COMMENT

THE TRANSNATIONAL REACH OF RULE 10b-5

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I. INTRODUCTION

Canadian directors of a Canadian corporation with American shareholders knowingly purchase treasury shares at a price below the fair value of those shares. Can an American shareholder maintain a derivative action in a United States court, claiming a violation of rule 10b-5? Does a federal court's jurisdiction over the subject matter depend upon whether the Canadian corporation's stock is traded on an American exchange or over the counter in the United States?

A Canadian broker-dealer fraudulently induces a United States
citizen living in Canada to purchase Canadian securities on the Toronto Stock Exchange. Is the American protected by rule 10b-5? Would the result change if the Canadian broker-dealer were registered with the SEC, maintained a permanent office in New York, and traded regularly on American exchanges?

A British corporation writes to its American shareholders, fraudulently advising them not to tender their shares in response to an offer by another British corporation. Does a United States court have subject matter jurisdiction over a suit brought under rule 10b-5 by an American shareholder who relied upon the advice to his detriment? Would the answer be different if agents of the British corporation had made the misrepresentations in person in the United States?

A German and a Japanese businessman meet in New York, and the latter fraudulently induces the former to purchase Japanese securities on the Tokyo Stock Exchange. Can the German maintain an action under rule 10b-5 in a United States court?

These hypothetical transactions may properly be labeled "transnational," for each transaction touches more than one nation in its conduct, in its effect, or in both. In each case the involvement of some combination of American territory, citizens, and interests is coupled with some significant foreign dimension. Transnational securities dealings are commonplace today, yet many of the jurisdictional questions which they engender remain unanswered.

The securities laws themselves offer little guidance on their transnational applicability. In response to increasing transnational activity in the securities field, Congress and the Securities and Exchange Commission have attempted to clarify the extent to which some sections of the securities laws apply in transnational settings. But the SEC

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2 Section 30(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78dd(b) (1970), does impose limitations on the applicability of the provisions of that Act to transactions which are part of a securities business conducted outside the United States. For an explanation of the scope of these limitations, see text accompanying notes 109-20 infra.

3 The 1964 Amendments to the Securities Exchange Act of 1934 require virtually all corporations with assets of more than one million dollars who are engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by means of an instrumentality of interstate commerce, to register each class of equity security held by more than 500 investors, unless the SEC chooses to take affirmative action to exempt a foreign issuer. 15 U.S.C. § 78l(g) (1970).

The SEC has addressed the transnational applicability of the securities laws in several areas in which they are silent. It has exempted certain foreign issuers from the registration requirements of § 12 of the Exchange Act, 15 U.S.C. § 78l (1970), and the companion reporting provisions of § 13, id. § 78m. 17 C.F.R. § 240.12g3-2 (1973), as adopted in SEC Release No. 34-8066, [1966-67 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,443, requires all foreign issuers of a class of securities held by 300 or more United States residents to comply either with § 12(g) of the Exchange Act or a substitute registration requirement. Issuers more than half of whose outstanding voting securities are held directly or indirectly by United States residents and whose businesses are either "admin-
has not addressed the transnational reach of the most basic investor protection provided by the securities law—rule 10b-5. Although the SEC need not make its rules apply to all transactions, the Commission has not exempted transnational stock deals from rule 10b-5. Nor has the Commission issued guidelines clarifying the extent to which transnational frauds may be remedied in United States courts. The task of filling the void has fallen exclusively on the courts.

This Comment will examine the present state of the case law on the question of the transnational applicability of rule 10b-5, primarily by focusing on the impact of the Second Circuit’s decision in Leasco Data Processing Equipment Corp. v. Maxwell. It will explore the problems faced by the courts in determining the proper reach of rule 10b-5 and evaluate the way in which the courts have dealt with those problems. It will suggest a more comprehensive approach for the courts to take in dealing with the complex issues involved, and will point to the need for extrajudicial assistance in the resolution of these issues.
II. Leasco Data Processing Equipment Corp. v. Maxwell

The gist of Leasco's complaint was that the defendants conspired to cause it to purchase stock of Pergamon Press Limited, a British corporation, at a price in excess of its true value. The facts, as alleged by Leasco and adopted by the Second Circuit for the limited purpose of its ruling, are as follows.

In early 1969, Robert Maxwell, a British citizen and the controlling shareholder in Pergamon, came to the headquarters of Leasco, an American corporation, in Great Neck, New York, and proposed to the chairman of Leasco that Pergamon and Leasco engage in a joint venture in Europe. Maxwell falsely stated that Pergamon had a computerized type-setting plant in Ireland and gave Leasco the most recent Pergamon annual report, which contained false and misleading statements of Pergamon's affairs. Later Leasco telephoned Maxwell in London to decline the joint venture, and Maxwell invited Leasco to England to discuss other areas of possible cooperation.

The next meeting between Maxwell and representatives of Leasco took place in London in April of 1969. Maxwell proposed that Pergamon purchase Leasco's European operations. Leasco's reply was that it was only interested in acquiring Pergamon and its related companies. During the course of this meeting, Maxwell and Clark, a director of Pergamon, whetted Leasco's interest by making exaggerated and misleading statements of Pergamon's performance and prospects.

The scene then shifted to New York where, in the early days of May, Leasco's director of corporate planning met with one Majhtenyi, an official of an American subsidiary of Pergamon. Again the meeting was characterized by false statements concerning the profitability of Pergamon's operations. Telephone calls from Maxwell to Leasco confirmed the glowing reports. Shortly thereafter Maxwell himself came to New York and met with a Leasco director in a hotel room, where further misrepresentations about the sales and earnings of Pergamon were made. Upon his return to London, Maxwell mailed to Leasco a letter containing a dozen documents, among which were a draft of the 1968 Pergamon annual report (containing false statement of profits) and a misleading report on Pergamon's financial affairs.

Representatives of Leasco traveled to England around May 30 and met with Maxwell and other directors of Pergamon. Misrepresentation again was the order of the day. These meetings were followed by telephone conversations between Maxwell in London and Leasco's

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7 The Second Circuit properly noted that the issue of subject matter jurisdiction persists throughout the trial, and that if Leasco's allegations proved false, the jurisdictional principles announced in its opinion should be applied to the proven facts.


9 Id. at 1331.

10 Id.
chairman in New York, in which Maxwell made further false statements, particularly with respect to Pergamon’s profits from the sale of back issues.\footnote{Id.}

In June 1969, Maxwell returned to the United States to continue negotiations. After Maxwell made more misrepresentations in New York, an agreement was signed there on June 17, 1969. By the terms of the agreement, Leasco was to buy Maxwell’s Pergamon stock directly and to acquire the publicly held Pergamon stock by means of a tender offer to be made by a wholly owned subsidiary. The closing of the agreement was to take place in London.\footnote{Id.}

Leasco officials accompanied Maxwell back to England, where Maxwell advised them that it would be in Leasco’s interest to purchase Pergamon stock on the open market as soon as possible. Later in June, Maxwell called Leasco in New York, advising it to purchase Pergamon stock on the open market to prevent a rumored countertoakeover bid. On June 20, Leasco, acting through a London banking firm, began buying Pergamon shares on the London Stock Exchange. By July 24, it had purchased 5,206,210 such shares, expending some $22,000,000; the stock was paid for with cash furnished by a wholly-owned subsidiary, Leasco International N.V., a Netherlands Antilles corporation.\footnote{Id.}

Leasco subsequently learned that 600,000 of these shares had been secretly sold by one or more of the defendants. In August, Leasco was provided with data indicating that previous representations concerning sales of back issues of Pergamon had been misleading. Sensing fraud, Leasco declined to go forward with the tender offer. However, it was left with $22,000,000 of Pergamon stock acquired on the London Stock Exchange.\footnote{Id.}

Characterizing the actual purchases as transactions among foreigners, on a foreign exchange, in foreign securities not traded in American markets, Maxwell and his codefendants asserted lack of subject matter jurisdiction.\footnote{Leasco Data Processing Equip. Corp. v. Maxwell, [1971-72 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,454, at 92,246-48 (S.D.N.Y. 1972).} District Court Judge Ryan viewed the entire series of negotiations, the June 17 agreement signed in New York, and the subsequent purchase of Pergamon shares as a single, continuing transaction. He held that subject matter jurisdiction existed on the basis of the defendants’ conduct within the United States and the foreseeable impact of the transaction upon Leasco’s value.\footnote{Id. at 92,243-44.} Judge Ryan did not state these bases as alternative holdings, but portions of his opinion suggested that the impact on Leasco stock alone was
sufficient for jurisdiction, regardless of the existence of any conduct within the United States.\(^\text{17}\)

On appeal the Second Circuit affirmed subject matter jurisdiction on the basis of substantial conduct within the United States.\(^\text{18}\) But in dicta the appellate court strongly suggested that the adverse effects on Leasco were not sufficient to establish jurisdiction in the absence of illegal conduct within the United States.\(^\text{19}\) While Judge Friendly, writing for the court, did not attempt to develop a general rule for the transnational applicability of rule 10b-5, he did, through a set of hypotheticals, stake out the parameters of the problem, from which this Comment will attempt a formulation of the principles guiding the transnational reach of rule 10b-5.

III. PRESENT GUIDELINES FOR THE TRANSNATIONAL APPLICABILITY OF RULE 10B-5

A. Underlying Principles of International Law

The fundamental basis of a state's jurisdiction is territorial: a state has jurisdiction to prescribe rules governing conduct within its territory.\(^\text{20}\) However, there are a number of additional bases of jurisdiction, which enjoy varying degrees of acceptance.

First, the objective territorial principle—an expansion of the territorial principle—provides that a nation may regulate conduct which occurs outside its territory and produces an effect within its territory.\(^\text{21}\) This principle is generally accepted, although the precise formulation of the principle varies among states.\(^\text{22}\)

Second, under the nationality principle a state has jurisdiction over the conduct of its citizens, even if that conduct occurs outside its boundaries.\(^\text{23}\) The nationality principle is universally accepted by members of the international community, but the extent to which it is used varies widely in the different national legal systems.\(^\text{24}\)

Third, under the passive personality principle a state may exert jurisdiction over conduct which injures one of its citizens. This doc-

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\(^{17}\) See id. at 92,248.
\(^{18}\) 468 F.2d 1326, 1333-39.
\(^{19}\) Id. at 1334.

\(^{20}\) RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES, §§ 10(a), 17(a) (1965) [hereinafter cited as RESTATEMENT (SECOND)]; Research in International Law: Jurisdiction with Respect to Crime, 29 Am. J. Int'l L. 435, 445, 480-84 (Supp. 1935) [hereinafter cited as Research in International Law].


\(^{22}\) See Research in International Law, supra note 20, at 487-94.

\(^{23}\) RESTATEMENT (SECOND), supra note 20, § 30; Research in International Law, supra note 20, at 445, 519.

\(^{24}\) Research in International Law, supra note 20, at 445, 519-35.
trine is asserted in some form by a number of states and rejected by others, including the United States.

Fourth, the protective principle, claimed by most states, gives a state jurisdiction to prescribe rules attaching legal consequences to conduct that threatens its national security or the operation of government functions.

Fifth, under the universality principle the nation that has custody of a person committing an act has jurisdiction over that act. This principle is universally accepted with respect to the crime of piracy, and is widely accepted with respect to a limited class of other universally recognized offenses.

Of these five, the territorial, objective territorial, and nationality principles are most relevant to construing the transnational reach of section 10(b).

B. The Role of International Law and Congressional Intent

The principles of international law outlined above define the jurisdiction of the United States to prescribe a rule of law (prescriptive jurisdiction). Congress, however, may choose to exceed the limits imposed on its prescriptive jurisdiction and thereby violate international law, and its enactments which do violate international law retain their force within the United States' legal system. From the viewpoint of the United States courts, then, the only limits upon congressional power to prescribe rules of law are those imposed by the Constitution. As Judge Friendly explained in Leasco:

[If] Congress has expressly prescribed a rule with respect to conduct outside the United States, even one going beyond the scope recognized by foreign relations law, a United States court would be bound to follow the Congressional direction unless this would violate the due process clause of the Fifth Amendment.

When, therefore, a United States court is asked to apply an act of Congress to a transnational dispute, the court must focus initially on the express statutory language relating to the intended reach of the act. But the Securities Exchange Act of 1934 is silent on the question

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26 Id. 445, 579.
27 The passive personality principle is not listed as an accepted jurisdictional principle in the RESTATEMENT (SECOND), supra note 20.
28 RESTATEMENT (SECOND), supra note 20, § 33; Research in International Law, supra note 20, at 445, 543.
29 RESTATEMENT (SECOND), supra note 20, § 34; Research in International Law, supra note 20, at 445, 563.
30 See Research in International Law, supra note 20, at 445, 573-92. But see RESTATEMENT (SECOND), supra note 20, § 34, Reporters' Note 2.
31 See United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945).
of the transnational applicability of section 10(b). In the absence of express congressional direction, the principles of international law operate as a limitation upon the scope of section 10(b), for it is a fundamental canon of statutory interpretation that "an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains."32

In short, the jurisdictional principles of international law restrict a United States court's freedom to apply section 10(b) in the transnational setting. The defendant who is able to demonstrate that the facts of his case do not comport with any of these principles will clearly defeat the invocation of jurisdiction.

But the principles of international law set only the outer limits of section 10(b)'s transnational reach; the courts remain free to find that Congress intended to stop short of these limits.33 However, the absence of evidence of the actual intent of Congress leaves the courts with no basis for finding that Congress intended to stop short of the limits imposed by international law—except speculation as to what Congress would have intended had they thought about the question. The result is that the principles of international law function as more than mere benchmarks. The plaintiff who is able to sift through the complex facts of a transnational security sale and point to elements which satisfy one or more of these principles is in a good position to sustain his jurisdictional claim.

The court's opinion in Leasco represents, in part, an attempt to impose limits on the reach of section 10(b) short of the boundaries established by international law.34 But the lack of any expressed policy justification for the limits suggested by the court reflects the difficulties encountered by a court which seeks to look beyond the broad guidelines provided by the principles of international law.

C. Judicial Application of Rule 10b-5 in the Transnational Setting

1. Jurisdiction Based on Acts Within the United States

Under the territorial principle, the United States has jurisdiction to prescribe rules with respect to transactions which occur within its territorial boundaries. However, securities transactions increasingly fail to respect national boundaries. The purchase and sale of securities involves a series of separate but interrelated events which may take place in a number of national jurisdictions. The relevant question, then, becomes; what event or combination of events within the United States is sufficient to establish subject matter jurisdiction?

34 See text accompanying notes 60-63, 77-80 infra.
a. The Cases

In *Kook v. Crang*, the initial case to consider the transnational reach of the securities laws, the plaintiff, an American citizen acting through a Canadian broker, purchased stock in a Canadian corporation on the Toronto Stock Exchange. When the securities declined in value, the plaintiff sued the Canadian broker, claiming violation of the Federal Reserve Board margin requirements promulgated under section 7(c) of the Exchange Act.

The broker was registered with the SEC under section 15 of the Exchange Act, maintained an office in New York, and carried on substantial business with members of the NYSE; but these activities were not related to the plaintiff's purchases. The plaintiff's orders were placed and payments received in Canada. Credit was extended and collateral was held in Canada. Confirmation and all margin calls emanated from Canada.

Finding that "[a]ll the essentials of these transactions occurred without the United States," the court dismissed the action for lack of subject matter jurisdiction. The court's dismissal was not based on its reading of the principles of international law, but rather on its interpretation of congressional intent as expressed in section 30(b), which states:

> The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States . . .

The court held that "'jurisdiction' as used in section 30(b) contemplates some necessary and substantial act within the United States," and that the use of the mails and telephone within the United States was insufficient to establish subject matter jurisdiction.

The court's refusal to apply the American margin requirements was reasonable in light of the defendant's insistence that the transaction take place in Toronto and the defendant's compliance with the

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39 182 F. Supp. at 390-91. The use of the mails or other facilities of interstate commerce is relevant in 3 distinct ways: (1) as a requisite for the finding of a violation of § 10(b); (2) as an element in determining subject matter jurisdiction; and (3) as an element in determining personal jurisdiction. This Comment does not deal with personal jurisdiction. With respect to the other 2 ways in which the use of the facilities of interstate commerce is significant, it should be noted that the use of those facilities which is sufficient to warrant the finding of a violation of § 10(b)—which is essentially the use which is necessary to give Congress the power to regulate under the commerce clause—is not necessarily sufficient to warrant a finding of subject matter jurisdiction. See note 101 infra.
40 182 F. Supp. at 389.
margin requirements of the Toronto Stock Exchange.\textsuperscript{41} In such a case it is fair to say that the plaintiff knowingly forwent the protection of the American margin requirements for the similar, though not identical, protection of the Canadian margin requirements.\textsuperscript{42} In addition, the impact on United States markets of compliance with Canadian rather than American margin requirements was not significant. And it is generally difficult to apply complex American rules, such as margin requirements, to a business which has only occasional American customers.\textsuperscript{43}

In \textit{Roth v. Fund of Funds, Ltd.},\textsuperscript{44} the Second Circuit applied section 16(b) to allow recovery of short swing insider profits made by a Canadian mutual fund with its principle place of business in Switzerland. The court based jurisdiction on the fact that the transactions in question were executed on the New York Stock Exchange by New York brokers acting as agents for the fund. \textit{Kook v. Crang} was distinguished on the ground that the transactions in that case were effected outside the United States on the Toronto Stock Exchange.\textsuperscript{45}

While the general test for jurisdiction established by the district court in \textit{Kook} and apparently approved by the Second Circuit in \textit{Roth}\textsuperscript{46} was that there must be "some necessary and substantial act within the United States," a narrow reading of the holdings of those cases might have suggested that the locus of the sale was determinative of jurisdiction.\textsuperscript{47} But any suggestion that the actual sale was the only act sufficient to establish jurisdiction under the Exchange Act was clearly rejected by the \textit{Leasco} court.

\textsuperscript{41} Id.

\textsuperscript{42} This justification for the holding is thrown into question by § 29(a) of the Exchange Act, set forth at note 128 infra, which voids any agreement to waive compliance with any provision of the Act. 15 U.S.C. § 78cc(a) (1970). But the agreements and expectations of the parties need not be considered only in terms of waiver; they can also be considered as one of the factors determining whether or not the terms of the Exchange Act are applicable in the first place. See text following note 131 infra.

\textsuperscript{43} In \textit{Kook v. Crang}, the broker in question carried on substantial business in New York, but this business was unrelated to the plaintiff's purchase. The transaction in question was part of the broker's Canadian operations.

\textsuperscript{44} \textit{405 F.2d 421 (2d Cir. 1968), aff'd 279 F. Supp. 935 (S.D.N.Y. 1968), cert. denied, 394 U.S. 975 (1969).}

\textsuperscript{45} Id. at 422.

\textsuperscript{46} The district court in \textit{Roth} used the \textit{Kook} test as a basis for distinguishing the two cases, 279 F. Supp. at 936. In affirming the district court, the Second Circuit did not indicate that it intended to apply a different standard than that specifically applied by the district court.

\textsuperscript{47} \textit{But cf.} Ferraioli v. Cantor, 259 F. Supp. 842 (S.D.N.Y. 1966), in which a former shareholder in a New York corporation commenced an action against a Canadian corporation which had previously controlled the New York corporation. Plaintiff claimed that the Canadian corporation had disposed of its controlling interest in the New York corporation to outsiders at a substantial premium over the existing market value without making full disclosure to minority shareholders or granting them an opportunity to sell at the same price—all allegedly in violation of § 10(b) and rule 10b-5. Because the plaintiff made no allegation that any of the defendant's acts connected with the sale occurred within the United States, the court dismissed the complaint. [1964-66 Transfer Binder] \textit{CCH FED. SEC. L. REP.} ¶ 91,615 (S.D.N.Y. 1965). On leave to amend, plaintiff alleged that the gravamen of the complaint was the fraudulent transfer of control. The court upheld jurisdiction because the transfer was partly consummated in the United States.
In *Leasco*, the fraudulently induced stock purchases were executed entirely on the London Stock Exchange. The Second Circuit found that the "abundant misrepresentations" alleged to have been made in the United States constituted sufficient conduct within the United States to bring the transaction within the prescriptive jurisdiction of the United States under the territorial principle. In the court's opinion Judge Friendly explained:

Conduct within the territory alone would seem sufficient from the standpoint of jurisdiction to prescribe a rule. It follows that when, as here, there has been significant conduct within the territory, a statute cannot properly be held inapplicable simply on the ground that absent the clearest language, Congress will not be assumed to have meant to go beyond the limits recognized by foreign relations law.

Having concluded that principles of international law did not preclude the application of section 10(b), the *Leasco* court turned to the question of Congressional intent, asking whether if Congress had thought about the point, it would not have wished to protect an American investor if a foreigner comes to the United States and fraudulently induces him to purchase foreign securities abroad—a purpose which its words can fairly be held to embrace.

Relying on the injury to *Leasco* and its shareholders, the court found that Congress would have wished to protect such an American investor, at least when substantial misrepresentations were made in the United States.

Judge Friendly's opinion offers some guidance as to limitations imposed on the transnational application of rule 10b-5 by, or under, the territorial principle. Specifically, *Leasco* suggests answers to the following questions: what type of conduct within the United States can form the basis for jurisdiction; how significant must the conduct be to the transaction and the injury in question; and of what significance is the nationality of the parties who perform acts within the United States.

b. Type of Conduct on Which Jurisdiction Can Be Based

The *Leasco* opinion contains dictum indicating that making telephone calls and sending mail to the United States is sufficient conduct to establish jurisdiction. And that dictum formed the basis of the Eighth Circuit's finding of jurisdiction in *Travis v. Anthes Imperial*
Thus, there would appear to be few, if any, limitations on the type of conduct which is sufficient for purposes of jurisdiction to impose a rule.

c. Required Relation Between the Conduct and the Transaction and Injury in Question

Conduct which establishes jurisdiction over a transaction must be related in some way to that transaction. The court in Leasco found it sufficient that the conduct within the United States was an “essential link” in leading Leasco to sign the June 17 tender offer agreement, and that that agreement was an “essential link” in inducing Leasco to make the open-market purchases which caused the damages. As the court explained:

[I]f defendants’ fraudulent acts within the United States significantly whetted Leasco’s interest in acquiring Pergamon shares, it would be immaterial, from the standpoint of foreign relations law, that the damage resulted, not from the contract whose execution Maxwell procured in this country, but from interrelated action which he induced in England or, for that matter, which Leasco took there on its own.

While the court did not require that the conduct in the United States be the direct cause of the damage, it did seem to contemplate some closer causal connection between that conduct and the damage than that the conduct simply be related in some incidental way to the transaction. Friendly’s doubts about jurisdiction extended to cases

53 [1972-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,718 (8th Cir. 1973), rev’g, 331 F. Supp. 797 (E.D. Mo. 1971). In Travis, Molson, a Canadian conglomerate, made a tender offer to the Canadian shareholders of Anthes, Limited, another Canadian corporation. The plaintiffs, American shareholders of Anthes, alleged that the defendants, Molson and Anthes, fraudulently induced them to refrain from selling their shares by falsely representing that after the expiration of the Canadian tender offer, a similar offer would be made to all American shareholders. Molson refused to extend a similar offer to the American shareholders, and the plaintiffs eventually sold their shares to Molson at the prevailing market price, which was substantially lower than the price that the plaintiffs could have received when they allegedly would have sold their shares but for the misrepresentations. The Eighth Circuit based its finding of jurisdiction on the allegations that numerous communications took place between the plaintiffs in the United States and the defendants in Canada through the mails and the telephone, and that the closing of the sale of plaintiffs’ shares to the defendant Molson took place in the United States. But the sale itself was not an essential link in the scheme by which the defendants allegedly defrauded the plaintiffs. The sale did not trigger the plaintiffs’ loss in any way; at most, it was the event which determined the size of the loss caused by the fraudulent scheme. The fact that the closing took place in the United States, then, was not of great significance. Jurisdiction must have been based primarily on the fact that substantial representations and misrepresentations were made in the United States through the use of the mails and the telephone. With respect to communications by mail and telephone, the court, citing Leasco, stated that “both the place of sending and place of receipt constitute locations in which conduct takes place” for the purpose of subject matter jurisdiction. Id. at 93,181 n.16.


55 468 F.2d at 1335.

56 Id.
in which all the misconduct and misrepresentations occurred in another country, not just to those cases in which all the significant conduct took place in another country. It is unlikely that the Leasco court would have found jurisdiction if all the negotiations in the United States were without misrepresentations, and all the misrepresentations occurred in England. It is even more unlikely that the court would have found subject matter jurisdiction if the sole import of any communications in the United States was to confirm plans to conduct negotiations in England.

The requirement that the actual misrepresentations which form the basis for the 10b-5 claim be made within the United States fails to take account of the nature of transnational securities dealings. These dealings usually touch upon the territory of more than one nation, and whether a particular misrepresentation is made in one country or another is often a matter of chance. The jurisdiction of a state should not turn on such chance occurrences, for the interest of the state is identical whether or not the particular misrepresentation is made within the state. The requirement that conduct within the territory be significant, or an essential link in the transaction, is better-suited to protecting the interests of a state in regulating conduct within its borders.

d. The Significance of Nationality When Jurisdiction is Based on Acts Within the United States

In Leasco, rule 10b-5 protection was extended to an American corporation even though the actual purchase was made by nominees of its wholly-owned foreign subsidiary. The court reasoned that Leasco, the United States corporation, was intimately involved in the transaction from the beginning; the debt securities of the foreign subsidiary used to raise the cash for purchasing the Pergamon shares were fully guaranteed by Leasco and convertible into Leasco common stock; and the foreign entity was accepted by both parties as the alter ego of Leasco.

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56 The court said: "If all the misrepresentations here alleged had occurred in England, we would entertain most serious doubt whether . . . § 10(b) would be applicable . . . ." Id. at 1334. And in discussing congressional intent, the court indicated that: "It tips the scales in favor of applicability when substantial misrepresentations were made in the United States." Id. at 1337. The requirement that the actual misrepresentations take place in the United States has been applied by the Southern District of New York in Finch v. Marathon Securities Corporation, 316 F. Supp. 1345, 1348-49 (1970) (jurisdiction denied despite fact that the contract for sale was originally executed in New York, because the alleged misrepresentations were made in London) and was apparently approved by the Eighth Circuit in Travis v. Anthes Imperial, Ltd., [1972-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,718 at 93,182 (1973) (jurisdiction upheld because misrepresentations were made in the United States).

68 468 F.2d at 1332.

69 Id. at 1338.
The Leasco court strongly suggested that the nationality of the plaintiff was crucial to its holding:

The case is quite different from another hypothetical we posed at argument, namely where a German and a Japanese businessman met in New York for convenience, and the latter fraudulently induced the former to make purchases of Japanese securities on the Tokyo Stock Exchange.80 In distinguishing the Leasco case from the German-Japanese hypothetical, Judge Friendly underscored the fact that even when jurisdiction is based on the territorial principle, some impact on American citizens or American interests is necessary for the application of rule 10b-5. In most cases, conduct within the United States will have some effect upon American citizens or interests. Even the German-Japanese hypothetical would adversely affect the United States interest in attracting foreigners to transact business in the United States, but as Judge Friendly implicitly suggests, this adverse effect would be de minimis. And the interest of the United States as a member of the international community in promoting cooperation among nations would support deferral by United States courts to the law of the nations more concerned with the transaction. If, however, the German and Japanese citizens were residents of the United States, engaged in a securities business here, the United States would have a strong interest in applying American law.

Any refusal of United States courts to extend rule 10b-5 protection to a foreigner defrauded by another foreigner within the United States, when it would extend such protection to an American defrauded by a foreigner in the same situation, raises questions under the equal protection guarantee implicit in the fifth amendment.61 If the refusal is compelled by the limitations imposed by international law upon the prescriptive jurisdiction of the United States, then there is no equal protection problem—for the equal protection guarantee applies only within the United States’ jurisdiction.62 But international law imposes no such limitations, for the territorial principle gives a nation prescriptive jurisdiction over conduct which occurs within its boundaries, regardless of whether or not any effects take place in its territory.63 Any refusal by the courts to assert subject matter jurisdiction in Judge Friendly’s German-Japanese hypothetical must be based on the court’s interpretation of congressional intent, in which case the equal protection problem is not so easily dismissed.

60 Id.
62 It may be argued that since Congress is free to exceed the limitations imposed by international law and extend the equal protection of American law to all foreigners, its failure to do so violates the fifth amendment. But the interest of the United States in abiding by the principles of international law is certainly compelling enough to justify any disparity of treatment.
63 See Restatement (Second), supra note 20, § 17, Comment a.
It may be argued that the jurisdiction within which the equal protection guarantee is effective is the subject matter jurisdiction of the courts, and that since congressional intent with respect to the applicability of section 10(b) determines the courts' subject matter jurisdiction, the equal protection guarantee is ineffective if Congress intended section 10(b) to be inapplicable. But to allow Congress to deny equal protection of the law to persons (foreigners transacting business between themselves) who are within the prescriptive jurisdiction of the United States by withholding subject matter jurisdiction from the courts is to ignore the fact that the fifth amendment is directed not only to the courts, but also to Congress. The jurisdiction within which the equal protection guarantee is applicable must be the prescriptive jurisdiction of the United States as defined by the principles of international law, not the subject matter jurisdiction of the courts as further limited by Congress. If, therefore, the refusal of the courts to extend section 10(b) protection to foreigners on the same basis as to American citizens is based upon the courts' interpretation of congressional intent, the equal protection problem must be squarely faced.

In addressing the equal protection questions posed by choice-of-law cases involving nonresidents and noncitizens of the forum state, Professor Brainerd Currie concluded:

a classification in terms of residence or citizenship is not reasonable merely because it coincides with the limits of a state's interest in applying its law. . . . Something more than the state's lack of concern for the victim is needed to establish the reasonableness of withholding the benefits of such a law [wrongful death statute] from persons "within the jurisdiction" of the state.64

Professor Currie was speaking primarily of the treatment of residents and citizens of states within the United States, but his conclusion is


The Supreme Court has distinguished between discrimination on the basis of state citizenship and discrimination on the basis of state residence, finding the latter brand of discrimination more easily justified. In Douglas v. New York, N.H. & H.R.R., 279 U.S. 377 (1929), the Court upheld a state law which it interpreted to grant preferential access to the state courts to residents over nonresidents and the Court implied that preferential access on the basis of citizenship would have violated the privileges and immunities clause of art. IV, § 2 of the Constitution. The bases for the Court's upholding the preferential treatment of residents were the overcrowding of the courts, convenience and the fact that residents pay for maintaining the courts.

Discrimination on the basis of residence was upheld by the Court, where discrimination on the basis of citizenship would have been held to violate art. IV, § 2 of the Constitution, in two earlier cases: Maxwell v. Bugbee, 250 U.S. 525 (1919) (tax rates); La Tourette v. McMaster, 248 U.S. 465 (1919) (eligibility for licensing as an insurance agent). In these two cases, unlike the Douglas case, the Court rejected a claim based on the 14th amendment as well as one based on art. IV, § 2. But only in Maxwell did the Court give reasons for its rejection of the equal protection claim: it found that any inequality in the incidence of the tax was incidental, and that the tax did not discriminate between residents and nonresidents as classes. 250 U.S. at 543.
equally applicable to the treatment of residents and citizens of foreign nations. The United States’ lack of concern for aliens does not establish the reasonableness of withholding rule 10b-5 protection from them. Moreover, classifications of aliens—or, at least, resident aliens—have been held to be suspect classifications which can only be justified by a showing of a compelling state interest.65 The United States’ lack of concern for aliens certainly does not rise to the level of a compelling state interest.

Professor Currie suggested, however, that the “limits of a state’s interests become vitally important” when both the victim and the perpetrator of wrongful conduct are nonresidents.66 Currie based this conclusion in part on the full faith and credit clause. Although that clause is operative only on an interstate level and not on an international one, the goal of cooperation which it advances has legitimacy among nations as well as among states. When the United States has no interest in a transaction involving two foreigners, and when the laws of the victim’s nation offer him protection, it is in the interest of the United States, as a member of the international community, to yield to the law of that nation. That interest may indeed be sufficient to justify the refusal to provide the equal protection of American law to that foreign victim, even though he is within the prescriptive jurisdiction of the United States.

2. Jurisdiction Based on Effects Within the United States

In a clear and precise recital of the objective territorial principle, Justice Holmes once wrote:

65 In re Griffiths, 41 U.S.L.W. 5143, 5144 (U.S. June 25, 1973); Graham v. Richardson, 403 U.S. 365, 372 (1971); Takahashi v. Fish and Game Comm’n, 334 U.S. 410, 420 (1948). Only resident aliens were involved in these cases, but in none of the cases did the Court indicate that heightened judicial solicitude was to be denied nonresident aliens. The rationale behind treating classifications based on alienage as inherently suspect applies equally to resident and nonresident aliens. There are numerous cases in which the Supreme Court has upheld the discriminatory treatment of aliens. One such case is Ohio ex rel. Clarke v. Deckebach, 274 U.S. 392 (1927), in which the Court upheld the exclusion of aliens from eligibility for licenses to operate pool and billiards rooms. But the Court in In re Griffiths, supra at 5144, observed that “the doctrinal foundations of Clarke were undermined in Takahashi v. Fish and Game Comm’n,” supra, and Graham v. Richardson, supra.

Several early immigration and deportation cases might appear to lend support to the discriminatory treatment of aliens. E.g. Fong Yue Ting v. United States, 149 U.S. 698 (1893) (deportation of Chinese laborers for failure to acquire certificates of residence held constitutional); Chae Chan Ping v. United States, 130 U.S. 581 (1889) (upheld refusal to readmit an alien who, after living here for 12 years, left the country with a certificate entitling him to return, where that refusal was dictated by the terms of a statute passed 7 days before his return). But the decisions in In re Griffiths, Graham, and Takahashi have drained these cases of much of their force. And any continuing force which those cases exert can be attributed to the inherent power of a nation to control immigration, the justifying factor in those cases, which is not a factor in the case of the applicability of rule 10b-5.

It should be emphasized that the nature of the discrimination and the nature of the alleged state interest determine the validity of a classification under the compelling state interest test, but they do not determine the applicability of that test. That the compelling state interest standard is the applicable one is determined by the nature of the class (aliens) as a “discrete and insular minority.” United States v. Carolene Prod. Co., 304 U.S. 144, 153 n.4 (1938).

66 Unconstitutional Discrimination, supra note 64, at 539.
Acts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a State in punishing the cause of the harm as if he [the actor] had been present at the effect, if the State should succeed in getting him within its power.67

The objective territorial principle is expressed in section 18 of the Restatement (Second) of Foreign Relations Law as follows:

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

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

(b) (i) the conduct and its effect are constituent elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems.68

a. Schoenbaum v. Firstbrook

It was the effects doctrine embodied in section 18 which, according to Judge Friendly,69 permitted the Second Circuit to apply rule 10b-5 in Schoenbaum v. Firstbrook.70 In Schoenbaum, Banff, a Canadian corporation whose common stock was traded on the American Stock Exchange, was controlled by Aquitaine of Canada, Ltd. Banff’s Board of Directors, dominated by Aquitaine nominees, approved the sale of Banff treasury shares to Aquitaine at market price. The negotiations, offer, acceptance, and delivery, as well as payment in Canadian funds, all took place in Canada, between Canadians. An American minority shareholder of Banff filed a derivative suit, alleging that Aquitaine was privy to inside information, which if disclosed would have substantially raised the market price of Banff shares.67


68 REStATEmENT (SECOND), supra note 20, § 18.

Note that the Restatement does not list actual intent to produce effects within the territory as a necessary element, as Holmes did in Strassheim, note 67 supra & accompanying text. But the requirement in (b)(iii) that the effect be “direct and foreseeable” serves the same purpose as an intent requirement.

The requirements in (b)(ii) and (b)(iii) have been criticized as “unsupported by the authorities.” Metzger, The Restatement of the Foreign Relations Law of the United States: Bases and Conflicts of Jurisdiction, 41 N.Y.U.L. Rev. 7, 15 (1966).

69 468 F.2d at 1333-34.

70 405 F.2d 200 (2d Cir. 1968), aff'g in part, rev'g in part, 268 F. Supp. 385 (S.D. N.Y. 1967). Having reversed the district court’s finding of lack of subject matter jurisdiction, the court went on to hold that the plaintiffs failed to state a cause of action under rule 10b-5, but the panel was reversed on this latter point after rehearing en banc. 405 F.2d 215, cert. denied, 395 U.S. 906 (1969).
In effect, the minority shareholder contended that Aquitaine, using its controlling position on Banff's board, had sold stock to itself for inadequate consideration, thus defrauding the corporation and its minority shareholders in violation of rule 10b-5.

The district court concluded that the Exchange Act had no extraterritorial application. In disagreeing with the district court, the Second Circuit found that the importance of maintaining fair and honest markets was sufficient to rebut "the usual presumption against extraterritorial application of legislation." Chief Judge Lumbard, speaking for the court, stated:

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.

The Schoenbaum court held that the Exchange Act is applicable to transactions which take place outside the United States, "at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors."

The Schoenbaum court did not explicitly ground its finding of jurisdiction on any principle of international law, but it implicitly based jurisdiction on the objective territorial principle. While the court limited its holding to the facts of the case, the broad terms of the objective territoriality principle would not seem to restrict the applicability of United States law to cases in which the traded stock is listed on an American exchange, and the Schoenbaum court's broad dicta on the importance of the investor-protecting policies of the securities laws left open the possibility that the courts could extend jurisdiction based on the impact of foreign transactions within the United States beyond the facts of Schoenbaum. Specifically, the broad language of Schoenbaum raised three questions:

First, what type of detrimental impact within the United States does Schoenbaum contemplate? Second, how crucial to the holding was

71 268 F. Supp. at 392.
72 405 F.2d at 206.
73 Id.
74 Id. at 208. A literal reading of this holding would extend 10b-5 protection to American investors defrauded by a foreign national in the purchase of stock in a foreign country, when, coincidentally, the stock was listed on an American exchange. But the principles of international law would not countenance such an extension of rule 10b-5 applicability. If the transaction did not take place on the American exchange, and if, unlike in Schoenbaum, no indirect effect was felt by other Americans in the United States, the sole basis for jurisdiction would be the nationality of the injured party. The United States rejects that basis of jurisdiction (the passive personality principle). Research in International Law, supra note 20, at 445, 579.
the registration of Banff stock on an American exchange? Would a substantial over-the-counter market in the United States or a substantial number of American shareholders be sufficient for jurisdictional purposes? Third, does jurisdiction depend upon injury to domestic investors or American investors?

b. **Type of Impact Sufficient for Jurisdiction**

The *Schoenbaum* court found that the following effect within the United States was sufficient to warrant the assertion of jurisdiction:

A fraud upon a corporation which has the effect of depriving it of fair compensation for the issuance of its stock would necessarily have the effect of reducing the equity of the corporation's shareholders and this reduction in equity would be reflected in lower prices bid for the shares on the domestic stock market.\(^76\)

In *Schoenbaum*, the “impairment of the value of American investment” resulted from the sale by a corporation of its own stock. There are, of course, other contexts in which fraudulent foreign transactions would impair the value of American investments.

For example, if Banff were fraudulently induced to purchase stock in another corporation at a price higher than the actual value, Banff assets would be depleted, the equity underlying Banff's American shareholders' investment would be reduced, and Banff stock would bring a lower price on the domestic market. American shareholders would feel the effects of the transaction irrespective of any domestic market in the securities purchased. Would these effects warrant the application of rule 10b-5 to the transaction?

This was one question before the court in *Leasco*, with the single exception that, unlike Banff in the above hypothetical, the purchaser, Leasco, was an American corporation. The foreign securities purchased by Leasco were not listed on an American exchange or traded over the counter in the United States, but Leasco stock was traded on the New York Stock Exchange. Because Leasco's purchase of foreign securities at an inflated price had the effect of depressing the value of Leasco as a going concern and the price of Leasco stock, the district court found that rule 10b-5 was applicable on the *Schoenbaum* rationale. The court explicitly rejected the argument that the only impact sufficient to warrant the assertion of subject matter jurisdiction was an impact on domestic markets in the securities being bought and sold.\(^76\)

On appeal, the Second Circuit upheld subject matter jurisdiction on the basis of the defendants' “significant conduct” within the United States.

\(^75\) Id. 208.

States, but refused to extend the *Schoenbaum* rationale to the *Leasco* case. The court advised:

If all the misrepresentations here alleged had occurred in England, we would entertain most serious doubt whether ... § 10(b) would be applicable simply because of the adverse effect [in the United States] of the fraudulently induced purchases in England of securities of an English corporation, not traded in an organized American securities market, upon an American corporation whose stock is listed on the New York Stock Exchange and its shareholders.\(^7\)

In basing subject matter jurisdiction on the defendants' conduct within the United States, rather than on the effect of the transaction within the United States, the court impliedly indicated a need to impose some limitations on the transnational reach of rule 10b-5. But Judge Friendly's opinion clarifies neither the source nor the scope of these limitations.

Judge Friendly indicated that the language of section 10(b) was "much too inconclusive to lead us to believe that Congress meant to impose rules governing conduct throughout the world in every instance where an American company bought or sold a security."\(^7\)\(^8\) In the same section of the opinion, Judge Friendly expressed doubts about whether the effects in *Leasco* fell within the ambit of section 18 of the *Restatement (Second) of Foreign Relations Law*.\(^7\) It is unclear then to what extent the limitations contemplated by the court were attributable to its interpretation of congressional intent, and to what extent they were dictated by its reading of the principles of international law.

With respect to the objective territorial principle, the *Leasco* case is indistinguishable from *Schoenbaum*, for the impact on American shareholders is the same whether the corporation is damaged by selling its own stock or by purchasing another's stock. It is, perhaps, tenable to suggest that Congress intended to protect American shareholders of a foreign corporation from the adverse effects of a fraud perpetrated against the foreign corporation in the sale of its own stock (*Schoenbaum*), but did not intend to protect American shareholders of an American corporation which was deceived abroad in the purchase of another's stock (*Leasco*). But the reason for such congressional intent is not readily apparent, and the Second Circuit provides no explanation in *Leasco*.

Beyond the *Leasco* and *Schoenbaum* situations, there are other types of adverse impact which might be sufficient to establish jurisdiction under the effects doctrine. In addition to stating that Congress intended "to protect domestic investors who have purchased foreign

\(^7\) 468 F.2d at 1334.
\(^8\) Id.
\(^9\) Id. at 1333-34.
securities on American exchanges,” Schoenbaum advised that Congress also sought to “protect the domestic securities market from improper foreign transactions in American securities.” The Schoenbaum opinion offered no examples of the type of activities contemplated by this statement, but several examples suggest themselves. Consider the activities of offshore mutual funds. These funds deal in American securities, and fraudulent transactions by these funds can discourage foreign investors from dealing further in American securities. A number of the offshore funds have come under 10b-5 attack, but jurisdiction has been denied unless the plaintiff could show that shares in the funds were sold to Americans or that the funds were actually controlled and directed from within the United States.

Consider also the case of one foreigner fraudulently inducing another foreigner to purchase abroad a large block of American stock which is widely held but thinly traded. That transaction would affect the market price in the United States, and to the extent that American investors relied on the market price to their detriment, there would be an adverse impact on American investors. The SEC staff has taken the position that purchases in foreign markets, which otherwise fall within the proscription of rule 10b-5, violate that rule because these purchases would have an impact on the price of the stock in the American market. The same rationale calls for the application of rule 10b-5 to foreign transactions such as the one described above, which can be expected to have an impact on prices in the American market.

Any transaction directly or indirectly involving or affecting Americans is arguably a proper target of American law under the objective territorial principle, for the objective territorial principle contains no self-imposed limitations—except for requirements, present in some versions and absent in others, of intent, foreseeability and substantiability of effect. At its extreme, the objective territorial principle blends into the passive personality principle of asserting jurisdiction over conduct which injures one’s nationals—a principle which the United States rejects. There is clearly a need for some limitation on the type of impact within the United States which is sufficient for jurisdictional purposes.

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80 See text accompanying note 73 supra.
81 See e.g., N.Y. Times, Dec. 2, 1972, at 49, col. 7.
82 Compare SEC v. United Financial Group, Inc., 474 F.2d 354 (9th Cir. 1973) (discussed at text accompanying notes 105-07 infra) with Investment Properties Int’l, Ltd. v. I.O.S., Ltd., [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,011, (S.D.N.Y. 1971); Recaman v. Fidelity Bank, Civil No. 73-337 (E.D. Pa. February 16, 1973) (in denying temporary restraining order, court explained partially that “there is substantial reason for believing that the Court may lack subject matter jurisdiction” over transactions involving shares in a foreign-based investment fund, none of whose shareholders were United States citizens and no purchases or sales of which took place in the United States).
83 See note 3 supra.
84 See notes 67-68 supra & accompanying text.
If one accepts Judge Friendly's dictum that a United States court would not have subject matter jurisdiction in *Leasco* if none of the misrepresentations had taken place in the United States, one could try to explain the *Schoenbaum* and *Leasco* holdings without resort to the objective territorial principle—merely by broadening the territorial notions of jurisdiction and adopting a somewhat strained reading of *Schoenbaum*. On this reading, the facts of *Schoenbaum* would be viewed as a two-stage operation. First, the controlling directors and management of Banff made a decision to come to the United States and register Banff on the American Stock Exchange with the purpose of attracting American investors. Second, these same controlling parties then entered into a fraudulent stock scheme that injured these same American investors. On this basis *Schoenbaum* could be distinguished from the hypothetical *Leasco* case (with no misrepresentations in the United States), in which a corporation was defrauded by a third party foreign national who had nothing to do with the American investors' original decision to invest in the United States.

While a broadened interpretation of the territorial principle can explain the limitations on the transnational application of rule 10b-5 contemplated by the Second Circuit in *Leasco*, it offers no compelling justification for these limitations. Indeed, reliance on the territorial principle may prove less satisfactory than reliance on the objective territorial principle, for the United States has a greater interest in regulating securities transactions which have an effect within the United States than transactions which merely take place within the United States.

The proper scope for the applicability of rule 10b-5 cannot be defined by resorting simply to either the territorial or the objective territorial principles. These principles do provide convenient descriptive categories and suggest ways of distinguishing cases, but they provide no substitute for the comprehensive policy analysis that is necessary for the determination whether a particular type of impact justifies the application of rule 10b-5.

c. Indicators of the Existence of a Domestic Market in the Affected Security

While issuing broad dicta on the importance of protecting domestic markets, the *Schoenbaum* court carefully limited its holding to the case in which the stock of the injured corporation is traded on an American exchange. But if jurisdiction is based solely upon the effects of a transaction within the United States, there is no reason to require registration on an American exchange; the necessary effects would be felt as long as there exists a domestic market in the affected

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85 405 F.2d at 206.
86 See text accompanying note 74 supra.
securities. The district court in *Leasco* agreed with Judge Frankel's statement of the question in *Investment Properties International Ltd. v. I.O.S., Ltd*:

> does the transaction have some significant impact on the domestic securities market or on domestic investors, and is extraterritorial application therefore necessary to protect securities trading in the United States and/or American investors?

Under Judge Frankel's broad formulation of the impact requirement, trading on an American exchange would not be the only type of domestic trading sufficient to warrant the application of rule 10b-5. This result is consistent with the general requirements of the objective territorial principle and is supported by the fact that Congress did not generally restrict the protection of the securities laws to those who traded on the organized exchanges. Certainly, Congress would not have intended to extend protection in a *Schoenbaum*-type situation to the American investor who buys foreign stock on an American exchange but not to the American investor who buys foreign stock over the counter in the United States.

The listing of a stock on an American exchange or on NASDAQ has a dual significance. First, either should give rise to a presumption of the existence of both a domestic market in the security and the existence of American shareholders. In the absence of such listing, a court seeking to determine the impact of a transaction within the United States would have to examine other factors such as registration of the initial offering under the 1933 Act, the nationality of shareholders, and the manner in which they acquired their interests. Second, to the extent that intent to produce effects within a nation is an element of the objective territorial principle, the listing of a stock on an American exchange or on NASDAQ would lay the basis for a finding of implied intent to affect, since it would put the parties to a transnational stock deal on notice of the probable existence of an American market. If the company itself is the defendant, the listing of the company's securities provides an even stronger basis for a finding of intent to produce effects within the United States, since it

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89 Corporations of significant size, both foreign and domestic, are required to register their securities and satisfy the reporting requirements of the Exchange Act whether or not they are listed on an exchange. And the language of § 10(b) makes rule 10b-5 applicable to all purchases and sales of securities via interstate commerce regardless of whether they are executed on a stock exchange or over the counter.
90 The Second Circuit in *Leasco* took notice of congressional intent to apply § 10(b) to purchases and sales of securities "whether or not these [securities] were traded on organized United States markets." 468 F.2d at 1336.
91 See notes 67-68 supra & accompanying text.
reflects an active effort on the company's part to secure an American market.

d. Protecting American Investors vs. Protecting Domestic Investors

_Schoenbaum_ and _Investment Properties_ used the terms "domestic investor" and "American investor" interchangeably, without regard to their distinct meanings. An American investor could be defined reasonably as a United States national who invests; a domestic investor as any person, regardless of nationality, who invests through domestic exchanges or domestic over-the-counter markets. Basing subject matter jurisdiction on injury to American investors will produce different results than basing jurisdiction on injury to domestic investors.

By using the terms "domestic investor" and "American investor" interchangeably _Schoenbaum_ perhaps meant to limit the extension of rule 10b-5 protection under the effects doctrine to Americans who invest through domestic facilities or to American investors regardless of where they invest. But any interpretation which restricts protection to Americans offends the principle that all persons, including aliens and foreign citizens, are to receive equal protection of the law. Moreover, if the purpose of the Exchange Act was not only to protect the investments of individuals but also to preserve the integrity of American markets necessary for the free flow of capital, to fail to extend equal rule 10b-5 protection to foreign nationals who choose to invest through American markets would contravene congressional intent.

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91 In successive sentences, the _Schoenbaum_ court spoke of congressional intent "to protect domestic investors" and "to protect American investors." 405 F.2d at 206. For the interchangeable use of the terms in _Investment Properties_, see text accompanying note 88 *supra*.

92 But the _Schoenbaum_ court did not inquire into the number of American shareholders in Banff, nor did it ask where the American plaintiff acquired his shares. Perhaps the court depended upon Banff's registration on the American Stock Exchange as prima facie evidence of the existence of American shareholders who purchased the stock domestically.

93 If, of course, the restriction is compelled by the principles of international law, there is no equal protection problem. Note 62 *supra* & accompanying text. But the objective territorial principle, which gives a state prescriptive jurisdiction over conduct which produces an effect within that state, does not specify that that effect must be felt by a citizen of that state, rather than by a foreign national. In the case of a foreign citizen who invests through American facilities, however, it may not be necessary to rely upon the conclusion that a state has jurisdiction to regulate conduct which affects foreigners within that state, for any conduct which affects a foreign citizen by way of his investments through American markets also affects those American markets. By either line of reasoning, the United States has prescriptive jurisdiction, and the equal protection problems must be faced.

Not as in the case of the German and Japanese businessmen, text accompanying note 60 *supra*, who meet in New York for convenience, the United States has a significant interest in protecting the foreigner who invests through American markets. And as the interest of the United States in affording protection is greater, the interest of the United States in yielding to the law of another nation is less compelling, and the differential treatment is more difficult to justify within the confines of the guarantee of equal protection. See generally text accompanying notes 64-66 *supra*.

94 See note 73 *supra* & accompanying text.
3. The Significance of Nationality

a. Nationality of the Plaintiffs

As already indicated, the Leasco court found that the actual purchaser, a Netherlands Antilles corporation, was but an alter ego of the American plaintiff, who was ultimately responsible for the performance of the obligation to acquire the shares. This insight was crucial to the court's finding of subject matter jurisdiction. But there was no suggestion in Leasco that nationality alone was determinative of subject matter jurisdiction. Indeed the United States rejects the passive personality principle, which gives a nation jurisdiction to prescribe rules governing conduct which injures one of its citizens.

While the American nationality of the plaintiff is not a sufficient element for jurisdiction, it was apparently a necessary one in Leasco. In other cases, such as the case of a foreign investor purchasing American securities on an American exchange, American nationality would, no doubt, not even be necessary. The nationality of the plaintiff is, then, but one element in the jurisdictional calculus.

b. Nationality of the Defendants

The Leasco court's willingness to "pierce the nationality veil" and identify the actual nationality of the characters involved in a securities transaction would undoubtedly extend to defendants as well as to plaintiffs. And the nationality of the defendants, unlike that of the plaintiffs, provides by itself a proper basis for jurisdiction (the nationality principle). 96

Despite the United States' acceptance of the nationality principle, 97 no court has applied the securities laws solely on the basis of the defendant's nationality. In a couple of cases, however, the American nationality of the defendants, as determined after the nationality veil has been pierced, can explain the application of section 10(b) beyond the limits suggested by the cases in which jurisdiction was based solely upon conduct or effects within the United States.

In SEC v. Gulf Intercontinental Finance Corp., 98 a group of Florida businessmen organized a Canadian corporation, Gulf Intercontinental, to raise new capital for their automobile sale and leasing business. Gulf Intercontinental securities (8 and 8-1/2% notes) were sold in Canada to Canadians by means of an advertising campaign in sixty-three of the leading daily newspapers in principal Canadian cities. When the scheme was unable to earn monthly interest requirements on the notes and a substantial principal impairment resulted,

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95 Text accompanying notes 58-60 supra.
96 Text accompanying notes 23-32 supra.
97 RESTATEMENT (SECOND), supra note 20, § 30 (1965).
the SEC sought an injunction, appointment of a receiver, and an accounting to the investors defrauded in violation of rule 10b-5. With respect to the defendants' nationality, the district court concluded:

Looking through the transparent fabric of this promotional scheme, it becomes obvious that the true issuers of the notes . . . were the Florida defendants . . . . Gulf Intercontinental was nothing more than a conduit . . . .

But the court did not expressly base its finding of subject matter jurisdiction on the defendants' nationality. Referring to the fact that a substantial number of copies of the Canadian newspapers containing Gulf Intercontinental's advertising were circulated in the United States, the court said:

It is sufficient for subject matter jurisdiction under the Acts that such offers be made within the United States without a showing that such offers were accepted by actual sale, or that the alleged misrepresentations were in fact successful in inducing the sale of such securities by reliance thereon.

And the court continued to say that even if the offer had been made entirely outside the nation, rule 10b-5 protection would be available as long as the scheme "necessarily must be accomplished in part by use of the mails or interstate facilities." Since there was no domestic market in the securities, the effects doctrine of Schoenbaum

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99 Id. at 995 (footnote omitted).
100 Id. at 994-95 (footnotes omitted).
101 Id. at 995. In reaching this conclusion, the court relied on cases which held that the requirement in the Securities Act that some use be made of the facilities of interstate commerce was intended to create a basis for federal jurisdiction, and that the use of these facilities need not be central to the fraudulent scheme and may be entirely incidental to it (United States v. Cashin, 281 F.2d 669, 673 (5th Cir. 1960); Creswell-Keith, Inc. v. Willingham, 264 F.2d 76 (8th Cir. 1959)). 223 F. Supp. at 995 n.16. But the court's reliance on these cases was misplaced. It should not be assumed that the use of interstate facilities which is sufficient to give Congress the power to regulate under the commerce clause of the Constitution is also sufficient to give the United States jurisdiction to regulate under the principles of international law. Nor should it be assumed that Congress intended to utilize its prescriptive jurisdiction as defined by international law to the same extent it intended to use its powers as defined by the Constitution.
102 See text accompanying notes 54-57 supra.
103 Text accompanying notes 38-39 supra.
104 Text accompanying notes 49, 57 supra.
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offers no support for subject matter jurisdiction. If the Gulf Intercontinental decision is not to be viewed as a departure from the territorial and objective territorial principles of jurisdiction as applied in these cases, the nationality of the defendants must be regarded as the determinative factor.

Nationality played a similar role in a more recent case involving offshore mutual funds, SEC v. United Financial Group, Inc.105 The Commission, alleging violation of rule 10b-5, sought an injunction and appointment of a receiver pendente lite against UFG, a Delaware holding company which controlled a large complex of mutual funds incorporated in foreign countries. The Ninth Circuit based its finding of jurisdiction on its conclusion that "the complex of foreign companies was in fact directed and controlled as an integrated whole from the United States," combined with its findings that Americans held shares in some of the funds and that the defendants made use of the mails and other facilities of interstate commerce.106

But these latter two findings alone do not support jurisdiction, absent an expansion of the acts and effects doctrines as articulated by the Schoenbaum and Leasco courts. From all of the shareholders in over twenty investment companies, the SEC was able to identify only three Americans, all of whom purchased their shares abroad.107 After Leasco, the effects doctrine of Schoenbaum does not support jurisdiction in such a case. The facilities of interstate commerce were used to prepare and distribute prospectuses, to set up sales meetings, and to consummate investment transactions. But there was no indication in the court's opinion that any misrepresentations were made through the facilities of interstate commerce or that the use of these facilities constituted an essential link in the allegedly fraudulent transactions. The conduct within the United States appears less significant than the conduct in Leasco. The American nationality of the defendant emerges, then, as a critical, if not the decisive, factor.

In summary, the nationality of the defendants has not yet provided the sole basis for a court's finding of jurisdiction.108 But the defendant's nationality, like the plaintiff's nationality, is sometimes the swing weight in the jurisdictional balance.

105 474 F.2d 354 (9th Cir. 1973).
106 Id. at 356.
107 Id.
108 The American nationality of the parties who controlled an off-shore mutual fund was considered significant, but not sufficient for subject matter jurisdiction over transactions in shares of the fund, in Finch v. Marathon Securities Corp., 316 F. Supp. 1345 (S.D.N.Y. 1970). The court refused application of § 10(b) because the substance of the fraud occurred outside the United States, the parties were predominately foreign, the subject shares were in a foreign corporation and were neither registered nor traded on a national exchange, and there was no domestic injury. Id. at 1349. But the court indicated that the "jurisdiction gap" was "partially bridge[d]" by the facts that 6 of the fund's 8 directors were American and an Illinois corporation "maintained substantial control over" the fund. Id. at 1347.
4. The Section 30(b) Exemption

Essential to any comprehensive study of the transnational applicability of section 10(b) is the little-explored section 30(b) of the Exchange Act, which provides:

The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.\(^\text{109}\)

The only “persons” eligible for the section 30(b) exemption are professionals, such as brokers, dealers, banks, and investment companies, who regularly engage in securities trading in the course of their business.\(^\text{110}\)

A more difficult question of interpretation stems from the phrase “without the jurisdiction of the United States.” In most cases, courts have read “jurisdiction” in the territorial sense, thereby making the exemption available to all persons transacting a business in securities outside the territory of the United States.\(^\text{111}\) At least one commentator has suggested that Schoenbaum departed from this territorial interpretation.\(^\text{112}\) But a close reading of Schoenbaum indicates that the court may have based its holding that the section 30(b) exemption was unavailable solely on the absence of a business in securities, rather than on the conclusion that the transaction was not “without the jurisdiction of the United States” under section 30(b).\(^\text{113}\) And the following dictum, if not the result of oversight, suggests that the court adopted the territorial interpretation of jurisdiction in section 30(b):

The purpose of [section 30(b)] is to permit persons in the securities business to conduct transactions in securities out-

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In Leasco, Fleming Ltd., a British Merchant Bank and investment counsellor that regularly trades in securities, claimed exemption under § 30(b) in the district court. The Second Circuit did not deal with the § 30(b) exemption, and it is unclear whether the district court based its denial of the 30(b) exemption on a finding that Fleming was not “without the jurisdiction of the United States,” or on a finding that Fleming was not transacting a “business in securities.” See [1971-72 Transfer Binder] CCH Fed. Sec. L REP. ¶ 93,454, at 92,243-44. If one considers the general holding in Leasco that the transaction was within the jurisdiction of the United States, the former reading is preferable.


\(^{112}\) Id.

\(^{113}\) See 405 F.2d at 207-08.
side of the United States without complying with the burdensome reporting requirements of the Act and without being subject to its regulatory provisions.\textsuperscript{114}

But the territorial interpretation and the expansive section 30(b) exemption which it supports are inconsistent with the thrust of the Schoenbaum holding.\textsuperscript{115} Indeed, in SEC v. United Financial Group, Inc., the Ninth Circuit cited Schoenbaum to support its conclusion that the meaning of "jurisdiction" was not limited to "territorial limits."\textsuperscript{116}

As the SEC maintained in its amicus brief in Schoenbaum, to interpret "without the jurisdiction of the United States" as the equivalent of "without the United States" "would do violence to the accepted canon of statutory construction that, if possible, effect must be given to every word of a statute."\textsuperscript{117} "Jurisdiction" should be read to mean the prescriptive jurisdiction of the United States, as defined by the principles of international law.\textsuperscript{118}

The remaining key phrase in section 30(b) is the phrase "insofar as," through which Congress interjected the concept of divisibility into its regulatory scheme. The phrase acknowledges that securities business is divisible into transactions within and transactions without the prescriptive jurisdiction of the United States, and it focuses attention not on the general character of that person's business, but on the nature of the particular transactions involved in the case in controversy. If a given transaction or activity is determined to lie without the jurisdiction of the United States, the provisions of the Exchange Act are inapplicable. Thus, for example, in Kook v. Crang a Canadian broker, who was registered with the SEC and did business in the United States, was held not to be subject to the margin requirements of section 7(c)\textsuperscript{119} with respect to a transaction on the Toronto Stock Exchange in securities not traded in the United States.\textsuperscript{120} The same divisibility principle governs the applicability of section 10(b) to persons transacting businesses in securities.

\textsuperscript{114} Id. at 207 (emphasis added).

\textsuperscript{115} Schoenbaum held that Congress intended rule 10b-5 to apply to a transaction which takes place outside the United States among foreigners who are not conducting a business in securities, if the transaction has an adverse impact on domestic markets and American investors. Text accompanying notes 74-75 supra. The combined Schoenbaum holding and dicta suggest the anomalous conclusion that Congress intended to protect the American investor from the effects of a fraudulent extraterritorial transaction if that transaction was an isolated transaction of a foreign individual or corporation, but not if that transaction was part of the business of a securities dealer.

\textsuperscript{116} 474 F.2d 354, 357 n.8 (9th Cir. 1973).

\textsuperscript{117} Brief for SEC as Amicus Curiae, at 23, Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968). See 2 J. SUTHERLAND, STATUTORY CONSTRUCTION § 4705 (3d ed. J. Horack 1943).

\textsuperscript{118} Cf. Unconstitutional Discrimination, supra note 64, at 530-36, in which Currie discusses the meaning of the phrase "within its jurisdiction" in the equal protection clause of the fourteenth amendment.


\textsuperscript{120} 182 F. Supp. 388 (S.D.N.Y. 1960); text accompanying notes 35-41 supra.
IV. DERIVING A JURISDICTIONAL CALCULUS

A. The Inadequacy of the Current Approach and the Relevance of Choice-of-Law Principles

The present limits on the transnational applicability of rule 10b-5 are the result of a jurisdictional calculus which resorts to general principles of international law in setting the outer limits of applicability, and speculation on congressional intent in determining the proper scope of section 10(b) within those outer limits. This two-step analysis is inadequate to the task of resolving the complex jurisdictional questions presented by transnational securities dealings. The principles of international law, particularly the objective territorial principle, provide little more than broad guidelines, and speculation on congressional intent behind section 10(b) offers little promise of providing satisfactory answers to these jurisdictional questions.

Congress never considered the applicability of section 10(b) in many of the domestic contexts in which it is presently applied, much less in the transnational setting. In the domestic context, judicial application of section 10(b) in circumstances beyond those contemplated by Congress in 1934 has proven beneficial. In the transnational setting, judicial application of section 10(b) in circumstances beyond those contemplated by Congress in 1934 is necessary in many cases, but the courts should neither undertake to apply section 10(b) nor refuse its application without an appreciation of the consequences of their doing so. This appreciation does not come simply from bald speculation on what Congress would have intended if it had considered the particular question.

If the courts are to base their jurisdictional decisions in the transnational setting on the somewhat artificial concept of congressional intent, that "congressional intent" must reflect more than the underlying purposes of the Exchange Act. The "congressional intent" which is relevant to the transnational application of the Exchange Act is the vector sum of the following elements: the underlying purposes of the Exchange Act; other policies and interests of the United States; the legitimate expectations of the parties; the need for certainty and predictability; the policies and interests of other nations; and the common interest of all nations in international harmony. These are the elements which, in the absence of an express statutory directive to apply the forum's law, are relevant to the choice of law under modern conflicts principles.

The cases dealing with the transnational application of section 10(b) in many of the domestic contexts in which it is presently applied, much less in the transnational setting. In the domestic context, judicial application of section 10(b) in circumstances beyond those contemplated by Congress in 1934 has proven beneficial. In the transnational setting, judicial application of section 10(b) in circumstances beyond those contemplated by Congress in 1934 is necessary in many cases, but the courts should neither undertake to apply section 10(b) nor refuse its application without an appreciation of the consequences of their doing so. This appreciation does not come simply from bald speculation on what Congress would have intended if it had considered the particular question.

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The cases dealing with the transnational application of section


2 Restatement (Second) of Conflict of Laws § 6 (1971).
10(b) are notable for their failure to consider these factors. The defendants in *Leasco* argued that since choice-of-law principles would select the law of England as the applicable law, application of section 10(b) would violate international law. The *Leasco* court properly rejected that argument, for the limits on the United States' jurisdiction to prescribe a rule are set by the principles of international law, not by choice-of-law principles. But the court went on to say that even if choice-of-law principles indicated that English law should govern, section 10(b) would still be applicable because in the circumstances described in § 17 of the Restatement of Foreign Relations Law, under which this case fits, the nation where the conduct has occurred has jurisdiction to displace foreign law and to direct its courts to apply its own.

The problem with this statement is that Congress did not explicitly direct the courts to apply section 10(b) in cases like *Leasco*. In view of that fact, which Friendly acknowledged, his dismissal of choice-of-law principles does injustice to their true relevance. In the absence of express congressional intent, choice-of-law principles are a useful guide to interpreting a statute's spatial reach. We turn, then, to a brief analysis of how the interests considered important under choice-of-law principles relate to the transnational application of section 10(b).

**B. Choice-of-Law Principles and the Transnational Applicability of Rule 10b-5**

1. Reducing Uncertainty and Rewarding Expectations


   The parties to a transnational contract will often specify the law applicable to the transaction and an exclusive forum for the settle-

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123 468 F.2d at 1338.
124 *Id.* at 1339.
125 *Id.* at 1334.
126 *Cf.* Currie, *Notes on Methods and Objectives in the Conflict of Laws*, 1959 DUKE L.J. 171, 178. For an example of a case in which the court referred to choice-of-law principles (particularly the outdated lex loci delicti test) as a guide to the interpretation of a statute, see Vanity Fair Mills, Inc. v. T. Eaton Co., 234 F.2d 633 (2d Cir. 1956), cert. denied, 352 U.S. 871 (1956).

Although Judge Friendly dismissed the defendants' conflicts argument as irrelevant in *Leasco*, he resorted to conflicts principles to support the applicability of rule 10b-5. Friendly referred to the modern choice-of-law principle of looking to the state which has "the most significant relationship" to the transaction for the purpose of determining the applicable law, in order to counter the suggestion that Congress would have wished to withdraw protection from an American investor who is the subject of a fraudulent misrepresentation in New York simply because the final event (mailing the stock certificate) took place abroad. 468 F.2d at 1337. By pointing to conflicts principles to suggest congressional intent to apply section 10(b), Friendly's opinion clearly raises the possibility that in the proper case, conflicts principles may be used to suggest congressional intent not to apply section 10(b).
ment of all disputes arising under the contract. Choice-of-law clauses generally serve a useful purpose in reducing the uncertainty inherent in transnational business ventures, and enforcement of these clauses normally rewards the legitimate expectations of the parties. But agreements to apply another nation's law necessarily involve waiving any rights which the parties may have under American law, and Congress explicitly provided in section 29(a) that compliance with the provisions of the Exchange Act cannot be waived by contract. If, then, an analysis of the principles of international law and of the factors relevant to a determination of Congressional intent produces the conclusion that rule 10b-5 is applicable to a transaction, an agreement to apply another nation's law is unenforceable as such in a United States court.

Choice-of-forum clauses, in addition to reducing uncertainty, serve important purposes of providing a neutral forum and preventing inconvenience. While American state courts have traditionally displayed hostility to these clauses, the Supreme Court in a recent admiralty case, *The Bremen v. Zapata Off-Shore Co.*, held that choice-of-forum clauses are prima facie valid. The Court stated that a forum clause should be enforced unless: (1) the clause was secured by fraud or overreaching, (2) "enforcement would contravene a strong public policy of the state in which the suit is brought . . . .", or (3) the contractual forum would be so inconvenient that one of the parties would "for all practical purposes be deprived of his day in court."

The Zapata standards for enforceability of forum clauses are applicable in suits brought under the federal securities laws. If choice-of-forum clauses involved no more than the selection of the site for resolving disputes, they might well be enforceable in actions for fraud. But to the extent that the contractual forum can be expected to apply its own law, rather than rule 10b-5, enforcement of the choice-of-forum clause would contravene United States policy in cases in which rule 10b-5 would be applied by an American court—particularly in light of section 29(a).128

127 For example, in *Leasco* the parties agreed that the tender offer was to comply with the Code on Take-overs and Mergers of the City of London and the regulations of the London Stock Exchange. 468 F.2d at 1332.

128 Section 29(a) provides:

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.


130 Id. at 18.

131 In *Wilko v. Swan*, 346 U.S. 427 (1953), the Supreme Court held that an agreement to arbitrate future controversies was void under § 14 of the Securities Act, 15 U.S.C. § 77n (1970), which is virtually identical to § 29(a) of the Exchange Act. But in *Alco Standard Corp. v. Benalal*, [1972-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,640 (E.D. Pa. 1972), a case arising under § 10(b) of the Exchange Act, a district court "question[ed] the application of *Wilko v. Swan* [sic] to a factual situation in which a strong and sophisticated party chooses his forum in advance . . . ." Id. at 92,892 n.7. The court refused to defer to arbitration on other grounds, but clearly im-
b. Expectations of the Parties as an Element in the Jurisdictional Calculus

While choice-of-law and choice-of-forum clauses may not be enforceable as such, it does not necessarily follow that the expectations of the parties, whether formally expressed in agreements or not, are entitled to no weight at all in determining the applicability of rule 10b-5. Indeed, section 29(a) bars only the waiver of acknowledged rights under the Exchange Act. When a provision of the Exchange Act is applicable, section 29(a) removes the binding effect of any agreement not to assert a claim under that provision. On its face, section 29(a) does not bar the weighing of the parties' expectations along with the other factors relevant to a choice-of-law analysis for the purpose of determining whether or not Congress intended that provision to be applicable in the first place.

This reading of section 29(a) may strike some as too strained; the language of section 29(a) can be read as evidencing a congressional intent that the availability of claims under the Exchange Act be determined without regard to the prior agreements and expectations of the parties. In the domestic setting, such a broad reading of section 29(a) consists with the broad investor-protection policies of the Exchange Act. But in the transnational setting, the former, narrow reading of section 29(a) is preferable. Congress gave no more thought to the applicability of section 29(a) in the transnational setting than it did to the applicability of section 10(b). If, as this Comment has suggested with respect to section 10(b), the missing congressional intent is to be supplied by an examination of the relevance and strength of various factors, the relevance of the parties' expectations cannot be dismissed simply by a broad reading of section 29(a).

In his dissenting opinion in Alberto-Culver Co. v. Scherk, Civil No. 72-1158, at 7, 12 (7th Cir., Aug. 2, 1973), Judge Stevens, arguing for the enforcement of an arbitration clause, observed that a literal reading of § 29(a) does not render void a plaintiff's waiver of his right to sue in a federal court, but only "renders void any waiver by a plaintiff of defendant's obligation to comply with the statute." Judge Stevens did acknowledge, however, that the underlying policy of the statute "justifies an expansion of the coverage of § 29(a) of the 1934 Act beyond its literal meaning." Id. at 13. At any rate, even if the 2 types of waiver discussed by Judge Stevens are at all distinguishable, his observation is only relevant to the determination of the proper forum (the enforceability of an arbitration clause); it is not relevant to the question with which we are dealing—whether a plaintiff can waive the applicability of the Act.

In evaluating the significance of the parties' expectations in determining the applicability of rule 10b-5, it is useful to distinguish between disputes over fulfillment of the terms of a contract and actions for fraud. In contract disputes, the agreements and expectations of the parties with respect to the applicable law are crucial, for the terms to which the parties agreed may be determined in part by the applicable law. In such cases, application of the agreed-upon law would be necessary in order to reward the legitimate expectations of the parties.

There is no comparable expectation or reliance interest in an action for fraud. First, it is unlikely that parties to a transaction contemplate what state's law of fraud would be applicable. And second, even if the parties do expressly agree that a particular law of fraud would be applicable, fraud is sufficiently tainted with moral blame to render any reliance upon such an agreement unworthy of legal recognition. Indeed, Professor Ehrenzweig says that precisely because of the moral blame which attaches to fraud, a court in a fraud action involving foreign elements will always apply its own law, regardless of differing standards of behavior in the relevant states.4

Rule 10b-5, of course, differs substantially from the common law of fraud: the standards of conduct are significantly higher and the requirements of proof significantly easier under rule 10b-5.8 The differences are significant enough that the parties to a transnational securities venture may well wish to establish at the outset whether or not rule 10b-5 is applicable. It could be argued that the differences are more significant than the differences among various states' common laws of fraud that have been disregarded by forum courts in always applying their own law, and that the reliance interest is therefore greater in the case involving the possible application of rule 10b-5 than in the case involving the application of one or another state's common law of fraud. And it could be argued further that since the moral blame attached to behavior prohibited by rule 10b-5 but not by common law fraud is less than that attached to behavior which would be prohibited by any version of common law fraud, the reliance interest is more worthy of judicial recognition in the case involving the possible application of rule 10b-5.

These arguments are not without merit, for there is some value in permitting parties involved in arm's-length negotiations to define the duties owing to each other, short of dispensing with the fundamental duties of fair dealing which are embodied in a nation's common law of fraud.136 But the value of rule 10b-5 in promoting sound

134 A. EHRENZWEIG, CONFLICT OF LAWS 558-59 (1962).
135 Rule 10b-5 has gone beyond the common law of fraud in expanding recognition of nondisclosure and dispensing with the scienter and privity requirements. See generally 1 A. BROMBERG, SECURITIES LAW: FRAUD § 2.7(1) (1971); 2 id. §§ 8.1, 8.5(311).
136 The agreements and expectations of the parties are, of course, only relevant in disputes between those parties. For example, an agreement that American law would not
securities markets has been demonstrated in the domestic context, and any expectation or agreement of the parties that rule 10b-5 would not apply should not predominate over conflicting national or global policies and interests.

2. Policies and Interests of the United States

a. Protecting American Investors and American Markets

One source of confusion in the cases discussed above is uncertainty over whether Congress intended the securities laws to protect American investors or to protect American markets or both. It is unlikely that the drafters of the 1934 Act gave much consideration to the distinction. As long as Americans invested overwhelmingly in domestic markets and the domestic markets were overwhelmingly American, the distinction was irrelevant. However, as more Americans invest in foreign markets and more foreigners invest in American markets, the distinction between protecting American investors and protecting American markets becomes crucial to an assessment of the appropriate transnational applicability of rule 10b-5.

In the absence of congressional clarification of the importance of each form of protection, the courts themselves must engage in an evaluation of the United States' interests. While protecting American investors and protecting the integrity of American markets may no longer be accomplished in a single stroke, the United States retains an interest in each. The magnitude of the interest will, of course, vary from case to case, according to, respectively, the number of American investors involved and the directness and magnitude of the impact on American markets.

It was primarily the United States' interest in protecting American investors which supported jurisdiction in Schoenbaum, and which argues in favor of jurisdiction in Leasco even in the absence of conduct in the United States. This same interest offers support for extending rule 10b-5 protection to the individual American investor who buys stock in a foreign market, although the magnitude of the United States' interest in protecting this individual investor is probably outweighed by considerations of international harmony.\textsuperscript{137}

It is the United States' interest in protecting the integrity of its securities markets which justifies the application of rule 10b-5 to pro-
protect a foreign investor defrauded in transacting business in the American markets. This interest in protecting the integrity of American markets in order to promote the free flow of capital to American business suggests that rule 10b-5 protection should be extended to foreign investors who participate indirectly in the domestic securities markets through offshore mutual funds—a step which the courts have been hesitant to take.139

b. United States Monetary Policy

United States monetary policy is interwoven with securities regulation. In 1964, as part of the program to reduce the balance of payments deficit and protect United States gold reserves, the SEC relaxed the requirements for the registration of foreign offerings by domestic issuers in order to encourage foreign investment.140 Like SEC relaxation of these registration requirements, court decisions construing the reach of rule 10b-5 will have an effect on the United States’ balance of payments. Should the courts extend anti-fraud protection to American investors overseas but deny protection to foreign investors in American securities, this policy would encourage the flow of investment capital from the United States and contribute to our balance of payments deficit. This is one of the lessons of the Fund of Funds fiasco which soured many foreigners to American investments.141

The formulation of monetary policy is not, of course, within the realm of the courts. The 1964 decision of the SEC to relax registration requirements came at the recommendation of a Presidential Task Force.141 While the courts should be mindful of express monetary policy and changes in monetary policy, it would be improper for them to act unilaterally in this area.

c. Protecting Foreigners Who Transact Business in Foreign Securities with Other Foreigners in the United States

The United States retains some interest in securities transactions between foreigners in the United States, even if the transaction does not touch directly upon any American citizen or domestic market. If the extension of rule 10b-5 protection to these foreigners would encourage them to transact business in the United States, indirect benefits would flow to the domestic securities markets and to the domestic economy in general. In the case of the Japanese and the German businessmen meeting in New York for convenience to transact

138 See cases discussed in notes 85, 105 supra & accompanying text.
139 Registration of Foreign Offerings by Domestic Issuers, 17 C.F.R. § 231.4708 (1973).
140 See notes 146-48 infra & accompanying text.
141 PROMOTING FOREIGN INVESTMENT, supra note 3, at 7-8.
business in Japanese securities, these benefits may be de minimis. But if the Japanese and German businessmen have permanent offices in New York, the benefits may be of some significance.

3. Policies and Interests of Other Nations

a. Interests Reflected by Differences Between a Foreign Nation's Law and American Law

Accommodation of the interests of the United States and other nations is not always an easy task, particularly in areas in which these interests are in direct conflict. For example, the bank secrecy laws of such nations as Germany and Switzerland can conflict directly with the disclosure requirements of the United States securities laws\textsuperscript{142} and with the discovery procedures of American courts.\textsuperscript{143} Attempts to enforce American disclosure requirements and subpoenas can place a German or Swiss national in a position of obeying United States law only at the risk of being found guilty of violating his own nation's law. To a lesser degree, application of American antitrust laws in the transnational setting can raise similar conflicts. As a matter of basic economic policy, some nations encourage cartels and other cooperative arrangements which would constitute violations of the United States' antitrust laws.\textsuperscript{144}

The application of rule 10b-5 to securities transactions which produce effects within the United States does not involve the same potential for direct conflict with the policies of foreign nations, for fraud is widely recognized as a tort. Other nations may set more lenient standards of conduct and stricter requirements of proof than are imposed by rule 10b-5, but those standards and requirements do not call for conduct inconsistent with the conduct called for by rule 10b-5. The application of those standards and requirements may produce different results than the application of rule 10b-5, but the differences do not represent any significant policy of the other nations. Certainly it cannot be said generally that other nations have made conscious decisions that their national interest is best served by the imposition of lower standards of conduct and stricter requirements of proof than those imposed by rule 10b-5. Those nations do not, then, have strong interests in the application of their own standards rather than 10b-5 standards in cases involving Americans and their own nationals.


\textsuperscript{143} See, e.g., Societe Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers, 357 U.S. 197 (1958); United States v. First National City Bank, 396 F.2d 897 (2d Cir. 1968).

\textsuperscript{144} See H. STEINER & D. VAGTS, TRANSNATIONAL LEGAL PROBLEMS 912 (1968); C. EDWARDS, TRADE REGULATIONS OVERSEAS (1966).
b. Interests Reflected by the Existence of a Foreign Nation's Law

Foreign nations have an interest in developing their own regulatory schemes for securities transactions and corporate management. For example, in Schoenbaum Canada had an interest in regulating the internal operation of a Canadian corporation—more specifically, the duties of controlling persons to the corporation and its shareholders. While the absence of remedies available to the corporation or the minority shareholders would not imply the existence of any significant Canadian policy sufficient to bar the application of rule 10b-5, the existence of such remedies under Canadian law might support an American court's deferral to Canadian law. But Canada's interest in having injuries remedied through the application of its own law, rather than American law, is hardly compelling.

c. Protecting Nationals from Inconvenience

Foreign nations retain an interest in protecting nationals who do business with Americans within their own territory from the inconvenience of law suits in the United States. But inconvenience to the parties is more properly considered in determining whether a United States court has jurisdiction over the person, and whether a suit brought in the United States should be dismissed under the principle of forum non conveniens. Inconvenience has no bearing on the question whether section 10(b) is applicable.

In general, in cases of fraud and other misconduct which may violate rule 10b-5, the interests and policies of other nations do not militate strongly against the applicability of United States law. The transnational applicability of rule 10b-5 should depend primarily upon the strength of the other factors in our jurisdictional calculus.

4. The Needs of the International Community

It has been the increased transnational activity in the securities business that has given rise to the complex jurisdictional questions of the transnational applicability of section 10(b), and it is with an eye to facilitating further transnational securities activity that the courts should approach these jurisdictional questions. The most important elements in the jurisdictional calculus are the need to promote the harmonious relations among nations and nationals that are essential to successful commercial intercourse, and more specifically, the need to promote sound transnational securities markets. While these needs may occasionally pull the courts in different directions, they both point to the desirability of uniformly high standards of conduct for participants in the transnational securities markets. As the nation with the most sophisticated securities laws, the United States has a re-

145 See Restatement (Second) of Conflict of Laws § 6, Comment d (1971).
sponsibility to lead the international community toward the development and enforcement of uniformly high standards of conduct, but of doing so in a spirit of cooperation rather than imposition.

The goals of sound transnational securities markets and harmonious relations among nations require that the umbrella of protection afforded by rule 10b-5 be neither offered every American investor abroad nor denied every foreign investor in the United States or abroad. They also require that the United States' courts be neither overzealous in extending rule 10b-5 protection in cases in which protection is available under some applicable foreign law nor reticent in extending rule 10b-5 protection in cases in which no adequate alternative protection exists.

The recent collapse of IOS illustrates the harms which can occur when the SEC and the United States' courts refuse to fill a regulatory vacuum that works to the detriment of foreign investors. In that case, the aggressive merchandising techniques which are carefully regulated in the United States and other countries with sophisticated securities laws were exported into comparatively undeveloped markets in which external regulation was limited. The IOS collapse not only harmed those unfortunate investors who held investments in IOS and its affiliated enterprises, but also impaired the growing confidence of many foreign investors in American securities. Some countries responded to the experience with sharply restrictiv; regulation designed to keep out foreign investment intermediaries.

Although the effects of overextension of rule 10b-5 in cases in which alternative protection is available are not likely to be as dramatic as the effects of underextension in cases in which no alternatives are available, such overextension may indirectly deter transnational securities dealings. The prospect of being subject to American securities laws, and the resultant need to become familiar with these American laws, may discourage foreigners from entering into transactions with Americans. And the increased willingness of foreign nations to apply their laws in the transnational setting—a possible result of extended application of American law in the transnational setting—may have a similar effect upon American businessmen and investors. But it is probably safe to say that the situations in which the availability of rule 10b-5 protection would discourage transnational securities activity are far less numerous than those in which the availability of rule 10b-5 protection would encourage such activity. And as for those cases in which the availability of rule 10b-5 protection would discourage transnational securities activity, some of this discouragement may be a

146 See generally N.Y. Times, Nov. 30, 1972, at 63, col. 7.
reasonable price to pay for the increased soundness of the transnational securities markets.

C. Institutional Considerations: The Locus of Decisionmaking

Courts should attempt to weigh the complex elements involved in determining the proper reach of rule 10b-5 and the American securities laws in general, but there should be no illusion that the courts can succeed unaided. Professors Brainerd Currie and Albert Ehrenzweig have suggested that the courts are ill-equipped to handle the complex weighing of competing interests which choice-of-law principles require.\(^{140}\) When speaking of the application of conflicts principles in an international context, this conclusion is inescapable. The judicial mechanism is not geared to making national securities policy, balancing the competing policies of different nations, or structuring an international regulatory system.

While the United States courts cannot be expected to do an adequate job of determining the proper transnational reach of rule 10b-5, it is not immediately apparent what body is best suited to the task. The SEC can play an important role in clarifying the significance of the application of rule 10b-5 in different contexts to the goals of protecting American investors and American securities markets. The SEC has established an Office of International Corporate Finance, whose duties include supervising offerings of American securities abroad and offerings of foreign securities in the United States, and resolving the problems arising from the need to meet the accounting and disclosure requirements of more than one nation.\(^{150}\) The Office of International Corporate Finance should address itself to the question of the appropriate transnational reach of rule 10b-5.

The inquiry should not stop with the SEC. Congress has a threefold contribution to make. First, Congress should clarify the extent to which the securities laws are intended to protect American investors and the extent to which these laws are intended to protect American markets. Second, Congress should attempt to clarify the manner in which the transnational application of rule 10b-5 and other parts of the securities laws should depend upon other national concerns, such as United States monetary policy and foreign policy in general. In this latter endeavor, the Congress should seek input from the executive branch of government. Third, Congress should address the question of the proper scope of the American securities laws in light of the policies and interests of other nations and the international community as a whole. Congressional hearings drawing upon the expertise of skilled comparativists in the securities field and representatives of


American and foreign securities industries are necessary and appropriate steps toward the goal of establishing the proper scope of the American securities laws.

Congress' ability to develop reasonable limitations on the applicability of the securities laws depends largely upon the quality of the information and advice which it receives from those most familiar with the problems—the members and the students of the securities industry. But even among the members and the students of the industry, there is inadequate understanding of the regulatory problems posed by the transnational character of today's securities industry. There is a need for cooperative programs which bring together securities scholars from around the world for the purpose of developing a common understanding of the workings of the various market systems and an appreciation of the emerging problems. This common understanding could then be utilized to consider the proper transnational reach of the American securities laws, to resolve the conflicts generated by the increased integration of the world capital markets, and eventually to develop a common regulatory scheme which a worldwide securities industry will demand.\textsuperscript{151} It is only through such cooperative programs that the problems inherent in the present structure of the securities industry will be resolved.

\textsuperscript{151} Professor Robert H. Mundheim, the Director of the Center for Study of Financial Institutions at the University of Pennsylvania, has proposed the creation of an International Faculty with these precise goals in mind.