are silent concerning the scope of its application to securities transactions that traverse national

6. See *SEC v. Kasser*, 548 F.2d 109, 111 (3d Cir. 1977).

7. See *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 422 (9th Cir. 1983).

8. See *infra* Part III (discussing the varying facts of transnational securities fraud cases).

9. See *infra* notes 64-67 and accompanying text (discussing the presumption against applying United States laws extraterritorially).

10. See *infra* notes 88-123 and accompanying text (discussing instances in which courts granted subject matter jurisdiction using an effects approach or a conduct approach analysis).

11. See *infra* notes 88-108 and accompanying text (discussing the elements and the application of the effects approach).

12. See *infra* notes 109-123 and accompanying text (discussing generally the conduct approach).

13. See *Robinson v. TCI/US W. Cable Communications Inc.*, 117 F.3d 900, 904 (5th Cir. 1997) (remarking that the plaintiff’s allegations required the court “to confront the rather nebulous issue of the extent to which the American securities laws may be applied extraterritorially”). Also at issue is whether a United States court will have personal jurisdiction over the litigants and whether a United States court is the proper forum in a particular case. See also, *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1339-44 (2d Cir. 1972) (discussing personal jurisdiction, venue, and forum non conveniens in the context of a transnational securities fraud case); see, e.g., DAVID EPSTEIN ET AL., *INTERNATIONAL LITIGATION: A GUIDE TO JURISDICTION, PRACTICE AND STRATEGY* §§ 5.06, 6.01-.09 (3d ed. 1998) (discussing generally personal jurisdiction and forum issues in transnational litigation). This article, however, is restricted to the issue of whether a United States court has subject matter jurisdiction in a transnational securities fraud case.

boundaries.¹⁴ Every circuit addressing the issue has acknowledged instances and developed guidelines to determine when a United States court has subject matter jurisdiction over a transnational securities transaction.¹⁵ There is sharp disagreement among the circuit courts, however, about the precise degree of domestic conduct that a plaintiff must prove to allow a federal court to exercise jurisdiction.¹⁶

The Seventh Circuit has recognized three different approaches that United States courts use to determine whether they have jurisdiction in a transnational securities fraud case.¹⁷ Under the first approach, the restrictive conduct approach, a plaintiff must prove that conduct satisfied all of the elements of a *prima facie* securities fraud claim.¹⁸ Under the second approach, the broader conduct approach, a plaintiff merely has to prove that some conduct pertaining to the fraud occurred in the United States.¹⁹ Under the third approach, the balancing conduct approach, a plaintiff must prove that the conduct in the United States was not merely preparatory and that the conduct directly caused the loss the plaintiff alleged.²⁰ These three approaches have emerged to quantify the amount of authority Congress intended to bestow upon the judiciary in transnational fraud cases.²¹

This Comment uses the threefold distinction proposed by the Seventh Circuit to examine the split among the circuit courts regarding the proper scope and application of the conduct approach to

14. See *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 663-64 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 890 (1999) (stating that Congress provided "little meaningful guidance on the issue"). One commentator suggests, however, that the legislative history of the federal securities laws provides more guidance than courts acknowledge. See Margaret V. Sachs, *The International Reach of Rule 10b-5: The Myth of Congressional Silence*, 28 COLUM. J. TRANSNAT'L L. 677, 694-99 (1990) [hereinafter *The International Reach of Rule 10b-5*] (arguing against the extraterritorial application of federal securities laws).

15. See *Kauthar*, 149 F.3d at 666-67; *Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 127-31 (2d Cir. 1998), *cert. denied*, 119 S. Ct. 1029 (1999); *Robinson*, 117 F.3d at 906-07; *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987); *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 424-25 (9th Cir. 1983); *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 415-21 (8th Cir. 1979); *SEC v. Kasser*, 548 F.2d 109, 112-15 (3d Cir. 1977).

16. See *Kauthar*, 149 F.3d at 665-66; *Robinson*, 117 F.3d at 905-06; *Zoelsch*, 824 F.2d at 30-31; *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1046 n.6 (2d Cir. 1983).

17. See *Kauthar*, 149 F.3d at 665-66.

18. See *infra* notes 133-49 and accompanying text (discussing the restrictive conduct approach).

19. See *infra* notes 150-213 and accompanying text (discussing the broader conduct approach).

20. See *infra* notes 214-305 and accompanying text (discussing the balancing conduct approach).

21. See *Kauthar*, 149 F.3d at 665.

transnational securities fraud cases. This Comment begins by describing the policies of the Exchange Act and the basic elements of securities fraud.²² Subsequently, this Comment explains the principles underlying the extension of jurisdiction beyond domestic borders as well as the basic policies supporting the application of national securities laws to transnational transactions.²³ This Comment then discusses the three different analyses of the conduct approach that courts have adopted to determine the scope of their subject matter jurisdiction in transnational securities fraud cases.²⁴ Next, this Comment critically analyzes recent developments in the debate concerning subject matter jurisdiction over transnational securities cases.²⁵ Finally, this Comment proposes that courts adopt a broader approach to determining whether they have subject matter jurisdiction over a particular transnational fraud case to provide the clearest procedural standards and to best serve the remedial policies of federal securities legislation.²⁶

II. BACKGROUND

Before examining the principles of federal jurisdiction that justify the extraterritorial application of the Exchange Act's antifraud provisions,²⁷ it is important to understand the basic policies underlying the federal securities laws as well as the elements of a *prima facie* securities fraud case under Section 10(b) of the Exchange Act.²⁸

A. Securities Fraud

Congress enacted the Exchange Act to regulate and control secondary trading of securities.²⁹ Congress decided that such regulation was necessary to protect interstate commerce and to maintain "fair and honest markets" for securities transactions.³⁰ The

22. See *infra* Part II.A.

23. See *infra* Part II.B-D.

24. See *infra* Part III.

25. See *infra* Part IV.

26. See *infra* Part V.

27. See *infra* Part II.D (discussing the jurisdictional provisions of the Exchange Act).

28. See *infra* Part II.A (discussing securities fraud).

29. See 15 U.S.C. § 78b (1994). The Securities Act of 1933 ("Securities Act") deals with the initial process of distributing securities conducted by the issuer. See I LOSS & SELIGMAN, *supra* note 1, at 225 (3d ed. 1998). In contrast, the Exchange Act regulates secondary trading such as trading of securities during the post-distribution period. See *id.* at 226.

30. See 15 U.S.C. § 78b.

Exchange Act, as remedial legislation,³¹ achieves its purpose through three primary mechanisms. First, the federal securities laws implement a philosophy of mandatory full disclosure that requires market participants to reveal material information pertaining to the securities they are offering, selling, or purchasing.³² Second, the federal securities laws maintain market integrity by protecting investors from fraud.³³ Finally, the securities laws “promote ethical standards of honesty and fair dealing” by market participants through the imposition of civil liabilities.³⁴

Section 10(b) of the Exchange Act is a catch-all antifraud provision.³⁵ Section 10(b) prohibits anyone from using “any manipulative or deceptive device or contrivance” in the sale or purchase of securities.³⁶ Section 10(b), however, is not self-operative because Congress delegated authority to implement the statute to the Securities Exchange Commission (“SEC”).³⁷ The SEC has authority under Section 10(b) to issue rules and regulations that it deems “necessary or appropriate in the public interest or for the protection of investors.”³⁸ Using this congressionally delegated authority, the SEC issued Rule 10b-5, which, like Section 10(b), employed very broad antifraud language.³⁹

31. *See* *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967). Generally, “remedial legislation should be construed broadly to effectuate its purposes.” *Id.*

32. *See id.* Congress adopted a mandatory disclosure policy due to pervasive securities fraud prior to the adoption of the federal securities laws. *See* 1 LOSS & SELIGMAN, *supra* note 1, at 193 (3d ed. 1998). Furthermore, the state securities laws were ineffective in preventing and punishing securities fraud. *See id.* at 198.

33. *See* *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976).

34. *Id.*

35. *See id.* at 203; *see also* 7 LOSS & SELIGMAN, *supra* note 1, at 3411 (3d ed. 1991) (describing Section 10(b) as an “omnibus” provision). Section 10(b) of the Exchange Act provides:

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

. . . .

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

15 U.S.C. § 78j (1994).

36. 15 U.S.C. § 78j(b).

37. *See* 7 LOSS & SELIGMAN, *supra* note 1, at 3411-12 (3d ed. 1991).

38. 15 U.S.C. § 78j(b).

39. *See* 17 C.F.R. § 240.10b-5 (1998). Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any

Although Rule 10b-5 does not provide for an express private right of action to injured investors, courts have found that injured investors have an implied private right of action in some circumstances.⁴⁰ Generally, the situations in which courts recognize a cause of action involve the misrepresentation or omission of corporate information,⁴¹ insider trading,⁴² or intentional manipulation.⁴³ A plaintiff suing under Section 10(b) and Rule 10b-5 has the burden of proving that a defendant “1) made a misstatement or omission, 2) of material fact, 3) with scienter [knowledge], 4) in connection with the purchase or sale of securities, 5) upon which the plaintiff relied, and 6) that reliance proximately caused the plaintiff’s injury.”⁴⁴

B. Federal Subject Matter Jurisdiction

Subject matter jurisdiction is the power of a court to rule on a

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

Id.

40. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976); see also 2 THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* 63 (2d ed. 1990) (explaining that the Supreme Court has recognized a private right of action under Rule 10b-5 where the plaintiff is a buyer or seller of securities, the defendant acted with scienter, and the conduct was deceptive).

41. See, e.g., *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1333 (7th Cir. 1995) (recognizing that there is a Rule 10b-5 cause of action against a corporation if the corporation made overly optimistic corporate projections in bad faith or without a reasonable basis); *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 268 (2d Cir. 1993) (holding that corporations have a duty to disclose “whenever secret information renders prior public statements materially misleading”).

42. See, e.g., *United States v. O’Hagan*, 521 U.S. 642, 651-52 (1997). Insider trading occurs when a corporate insider buys or sells his corporation’s securities using material, nonpublic information. See *id.* For an extensive discussion of insider trading, see 7 LOSS & SELIGMAN, *supra* note 1, at 3448-3545 (3d ed. 1991) and 8 LOSS & SELIGMAN, *supra* note 1, at 3547-3937 (3d ed. 1991).

43. See, e.g., *Ernst & Ernst*, 425 U.S. at 214 (holding that manipulation involves intentional wrongdoing rather than negligent conduct).

44. *Stransky*, 51 F.3d at 1331 (citing *In re Phillips Petroleum Sec. Litig.*, 881 F.2d 1236, 1244 (3d Cir. 1989)). Plaintiffs must have standing to sue under Rule 10b-5. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 754-55 (1975) (holding that only purchasers and sellers of securities have standing to sue under Rule 10b-5); see also HAZEN, *supra* note 40, at 70-80 (discussing standing to sue under Rule 10b-5). Furthermore, plaintiffs must plead allegations of securities fraud with particularity. See *FED. R. CIV. P. 9(b)*; see also HAZEN, *supra* note 40, at 66-70 (discussing the requirement of pleading securities fraud with particularity).

plaintiff's claim.⁴⁵ In order for a party to obtain an enforceable judgment, the court before which a case appears must have valid authority to hear the case.⁴⁶ Thus, there must be sufficient facts to support subject matter jurisdiction before a court can adjudicate a claim.⁴⁷ If, following a factual analysis, a court determines that it lacks subject matter jurisdiction over a case, the court must dismiss the claim.⁴⁸ Generally, a plaintiff must present sufficient jurisdictional facts in the complaint to establish that the court is competent to hear the case.⁴⁹ The presence of proper federal jurisdiction, however, is predicated on the type of claim before the court, not on the merits of the claim.⁵⁰

Article III of the United States Constitution defines the scope of federal judicial power by restricting the types of cases and controversies that federal courts may hear.⁵¹ Furthermore, under the

45. See 5A CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1350 (2d ed. 1990 & Supp. 1998).

46. See RESTATEMENT (SECOND) OF JUDGMENTS § 11 (1982) ("A judgment may properly be rendered against a party only if the court has authority to adjudicate the type of controversy involved in the action.").

47. See 4 WRIGHT & MILLER, *supra* note 45, § 1063; see also EPSTEIN ET AL., *supra* note 13, § 5.02 (stating that an analysis of United States jurisdiction begins with an analysis of subject matter jurisdiction).

48. See FED. R. CIV. P. 12(b)(1). "Whenever it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court shall dismiss the action." *Id.* at 12(h)(3); see also 5A WRIGHT & MILLER, *supra* note 45, § 1350 (discussing motions to dismiss for lack of subject matter jurisdiction).

49. See FED. R. CIV. P. 8(a)(1); see also 13 WRIGHT & MILLER, *supra* note 45, § 3522 ("[T]he facts showing the existence of jurisdiction must be affirmatively alleged in the complaint."). A court may, however, dismiss a case for lack of subject matter jurisdiction on the basis of (1) the complaint alone; (2) the complaint plus undisputed facts; or (3) the complaint plus undisputed facts and facts resolved by the court. See *Robinson v. TCI/US W. Communications Inc.*, 117 F.3d 900, 904 (5th Cir. 1997).

50. See 13 WRIGHT & MILLER, *supra* note 45, § 3522. Even if a claim fails on its merits, a federal court may still have subject matter jurisdiction to hear and rule on the claim. See *id.*

51. See 15 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 100.02 (3d ed. 1998); see also *Omni Capital Int'l v. Rudolf Wolff & Co.*, 484 U.S. 97, 103-04 (1987) (agreeing that "the jurisdictional limits that Art. III of the Constitution places on the federal courts relate to subject-matter jurisdiction only"); 13 WRIGHT & MILLER, *supra* note 45, § 3521 (discussing the "Constitutional Basis of the Judicial Power of the Federal Courts"). Article III provides, "[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may . . . establish." U.S. CONST. art. III, § 1. Further, the Supreme Court has original jurisdiction in "all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made." *Id.* § 2. In all such cases, "the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such exceptions . . . as the Congress shall make." *Id.*

doctrine of federalism,⁵² the Constitution gives Congress the power to create the lower federal courts as Congress deems necessary.⁵³ Congress also has the power to limit or expand the jurisdiction of the lower courts.⁵⁴ Jurisdiction, however, cannot exceed the limits imposed upon the judiciary by the Constitution.⁵⁵ Thus, the federal courts are courts of limited jurisdiction because both the Constitution and Congress restrict the types of cases and controversies that federal courts are competent to decide.⁵⁶

Congress has expressly granted lower federal courts with jurisdiction in two types of cases: those “arising under” a federal question⁵⁷ and diversity of citizenship cases.⁵⁸ In particular, Congress specifically granted jurisdiction to the federal judiciary to decide cases arising under the Securities Act of 1933 (“Securities Act”)⁵⁹ and the

52. See RESTATEMENT (SECOND) OF JUDGMENTS § 11 cmt. a (1982) (noting that restrictions on the jurisdiction of federal courts are “a consequence of the legal structure of American federalism”). The doctrine of federalism holds that the authority of the federal government cannot exceed what the Constitution allows. See *id.*

53. See 15 MOORE ET AL., *supra* note 51, ¶ 100.20[1].

54. See *id.* ¶ 100.20[2]. Congress also has the constitutional authority to vest exclusive jurisdiction in the federal judiciary, thereby precluding state courts from exercising jurisdiction over certain cases. See *The Moses Taylor*, 71 U.S. (4 Wall.) 411, 428-29 (1866) (citing *Martin v. Hunter’s Lessee*, 14 U.S. (1 Wheat.) 304 (1816)).

55. See 15 MOORE ET AL., *supra* note 51, ¶ 100.20; see also 13 WRIGHT & MILLER, *supra* note 45, § 3521. In a terse opinion on diversity jurisdiction, Chief Justice Marshall wrote, “[t]urn to the article of the constitution of the United States, for the statute cannot extend the jurisdiction beyond the limits of the constitution.” *Hodgson v. Bowerbank*, 9 U.S. (5 Cranch) 303, 304 (1809).

56. See RESTATEMENT (SECOND) OF JUDGMENTS § 11 cmt. a (1982). “It is a fundamental precept that federal courts are courts of limited jurisdiction. The limits upon federal jurisdiction, whether imposed by the Constitution or by Congress, must be neither disregarded nor evaded.” *Owen Equip. & Erection Co. v. Kroger*, 437 U.S. 365, 374 (1978).

57. See 28 U.S.C. § 1331 (1994) (“The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States.”).

58. See 28 U.S.C.A. § 1332 (1994 & Supp. 1996).

59. See 15 U.S.C.A. § 77v(a) (1994 & Supp. 1996) (discussing the “[j]urisdiction of offenses and suits”). Congress granted concurrent jurisdiction to controversies arising under the Securities Act as follows:

The district courts of the United States and United States courts of any Territory, shall have jurisdiction of offenses and violations . . . concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States.

Id.

Exchange Act.⁶⁰

C. *Limits on the Extraterritorial Reach of Federal Jurisdiction*

Two basic legal principles limit the extraterritorial application of United States laws: the presumption against extraterritoriality⁶¹ and the doctrine of international comity.⁶² However, neither principle acts as an absolute bar, particularly if domestic interests are at stake.⁶³

1. The Presumption Against Extraterritoriality

Congress has the constitutional authority to extend the reach of domestic laws beyond the United States' borders.⁶⁴ If, however, Congress is silent with regard to whether jurisdiction extends beyond the borders of the United States, there is a presumption against extraterritoriality.⁶⁵ The basic justification for this canon of statutory

60. See *id.* § 78aa; see also *infra* Part II.D (discussing the subject matter jurisdiction provisions in the Exchange Act). Congress granted exclusive jurisdiction to the federal judiciary for claims arising under the Exchange Act as follows:

The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. . . . Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder . . . may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.

15 U.S.C. § 78aa.

61. See *infra* Part II.C.1 (discussing the presumption against extraterritoriality with regard to domestic legislation).

62. See *infra* Part II.C.2 (explaining that principles of international comity may restrict the jurisdictional reach of United States courts).

63. See *infra* Part II.C.3 (discussing situations in which United States courts recognize their authority to exercise their jurisdiction extraterritorially, despite the ordinary presumption against extraterritoriality and the principles of international comity).

64. See *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) ("Congress has the authority to enforce its laws beyond the territorial boundaries of the United States."). For an excellent critique of the presumption against extraterritoriality, see Jonathan Turley, "When in Rome": *Multinational Misconduct and the Presumption Against Extraterritoriality*, 84 NW. U. L. REV. 598 (1990) (arguing that the presumption against extraterritoriality is an archaic relic of legal realism that discourages multinational corporations from promoting corporate responsibility).

65. See *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949) (holding that a federal labor law did not apply extraterritorially); see also *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 794-99 (1993) (holding that the Sherman Antitrust Act, which governs restraints on interstate and foreign commerce, applies to foreign conduct); Wade Estey, Note, *The Five Bases of Extraterritorial Jurisdiction and the Failure of the Presumption Against Extraterritoriality*, 21 HASTINGS INT'L & COMP. L. REV. 177, 181-207 (1997)

construction is that Congress is interested in the status of domestic rather than foreign concerns.⁶⁶ The presumption against extraterritoriality can be overcome if the language and structure of a statute or its legislative history indicate a congressional intent that the statute ought to apply to areas outside of the United States.⁶⁷

2. Principles of International Comity

International comity is the practice of courtesy and good will that one nation shows for the national interests of another nation.⁶⁸ If the presumption against extraterritoriality does not preclude a United States court from having jurisdiction, principles of international comity may restrict the extraterritorial application of American laws.⁶⁹ Principles of international comity discourage the application of one nation's laws if they conflict with the laws of another nation and have an adverse effect on the other nation's ability to enforce its own laws.⁷⁰ In other words, the exercise of international comity helps protect against conflicts between domestic law and the law of foreign

(proposing a reformulation of the presumption against extraterritoriality). *But see Arabian Am. Oil Co.*, 499 U.S. at 246-47 (holding that Title VII, which protects against employment discrimination, does not apply extraterritorially).

66. *See Foley Bros.*, 336 U.S. at 285. The *Foley Bros.* court stated the following:

The canon of [statutory] construction which teaches that legislation of Congress, unless a contrary intent appears, is meant to apply only within the . . . United States is a valid approach whereby unexpressed congressional intent may be ascertained. It is based on the assumption that Congress is primarily concerned with domestic conditions.

Id. (citations omitted).

67. *See id.* *But see Arabian Am. Oil Co.*, 499 U.S. at 261 (Marshall, J., dissenting) (stating that the presumption against extraterritoriality is "not a clear-statement rule" and can be applied "only after exhausting all of the traditional tools" of statutory analysis, such as legislative history, statutory structure, and administrative interpretations).

68. *See Merritt B. Fox, The Political Economy of Statutory Reach: U.S. Disclosure Rules in a Globalizing Market for Securities*, 97 MICH. L. REV. 696, 729 n.81 (1998). Comity is not a formal obligation one nation owes to another; rather, it is a display of goodwill on the part of one nation toward another. *See id.*

69. *See Hartford Fire Ins. Co.*, 509 U.S. at 814-15 (Scalia, J., concurring in part and dissenting in part).

70. *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 101 cmt. e (1987). There are various definitions of comity. *See id.* International comity can be described 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." *Hilton v. Guyot*, 159 U.S. 113, 164 (1895); *see also* BLACK'S LAW DICTIONARY 267 (6th ed. 1990) (defining "comity"). International comity does not strip courts of subject matter jurisdiction; rather, international comity serves as a justification to refuse to exercise jurisdiction. *See EPSTEIN ET AL., supra* note 13, § 5.07[1].

nations.⁷¹ Thus, the Supreme Court expresses hesitation regarding the imposition of United States laws upon foreign parties in foreign jurisdictions.⁷²

3. Overcoming Territorial Limitations on Jurisdiction

Generally, if Congress intends to extend the jurisdiction of United States courts beyond domestic borders, the language of the statute must provide some indicia of that intent.⁷³ Indicia of congressional intent include statutory provisions addressing conflict of laws issues⁷⁴ and express grants of extraterritorial jurisdiction.⁷⁵ The Supreme Court, however, has held that jurisdiction applies extraterritorially in certain situations, even without express statutory language or other indications of congressional intent, despite the presumption against extraterritoriality and principles of international comity.⁷⁶ The

71. See *Hartford Fire Ins. Co.*, 509 U.S. at 816-17 (Scalia, J., concurring in part and dissenting in part) (citing *McCulloch v. Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10, 20-22 (1963)) (discussing conflict of laws principles and international comity); see also EPSTEIN ET AL., *supra* note 13, § 5.07[1] (stating that choice of law theories include elements of comity). Although comity is essentially a conflict of laws issue, “conflict of laws is that part of the law of each state which determines what effect is given to the fact that the case may have a significant relationship to more than one state.” RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 2 cmt. b & c (1988). Accordingly, the Restatement definition of conflict of laws applies solely to conflicts among the States of the United States, and not to conflicts between the United States and other nation states. See *id.* § 10. International cases and controversies may involve different circumstances requiring a resolution that differs from the appropriate resolution in an entirely domestic case. See *id.* However, “an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains” *Murray v. Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64 (1804).

72. See *Arabian Am. Oil Co.*, 499 U.S. at 255 (holding that Title VII does not apply extraterritorially to foreign employers of American employees working abroad). In *Arabian American Oil Co.*, only Justice Marshall, in a separate dissenting opinion, explicitly discussed principles of international comity. See *id.* at 261-63 (Marshall, J., dissenting). The majority, however, did implicitly address international comity concerns when Chief Justice Rehnquist stated: “Without clearer evidence of congressional intent to do so . . . , we are unwilling to ascribe to that body a policy which would raise difficult issues of international law by imposing this country’s employment-discrimination regime upon foreign corporations operating in foreign commerce.” *Id.* at 255.

73. See *id.* at 250-51.

74. See *id.* at 256 (concluding that the statute’s jurisdiction did not extend beyond the United States because the statute spoke “in terms of ‘states’” and did not “mention foreign nations”).

75. See *id.* at 258.

76. See *Hartford Fire Ins. Co.*, 509 U.S. at 769-70 (holding that the Sherman Antitrust Act applies to foreign conduct that causes adverse domestic effects); *Steele v. Bulova Watch Co.*, 344 U.S. 280, 285 (1952) (holding that the Lanham Trademark Act applies extraterritorially). In a separate opinion to *Hartford Fire Insurance Co.*, Justice Scalia questioned whether federal statutes should be extended extraterritorially on the

Supreme Court ruled that the Lanham Act, which regulates improper trademark usage, applies extraterritorially because: (1) violations of the Lanham Act have an effect within the United States; (2) the Lanham Act provides a "broad jurisdictional grant"; and (3) Congress has the authority to regulate commerce with foreign nations.⁷⁷

Similarly, the Supreme Court held that federal antitrust laws extend beyond domestic borders if the parties intended anticompetitive conduct in another country to have a substantial effect in the United States and the conduct actually did have a substantial domestic effect.⁷⁸ International comity becomes an issue in such a situation only if "there is in fact a true conflict between domestic and foreign law."⁷⁹ No conflict of law problem exists, however, if someone is subject to the laws of two countries and must comply with the laws of both countries.⁸⁰ Thus, a conflict of law situation does not arise merely because both countries have strong policy reasons for encouraging certain conduct through their rules and regulations.⁸¹

basis of "boilerplate language," like that of the Sherman Antitrust Act. *See Hartford Fire Ins. Co.*, 509 U.S. at 814 (Scalia, J., concurring in part and dissenting in part). Justice Scalia agreed that certain federal laws sometimes reach extraterritorially, but only because precedent compelled him to do so. *See id.* (Scalia, J., concurring in part and dissenting in part) ("[I]f the question were not governed by precedent, it would be worth considering whether the presumption [against extraterritoriality] controls the outcome here.").

77. *See Steele*, 344 U.S. at 284, 286-89.

78. *See Hartford Fire Ins. Co.*, 509 U.S. at 795-96.

79. *Id.* at 798 (quoting *Société Nationale Industrielle Aérospatiale v. United States Dist. Court for the S. Dist. of Iowa*, 482 U.S. 522, 555 (1987) (Blackmun, J., concurring in part and dissenting in part)).

80. *See id.* at 799 (citing RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 403 cmt. e (1987)). For example, a person may harm someone in another country by shooting a bullet across national boundaries. *See Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 987 (2d Cir. 1975); A.L.I. FED. SECURITIES CODE § 1905 cmt. (3)(b) (1980) (describing the "subjective territorial principle"). Both the country in which the conduct (the shooting) occurs and the country in which the effect (the harm to the victim) occurs have a legitimate interest in exercising jurisdiction over the shooting. *See Bersch*, 519 F.2d at 987.

81. *See Hartford Fire Ins. Co.*, 509 U.S. at 799 (citing RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 415 cmt. j (1987)). Justice Scalia thought the majority's decision regarding international comity was misguided because it failed to distinguish between the district court's jurisdiction over the case and the substantive merits of the case. *See id.* at 812 (Scalia, J., concurring in part and dissenting in part). According to Justice Scalia, "it is important to distinguish two distinct questions raised by this petition: whether the District Court had jurisdiction, and whether the Sherman Act reaches the extraterritorial conduct alleged here." *Id.* (Scalia, J., concurring in part and dissenting in part). Justice Scalia suggested that the question of a statute's extraterritorial reach must be subjected to a two-step analysis. *See id.* at 814-15 (Scalia, J., concurring in part and dissenting in part). First, a court must use the presumption against extraterritoriality to analyze whether the statute transcends

D. *Jurisdiction under the Exchange Act*

Federal jurisdiction over securities claims is predicated upon specific congressional grants of jurisdiction.⁸² Under the Exchange Act, the federal judiciary has exclusive jurisdiction over “all suits in equity and actions at law brought to enforce any liability or duty” arising under the Exchange Act.⁸³ This jurisdictional grant, however, does not expressly state whether jurisdiction extends extraterritorially.⁸⁴ Furthermore, since the legislative history is barren with regard to the extraterritorial reach of subject matter jurisdiction under the Exchange Act,⁸⁵ courts have developed two different “approaches”⁸⁶ to determine whether they have jurisdiction over transnational securities transactions: the effects approach and the conduct approach.⁸⁷

domestic borders. *See id.* at 814 (Scalia, J., concurring in part and dissenting in part). If the court can rebut the presumption against extraterritoriality, it must then apply principles of international comity and, if possible, avoid construing an act of Congress in a manner that would violate the laws of nations. *See id.* at 814-15 (Scalia, J., concurring in part and dissenting in part). If “interacting interests” of the United States and of another country are both implicated, the court should attempt to limit the reach of the statute to conduct occurring within domestic borders. *See id.* at 815-16 (Scalia, J., concurring in part and dissenting in part). The majority disagreed with Justice Scalia, noting that Scalia’s analysis of comity does not comport with common interpretations of the Sherman Antitrust Act. *See id.* at 797 n.24.

82. *See* 15 U.S.C. §§ 77v, 78aa (1994); *see also supra* notes 59-60 (quoting respectively the jurisdictional provisions of the Securities Act and Exchange Act).

83. *Id.* § 78aa. The Securities Act, on the other hand, expressly confers concurrent jurisdiction upon the federal judiciary and the state judiciaries. *See id.* § 77v.

84. *See* Schoenbaum v. Firstbrook, 405 F.2d 200, 206-09 (2d Cir. 1968); *see also* Kauthar SDN BHD v. Sternberg, 149 F.3d 659, 664 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 890 (1999) (indicating that “the statutory language [of the Exchange Act] gives us little guidance”).

85. *See* SEC v. Kasser, 548 F.2d 109, 114 n.21 (3d Cir. 1977). Focusing more on personal jurisdiction than subject matter jurisdiction, one scholar argues that legislative history is more replete with discussions of the extraterritorial reach of the securities laws than courts acknowledge since Congress was in fact aware of the growing internationalization of investment markets at the time it enacted the securities laws. *See The International Reach of Rule 10b-5, supra* note 14, at 677, 694, 704-05.

86. *See* Kauthar, 149 F.3d at 665. The Seventh Circuit recently suggested that the term “test” is problematic because it indicates that there are accepted canons of statutory interpretation that courts consistently apply to transnational securities fraud cases. *See id.* The Seventh Circuit rejected the use of the term “test” and adopted the term “approach” to describe the current status of the law because “‘test’ is too inflexible a term.” *Id.* Twenty years before the Seventh Circuit’s observation, one commentator suggested that the term “test” oversimplifies the methods of determining subject matter jurisdiction in transnational securities fraud cases. *See* Suzanne A. Schiro, Comment, *Jurisdiction in Transnational Securities Fraud Cases: SEC v. Kasser*, 7 DENV. J. INT’L L. & POL’Y, 279, 286 n.46 (1978); *see also* Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 416, n.11 (8th Cir. 1979).

87. *See* Kauthar, 149 F.3d at 665. The Seventh Circuit observed, “[a]lthough the circuits that have confronted the matter seem to agree that there are some transnational

1. Effects Approach

The effects approach supports the United States courts' jurisdiction if actions in another country have a direct effect on American investors or markets.⁸⁸ *Schoenbaum v. Firstbrook*⁸⁹ was the first major securities fraud case to extend subject matter jurisdiction beyond the national boundaries of the United States.⁹⁰ In *Schoenbaum*, an

situations to which the antifraud provisions of the securities laws are applicable, agreement appears to end at that point." *Id.* The United States Supreme Court has denied certiorari to numerous cases involving the issue of subject matter jurisdiction over transnational securities transactions. *See id.* at 659; *Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118 (2d Cir. 1998), *cert. denied*, 119 S. Ct. 1029 (1999); *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118 (2d Cir. 1995), *cert. denied*, 116 S. Ct. 702 (1996); *Alfadda v. Fenn*, 935 F.2d 475 (2d Cir. 1991), *cert. denied*, 112 S. Ct. 639 (1991); *United States v. Cook*, 573 F.2d 281 (5th Cir. 1978), *cert. denied*, 99 S. Ct. 119; *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977), *cert. denied*, 97 S. Ct. 2649; *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975), *cert. denied*, 96 S. Ct. 453; *Schoenbaum*, 405 F.2d at 200, *cert. denied*, 89 S. Ct. 1747. Some Supreme Court Justices appear to have tacitly accepted the extension of jurisdiction beyond domestic borders when federal securities laws are at issue. *See, e.g.*, *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 529-31 (1974) (Douglas, J., dissenting) (Brennan, J.; White, J.; Marshall, J., concurring with the dissent) (noting that foreign defendants can be held liable for securities fraud if "they have profited by virtue of proscribed conduct within our boundaries"). The *Scherk* majority expressly refrained from deciding the issue of jurisdiction over a transnational securities transaction because the lower court did not consider the issue and the petitioner failed to raise the issue on appeal. *See id.* at 516 n.9. In contrast, the dissenting opinion stated, "[w]hen a foreign corporation undertakes fraudulent action which subjects it to the jurisdiction of our federal securities laws, nothing justifies the conclusion that only a diluted version of those laws protects American investors." *Id.* at 530-31 (Douglas, J., dissenting).

88. *See Kauthar*, 149 F.3d at 665.

89. *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968).

90. *See id.* at 204. It is significant that this first decision, as well as many subsequent decisions, emanated from the Second Circuit Court of Appeals because the Supreme Court of the United States has characterized the Second Circuit as the "Mother Court" of securities law. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting); *Continental Grain (Austl.) Pty. Ltd.*, 592 F.2d at 413 (citing Justice Blackmun's dissent in *Blue Chip Stamps*); James J. Finnerty, III, *The "Mother Court" and the Foreign Plaintiff: Does Rule 10b-5 Reach Far Enough?*, 61 *FORDHAM L. REV.* S287, S294 (1993); Roberta S. Karmel, *The Second Circuit's Role in Expanding the SEC's Jurisdiction Abroad*, 65 *ST. JOHN'S L. REV.* 743, 743 (1991). Prior to *Schoenbaum*, a United States District Court dismissed a lawsuit by an American plaintiff against Canadian defendants for lack of subject matter jurisdiction under the Exchange Act because "all the essentials of [these] transactions occurred without the United States." *Kook v. Crang*, 182 F. Supp. 388, 390 (S.D.N.Y. 1960). Although the court admitted there were sufficient contacts with the United States to allow the court to exercise jurisdiction over the foreign defendants, the court held that Congress legislates in order to control domestic conditions, not foreign ones. *See id.* at 390-91 (citing *Foley Bros. Inc., v. Filardo*, 336 U.S. 281 (1949)). In other words, while there was personal jurisdiction over the defendants, there was no subject matter jurisdiction over the alleged wrongdoing. *See id.* at 390.

American shareholder of a Canadian corporation⁹¹ initiated a shareholder derivative suit⁹² under Section 10(b) of the Exchange Act.⁹³ The plaintiff alleged that the defendants, who were Canadian and American, attempted to defraud the corporation by failing to disclose material information in order to buy securities at prices artificially below the market price.⁹⁴ All of the actions pertaining to the alleged fraud occurred in Canada rather than the United States.⁹⁵ Furthermore, the buyers and sellers involved in the transaction were all foreigners.⁹⁶ The district court dismissed the plaintiff's action on the ground that the court lacked subject matter jurisdiction,⁹⁷ holding that such jurisdiction does not extend extraterritorially under the Exchange Act.⁹⁸

The Second Circuit Court of Appeals reversed the district court's holding on subject matter jurisdiction.⁹⁹ The court held that the plaintiff rebutted the presumption against extraterritorial applicability by showing that the defendants' conduct in Canada had a direct effect on American interests.¹⁰⁰ The court predicated its reasoning on the "belief" that Congress intended the Exchange Act to extend

91. The corporation, Banff Oil Ltd., conducted all of its operations in Canada. *See Schoenbaum*, 405 F.2d at 204. The corporation's common stock was "registered with the SEC and traded upon both the American Stock Exchange and the Toronto Stock Exchange." *Id.*

92. A shareholder derivative suit is an action brought on behalf of a corporation by one or more shareholders of the corporation to enforce a right belonging to the corporation. *See* FED. R. CIV. P. 23.1.

93. *Schoenbaum*, 405 F.2d at 204. For a discussion of the elements of a cause of action under Section 10(b) of the Exchange Act, see *supra* notes 35-44 and accompanying text.

94. *See Schoenbaum*, 405 F.2d at 204-05. In essence, the plaintiff accused the defendants of engaging in "insider trading" because the defendants breached their fiduciary duty to the corporation and its shareholders by deceiving the corporation through withholding material information. *See id.* at 205; *see also supra* note 42 (defining insider trading).

95. *See Schoenbaum*, 405 F.2d at 204-06.

96. *See id.*

97. *See id.* at 204 (discussing the *Schoenbaum* district court opinion). The defendants moved for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure and for dismissal for lack of subject matter jurisdiction pursuant to rule 12(b). *See id.* The district court never reached the issue of summary judgment because it held that it lacked subject matter jurisdiction. *See id.*

98. *See id.*

99. *See id.* Ultimately, however, the appellate court affirmed the trial court's ruling with regard to summary judgment because the plaintiff failed "to state a cause of action under § 10(b) of the Exchange Act." *Id.*; *see also supra* notes 29-44 and accompanying text (discussing the elements of a cause of action under Section 10(b) of the Exchange Act and Rule 10b-5).

100. *See Schoenbaum*, 405 F.2d at 206.

extraterritorially when necessary to protect American investors.¹⁰¹ The court noted that Congress enacted the Exchange Act to protect domestic investors and domestic securities markets.¹⁰² If the plaintiff's allegations were true, then there would be a "detrimental effect" to United States investors and United States securities markets.¹⁰³ Consequently, United States courts have an interest in applying the fraud provisions of the Exchange Act to the defendants' conduct because that conduct could have had negative domestic effects.¹⁰⁴

Therefore, according to the Second Circuit, the effects approach permits the exercise of federal jurisdiction when there is a sufficiently adverse effect on United States investors or on the United States securities market.¹⁰⁵ A transaction has a sufficiently adverse domestic effect if "foreseeable and substantial harm to interests in the United States" results.¹⁰⁶ Courts must determine whether or not conduct

101. *See id.* The court remarked,

We disagree with the district court's conclusion. We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities.

Id.

102. *See id.*

103. *See id.* (citing *Strassheim v. Daily*, 221 U.S. 280, 285 (1911)). The court stated that the "impairment of the value of American investments . . . has . . . a sufficiently serious effect upon United States commerce to warrant assertion of jurisdiction for the protection of American investors." *Id.* at 208-09.

104. *See id.* at 206-09. Justice Holmes earlier declared, "[a]cts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a State in punishing the cause of the harm as if [the actor] had been present at the effect, if the State should succeed in getting [the actor] within its power." *Strassheim*, 221 U.S. at 285.

105. *See Schoenbaum*, 405 F.2d at 206-09. Thus, the *Schoenbaum* court "announced" the effects approach. *See Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 122 (2d Cir. 1995). The American Law Institute formulates the effects test as follows: "(1) The United States may generally exercise jurisdiction to prescribe with respect to . . . (c) conduct, regardless of where it occurs, significantly related to a [securities] transaction . . . , if the conduct has, or is intended to have, a substantial effect in the United States; . . ." RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW § 416 (1987). The Restatement (Third) delineates three categories of jurisdiction under international law: "jurisdiction to prescribe," "jurisdiction to adjudicate," and "jurisdiction to enforce." *Id.* § 401. Jurisdiction to prescribe, the type at issue for transnational securities fraud cases, limits a state's ability "to make its laws applicable to the activities, relations or status of persons, or in the interests of persons in things, whether by legislation, by executive act or order, by administrative rule or regulation, or by determination of a court." *Id.* § 401(a).

106. *Tamari v. Bache & Co. (Leb.) S.A.L.*, 730 F.2d 1103, 1108 (7th Cir. 1984). Some courts and commentators characterize the effects approach as the "objective

outside the United States has a significant effect in the United States on a case-by-case basis.¹⁰⁷ For example, if American stakes in a foreign investment trust amount to only .5% of the total investment, there is not a significant effect on the Americans if someone in Europe defrauds the trust fund.¹⁰⁸

2. Conduct Approach

The conduct approach predicates jurisdiction on conduct in the United States, even if the conduct has no effect on domestic interests.¹⁰⁹ *Leasco Data Processing Equipment Corp. v. Maxwell*¹¹⁰ was the first case to propose the “conduct” approach, which allows a United States court to have subject matter jurisdiction when domestic conduct contributes to the commission of fraud that affects investors and securities markets outside of the United States.¹¹¹ In *Leasco*, British plaintiffs sued British defendants in a United States district court.¹¹² The plaintiffs alleged that the defendants committed securities fraud by making false representations regarding the profitability of a company that sold its shares on the London Stock Exchange.¹¹³ Although United States investors or United States investment markets suffered no deleterious effects,¹¹⁴ the Second Circuit Court of Appeals

territorial principle” because it “grants jurisdiction over acts which cause foreseeable and substantial effects within the territory regardless of where those acts occurred.” *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 416 (8th Cir. 1979) (quoting Note, *The Extraterritorial Application of the Antifraud Provisions of the Securities Act*, 11 CORNELL INT’L L.J. 137, 139 (1978)); see also A.L.I. FED. SECURITIES CODE § 1905 cmt. 4 (1980) (referring to the effects approach as the “objective territorial approach”).

107. See *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1016 (2d Cir. 1975).

108. See *id.* at 1016-17. The court also noted that “the fraud was practiced not on individual Americans who purchased securities but on the trust in which they had invested.” *Id.* at 1016.

109. See *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 665 (7th Cir. 1998), cert. denied, 119 S. Ct. 890 (1999).

110. *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972).

111. See *id.* at 1334. Chief Judge Friendly clearly differentiated the problem presented in *Leasco* from the problem presented in *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), on the grounds that *Schoenbaum* involved stock listed on a domestic securities exchange and the transaction had an adverse effect on American investors. See *Leasco*, 468 F.2d at 1333-34.

112. See *Leasco*, 468 F.2d at 1330.

113. See *id.* at 1330-33. The plaintiffs’ cause of action for securities fraud arose under Section 10(b) of the Exchange Act and Rule 10b-5. See *id.* at 1330; see also *supra* notes 35, 39 (providing the text of Section 10(b) and Rule 10b-5).

114. Indeed, any harmful effects resulting from the defendants’ conduct in the United States would be felt in Europe, where the plaintiffs actually purchased the stock touted by the defendants. See *Leasco*, 468 F.2d at 1334-35. If any of the defendants’ overseas

held that the federal district court had jurisdiction under the Exchange Act to hear the case because the defendants made "abundant" or "substantial" misrepresentations in the United States directed at foreign buyers.¹¹⁵ In other words, the defendants' conduct in the United States justified the exercise of jurisdiction by a United States court.¹¹⁶

Under the conduct approach proposed by the *Leasco* court, the presumption against extraterritoriality does not apply when the conduct involved occurs within the United States, not outside.¹¹⁷ A court cannot assume, however, that Congress always intends laws to be applicable to the fullest extent allowed by the Constitution.¹¹⁸ With regard to the application of federal securities laws to transnational transactions, the defendant's conduct in the United States must be an "extensive act" that forms "an essential link" in the chain of causation.¹¹⁹ The conduct, however, need not occur entirely in the United States, considering that the language of the general antifraud provision of the Exchange Act is broad in scope.¹²⁰

Finally, the *Leasco* court noted that there may be conflict of laws issues when a court presides over a transnational securities fraud claim.¹²¹ It is likely, however, that Congress would want to protect American investors from foreigners committing securities fraud in the United States, even if the misconduct occurs only partially in the United States.¹²² Furthermore, a nation has the power to direct its own law, rather than foreign law, if misconduct occurs on native soil.¹²³

III. DISCUSSION

While many courts recognize that the conduct approach confers jurisdiction when conduct pertaining to a fraudulent securities

conduct had an adverse effect which was "detrimental to the interests of American investors," the district court could have used the effects approach to justify the exercise of jurisdiction. *Id.* at 1333-34 (favorably quoting *Schoenbaum*, 405 F.2d at 208).

115. *See Leasco*, 468 F.2d at 1334-35.

116. *See id.* at 1334.

117. *See id.*

118. *See id.*; *see also supra* notes 51-56 and accompanying text (discussing the Constitutional limits to federal subject matter jurisdiction).

119. *See Leasco*, 468 F.2d at 1335; *see also* *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 417-18 (8th Cir. 1979) (stating that *Leasco* analyzes the problem "from the perspective of causation").

120. *See Leasco*, 468 F.2d at 1336.

121. *See id.* at 1337.

122. *See id.*

123. *See id.*

transaction occurs in the United States,¹²⁴ the circuits disagree on the precise degree of domestic conduct required to grant subject matter jurisdiction to domestic federal courts.¹²⁵ The Seventh Circuit demarcated three different approaches to the conduct analysis: a restrictive approach,¹²⁶ a broader approach,¹²⁷ and a balancing approach.¹²⁸ The restrictive approach demands that plaintiffs prove that the conduct in the United States satisfies the prima facie elements of a securities fraud case.¹²⁹ The broader approach requires plaintiffs to prove that some of the conduct germane to the securities fraud occurred in the United States.¹³⁰ The balancing approach involves a case-by-case determination, which analyzes jurisdiction by weighing

124. See *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 890 (1999); *Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118 (2d Cir. 1998), *cert. denied*, 119 S. Ct. 1029 (1999); *Robinson v. TCI/US W. Communications, Inc.*, 117 F.3d 900 (5th Cir. 1997); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27 (D.C. Cir. 1987); *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983); *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979); *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977). The American Law Institute formulates the conduct test as follows:

1) The United States may generally exercise jurisdiction to prescribe with respect to

...

(b) any transaction in securities

(i) carried out, or intended to be carried out, on an organized securities market in the United States, or

(ii) carried out, or intended to be carried out, predominantly in the United States, although not on an organized securities market;

...

(d) conduct occurring predominantly in the United States that is related to a transaction in securities, even if the transaction takes place outside the United States;

RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 416 (1987).

125. See *Robinson*, 117 F.3d at 905. Once courts acknowledge that the federal securities laws apply extraterritorially to some degree, concurrence "appears to end." See *Kauthar*, 149 F.3d at 665. Indeed, "[t]he chronic difficulty . . . has been describing, in sufficiently precise terms, the sort of conduct occurring in the United States that ought to be adequate to trigger American regulation of the transaction." *Id.*

126. See *infra* notes 133-49 and accompanying text (discussing the restrictive approach); see also *Kauthar*, 149 F.3d at 665-66 (proposing the distinction of the three different conduct approaches).

127. See *infra* notes 150-213 and accompanying text (discussing the broader approach).

128. See *infra* notes 214-305 and accompanying text (discussing the balancing approach).

129. See *infra* notes 133-49 and accompanying text (discussing the restrictive approach).

130. See *infra* notes 150-213 and accompanying text (discussing the broader approach).

the conduct in the United States against the conduct in other countries.¹³¹ All three of these approaches address different policy and legal dilemmas that arise from the purposes of the Exchange Act and the principles of subject matter jurisdiction.¹³²

A. *Restrictive Conduct Approach: Actual Violation*

The narrowest of the conduct tests holds that the domestic conduct alone must actually violate the securities laws.¹³³ In other words, the conduct in the United States must fulfill all of the elements for a cause of action under Section 10(b) and Rule 10b-5 in order for a United States court to exercise jurisdiction.¹³⁴ Conduct that is even vaguely preparatory in nature will not be sufficient to confer jurisdiction.¹³⁵ Rather, the conduct must directly cause the complainant's losses.¹³⁶

131. See *infra* notes 214-305 and accompanying text (discussing the balancing approach).

132. See *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 665-66 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 890 (1999). "Identification of those circumstances that warrant such regulation [beyond United States borders] has produced a disparity in approach, to some degree doctrinal and to some degree attitudinal, as the courts have striven to implement [congressional intent]." *Id.* at 665.

133. See *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987). The Court of Appeals for the Circuit of the District of Columbia appears to be the only circuit that uses the restrictive analysis to construe the conduct approach. See *Kauthar*, 149 F.3d at 665 (placing the District of Columbia Circuit at the narrow "end of the spectrum" of conduct approach cases). *But see* *Robinson v. TCI/US W. Cable Communications Inc.*, 117 F.3d 900, 905 n.10 (5th Cir. 1997) (stating that *Zoelsch* "cannot reasonably be read to have fashioned a new rule" that is more restrictive than the Second Circuit's approach). Circuit Judge Bork drafted the *Zoelsch* opinion for the District of Columbia Circuit. See *Zoelsch*, 824 F.2d at 28. In his concurrence, Chief Judge Wald distanced himself from the reasoning the majority employed. See *id.* at 37 (Wald, C.J., concurring). Chief Judge Wald expressed both his disagreement with the "restrictive test" and his agreement with the "less strict approach adopted by the Third, Eighth, and Ninth Circuits . . ." *Id.* at 36 (Wald, C.J., concurring); see also *infra* notes 150-213 and accompanying text (discussing the less restrictive approach proposed by the Third, Eighth, and Ninth Circuits).

134. See *Zoelsch*, 824 F.2d at 31; see also *supra* notes 35-44 and accompanying text (discussing the elements of a cause of action under Section 10(b) of the Exchange Act and Rule 10b-5). The *Zoelsch* court enumerated the basic elements of a Section 10(b) cause of action that must occur in the United States. See *Zoelsch*, 824 F.2d at 31. Generally, a plaintiff alleging transnational securities fraud must prove that the activity in the United States included: (1) fraudulent statements or misrepresentations; (2) made by the defendant with scienter; (3) in connection with the sale or purchase of securities; and (4) which caused harm to the plaintiff. See *id.* Under the restrictive approach, only the plaintiff's damages and his actual reliance may occur outside the United States. See *id.*

135. See *Zoelsch*, 824 F.2d at 30-35.

136. See *id.*

Proponents of the “restrictive approach”¹³⁷ base their argument on several premises.¹³⁸ First, principles of international comity may suggest that jurisdiction should not be exercised if it would impinge upon the jurisdiction of another nation.¹³⁹ Closely connected with the issue of international comity is the presumption against extra-territoriality.¹⁴⁰ The restrictive approach ultimately rebuts the presumption against extraterritoriality.¹⁴¹ The policy underlying this presumption, however, is crucial for understanding the restrictive approach because this approach, like the presumption against extra-territoriality, assumes that the legislature is concerned entirely with domestic interests, not foreign ones.¹⁴²

Furthermore, according to proponents of the restrictive approach, federal courts cannot overstep the limits of jurisdiction conferred upon the courts by Congress.¹⁴³ This assertion is based upon the premise that Congress limits jurisdiction for sound reasons, such as judicial economy.¹⁴⁴ Unless Congress clearly intended for parties predominantly involved in foreign transactions to have access to United States courts, courts should be leery of allowing the litigation, especially when the conduct occurring in the United States does not significantly contribute to securities fraud occurring beyond United States borders.¹⁴⁵ Jurisdictional tests that are too fact specific provide strong

137. See *Kauthar*, 149 F.3d at 666 n.10.

138. See *Zoelsch*, 824 F.2d at 31-33. The District of Columbia Circuit was very dubious of any extension of United States jurisdiction beyond United States borders, stating, “[w]ere it not for the Second Circuit’s preeminence in the field of securities law and our desire to avoid a multiplicity of jurisdictional tests, we might be inclined to doubt that an American court should ever assert jurisdiction over domestic conduct that causes loss to foreign investors.” *Id.* at 32.

139. See *id.* at 31; see also *supra* notes 68-72 and accompanying text (discussing principles of international comity). *Zoelsch* begins its analysis by addressing the issue of international comity even though the majority noted that such considerations “appear[ed] to be minimal or nonexistent . . .” *Zoelsch*, 824 F.2d at 31.

140. See *Zoelsch*, 824 F.2d at 31; see also *supra* notes 64-67 and accompanying text (discussing the presumption against extraterritoriality).

141. See *supra* notes 64-67, 117 and accompanying text (discussing the reasoning behind the presumption against extraterritoriality and explaining why the conduct approach does not fall within the ambit of that presumption).

142. See *Zoelsch*, 824 F.2d at 31-32 (construing the territoriality of domestic legislation).

143. See *id.* at 29-30; see also *supra* notes 45-60 and accompanying text (discussing the limits of federal jurisdiction).

144. See *Zoelsch*, 824 F.2d at 32.

145. See *id.* The *Zoelsch* court cites an oft-quoted passage by Judge Friendly of the Second Circuit: “When . . . a court is confronted with transactions that on any view are predominantly foreign, it must seek to determine whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be

incentives to increase litigation over the issue of jurisdiction itself.¹⁴⁶

Finally, advocates of the restrictive approach argue that it avoids creating numerous cumbersome jurisdictional tests.¹⁴⁷ Needless legal tests arise and multiply as courts violate the limits imposed by Congress and as judges try to make decisions based upon policy.¹⁴⁸ In other words, the principle of separation of powers dictates against adopting an overly liberal interpretation of the jurisdiction provisions of the Exchange Act because policy decisions are the proper domain of the legislative branch, not the judicial branch.¹⁴⁹

B. Broad Conduct Approach: Lesser Quantum of Domestic Conduct

The Third, Eighth, and Ninth Circuits adopted the broadest standard of analysis for the conduct approach.¹⁵⁰ The broad conduct test

devoted to them rather than leave the problem to foreign countries.” *Zoelsch*, 824 F.2d at 32 (quoting *Berch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 (2d Cir. 1975)). Judge Friendly has been applauded for his “comprehensive and scholarly opinions on [the] subject” of securities jurisprudence. *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 413 (8th Cir. 1979); *see also* Margaret V. Sachs, *Judge Friendly and the Law of Securities Regulation: The Creation of a Judicial Reputation*, 50 SMU L. REV. 777, 778-93 (1997) (describing the development of Judge Friendly’s reputation in securities regulation).

146. *See Zoelsch*, 824 F.2d at 32 n.2 (criticizing the balancing test approach and any test basing jurisdiction upon the specific facts of the case).

147. *See id.* In this regard, Judge Bork expressed doubt as to whether United States courts should ever exercise jurisdiction over domestic acts that cause foreign losses. *See id.* at 32.

148. *See id.* Thus, the majority in *Zoelsch* feared that it would engage in improper “judicial activism” if it adopted a broader approach. *See id.* at 36 (Wald, C.J., concurring).

149. *See id.* at 32-33.

150. *See Butte Mining PLC v. Smith*, 76 F.3d 287, 291 (9th Cir. 1996) (stating that jurisdiction exists when “substantial steps in the perpetuation of the fraud were taken here”); *Zoelsch*, 824 F.2d at 36-37 (Wald, C.J., concurring) (refusing to adopt the restrictive approach used by the majority); *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 424 (9th Cir. 1983) (adopting the test used by the Third and Eighth Circuits); *Continental Grain*, 592 F.2d at 418-20 (concluding that jurisdiction exists when the conduct in the United States is material); *SEC v. Kasser*, 548 F.2d 109, 114 (3d Cir. 1977) (holding that the federal securities laws “do grant jurisdiction in transnational securities cases where at least some activity designed to further a fraudulent scheme occurs within this country”); *Straub v. Vaisman & Co.*, 540 F.2d 591, 595 (3d Cir. 1976) (recognizing the issue of fraudulent domestic conduct having an effect on foreign nationals, but holding that the case at bar did not involve a predominantly foreign transaction); *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 524 (8th Cir. 1973) (holding that jurisdiction “attaches whenever there has been significant conduct with respect to the alleged violations in the United States”); *see also Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 666 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 890 (1999) (placing the Third, Eighth, and Ninth Circuits at the broad “end of the spectrum” of conduct approach cases); *Robinson v. TCI/US W. Cable Communications Inc.*, 117 F.3d 900, 906 (5th Cir. 1997) (“The Third, Eighth, and Ninth Circuits . . . generally

requires “some lesser quantum of conduct” than do the other methods of analysis.¹⁵¹ Courts applying the broad standard hold that *some* conduct in the United States is sufficient to confer jurisdiction over the fraudulent transaction if the conduct is meant to perpetuate the fraudulent scheme.¹⁵² Mere preparation, however, as opposed to material conduct, is not enough to allow jurisdiction.¹⁵³ Proponents of the broader conduct approach claim that a broader interpretation comports with the remedial purposes of the Exchange Act¹⁵⁴ because the Exchange Act must protect a wide range of litigants to effectively promote higher ethical standards in business transactions.¹⁵⁵

1. Eighth Circuit Conduct Analysis Jurisprudence: Reasoning on the Basis of Policy

The Eighth Circuit was the first circuit to expressly adopt the conduct analysis originally proposed by the Second Circuit in *Leasco Data Processing Equipment Corp. v. Maxwell*.¹⁵⁶ According to the Eighth Circuit, a court has subject matter jurisdiction in a transnational fraud case if there was “significant conduct” in the United States with regard to the alleged wrongdoing.¹⁵⁷ If there has been significant domestic conduct, the fact that the buyer purchased the foreign securities abroad is irrelevant.¹⁵⁸ The question, however, remains: What constitutes significant conduct in the United States?¹⁵⁹

The Eighth Circuit suggested that courts must examine the transaction as a whole to determine whether the conduct is significant

require some lesser quantum of conduct.”); *Zoelsch*, 824 F.2d at 31 (observing that the Third, Eighth, and Ninth Circuits have “relaxed” the conduct test in comparison to the Second Circuit).

151. *Robinson*, 117 F.3d at 906.

152. *See Kasser*, 548 F.2d at 114.

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

154. *See id.* at 424; *see also supra* notes 29-34 and accompanying text (discussing the remedial purposes of the Exchange Act).

155. *See Grunenthal*, 712 F.2d at 425.

156. *See Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 523-24 (8th Cir. 1973); *see also Leasco Data Processing Equip. Corp., v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972). The *Travis* court noted that cases involving transnational securities fraud are not restricted to instances in which there are adverse domestic effects. *Travis*, 473 F.2d at 523-24 n.14 (construing *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968)). The court observed that *Schoenbaum* was not a “limiting decision” which “set forth the exclusive circumstances in which extraterritorial application of the [Exchange] Act is proper.” *See id.* (favorably citing *Leasco Data Processing Equip. Corp.*, 468 F.2d 1326.

157. *See Travis*, 473 F.2d at 524.

158. *See id.*

159. *See id.*

enough to allow a federal court to exercise jurisdiction.¹⁶⁰ A big-picture examination is necessary because the essential elements of a scheme to defraud may slowly unfold over time and across national borders.¹⁶¹ Furthermore, whether the securities at issue are registered or traded on an organized domestic market is irrelevant because the Exchange Act's general antifraud provision expressly applies to transactions involving unregistered securities.¹⁶²

In *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds Inc.*, the Eighth Circuit further examined the issue of United States subject matter jurisdiction over a transnational securities fraud case.¹⁶³ In *Continental Grain*, the Australian plaintiff¹⁶⁴ alleged that Australian and American defendants violated Section 10(b) and Rule 10b-5 by concocting a "scheme of nondisclosure" regarding the status of a 10-year license agreement supposedly belonging to an Australian corporation in which the plaintiff invested.¹⁶⁵ Aware of the impending termination of the licensing agreement, the defendants made several transpacific telephone calls and corresponded by letter in order to ensure that the loss of the licensing agreement would not be disclosed to the plaintiff and thereby "spoil the deal."¹⁶⁶ Ultimately, the defendants executed the contract for the sale of the Australian target company in California, after which the parties finalized the deal in Australia.¹⁶⁷

160. See *id.* at 526. The District of Columbia Circuit expressly rejected this argument. See *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 36 (D.C. Cir. 1987) (using the restrictive approach to analyze the defendants' conduct). In *Zoelsch*, the plaintiff argued that the court should "consider all the activity that surrounds any given securities transaction as a single mass." *Id.* The court, utilizing the restrictive approach, brushed aside this argument: "[i]t is obvious that this suggestion is completely antithetical to the approach we have adopted here. It bears no relation to the tests for determining jurisdiction that have been adopted by any of the federal appellate courts There seems nothing to recommend it." *Id.*

161. See *Travis*, 473 F.2d at 526; see also *supra* notes 40-44 and accompanying text (discussing the elements of securities fraud).

162. See *Travis*, 473 F.2d at 526; see also 15 U.S.C. § 78j(b) (1994) (prohibiting the use of any manipulative or deceptive device with regard to the sale or purchase of any registered or unregistered security). For an account of the basic elements of securities fraud, see *supra* notes 40-44 and accompanying text.

163. See *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979).

164. The plaintiff was a wholly-owned Australian subsidiary of a Delaware corporation. See *id.* at 411.

165. See *id.* at 411-13. The licensing agreement at issue was significant because it was the primary asset of the company in which the plaintiff invested. See *id.* at 411.

166. See *id.* at 411-12.

167. See *id.* at 412-13. After the execution of the sales contract in California, the contract was hand delivered to the plaintiff in Australia. See *id.* The closing of the deal

The district court dismissed the plaintiff's lawsuit due to lack of subject matter jurisdiction and lack of personal jurisdiction.¹⁶⁸ The Eighth Circuit reversed the district court's ruling, using the broad conduct approach as the basis for its holding.¹⁶⁹ Although the Eighth Circuit had already ruled on the issue,¹⁷⁰ the *Continental Grain* court decided to reexamine the issue in light of the Third Circuit's jurisprudence on the conduct approach.¹⁷¹

In *Continental Grain*, the court clearly acknowledged that its decision to adopt a broader conduct approach was based on policies of international law, the Exchange Act's language, and the Exchange Act's remedial goals.¹⁷² First, the court noted that a broader analysis of conduct does not violate principles of international law because under the "subjective territorial principle," a country can base jurisdiction on conduct occurring within its borders.¹⁷³ Furthermore, the Exchange Act can apply to foreigners because nationality is not a basis for conferring subject matter jurisdiction under the Exchange Act.¹⁷⁴

was held in Australia in order to avoid United States taxes. *See id.* At the closing, the plaintiff made its initial payment in Australian dollars, after which the defendant's corporate secretary converted the payment to United States funds and then wired the payment to the United States. *See id.* Finally, the plaintiff paid the balance of the purchase price in Australia, after which these funds were also wired to the United States. *See id.* at 413.

168. *See id.* at 413.

169. *See id.* at 421-22.

170. *See Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 523-24 (8th Cir. 1973).

171. *See Continental Grain*, 592 F.2d at 418-19; *see also infra* notes 183-98 and accompanying text (discussing the Third Circuit's jurisprudence on the conduct approach). The court averred, "[w]e believe . . . that the Third Circuit . . . extended the boundaries of the necessary domestic conduct required to find subject matter jurisdiction . . ." *Continental Grain*, 592 F.2d at 418 (citing *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977)). Despite the decision to reexamine the issue of jurisdiction in transnational securities cases, the court observed that the Third Circuit's broad approach was consistent with a prior Eighth Circuit ruling. *See id.* at 419. *Compare Kasser*, 548 F.2d at 114 (holding that jurisdiction exists "where at least some activity designed to further a fraudulent scheme occurs within this country"), with *Travis*, 473 F.2d at 524 (holding that jurisdiction attaches "whenever there has been significant conduct with respect to the alleged violations in the United States").

172. *See Continental Grain*, 592 F.2d at 415-16.

173. *See id.* at 416. An example of the "subjective territorial principle" is that of a person who shoots a bullet across national boundaries and harms someone in the other country. *See Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 987 (2d Cir. 1975); A.L.I. FED. SECURITIES CODE § 1905 cmt. (3)(b) (1980) (describing the "subjective territorial principle"). Both the country in which the conduct (the shooting) occurs and the country in which the effect (the harm to the victim) occurs have a legitimate interest in exercising jurisdiction over the shooting. *See Bersch*, 519 F.2d at 987. If one country asserts jurisdiction on the grounds that the gun was made in that country, however, the connections of the shooting to that country become more tenuous. *See id.*

174. *See Continental Grain*, 592 F.2d at 417 ("Nor do we view the nationality of

Second, the language of Section 10(b) is broad and is meant to cover all sales and purchases of securities,¹⁷⁵ regardless of whether the transactions transpire on an organized United States market or not.¹⁷⁶ Section 10(b) does not exempt fraudulent acts in the United States simply because their effects are “exported” to another country.¹⁷⁷ Congress did not intend to allow the United States to be used as a safe haven for fraudulent transnational transactions.¹⁷⁸

Finally, the court observed that the Exchange Act expressly applies to foreign commerce.¹⁷⁹ Given the high standards of conduct encouraged by the Exchange Act, “[t]he range of significant conduct should . . . be fairly inclusive.”¹⁸⁰ A broader interpretation of the conduct analysis thus discourages people from using the United States as a base of operations for fraudulent security schemes.¹⁸¹ Furthermore, a broader application of American securities laws prevents the likelihood that foreign courts will refuse to provide protections to Americans defrauded by foreign securities schemes.¹⁸²

2. Third Circuit Conduct Analysis Jurisprudence: Loosening the Standards

The Third Circuit was the next federal court to adopt the broad conduct approach.¹⁸³ In *SEC v. Kasser*,¹⁸⁴ the SEC sought injunctive

defendants . . . as having any independent significance for jurisdictional purposes.”) (citing *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1016 (2d Cir. 1975)).

175. *See supra* notes 35-39 and accompanying text (discussing the language of Section 10(b) of the Exchange Act and Rule 10b-5).

176. *See Continental Grain*, 592 F.2d at 418 (citing *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1336 (2d Cir. 1972)); *see also supra* notes 35-44 and accompanying text (discussing the elements of a cause of action under Section 10(b) of the Exchange Act).

177. *See Continental Grain*, 592 F.2d at 420.

178. *See id.* at 420-21 (“We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.”) (citing *Vencap*, 519 F.2d at 1017).

179. *See id.* at 421.

180. *Id.*

181. *See id.* at 420

182. *See id.* at 421; *infra* notes 194-97 and accompanying text (discussing the benefits of international reciprocity with regard to the enforcement of fraudulent securities activity).

183. *See SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977).

184. Prior to *Kasser*, the Third Circuit recognized that subject matter jurisdiction may be at issue in cases involving transnational securities transactions. *See Straub v. Vaisman & Co.*, 540 F.2d 591, 595 (3d Cir. 1976). The *Straub* court held that there was jurisdiction under the conduct approach because the transaction was predominantly domestic. *See id.* The court did not provide an in depth analysis of subject matter jurisdiction, however, since “the difficulties inherent in any attenuation of jurisdiction

relief against defendants who had developed a fraudulent, “ponzi’-like scheme,”¹⁸⁵ which laundered money through corporations and banks located in Canada, Switzerland, and the United States.¹⁸⁶ *Kasser*, therefore, involved a true transnational scheme because the disputed transactions involved both conduct in the United States and in other countries.¹⁸⁷ As a general proposition, the *Kasser* court asserted that if at least some activity pertaining to the advancement of a transnational fraud scheme occurs within the United States, then a United States federal court has jurisdiction to hear the case.¹⁸⁸

Under the broader conduct approach, the actual locus of the harm does not have to be in the United States.¹⁸⁹ Congress expressly provided that the securities laws apply to “foreign commerce,” thereby providing that the securities laws encompass a “broad jurisdictional scope.”¹⁹⁰ Indeed, the Exchange Act broadly defines “interstate

[were] not seriously implicated in the circumstances of [the] case[.]” *Id.*

185. See *Kasser*, 548 F.2d at 111. A ponzi scheme derives its name from renowned speculator-swindler Charles Ponzi. See *United States v. Cook*, 573 F.2d 281, 282 n.3 (5th Cir. 1978). Ponzi was an Italian immigrant who employed a scheme involving international postal reply coupons to bilk unsuspecting Americans out of millions of dollars. See *id.* After serving a prison sentence for his activity, the United States deported Ponzi to Italy where Mussolini hired him to work in the finance ministry. See *id.*

A Ponzi scheme operates by promising high profits from fictitious sources. See AMERICAN HERITAGE DICTIONARY 1407 (3d ed. 1992). Money owed to earlier investors in the scheme are paid off with funds contributed by later investors. See *id.* In *Kasser*, the defendants promised to invest in a forestry development using funds obtained from the Canadian-owned Manitoba Development Fund. See *Kasser*, 548 F.2d at 110-11. Instead, the defendants “recirculated the proceeds” and converted them for their own personal use by making equity investments that were supposed to be made using other proceeds. See *id.* at 111. As a result of the defendants’ activity, two of the defendant corporations went bankrupt after \$45,000,000 of the Manitoba Development Fund’s investments had already been fraudulently diverted to those corporations. See *id.*

186. See *Kasser*, 548 F.2d at 111. The district court dismissed the case on the grounds that it lacked subject matter jurisdiction because the alleged fraud pertained to “essentially foreign transactions without impact in this country.” *Id.* at 112 (quoting *SEC v. Kasser*, 391 F. Supp. 1167, 1176 (D.C.N.J. 1975)). The district court held that “miscellaneous acts” in the United States were not substantial enough to transform the transaction from a foreign one to a domestic one. See *id.* (quoting *SEC v. Kasser*, 391 F. Supp. 1167, 1177 (D.C.N.J. 1975)).

187. See *id.* at 111-12. The court remarked, “[t]ransnational in character, the fraudulent transactions arranged by the defendants spanned at least two continents. But it is clear that a number of acts were committed within the United States.” *Id.* at 111.

188. See *id.* at 114. The District of Columbia Circuit noted that the language in the *Kasser* opinion “seems more permissive,” thereby creating a “loosening of the jurisdictional requirements.” *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987).

189. See *Kasser*, 548 F.2d at 114.

190. *Id.* In a footnote, the court observed that “the legislative history is silent respecting the jurisdictional scope” *Id.* at 114 n.21.

commerce” as including transactions transpiring “between any foreign country and any State.”¹⁹¹ According to the Third Circuit, it is unlikely that Congress intended to “immunize” defendants simply because pervasive fraudulent activity happens to affect foreign interests instead of American interests.¹⁹² Consequently, instead of adopting a narrow ruling, courts should determine whether or not “the sum total” of the conduct in the United States was substantial.¹⁹³

Kasser also set forth three important policy rationales for broadly reading the jurisdictional scope of the Exchange Act.¹⁹⁴ First, denying jurisdiction might encourage defrauders and manipulators of foreign securities to use the United States as a “base of operations” since they would have an effective “safe haven.”¹⁹⁵ Second, refusing jurisdiction raises the risk that other nations might refuse to enforce their securities laws when conduct in those countries leads to detrimental effects in the United States.¹⁹⁶ In other words, exercising jurisdiction increases the possibility that foreign courts will take “reciprocal action” when United States interests are at stake.¹⁹⁷ Finally, Congress devised the foreign securities laws not only to prevent fraud and to protect investors, but also to encourage high ethical standards of conduct in securities

191. *Id.* (citing 15 U.S.C. § 78c(a)(17) (1994)). The Securities Act also defines “interstate commerce” to include transactions taking place in “any foreign country.” 15 U.S.C. § 77b(a)(7) (1994).

192. *See Kasser*, 548 F.2d at 114. The court stated that it “decline[d] to immunize, for strictly jurisdictional reasons, defendants who unleash from this country a pervasive scheme to defraud a foreign corporation. This would appear to be especially appropriate where the corporation is owned by a foreign governmental subdivision of a neighboring nation.” *Id.*

193. *See id.* at 115 (holding that the dispositive factor was whether “the sum total of the defendants’ intra-national actions was substantial”). The court indicated that the sum total of the conduct in the United States must be examined to determine whether that conduct directly caused the losses outside domestic territory. *See id.*

194. *See id.* at 116. The court remarked, “it should be recognized that this case in a large measure calls for a policy decision” *Id.* (citing *Straub v. Vaisman & Co.*, 540 F.2d 591, 595 (3d Cir. 1976)).

195. *See id.*, 548 F.2d at 116. Employing a powerful analogy, the court remarked, “[w]e are reluctant to conclude that Congress intended to allow the United States to become a ‘Barbary Coast,’ as it were, harboring international securities ‘pirates.’” *Id.* The Barbary Coast spans along the Mediterranean coast of northern Africa from the Atlantic Ocean to Egypt. *See AMERICAN HERITAGE DICTIONARY* 147 (3d ed. 1992). From the 16th to the 19th century, pirates, financially backed by wealthy patrons, frequently used the Barbary Coast as a base of operations to raid and loot ships sailing on the Mediterranean. *See id.*

196. *See Kasser*, 548 F.2d at 116. The *Kasser* court stated, “our inclination towards finding jurisdiction is bolstered by the prospect of reciprocal action against fraudulent schemes aimed at the United States from foreign sources.” *Id.*

197. *Id.*

transactions.¹⁹⁸

3. Ninth Circuit Conduct Analysis Jurisprudence: Raising the Standards of Business Ethics

The Ninth Circuit adopted the broad conduct approach in *Grunenthal v. Hotz*.¹⁹⁹ In *Grunenthal*, a West German plaintiff alleged that Bahamian, Mexican, and Swiss defendants violated Section 10(b) of the Exchange Act by making misrepresentations with regard to an agreement for the sale of a Mexican corporation.²⁰⁰ The litigants negotiated the deal in a series of meetings, most of which took place outside the United States.²⁰¹ The district court presiding over the case dismissed it for lack of subject matter jurisdiction.²⁰² The Ninth Circuit reversed the lower court's ruling²⁰³ by expressly adopting the subject matter jurisdiction analysis proposed by the Third and Eighth Circuits.²⁰⁴

198. *See id.*; *see also supra* notes 29-34 and accompanying text (discussing the public policies underlying the federal securities laws, including the promotion of higher ethical standards).

199. *See Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983).

200. *See id.* at 422-23.

201. *See id.* The first meeting occurred in Germany, the second in the Bahamas, and the third in Mexico. *See id.* The parties met in Los Angeles, California to execute the agreement and were supposed to close the transaction in the Bahamas, but the Bahamian trustees declined to approve the final sale. *See id.* at 423. The gravamen of the plaintiff's complaint was that the defendants misrepresented the identity of the target company's beneficial owner during their meeting in the United States. *See id.* Further, the plaintiff alleged that the defendants misrepresented their intention to actually perform the terms of the agreement, which they executed in the United States. *See id.*

202. *See id.* The district court relied on Second Circuit precedent since there was no controlling precedent in the Ninth Circuit at that time. *See id.* The lower court determined that the lawsuit should be dismissed on the grounds that there was no detrimental effect in the United States and that the defendants' conduct in the United States was not significant enough to establish a jurisdictional nexus. *See id.* (extensively citing *Grunenthal GmbH v. Hotz*, 511 F. Supp. 582, 588 (C.D. Cal. 1981)). The district court noted that the conduct in each of the countries appeared "at least equal to the conduct in the [United States]." *Id.* (citing *Grunenthal GmbH*, 511 F. Supp. at 588). The lower court held that the misrepresentations made in Los Angeles were merely repetitions of misrepresentations the defendants had previously made extraterritorially. *See id.* (citing *Grunenthal GmbH*, 511 F. Supp. at 588). According to the trial judge, execution of the agreement in the United States appeared to be for the sake of "convenience" only. *See id.* (citing *Grunenthal GmbH*, 511 F. Supp. at 588).

203. *See id.* at 426. The Ninth Circuit remarked that "the jurisdictional hook need not be large to fish for securities law violations . . ." *Id.* at 424 (quoting *Lawrence v. SEC*, 398 F.2d 276, 278 (1st Cir. 1968)).

204. *See id.* The *Grunenthal* court noted that "the test used by the Third and Eighth Circuits advances the policies underlying federal securities laws." *Id.* The court further observed that while the Ninth Circuit "has spoken infrequently on the topic of subject matter jurisdiction over transnational securities transactions[,] it did adopt the "effects"

The Ninth Circuit articulated two basic policies in support of its conclusion.²⁰⁵ First, similar to the Third Circuit, denying jurisdiction would serve as an incentive for people who want to use the United States as a base of operations from which to commit fraud in other countries.²⁰⁶ Second, upholding jurisdiction over transnational transactions encourages a "high standard of business ethics in the securities industry."²⁰⁷ Business ethics are particularly important in transnational transactions because the domestic actors are often professionals²⁰⁸ who should be encouraged to behave responsibly in situations where the effects may not be felt in this country.²⁰⁹

While merely preparatory conduct is still insufficient to bestow jurisdiction upon United States courts,²¹⁰ the execution of an agreement in the United States mitigates strongly in favor of granting jurisdiction.²¹¹ The appellate court rejected the district court's reasoning that jurisdiction should be denied when a defrauder engages in conduct in the United States merely for the sake of convenience.²¹² Convenience is an irrelevant factor when determining whether the domestic conduct is sufficient for a United States court to exercise jurisdiction because if convenience were a relevant consideration, it would be easy for foreign citizens and corporations to use the United States as a base of operations for securities fraud.²¹³

C. *Balancing Conduct Approach: Higher Quantum of Domestic Conduct*

The third approach to the conduct test attempts to balance the competing interests involved in a transnational transaction by mediating the conflict between the constitutional limits on the

approach in decisions prior to *Grunenthal, Id.* (citing *Des Brisay v. Goldfield Corp.*, 549 F.2d 133 (9th Cir. 1977); *SEC v. United Fin. Group*, 474 F.2d 354 (9th Cir. 1973)).

205. *See id.* at 424-25.

206. *See id.* (citing *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir. 1977)).

207. *Id.* at 425 (quoting *SEC v. Capital Gains Research Bureau Inc.*, 375 U.S. 180, 186 (1963)).

208. *See id.* The experts acting in a transnational securities transaction include lawyers, accountants, and underwriters. *See id.*

209. *See id.*

210. *See id.*

211. *See id.* The court noted that "the execution of the agreement in Los Angeles itself constituted an act that strongly support[ed] [its] assertion of jurisdiction." *Id.*

212. *See id.*

213. *See id.* (stating that denial of jurisdiction would "make it convenient for foreign citizens and corporations to use this country and its lawyers, accountants and underwriters to further fraudulent securities schemes") (citations omitted).

judiciary's jurisdiction and the protection of market integrity.²¹⁴ In order to establish jurisdiction under this balancing conduct approach, "substantial acts" relating to the fraud must occur in the United States.²¹⁵ This standard demands "a higher quantum of domestic conduct" than the broader approach requires, but a lesser level of conduct than the restrictive approach requires.²¹⁶ Mere preparatory activity in the United States is not sufficient to confer jurisdiction.²¹⁷ Furthermore, there is no United States jurisdiction if the majority of the conduct takes place in another country.²¹⁸ Rather, the domestic conduct must directly cause the plaintiff's loss in order to confer jurisdiction.²¹⁹

Proponents of the balancing conduct approach contend that it finds the proper balance between the competing interests of the narrow test and the broad test.²²⁰ On the one hand, like the narrow test, it does not impermissibly exceed the bounds of jurisdiction conferred upon the federal courts by Congress.²²¹ On the other hand, like the broad test, it sufficiently prevents the use of domestic securities markets as safe havens for fraudulent activity abroad.²²²

1. Second Circuit Conduct Analysis Jurisprudence: Setting the Standards

In a pair of decisions, the Second Circuit elaborated on the conduct approach it initially adopted in *Leasco*.²²³ *Bersch v. Drexel Firestone*,

214. See *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 666 (7th Cir. 1998), cert. denied, 119 S. Ct. 890 (1999). The Seventh Circuit noted, "[o]ur colleagues in the Second and Fifth Circuits have set a course between the two extremes [of the restrictive approach and the broader approach]. That approach requires a higher quantum of domestic conduct than do the Third, Eighth and Ninth Circuits." *Id.*

215. See *Psimenos v. E.F. Hutton & Co., Inc.*, 722 F.2d 1041, 1045 (2d Cir. 1983) (citing *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975)).

216. *Kauthar*, 149 F.3d at 666.

217. See *id.* (citing *Psimenos*, 722 F.2d at 1046).

218. See *Vencap*, 519 F.2d at 1018 (stating that jurisdiction exists "where the bulk of the activity was performed in foreign countries").

219. See *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir. 1975); see also note 44 (discussing plaintiff standing in Rule 10b-5 actions).

220. See *Kauthar*, 149 F.3d at 667 (noting that "[t]he Second and Fifth Circuits' iterations of the test embody a satisfactory balance of these competing considerations").

221. See *id.*

222. See *id.*

223. See *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975); *Vencap*, 519 F.2d at 1001. The Second Circuit decided both *Bersch* and *Vencap* on April 28, 1975, and Judge Friendly wrote the opinion for both cases. See *Bersch*, 519 F.2d at 977; *Vencap*, 519 F.2d at 1003.

*Inc.*²²⁴ involved a class action suit with a plaintiff class comprised primarily of foreign citizens and foreign residents,²²⁵ who invested in a Canadian corporation.²²⁶ The corporation only offered the stock to a select group of purchasers and did not offer the stock in the United States.²²⁷ In a series of transactions, the defendants allegedly defrauded the plaintiffs by making various “implied” misrepresentations concerning the corporation’s stability.²²⁸ The complaint also included several particular charges of illegal activity and mismanagement.²²⁹ Although the defendants had attempted to guarantee that their activities would not fall within the ambit of American securities laws,²³⁰ the plaintiffs alleged that the defendants engaged in sufficient conduct in the United States to allow a United States court to entertain the case.²³¹

The Second Circuit held that the defendants had in fact engaged in enough activity in the United States to authorize a United States court to preside over the case.²³² The *Bersch* court made three preliminary observations.²³³ First, the court warned that legislation is not always meant to reach the greatest possible extent.²³⁴ This limited extension is

224. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975).

225. *See id.* at 977-78. While most of the plaintiffs were from Australia, Canada, England, France, Germany, and Switzerland, there were some plaintiffs from various countries in Asia, Africa, Europe, and South America. *See id.*

226. *See id.* at 978. The corporation was organized under Canadian law and had its principal place of business in Switzerland. *See id.*

227. *See id.* at 980. Nevertheless, some Americans somehow obtained stock in the company, but it was “murky” from the court record how that came about. *See id.* at 991. According to the prospectus, the stock was “not being offered in the United States of America or any of its territories or possessions or any area subject to its jurisdiction.” *Id.* at 980 (quoting the prospectus). Furthermore, the offering was “being made to approximately 25,000 persons who are either (1) employees or sales associates of the Company, (2) certain clients presently holding investments in managed funds or other products of the Company, or (3) persons who have had a long-standing professional or business relationship with the Company.” *Id.* (quoting the prospectus).

228. *See id.* at 981.

229. *See id.* Specific charges included the failure to disclose that the corporation had committed illegal activities; keeping the corporation’s books and records in “chaotic condition”; corporate officials over-touting the corporation’s prospects for profits, failure of the underwriters to use due diligence in the prospectus; and failure to follow widely accepted accounting principles. *See id.* (listing the allegations of the plaintiffs’ complaint).

230. *See id.* at 982.

231. *See id.* at 984-85.

232. *See id.* at 985 (“We have no doubt that the activities within the United States . . . were sufficient to authorize the United States to impose a rule . . .”).

233. *See id.* at 985-86.

234. *See id.* at 985 (quoting *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334 (2d Cir. 1972)); *see also supra* notes 45-56 and accompanying text

particularly important in the context of transnational securities transactions because Congress did not intend to devote “the precious resources of United States courts and law enforcement agencies” to transactions that are “predominantly foreign.”²³⁵ Second, a judgment against an absent defendant may not be binding.²³⁶ Finally, the antifraud provisions of the securities laws regulate many transactions that occur on markets outside the United States or that involve securities that do not have to be registered under the Exchange Act.²³⁷

Bersch established three basic principles with regard to the antifraud provisions of the Exchange Act.²³⁸ First, federal courts have jurisdiction to preside over cases in which American residents experience financial losses in the United States, regardless of whether materially important conduct occurred in the United States.²³⁹ Second, federal courts have jurisdiction to hear cases in which American residents abroad suffer losses only if materially important conduct, which significantly contributes to the loss, occurs in the United States.²⁴⁰ Finally, United States courts do not have jurisdiction over cases in which foreigners in other countries suffer losses, unless the fraudulent conduct in the United States “directly caused” the losses.²⁴¹

(discussing the limits to federal jurisdiction). The *Leasco* court provided the following caveat: “it would be . . . erroneous to assume that the legislature always means to go to the full extent permitted.” *Leasco*, 468 F.2d at 1334; *see also supra* notes 109-23 and accompanying text (discussing the *Leasco* court’s proposal of the conduct approach to determine whether a United States court has subject matter jurisdiction over a transnational transaction).

235. *Bersch*, 519 F.2d at 985.

236. *See id.* at 986. Thus, *Bersch* involved principles of international comity because a judgment against the foreign defendants might conflict with the ruling of a foreign court. *See supra* notes 68-72 and accompanying text (discussing principles of international comity).

237. *See Bersch*, 519 F.2d at 986.

238. *See id.* at 993. The *Bersch* court observed:

We freely acknowledge that if we were asked to point to language in the statutes, or even in the legislative history, that compelled these conclusions, we would be unable to respond We recognize also that reasonable men might conclude that the coverage was greater, or less, than has been outlined in this opinion Our conclusions rest on case law and commentary concerning the application of securities laws and other statutes to situations with foreign elements and on our best judgment as to what Congress would have wished if these problems had occurred to it.

Id.

239. *See id.*

240. *See id.*

241. *See id.* Adherents of the broader conduct approach suggest that constitutional questions arise from the Second Circuit’s application of different “tests” to non-U.S. plaintiffs than to U.S. plaintiffs. *See Grunenthal GmbH v. Hotz*, 712 F.2d 421, 426 n.9 (9th Cir. 1983); *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d

In *IIT v. Vencap, Ltd.*,²⁴² the Second Circuit further examined “the extent to which the federal securities laws apply to transnational transactions.”²⁴³ *Vencap* is a unique decision because it begins with a discussion of the merits of the case before discussing whether or not the court had jurisdiction to preside over the case.²⁴⁴ This maneuver emphasizes the interrelation between procedural law and substantive law.²⁴⁵ This interrelation suggests that the Second Circuit was applying a multifactoral approach to determine whether or not a given transaction is transnational.²⁴⁶

The Second Circuit thus suggested that the facts of each case must be weighed to determine whether the court has subject matter jurisdiction over a transnational securities transaction.²⁴⁷ Conduct generally directed at a transnational transaction is not enough to confer jurisdiction.²⁴⁸ Furthermore, if the plaintiffs to the lawsuit are not

409, 418 n.14 (8th Cir. 1979); Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 569 (1976); Comment, *The Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363, 1376-77 (1973). The Second Circuit recently acknowledged that due process issues arise under the Fifth Amendment of the United States Constitution when determining whether a United States court has jurisdiction over a transnational securities fraud claim. See *Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 127-28 (2d Cir. 1998), *cert. denied*, 119 S. Ct. 1029 (1999).

242. *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975).

243. *Id.* at 1003-04.

244. See *id.* at 1011-14.

245. See *id.* at 1011. Judge Friendly stated:

Normally we would proceed at this point to the issue of subject matter jurisdiction since, if that did not exist, it is immaterial whether or not the plaintiffs have shown a sufficient probability of success on the merits to warrant the grant of interlocutory relief. But here *the two issues are interrelated*

Id. (emphasis added). In a subsequent decision, Judge Friendly stated:

[W]hen the contested basis of federal jurisdiction is also an element of plaintiff's asserted federal claim, the claim should not be dismissed for want of jurisdiction except when it “appears to be immaterial and made solely for the purpose of obtaining jurisdiction or where such a claim is wholly insubstantial and frivolous.”

AVC Nederland B.V. v. Atrium Inv. Partnership, 740 F.2d 148, 152-53 (2d Cir. 1984) (quoting *Bell v. Hood*, 327 U.S. 678, 682 (1945)). Both of these passages by Judge Friendly echo the words of Justice Holmes, “whenever we trace a leading doctrine of substantive law far enough back, we are very likely to find some forgotten circumstance of procedure at its source.” OLIVER WENDELL HOLMES, *THE COMMON LAW* 199 (Mark DeWolfe Howe, ed., Harvard University Press 1963) (1881).

246. See *Vencap*, 519 F.2d at 1016-18 (noting that conduct in the United States satisfying one element of fraud is not necessarily dispositive for determining subject matter jurisdiction).

247. See *AVC Nederland*, 740 F.2d at 154.

248. See *id.*

United States citizens, the conduct in the United States must be material to the actual completion of the fraudulent scheme.²⁴⁹ Likewise, foreign “transients” passing through the United States, who are protected by their own nations’ laws, cannot seek redress in United States courts.²⁵⁰ The Second Circuit justified treating foreign plaintiffs differently on the grounds that it is “unimaginable” that United States securities laws should protect foreign investors conducting transactions that for the most part take place abroad.²⁵¹

According to the standards proposed by the Second Circuit, subject matter jurisdiction can also be predicated upon some combination of the conduct test and the effects test,²⁵² even if the conduct by itself is insufficient to support subject matter jurisdiction.²⁵³ For instance, the

249. See *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir. 1991) (citing *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1046 (2d Cir. 1983) (discussing the extraterritorial reach of subject matter jurisdiction under the Commodity Exchange Act)). In *Alfadda*, the defendants’ conduct in the United States was material because it resulted in the consummation of the fraud. See *id.* at 478-79. Thus, *Alfadda* follows the holding of *Bersch v. Drexel Firestone, Inc.*, which required the activity in the United States to directly cause the loss to injured foreign investors for a United States court to exercise jurisdiction. See *id.*; see also *supra* notes 238-41 and accompanying text (discussing the three principles articulated in *Bersch*).

250. See *Europe and Overseas Commodity Traders v. Banque Paribas London*, 147 F.3d 118, 128 n.12 (2d Cir. 1998), *cert. denied*, 119 S. Ct. 1029 (1999). In its holding, the court stated that,

a series of [phone] calls to a transient foreign national in the United States is not enough to establish jurisdiction under the conduct test without some additional factor tipping the scales in favor of our jurisdiction. Without such added weight, the exercise of prescriptive jurisdiction [i.e., subject matter jurisdiction] by Congress would be unreasonable . . . and is particularly so when the transaction is clearly subject to the regulatory jurisdiction of another country with a clear and strong interest in redressing any wrong. We do not think Congress intended to make the securities laws have such a broad reach or to make U.S. courts available for such suits.

Id. at 129 (citations omitted).

251. See *Vencap*, 519 F.2d at 1016. Judge Friendly stated, “it is simply unimaginable that Congress would have wished the anti-fraud provisions of the securities laws to apply if, for example, [a United States citizen residing in the Bahamas] while in London had done all the [fraudulent] acts here charged and had defrauded only European investors.” *Id.*

252. Under the effects approach, a United States court has jurisdiction in a transnational securities fraud case if the alleged fraud had a substantial effect on United States investors or securities markets. See *supra* Part II.D.1 (discussing the effects approach).

253. See *Itoba Ltd. v. Lep Group. PLC*, 54 F.3d 118, 124 (2d Cir. 1995). The *Itoba* court remarked: “There is no requirement that [the conduct test and the effects test] be applied separately and distinctly from each other. Indeed, an admixture or combination of the two often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court.” *Id.* at 122. For discussions of *Itoba*, see Joseph P. Garland & Brian P. Murray, *Subject Matter*

mere failure to register a security in the United States is not significant enough conduct to give a United States court jurisdiction over a transnational securities transaction, even if the security is intended for sale in the United States.²⁵⁴ If the failure to register a security, however, is coupled with a deleterious effect to United States investment markets, then subject matter jurisdiction may be proper because the transaction defeats the basic purposes underlying full disclosure.²⁵⁵

2. Fifth Circuit Conduct Analysis Jurisprudence: Limiting Jurisdiction Absent an Express Legislative Command

When first confronted with the issue of subject matter jurisdiction over a transnational securities transaction, the Fifth Circuit declined “to formulate the outer perimeter of American jurisdiction.”²⁵⁶ In *MCG, Inc. v. Great Western Energy Corp.*,²⁵⁷ however, the Fifth Circuit adopted the Second Circuit’s balancing approach rather than the “more relaxed standard” of the Third, Eighth, and Ninth Circuits.²⁵⁸

The *MCG* court noted at the outset that the existence of subject matter jurisdiction “turns on the facts” in transnational securities fraud cases.²⁵⁹ *MCG* involved the sale of securities on the London Stock Exchange.²⁶⁰ The securities were not registered in the United States and were offered exclusively to investors who were not United States

Jurisdiction Under the Federal Securities Laws: The State of Affairs After Itoba, 20 MD. J. INT’L L. & TRADE 235 (1996); Mark B. Schwartz, Comment, *Itoba Ltd. v. Lep Group PLC: An Apple that Fell from the Wrong Branch*, 22 BROOK. J. INT’L L. 467 (1996).

254. See *Itoba*, 54 F.3d at 124. The same standards do not apply to the registration provisions and the antifraud provisions of the securities laws. See *id.*; see also *supra* note 29 (discussing the regulation regime of the federal securities laws).

255. See *Itoba*, 54 F.3d at 124; see also *supra* notes 29-34 and accompanying text (discussing the policies justifying the registration regime of the federal securities laws).

256. *United States v. Cook*, 573 F.2d 281, 283 (5th Cir. 1978). In *Cook*, the defendant operated a ponzi scheme out of Dallas, Texas by offering phony oil and gas wells in the United States as a means to defraud European investors. See *id.* at 282-83; see also *supra* note 185 (explaining ponzi schemes). The *Cook* court held there was no need to adopt a specific position regarding the conduct analysis of subject matter jurisdiction because the extensiveness of the scheme’s domestic operations gave the court “little pause” that the case fell within the limits of United States jurisdiction. See *Cook*, 573 F.2d at 283.

257. *MCG, Inc. v. Great W. Energy Corp.*, 896 F.2d 170 (5th Cir. 1990).

258. See *id.* at 174-75. Subsequently, the Fifth Circuit noted that *MCG* “merely noted the existence of the circuit split” and did not expressly adopt a position. *Robinson v. TCI/US W. Cable Communications Inc.*, 117 F.3d 900, 906 (5th Cir. 1997); see also *infra* notes 270-86 and accompanying text (discussing *Robinson*).

259. See *MCG*, 896 F.2d at 173.

260. See *id.* at 172.

citizens or nationals.²⁶¹ Several American investors, however, somehow procured the stock.²⁶² Subsequently, the American investors brought suit alleging that the defendants violated American securities laws by making fraudulent representations concerning the profitability of the investment.²⁶³

The district court dismissed the case due to a lack of subject matter jurisdiction because after the plaintiffs had “taken every measure to avoid the [federal] securities laws, plaintiffs could not now seek their protections.”²⁶⁴ The Fifth Circuit agreed that there was not enough activity in the United States to sustain jurisdiction.²⁶⁵ The appellate court held that determination of subject matter jurisdiction must be made on a case-by-case basis and that no single factor is per se dispositive.²⁶⁶ The Fifth Circuit noted that since the plaintiffs went to such lengths to acquire the securities, despite the express exclusion of American investors, they could not cry foul when the investment failed to produce the results they expected.²⁶⁷ The court further observed that the procedural issue of subject matter jurisdiction was not necessarily interwoven with the substantive merits of the case.²⁶⁸ Hence, when the determination of subject matter jurisdiction involves a “discrete set of facts” that is distinguishable from those involved in the case’s merits, a court can dismiss the case regardless of whether the claim is meritorious or not.²⁶⁹

Several years later, in *Robinson v. TCI/US West Cable Communications Inc.*,²⁷⁰ the Fifth Circuit had the opportunity to

261. *See id.*

262. *See id.* at 172-73. It is not clear from the facts how the American investors managed to circumvent the purchaser restrictions. *See id.* at 172. It was clear, however, that they tried to “structure transactions to their financial advantage.” *Id.* at 175 n.5. The plaintiffs knew that the transaction was not governed by United States securities laws, and yet they purposefully sought to procure the securities. *See id.* at 175.

263. *See id.* at 172-73.

264. *Id.* at 173.

265. *See id.* at 176.

266. *See id.* at 175.

267. *See id.* The court noted, “[h]aving gone to such lengths to structure a transaction not burdened by the securities laws, plaintiffs cannot expect to wrap themselves in their protective mantle when the deal sours.” *Id.* at 175.

268. *See id.* at 176; *see also supra* notes 49-50 and accompanying text (discussing the distinction between the merits of a case and subject matter jurisdiction).

269. *See MCG*, 896 F.2d at 176; *see also supra* notes 49-50 and accompanying text. When the facts pertinent to subject matter jurisdiction cannot be discerned from the facts pertinent to the merits, a claim cannot be dismissed due to lack of subject matter jurisdiction, unless the claim is legally insufficient. *See MCG*, 896 F.2d at 176 n.6 (citing *Bell v. Hood*, 327 U.S. 678 (1946)).

270. *Robinson v. TCI/US W. Cable Communications, Inc.*, 117 F.3d 900 (5th Cir.

reexamine its stance on subject matter jurisdiction over transnational securities claims.²⁷¹ In *Robinson*, a British plaintiff alleged that the defendant induced him to sell his shares in a British company for less than they were worth.²⁷² The complaint stated that the British company, which American companies controlled, instructed a British merchant bank to prepare an inaccurate statement of the true value of the company.²⁷³ The legal department of the controlling American company prepared and faxed the instructions to prepare the inaccurate statement in the United States.²⁷⁴ The legal department faxed the instructions to England on the American company's letterhead.²⁷⁵ The district court dismissed the complaint for lack of subject matter jurisdiction.²⁷⁶

Even though most of the conduct relating to the fraud occurred in England,²⁷⁷ the Fifth Circuit held that it had subject matter jurisdiction by using the conduct approach proposed by the Second Circuit.²⁷⁸ Notwithstanding the federal courts' limited jurisdiction and the presumption against extraterritoriality,²⁷⁹ the *Robinson* court held that when conduct in the United States is "of material importance" to the fraud or "directly caused" by the fraud, a United States court is competent to preside over a case of transnational securities fraud.²⁸⁰

The Fifth Circuit agreed that most of the material conduct of a transnational transaction may occur outside the United States,²⁸¹ however, the court held that when the events occurring in the United States are "key events," a United States court may properly exercise its jurisdiction.²⁸² The Fifth Circuit recognized the importance of the

1997).

271. *See id.* at 904-08.

272. *See id.* at 903.

273. *See id.* at 903-04.

274. *See id.* at 903.

275. *See id.*

276. *See id.*

277. *See id.* at 907.

278. *See id.*; *see supra* notes 109-23, 223-55 and accompanying text (discussing the conduct approach developed by the Second Circuit). The *Robinson* court was aware of the circuit split regarding the conduct approach. *See Robinson*, 117 F.3d at 905-06. After examining the different approaches, the Fifth Circuit declared, "[w]e adopt the Second Circuit's test as the better reasoned of the competing positions." *Id.* at 906.

279. *See Robinson*, 117 F.3d at 906.

280. *See id.* at 905-06 (citing *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 122 (2d Cir. 1995)). The Fifth Circuit suggested that the limited jurisdiction of the federal judiciary as well as the presumption against extraterritoriality were decisive in choosing between the alternative approaches to subject matter jurisdiction. *See id.* at 906.

281. *See id.* at 907.

282. *See id.*

policy considerations relied upon by the proponents of the broader approach.²⁸³ Given the limits of federal jurisdiction, however, the Fifth Circuit refused to broaden its jurisdiction on the ground that an over-extension of jurisdiction was “unwarranted in the absence of an express legislative command.”²⁸⁴ Courts should not extend jurisdiction beyond the minimum amount necessary to implement the purposes of American securities regulation.²⁸⁵ In this regard, the Fifth Circuit concurred with the restrictive approach’s apprehension about judicial activism, which bases judicial rulings on policy rather than on statutory language and limits of federal jurisdiction.²⁸⁶

3. Seventh Circuit Conduct Analysis Jurisprudence: Defining the “Approaches” to Conduct Analysis

*Kauthar SDN BHD v. Sternberg*²⁸⁷ made the Seventh Circuit Court of Appeals the most recent court to take a stance regarding the degree of conduct required to confer a federal court with jurisdiction over a transnational securities transaction.²⁸⁸ *Kauthar* involved a claim by a Malaysian corporation against American defendants.²⁸⁹ The plaintiff alleged that the defendants fraudulently induced it to invest thirty-eight million dollars in a Caribbean company that provided satellite communications services.²⁹⁰ Eventually, the Caribbean corporation went bankrupt, and the Malaysian plaintiff realized that the stock in the corporation was worthless.²⁹¹ The plaintiff filed suit alleging that the defendants violated United States securities laws because the defendants carried out a “host of alleged general activities” in the United States involving conduct sufficient to allow a United States

283. *See id.* at 906-07.

284. *Id.* at 906 (expressly rejecting the broader approach) (citing *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 32 (D.C. Cir. 1987)). The Fifth Circuit noted that the presumption of extraterritoriality informed its adoption of the Second Circuit approach. *See id.*

285. *See id.*; *see also supra* notes 29-44 and accompanying text (discussing the policies underlying the federal securities laws). The court observed that American securities laws “are designed to protect American investors and markets, as opposed to the victims of any fraud that somehow touches the United States.” *Robinson*, 117 F.3d at 906.

286. *See Robinson*, 117 F.3d at 906-07; *see also supra* notes 133-49 and accompanying text (discussing the restrictive approach).

287. *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 890 (1999).

288. *See id.* at 667.

289. *See id.* at 661.

290. *See id.* Although incorporated in the Caribbean island nation of Nevis, the company had its principal place of business in Fort Wayne, Indiana. *See id.*

291. *See id.* at 662.

federal court to exercise subject matter jurisdiction.²⁹² For instance, the defendants prepared documents with misrepresentations and material omissions in the United States and then sent the documents to the plaintiff in Malaysia.²⁹³

Although there was no effect on American investors or securities markets and the fraudulent transaction only affected the Malaysian corporation,²⁹⁴ the Seventh Circuit used the conduct analysis to conclude that the district court did have subject matter jurisdiction over the case.²⁹⁵ Observing that neither the language nor the legislative history of the Exchange Act offer much guidance,²⁹⁶ the Seventh Circuit immediately distinguished itself from other courts by noting that the term “test,” as used in previous cases discussing the conduct analysis, was “too inflexible a term” to describe the current status of the law.²⁹⁷ The term “test” is problematic because it indicates that there are accepted canons of statutory interpretation that courts consistently apply to transnational securities fraud cases.²⁹⁸ In lieu of the term “test,” the Seventh Circuit adopted the term “approach” to describe the current status of the law because it was a more flexible term.²⁹⁹

Noting the circuit split,³⁰⁰ the *Kauthar* court remarked that the disparity among the circuits involved both doctrinal and attitudinal disagreements.³⁰¹ The Seventh Circuit recognized that Congress did

292. *Id.* at 667. The district court dismissed the securities fraud counts for lack of subject matter jurisdiction. *See id.* at 663. The district court decided that neither the “effects” approach nor the “conduct” approach allowed it to hear the case. *See id.; supra* notes 88-123 and accompanying text (discussing the details of the effects and conduct approaches).

293. *See Kauthar*, 149 F.3d at 667.

294. *See supra* notes 88-108 and accompanying text (discussing the effects approach to determine subject matter jurisdiction in transnational securities fraud cases).

295. *See Kauthar*, 149 F.3d at 667.

296. *See id.* at 664.

297. *See id.* at 665.

298. *See id.* at 664-65.

299. *See id.* at 665. Twenty years before the Seventh Circuit’s observation, one commentator suggested that the term “test” oversimplifies the methods of determining subject matter jurisdiction in transnational securities fraud cases. *See Schiro, supra* note 86, at 286 n.46 (stating that the term “test” does not entail “a process of matching new facts to an old paradigm of effect or conduct”).

300. *See Kauthar*, 149 F.3d at 665.

301. *See id.* The Seventh Circuit made a threefold distinction among the possible approaches to a conduct analysis. *See id.* at 665-66. The Fifth Circuit expressly repudiated the threefold distinction proposed by the Seventh Circuit. *See Robinson v. TCI/US W. Communications Inc.*, 117 F.3d 900, 906 n.10 (5th Cir. 1997) (stating that the D.C. Circuit’s opinion on transnational jurisdiction over securities fraud cases “cannot reasonably be read to have fashioned a new rule” that is more restrictive than the Second Circuit). The Seventh Circuit noted the Fifth Circuit’s disagreement. *See*

not intend for the United States to become a haven for people to commit fraud on investors in other countries, but it warned that federal courts should guard against granting unfettered jurisdiction to cases involving transnational securities matters under the antifraud statutes.³⁰² Ultimately, the Seventh Circuit adopted the Second and Fifth Circuit standards since those circuits seemed to balance the competing interests of the Securities Act and the limited jurisdiction of courts.³⁰³ Thus, the Seventh Circuit articulated the balancing approach and its elements.³⁰⁴ Using the balancing approach, the Seventh Circuit specifically required that the conduct, which occurred in the United States and allegedly violated the federal securities laws, constitute a “substantial part” of the fraud and be material to its success.³⁰⁵

IV. ANALYSIS

There are three basic considerations facing the adoption of any conduct test: constitutional limitations on federal jurisdiction,³⁰⁶ principles of international law,³⁰⁷ and policies underlying the federal securities laws.³⁰⁸ The broader conduct approach, formulated by the Third, Eighth, and Ninth Circuits, best complies with the letter and spirit of the federal securities laws.³⁰⁹

Critics of the broader approach claim that such an interpretation exceeds the limited jurisdiction conferred upon federal courts by Congress.³¹⁰ A broader interpretation potentially opens the door to foreign plaintiffs who have no right to use the “precious resources of

Kauthar, 149 F.3d at 665-66 n.10. The Seventh Circuit, however, proceeded to utilize the distinction in its analysis of subject matter jurisdiction over transnational securities fraud cases. *See id.* at 665-66.

302. *See Kauthar*, 149 F.3d at 667.

303. *See id.* The court held that the district court did have subject matter jurisdiction over the fraud claim. *See id.*

304. *See id.*

305. *See id.*; *see also supra* notes 110-23, 223-55 and accompanying text (discussing the development of the balancing approach in the Second Circuit).

306. *See supra* notes 45-56 and accompanying text (discussing the limited jurisdiction of the federal judiciary).

307. *See supra* notes 64-72 and accompanying text (discussing the presumption against extraterritoriality and international comity).

308. *See supra* notes 82-123 and accompanying text (discussing the extraterritorial reach of jurisdiction under the Exchange Act).

309. *See supra* notes 29-34 and accompanying text (discussing the remedial purposes of the Exchange Act).

310. *See Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987) (arguing that the consequences of the broader approach is a “loosening” of jurisdictional requirements).

United States courts.”³¹¹ Critics attest that if obtaining subject matter jurisdiction over predominantly foreign transactions is too easy, then foreign investors may fear conducting business in the United States since they may not want to risk violating stringent United States securities laws by mistake.³¹²

Despite these criticisms, however, the broader approach does not violate the limits of federal jurisdiction because Congress can regulate activity that occurs within the United States but has an extraterritorial effect.³¹³ In fact, the broader approach appears to fulfill the jurisdictional provisions better than either the restrictive approach or the balancing approach, particularly in light of the breadth of the antifraud provision of the Exchange Act.³¹⁴ The restrictive and balancing approaches both base their positions on a confusing mix of procedural and substantive law under the auspices of judicial economy.³¹⁵

The major flaw with these less liberal approaches is that they require a plaintiff to prove too much before entering court. Under the restrictive approach, a plaintiff must prove that all of the elements of the securities fraud claim occurred in the United States.³¹⁶ Similarly, under the balancing approach, proof of subject matter jurisdiction is so fact intensive that needless jurisdictional tests emerge.³¹⁷ The

311. *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 121 (2d Cir. 1995).

312. See Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927, 935 (1994).

313. See *supra* notes 64-67 and accompanying text (discussing the presumption against extraterritoriality).

314. See *supra* notes 29-34 and accompanying text (discussing the remedial purposes of the federal securities laws).

315. See *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 (2d Cir. 1975). Judge Friendly wrote:

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

Id.

316. See *supra* notes 133-49 and accompanying text (describing the restrictive approach and its requirement that the domestic conduct actually violate the United States securities laws); see also *supra* notes 35-44 and accompanying text (discussing the prima facie elements of a securities fraud case).

317. See *supra* notes 133-49 and accompanying text (describing the restrictive approach's critique of the balancing approach). As Justice Douglas noted: "When a foreign corporation undertakes fraudulent action which subjects it to the jurisdiction of our federal securities laws, nothing justifies the conclusion that only a diluted version of those laws protects American investors." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 530-31 (1974) (Douglas, J., dissenting).

balancing approach does not even provide a clear test, rather it proposes a nebulous “approach” to the problem of determining subject matter jurisdiction in transnational securities fraud cases.³¹⁸

Although a court’s jurisdiction over a disputed securities transaction is distinguishable from the merits of the claim itself,³¹⁹ both the restrictive approach and the balancing approach combine the analysis of the merits of a transnational securities fraud claim with the analysis of the court’s jurisdiction over the claim.³²⁰ In doing so, they effectively violate the will of Congress by refusing to hear claims Congress has empowered them to hear pursuant to its constitutional authority.³²¹

The usual presumption against extraterritoriality simply does not apply to any of the various conduct analyses of subject matter jurisdiction because the conduct over which courts seek jurisdiction is *domestic* conduct, not foreign conduct.³²² Requiring that a lesser degree of the defendant’s conduct occur within the United States’ borders is arguably more effective from a procedural standpoint because it does not require a plaintiff to prove the claim before the court hears the claim.³²³ Under both the restrictive approach and the balancing approach, however, that is precisely what a plaintiff must prove in order to bring a claim before a federal court, thereby denying some plaintiffs of their day in court.³²⁴

Critics of the narrow conduct test argue that if jurisdiction is narrowed too much, there is a danger that the United States securities markets will become a “base of operations” for fraudulent foreign

318. See *supra* notes 287-305 and accompanying text (discussing the Seventh Circuit’s analysis of the conduct approach).

319. See *supra* notes 49-50 and accompanying text (describing the distinction between the merits of a claim and a court’s jurisdiction over that claim).

320. See *supra* notes 49-50 and accompanying text.

321. See *supra* notes 45-60 (discussing congressional limits on federal subject matter jurisdiction).

322. See *supra* notes 64-67, 73-81 and accompanying text (discussing the presumption against extraterritoriality and the rebuttal of that presumption). The basis for the presumption against extraterritoriality is that Congress focuses its concerns on domestic rather than foreign activity. See *supra* note 66 and accompanying text. The presumption against extraterritoriality does not apply to the conduct approach, however, since the conduct involved actually occurs within the United States thereby not involving foreign activity. See *supra* note 117 and accompanying text.

323. See *supra* notes 150-213 and accompanying text (discussing the broader conduct approach and its requirement that only some conduct in the United States is sufficient to confer jurisdiction in the United States).

324. See *supra* notes 133-49 and accompanying text (discussing the restrictive conduct approach); *supra* notes 214-305 and accompanying text (discussing the balancing approach).

securities transactions.³²⁵ Congress is concerned even when the fraudulent securities devices are directed towards foreigners because it is doubtful that they intended the United States to be used as a base of operations for securities fraud directed at investors in other countries.³²⁶ Furthermore, if American investors want to rely on the protections of the investment laws of other countries, American laws must protect foreign investors.³²⁷ Preventing the United States from becoming a base of operations for securities fraud becomes increasingly intolerable as the global financial community grows,³²⁸ particularly as new modes of communication emerge, increasing access to United States markets and investors.³²⁹

The fundamental difference among the approaches comes down to policy considerations.³³⁰ The broader approach places a heavier emphasis on policy considerations.³³¹ The balancing approach

325. See *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir. 1977).

326. See *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975).

327. See *supra* notes 172-82, 194-98, 205-09 and accompanying text (discussing the policy considerations invoked by adherents of the broader approach).

328. See *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 667 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 890 (1999) (stating that "we live in an increasingly global financial community").

329. See Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, 1998 SEC LEXIS 488, 63 F.R. 14806 (March 23, 1998) (discussing the SEC's views on the use of web sites to disseminate offering and solicitation materials for offshore sales of securities); see also Jack L. Goldsmith, *The Internet and the Abiding Significance of Territorial Sovereignty*, 5 IND. J. GLOBAL L. STUD. 475 (1998) (arguing that territorial regulation is the dominant way to regulate transnational transactions); Robert A. Prentice, *The Future of Corporate Disclosure: The Internet, Securities Fraud, and Rule 10b-5*, 47 EMORY L.J. 1 (1998) (analyzing the impact of the Internet on regulating securities fraud). A recent SEC suit against 44 scam artists, who used the Internet to implement fraudulent schemes against unwary investors, highlighted the dangers posed by new media such as computers. See Michael Schroeder & Rebecca Buckman, *U.S. Attacks Stock Fraud on Internet: SEC Hits Promoters Touting Small Issues*, WALL ST. J., Oct. 29, 1998, at C1. According to the SEC, the types of fraud involved were not novel although a new medium was used to execute the fraud. See *id.* Some observers noted that the Internet, as a medium of fraud, poses a more novel and difficult problem than the SEC is currently willing to acknowledge. See Jason Anders & Carrie Lee, *SEC Actions Underscore the Dangers But Won't Safeguard Online Investors*, WALL ST. J., Nov. 2, 1998, at A31B. The difficulties in policing the Internet for fraud are novel because many investors think they can make a quick buck through online investment services. See *id.* Furthermore, the "veil of anonymity," which is inherent to web site operations, aids swindlers in their schemes to defraud investors. See *id.*

330. See *supra* notes 147-49 and accompanying text (discussing the restrictive approach's rejection of policy considerations); see also *supra* notes 172-82 and accompanying text (discussing the broader approach's acceptance of policy considerations)

331. See *supra* notes 172-82, 194-98, 205-09 and accompanying text (discussing policy concerns such as preventing defrauders from using the United States as a base of

acknowledges those considerations, but its adherents seem more concerned with preserving the "precious resources" of the federal courts than with hearing legitimate claims.³³² Furthermore, the fact intensive inquiry proposed by adherents of the balancing approach blurs the distinction between the procedural elements of a claim and its merits.³³³ Consequently, the broader approach provides the clearest procedural framework for determining subject matter jurisdiction in transnational securities fraud cases.

V. PROPOSAL

Courts should adopt the broader conduct approach in determining whether they have subject matter jurisdiction to hear a transnational securities fraud case.³³⁴ Given that clear standards are necessary to determine the types of conduct that will make a court competent to hear a transnational securities fraud claim,³³⁵ the Supreme Court should take the opportunity to reconcile this circuit split. When it does, the Supreme Court should adopt the broader conduct approach on the basis that it complies with the Constitution, principles of international law, and the policies underlying the federal securities law.³³⁶

The broader approach, as proposed by the Third, Eighth, and Ninth Circuits, will provide the simplest and clearest jurisdictional standard since the restrictive approach is too narrow and the balancing approach is too ambiguous.³³⁷ Although the restrictive approach would also provide a clear standard, it would bar many litigants whose claims deserve to be heard on the merits because the restrictive approach excludes many cases that would be allowed under both the broader or

operations, encouraging reciprocity by other countries, and encouraging business ethics in the United States).

332. *See supra* note 235 and accompanying text (discussing the need to preserve judicial resources when foreign transactions are in dispute).

333. *See supra* notes 49-50 and accompanying text (discussing the difference between the merits of a case and subject matter jurisdiction).

334. Thus, this Comment reaches the conclusion drawn by the Third Circuit, when it stated: "We are reluctant to conclude that Congress intended to allow the United States to become a 'Barbary Coast,' as it were, harboring international securities 'pirates.'" *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir. 1977).

335. *See supra* notes 306-33 and accompanying text (discussing the need for clarity of procedural standards).

336. *See supra* notes 306-33 and accompanying text (comparing the different approaches adopted by the circuit courts).

337. *See supra* notes 150-213 and accompanying text (discussing the broader conduct approach); *see also* *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 36-37 (D.C. Cir. 1987) (Wald, C.J., concurring); *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 424 (9th Cir. 1983); *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 415 (8th Cir. 1979); *SEC v. Kasser*, 548 F.2d 109, 115 (3d Cir. 1977).

even the balancing approach.³³⁸ Furthermore, under the restrictive approach, plaintiffs would have to prove their cases on the merits *before* establishing that there are sufficient facts to support jurisdiction.³³⁹ Thus, the restrictive approach would deny deserving litigants of their day in court in order to advocate a parochial federalism, which opposes judicial activism.³⁴⁰

The broader approach will provide clearer procedural standards than the balancing approach due to the balancing approach's fact-intensive inquiry.³⁴¹ Due to the factual burden required by the balancing approach, it would provide an unclear procedural standard, which would needlessly multiply the jurisdictional standards at issue in transnational securities cases.³⁴²

The Seventh Circuit's adoption of the term "approach" in lieu of "test" to analyze conduct highlights the fact that the balancing approach would prevent courts from establishing clear procedural standards.³⁴³ Thus, the balancing approach, like the restrictive approach, would blur the distinction between the merits of a case and the competency of a federal court to hear a case.³⁴⁴

The broader approach would better serve the remedial purposes of securities legislation, which the restrictive and balancing approaches sacrifice for the sake of judicial economy.³⁴⁵ The resources of the federal judiciary may be "precious"; however, judicial economy should not be invoked if litigants with legitimate claims would be denied access to federal courts.³⁴⁶ When considering which type of conduct analysis to adopt in transnational securities cases, policy considerations should play a large role in order to implement the

338. *See supra* notes 133-49 and accompanying text (discussing the restrictive approach's exclusion of legitimate litigants).

339. *See supra* notes 316-18 and accompanying text (criticizing the restrictive approach's requirement that plaintiffs prove the merits of their case before establishing jurisdiction).

340. *See supra* notes 306-33 and accompanying text (examining the limited applicability and scope of the restrictive approach).

341. *See supra* notes 306-33 (discussing the lack of a test for determining subject matter jurisdiction when using the balancing approach).

342. *See supra* notes 306-33 and accompanying text.

343. *See Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 665 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 890 (1999).

344. *See supra* notes 306-33 and accompanying text (comparing the three approaches of conduct analysis).

345. *See supra* notes 306-33 and accompanying text.

346. *See supra* notes 306-33 and accompanying text (analyzing the broader approach).

remedial purposes of the securities laws.³⁴⁷

The primary concerns with adopting the broader approach are the limits on federal jurisdiction, the presumption against extraterritoriality, and principles of international comity.³⁴⁸ Despite these concerns, a broader reading of the jurisdictional grant under the Exchange Act is appropriate in transnational securities fraud cases. First, the broader approach does not exceed the limits imposed by the Constitution.³⁴⁹ Second, the broader approach does not exceed the jurisdictional grant given by Congress.³⁵⁰ Accordingly, courts could not exceed the Constitutional limits to their jurisdiction;³⁵¹ however, they could review federal law and determine the scope of a given statutory provision, including provisions bestowing jurisdiction upon the federal judiciary.³⁵²

Finally, adoption of the broader analysis of the conduct approach does not violate the presumption against extraterritoriality or principles of international comity.³⁵³ The presumption against extraterritoriality does not apply to any of the conduct analyses because the courts would rule on activity conducted within United States borders, not outside domestic borders.³⁵⁴ International comity becomes an issue only if a conflict arises with regard to another country's ability to adjudicate the transaction.³⁵⁵ However, principles of comity would not be violated simply because a litigant might be subject to the laws of two different nations because two countries can both legitimately exercise jurisdiction over the same transaction.³⁵⁶ Principles of

347. See *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir. 1977).

348. See *supra* notes 306-33 and accompanying text.

349. See *supra* notes 150-213 and accompanying text (discussing the broader approach's adherence to the text of the United States Constitution).

350. See *supra* notes 150-213 and accompanying text (examining the broader conduct approach as it fits with the scope of the Exchange Act).

351. See *supra* notes 45-60 and accompanying text (reviewing the limits of federal jurisdiction).

352. See *supra* notes 45-60 and accompanying text (noting that the scope of any given statutory provision is limited by federal jurisdiction).

353. See *supra* notes 306-33 and accompanying text (indicating that the presumption against extraterritoriality would not limit use of the broader analysis of domestic conduct).

354. See *supra* notes 306-33 and accompanying text (analyzing the broader approach).

355. See *supra* notes 68-72 and accompanying text (discussing principles of international comity).

356. See *supra* notes 68-72 and accompanying text. This is analogous to the so-called "subjective territorial principle," which would allow two different sovereigns to adjudicate the same wrongdoing, such as shooting a bullet across state lines. See *supra* note 173 (discussing the subjective territorial principle).

international comity do not impose any absolute obligations on courts to deny jurisdiction since comity concerns are a matter of courtesy and good will.³⁵⁷

VI. CONCLUSION

In transnational securities fraud cases, a broader conduct analysis of subject matter jurisdiction should be adopted because a broader analysis provides the clearest procedural standards and comports with the remedial purposes of the federal securities laws. Providing a broader exercise of subject matter jurisdiction over transnational securities transactions neither exceeds the constitutional limits of federal jurisdiction nor violates principles of international comity. Broadly interpreting the jurisdictional provisions of the Exchange Act also allows victims of transnational securities fraud to have access to federal courts without having to prove the merits of their claims first. Consequently, a broader analysis of subject matter jurisdiction over transnational securities fraud will preserve the broad antifraud protections provided in the Exchange Act by preventing the United States from becoming a safe harbor for international scam artists attempting to defraud investors in other countries.

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357. See *supra* notes 68-72 and accompanying text.