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I. INTRODUCTION

While American securities regulation is multi-faceted, its most visible function is controlling fraud in connection with the purchase or sale of securities. In exploring this function, this Article will first offer an overview of how the law operates with respect to fraud generally and explore the analytical strategies the law employs regarding insider trading specifically.[1] Then, it will look at the underlying philosophy of regulation: What American law is trying to accomplish through its rather aggressive regulatory posture and why. Finally, it will consider how appropriate this philosophy is when applied to the regulation of multi-national conduct, where American interests are affected along with those of other nations.

This last question is exceptionally important in light of the linkages that have developed among securities markets and the transnational interest existing in the management of investment portfolios.[2] A perception lingers in the United States that the question of extraterritorial fraud jurisdiction is relatively trivial. The reasoning behind this perception is that, because fraud is "bad," no nation should seriously object to the

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1. This Article will not address explicitly the express antifraud remedies, e.g., those found in the Securities Act of 1933 [hereinafter the Securities Act]. Most of these have built-in limitations with respect to the globalization issues. For instance, the draconian § 11 liability for false statements in a registration statement applies only when a registration statement must be filed; the Securities Exchange Commission [hereinafter the SEC], in its Reg. S and related initiatives, has expressly narrowed the class of transnational transactions in which registration is required. Some of what is said here applies by analogy to the express settings, however, particularly § 12(2), dealing with fraud in prospectuses generally, without regard to registration.

2. *See generally* Joseph A. Grundfest, *Internationalization of the World's Securities Markets: Economic Causes and Regulatory Consequences*, 4 J. FIN. SERV. RES. 349 (1990); U.S. OFFICE OF TECHNOLOGY ASSESSMENT, GLOBAL SECURITIES MARKETS AND INFORMATION TECHNOLOGY (July 1990).

application of the American antifraud provisions abroad where the result is simply to remedy such fraud.[3] As this Article shows, however, this is a simplistic view.[4] Properly understood, the antifraud provisions go well beyond the prohibition of classic forms of deceit or manipulation and delve into areas where reasonable regulatory minds can and do readily differ. Implicit conflicts among national regulatory regimes are inevitable. The primary purpose of this Article is to underscore the aspects of our regulatory philosophy most likely to lead to such conflicts and to consider how we might begin to resolve some of the forseeable tension.

II. RULE 10b-5

The principal antifraud provision of the securities laws in the United States is rule 10b-5. This rule bars fraud in connection with the purchase or sale of any security when the facilities of interstate commerce (defined to include facilities linking the United States and foreign countries) are used.[5] Rule 10b-5 covers fraud relating to all securities, from those issued by the largest public corporation to those issued by tiny limited partnerships and closely held corporations. To commit an actionable fraud under rule 10b-5, a person need not be engaged in securities trading (i.e., there is no privity requirement).[6] Rather, fraud consists of (1) material misstatements or "half-truths" that are reasonably calculated to influence the investing public[7] and (2) silence when an independent duty to speak is created by some prior conduct or pre-existing fiduciary relationship. The most important limitation on liability is that the defendant must have acted with scienter (i.e., some intent to deceive, or recklessness).[8] The scope of rule 10b-5 is sufficiently broad that aiders and abettors—those who knowingly and substantially assist a primary violation—are liable as well. This means that banks, law firms, accountants, and others are exposed regularly to lawsuits.

If undertaken willfully, violations of rule 10b-5 are crimes. The

3. *See, e.g.*, Andreas F. Lowenfeld, *Jurisdiction to Prescribe: Some Contributions From an International Lawyer*, 4 B.U. INT'L L.J. 91, 95 (1986).

4. In doing so, this Article builds on another recent work, Donald C. Langevoort, *Schoenbaum Revisited: Limiting the Scope of Antifraud Protection in an Internationalized Securities Market*, Law & Contemp. Probs. (forthcoming 1992).

5. Securities Exchange Act of 1934 [hereinafter the Securities Exchange Act], 15 U.S.C. §§ 3(a)(17), 10(b).

6. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860-62 (1968), *cert. denied*, 404 U.S. 1005 (1971).

7. *Id.*

8. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); *see generally* James D. Cox, *Ernst & Ernst v. Hochfelder: A Critique and an Evaluation of Its Impact Upon the Scheme of the Federal Securities Laws*, 28 HASTING L.J. 569 (1977).

SEC may also punish via a series of remedies such as civil fines and equitable relief. Just as important, American courts assume that persons injured by violations have a right to sue for damages if their harm was caused by the fraud.[9] In large-scale trading, rule 10b-5 violations can trigger class action lawsuits on behalf of large numbers of investors, which result in massive dollar awards.[10]

The Supreme Court case, *Basic, Inc. v. Levinson*,[11] illustrates the breadth of potential liability. In *Basic*, a company was involved in merger negotiations for a transaction that, in management's view, would be lucrative for the company's shareholders. After information leaked, stock exchange officials asked the company whether there were any ongoing material events that could explain the abnormal trading activity. In order to preserve the confidentiality of the negotiations, company officials denied any knowledge of the negotiations.

When the merger was announced, a class action was brought on behalf of all of the sellers of company stock between the time of the misrepresentation and the public announcement. Assuming that the negotiations had reached a stage of "materiality" at the time of the denial, the Court held that the company had indeed violated rule 10b-5, even though the company's motive in lying was to benefit its shareholders. Furthermore, according to the Court, damages would extend to all those who sold during the relevant period, whether or not they actually knew about, much less relied upon,[12] the company's denial (the so-called "fraud on the market" theory). Damages could be in the millions of dollars. Similar lawsuits are commonplace—and often successful—in cases where companies introduce new products with a burst of excessively optimistic publicity, and the products later turn out to be market failures.[13]

9. Courts generally require that the plaintiff show (1) either actual or presumed reliance on the misstatement or omission and (2) pecuniary loss caused by the fraud. *See* Huddleston v. Herman & MacLean, 640 F.2d 534, 554 (5th Cir. 1981), *aff'd on other grounds*, 459 U.S. 375 (1983).

10. Generally, each defrauded buyer or seller may recover the difference between the transaction price and the price the security would have traded at had the full truth been known (the "out-of-pocket" measure of damages). *See, e.g.*, Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1341 (9th Cir. 1976)(Sneed, J., concurring).

11. 485 U.S. 224 (1988).

12. For analyses and critiques of this holding, *see* Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059 (1990); Ayres, *Back to Basics: Regulating How Corporations Speak to the Market*, 77 VA. L. REV. 945 (1991).

13. *See* In re Apple Computer Sec. Lit., 886 F.2d 1109 (9th Cir. 1989). Later, the jury held the individual defendants liable for some $100 million, 23 Sec. Reg. & L. Rep. (BNA) 871 (N.D. Cal., May 30, 1991), but this ruling was in turn vacated by the trial judge.

Basic and similar cases provide important insight for American securities regulation. Note the emphasis on honesty above all else. Business or shareholder-oriented justifications for misstatements, no matter how compelling, are not acceptable.[14] Scienter is not defined as trying to harm someone or enriching one's self at another's expense. Rather, it is enough that one simply misstates or omits facts when one is aware of (or recklessly disregards) the truth. Also noteworthy are the consequences of liability. Violations of rule 10b-5 visit serious financial consequences on corporations and (ironically) non-trading shareholders, often seemingly disproportionate to the level of culpability. The resulting pressure to settle is substantial.[15]

The philosophy behind these doctrinal choices is not well articluated. The law under rule 10b-5 is largely the product of the ad hoc judicial decision-making expressed in what now amounts to thousands of decided cases, rather than a coherent statutory or administrative pronouncement.

One objective, of course, is to promote informed decision-making by investors, providing them with relatively—not totally[16]—complete and accurate information. Yet, it is by no means clear why this truth-telling value should necessarily override other values of equal if not greater interest to investors, like profit maximization. It seems, then, that these results reflect something even more embedded in American culture—the virtue of accountability. Unlike economic systems of many other societies,[17] the American economic system is relatively fragmented. Large numbers of enterprises possess dispersed equity ownership. Few are subject to substantial external control by banks or institutional sharehold-

14. *See* Basic, 485 U.S. at 239 n.17; Backman v. Polaroid Corp., 893 F.2d 1405 (1st Cir. 1990), *rev'd on other grounds*, 910 F.2d 10 (1st Cir. 1990) (en banc).

15. For a study of the pressure to settle in the context of actions under § 11 of the Securities Act, see Janet C. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497 (1991). Professor Alexander's article suggests that in § 11 cases, settlements are done largely without regard to the underlying merits of the action, primarily because of pressure from the investment banker defendants. How well this experience can be generalized to rule 10b-5 is not entirely clear, but anecdotally, at least, there is abundant evidence that many rule 10b-5 actions are settled to avoid the expense, distraction, and publicity attendant to the lawsuit.

16. Nothing in rule 10b-5 compels a corporation to divulge information to the marketplace simply because it is material. Rather, there must be an independent duty to disclose. *See, e.g.*, Backman, 910 F.2d at 10. As a result, there is always some body of proprietary data that is not made available to market participants, and investors must assume the risk that their choices will turn out to be wrong in light of the withheld information.

17. The cultural differences are usefully explored in Dan F. Henderson, *Security Markets in the United States and Japan: Distinctive Aspects Molded By Cultural, Social, Economic and Political Differences*, 14 HASTINGS INT'L & COMP. L. REV. 263 (1991).

ers—there is nothing comparable to the *keiretsu* of Japan or the banker involvement in Germany as behavioral checks. The belief is that, absent a strong emphasis on publicity and truth-telling, American business organizations will exercise their immense economic and political power in invisible and potentially self-serving ways. Historically, Americans have been very uncomfortable with this prospect. Thus, the truth-telling regime imposed by rule 10b-5 is valued not only because it operates to provide information for use by investors, but because of the belief that the very exposure that it creates, and the resulting need for lawyers, accountants, and other advisers that must be brought in from outside the corporation to manage the resulting risks, make it more likely that responsible behavior will occur in the first place.[18]

This disciplinary emphasis is particularly evident in the case law which defines what constitutes material information. American law essentially divides material information into two categories, quantitative and qualitiative. Quantitative information relates to the issuer's financial condition; qualititative information relates to the quality of how the company is being managed. The ill health of the company's top managers, their compensation packages, their misbehavior, their compliance with the law, and the like all become subject to public scrutiny under the truth-telling regime.[19] While some of this information is significant to basic investment decisions, the broad scope of the law in this area reflects a more extensive regulatory agenda—the same agenda, for instance, that introduced the Foreign Corrupt Practices Act into American securities regulation.[20]

III. INSIDER TRADING

The American law of insider trading is largely the product of the courts' interpretation of rule 10b-5.[21] As noted earlier, silence is not ac-

18. While the benefits of publicity cannot be denied, the costs in lawyers' and accountants' fees and on the freedom to operate flexibly are substantial. A cynic might view the primary motivation for such a system as flowing not from investors or the public but from the legal and other service communities, who have substantial influence at the SEC. *See* Donald C. Langevoort, *The SEC as a Bureaucracy: Public Choice, Institutional Rhetoric and the Process of Policy Formulation*, 47 WASH. & LEE L. REV. 527, 531-32 (1990).

19. *See* James D. Cox et al., SECURITIES REGULATION: CASES AND MATERIALS 96-121 (1991).

20. The Foreign Corrupt Practices Act of 1978 created greater federal oversight under the Securities Exchange Act over the asset control function (§ 13(b)(2)) and prohibited foreign bribery (§ 30A). The motivating concern was the discovery of "off books" slush funds used by high level managers to further both business and political ends.

21. Statutorily, § 16 of the Securities Exchange Act—which compels reporting of trades by certain high-level insiders and disgorgement of profits from short-swing trading—is the

tionable under the rule absent an independent duty to disclose. In *Chiarella v. United States*,[22] the Supreme Court indicated that such a duty arises when a company insider trades in that company's common stock because by definition he or she is dealing with a company shareholder (or someone who by virtue of the transaction becomes one). Under common law, a company shareholder is a beneficiary of the insider's fiduciary obligation. Subsequent cases have extended this reasoning to persons who are not directors or employees, but who nonetheless have some fiduciary-like relationship with the company (e.g., attorneys and investment bankers).[23] Liability also extends (under something of a conspiracy theory) to tippees who receive information from an insider in a communication which has no business purpose and thus operates as a self-serving breach of fiduciary duty by the insider.[24] All of this is subsumed under the so-called "abstain or disclose" theory.

When the alleged trading is in a debt security, or when an insider trades in the security of another issuer (to which he or she has no preexisting relationship), a second judicially created theory comes into play. Applying the "misappropriation" theory, it is fraud under rule 10b-5 to misuse for personal benefit through securities trading any information with which one has been entrusted.[25] Here, the source of the information, usually the defendant's employer, is defrauded rather than other investors. This was the approach used by prosecutors to prosecute a former reporter for the *Wall Street Journal* who bought shares of companies that he knew would be mentioned favorably in forthcoming columns.[26]

Finally, the SEC adopted rule 14e-3, which—quite apart from any

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only form of control. Today, there is some recognition of the relatively archaic nature of the disgorgement remedy in light of the fluorishing of rule 10b-5's coverage of insider trading, although its value is not dismissed entirely. *See* American Bar Ass'n Report, *Task Force on Regulation of Insider Trading-Part II: Reform of Section 16*, 42 BUS. LAW. 1087, 1091 (1987).

22. 445 U.S. 222 (1980).

23. *See* SEC v. Ingram, 694 F. Supp. 1437 (C.D. Cal. 1988).

24. *See, e.g.*, Dirks v. SEC, 463 U.S. 646 (1983). This approach to tippee liability also makes the tipper liable for the tippee's profits. The doctrine is broad enough to reach remote as well as direct tippees, so long as the remote tippee knows or has reason to know that the information is tainted by a breach of fiduciary duty. *See* United States v. Musella, 678 F. Supp. 1060 (S.D.N.Y. 1988).

25. United States v. Newman, 664 F.2d 12 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983).

26. United States v. Carpenter, 791 F.2d 1024 (2d Cir. 1986), *aff'd by an equally divided Court*, 484 U.S. 19 (1987). The reporter and his confederates were also convicted under the federal criminal wire and mail fraud statutes, and the Supreme Court unanimously upheld the conviction on the basis that insider trading is a clear-cut violation of those statutes. *See generally* Barbara B. Aldave, *The Misappropriation Theory: Carpenter and Its Aftermath*, 49 OHIO ST. L.J. 373 (1988).

notion of fiduciary duty or entrustment—simply makes it unlawful to trade while in possession of material information relating to a tender offer (once there has been a substantial step toward its commencement) when it is (or should be) known that the information came from either the bidder or the target.[27]

If an instance of trading or tipping violates the law under any of these three theories (conspiratorial, abstain or disclose, or misappropriation), criminal prosecution is a distinct possibility. However, the more frequent enforcement mechanism is an SEC action, which may result in disgorgement of any profits received plus a civil penalty of up to three times the amount of profits received or losses avoided. A private class action is also a possibility, but such actions play a very small role in this area compared to their more sizeable role in false publicity cases.[28]

As with the antifraud prohibition generally, the philosophy underlying the American law of insider trading is somewhat difficult to discern. Although there is no doubt the profits that insiders receive as a result of illegal trading come from other investors,[29] identifying those harmed is quite difficult. For most contemporaneous traders in the stock market, the presence of some insider buying or selling with an informational advantage does not cause any pecuniary harm. In all likelihood, they would have traded anyway, at roughly the same price. No doubt the insight that any harm from insider trading is extremely diffuse has much to do with the emphasis on public rather than private enforcement. By restricting the recovery to the amount of a defendant's profits, the rule strongly suggests that the prevention of unjust enrichment is the primary objective of the substantive law.

Admittedly, various other arguments in favor of prohibiting insider trading are often made. The prohibition operates to remove both a disincentive to prompt corporate disclosure and an incentive to manipulate corporate affairs in order to produce a volatile stock price.[30] It also is a means of assuring that executive compensation is open and controlled,

27. Rule 14e-3's validity was upheld in United States v. Chestman, 947 F.2d 551 (2d Cir. 1991)(en banc).

28. Pursuant to § 20(a) of the Securities Exchange Act, added to the law in 1988, class actions by contemporaneous traders are authorized against traders and tippers, but the most they can recover is the amount of the defendants' profits, and even that sum is reduced by any amounts already disgorged in an SEC proceeding. The statute expressly leaves open the possibility that other types of injury (e.g., to the source of the information in a misappropriation case) can be compensated in an implied right of action under rule 10b-5.

29. *See* William K.S. Wang, *Trading on Material Nonpublic Information on Impersonal Stock Markets: Who Is Harmed, and Who Can Sue Whom Under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217 (1981).

30. This seems to be an intent behind the statutory form of insider trading regulation,

not secret and episodic.[31] But, just as in rule 10b-5 generally, there is something more ideological as well. A strong streak of egalitarianism and obsession with the appearance of fair play leads many Americans to demand the removal of the more visible, excisable advantages attaching to employment, family status, or cultivated friendships that might be put to use in our supposedly fair and open markets. The "abstain or disclose" theory, at least, affirms the view that managers are supposed to work for shareholders. No one is seriously under the illusion that all investors have a right to complete informational equality, but at the same time there is the desire to remove those inequalities that do not seem to be a necessary incident to our system of business enterprise. Under this view, insiders should be content with their paychecks and not overreach for profits. That this smacks a bit of populism, of envy and resentment directed at the privileges of class and wealth, is hard to deny. But appeal to populism is a recurrent theme in American economic history.[32]

IV. EXPORTING AMERICAN PHILOSOPHY TO A GLOBAL MARKETPLACE

The foregoing should amply demonstrate that American securities regulation reflects substantive philosophical choices that are deeply embedded in our unique economic culture. The emphasis on truth-telling and fair play, the distrust of concentrated economic power, and the unease (while at the same time fascination) with privilege and status have all influenced the adoption of specific doctrinal principles in our law of fraud. It follows, of course, that other nations whose cultures reflect different values—or which have different social or economic mechanisms for accomplishing similar goals—will find our approach to the definition

§ 16(b) of the Securities Exchange Act. *See* Steve Thel, *The Genius of Section 16: Regulating the Management of Publicly Held Companies*, 42 HASTINGS L.J. 391 (1991).

31. For various views on these and other related objectives, see James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School"*, 1986 DUKE L.J. 628; R. CLARK, CORPORATE LAW 274-75 (1986); Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983); Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984).

32. For an illustration of the popular outrage as expressed in Congress, see the remarks of Rep. John Dingell, 134 CONG. REC. H7469 (daily ed. Sept. 13, 1988), who compared well-known trader Ivan Boesky to Icarus of Greek mythology, whose hubris caused him to fly on waxen wings toward the sun. Others have expressed the view that insider trading regulation in the United States is an example of special interest legislation at the behest of the investment banking and securities industries. *See* David D. Haddock & Jonathan R. Macey, *A Coasian Model of Insider Trading*, 80 NW. U. L. REV. 1449 (1986).

and sanction of lying in the securities context, both foreign and troublesome. This is the source of the implicit legal conflicts noted at the outset.

In a globalized securities market, where trading is fragmented in multiple markets and investor classes are multinational, the opportunity to impose the American antifraud philosophy is immense. In this section, we shall look at how American courts deal with the question of the extraterritorial application of rule 10b-5. There are two tests: one based on effects, the other based on conduct.

A. The Effects Test

It is now well established that rule 10b-5 can be applied to any fraudulent conduct that, although occurring abroad, causes significant adverse effects to investors or markets in the United States.[33] Simply to state this principle of subject matter jurisdiction demonstrates its breadth. If Americans invest in the most significant business enterprises world-wide and the securities or depository receipts of most large multinational corporations are traded in American markets, then it is difficult to imagine that misinformation placed into the world-wide information pool could not potentially trigger American jurisdiction, so long as the facilities of interstate commerce are somehow utilized in connection with the transaction. The *Basic* case, discussed earlier, provides a good example. If a Japanese company was engaged in an acquisition negotiation and falsely denied it, jurisdiction could be triggered if the shares were traded in New York, or (possibly) even if Tokyo was the sole trading site but a significant number of sellers were based in the United States.[34]

The law of insider trading presents even more intriguing situations. It is the case, of course, that foreigners who trade improperly in American markets while in possession of inside information are subject to American jurisdiction, even if the trades were initiated through brokers abroad. Although most of the cases that have been brought thus far have

33. The most significant statement of this principle is found in Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968)(en banc), *cert. denied*, 395 U.S. 906 (1969).

34. The Schoenbaum case emphasized that being listed on an American exchange was an important factor in the exercise of American jurisdiction. In theory, however, there is nothing in the effects test that would necessarily limit it to the listing situation. Whether the simple fact that a large number of tainted investment decisions occurred here is enough to justify the exercise of jurisdiction, however, is an open question. In Leasco Data Processing Equip. Co. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972), the court determined that a foreign purchase initated abroad by an American-owned company did not trigger jurisdiction. *See also* MCG Inc. v. Great Western Energy Corp., 896 F.2d 170 (5th Cir. 1990).

involved either American-based issuers or misappropriation from American-based firms, it will only be a matter of time before the connections become more remote.[35]

For example, consider a situation where a Japanese citizen trades in the shares of IBM, an American-based company that happens to be listed on the Tokyo Stock Exchange, based on information learned during an American executive's trip to Tokyo.[36] American jurisdiction could still be justified on one of two bases. First, the company whose shares were traded was American, so in the American way of thinking, its intangible property was misappropriated. Second, IBM is also traded in the United States, and many Americans are investors. Assuming that the tip was tainted, the breach of the fiduciary duty of full disclosure, in theory, could be extended to all investors, wherever they were trading. Conceivably, the same logic could apply even if the issuer were Japanese as long as its shares were traded in the United States.

These conclusions are not inevitable, of course; respectable counterarguments can be made, especially in the latter case. For instance, American courts might conclude that the harm associated with insider trading is truly inchoate and thus better dealt with by assuming that it is a harm only on the market where the trading occurs. But until the issue is addressed by the courts, at least the potential for such a broad extraterritorial reach remains.

B. The Conduct Test

The alternative mechanism for finding jurisdiction is the conduct test.[37] Significant conduct in the United States will suffice to trigger jurisdiction even if the harm is visited solely on foreign investors. Ameri-

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35. *See* DONALD C. LANGEVOORT, INSIDER TRADING: REGULATION, ENFORCEMENT AND PREVENTION § 14.03 (1991). For a suggestion that the extraterritorial scope of the law should be quite broad, see Ronald B. Bornstein & N. Elaine Dugger, *International Regulation of Insider Trading*, 1987 COLUM. BUS. L. REV. 375, 403-07.

36. To make the problem more difficult, one might assume that the tip or trade was illegal in the United States but legal in Japan. While the new Japanese regulatory scheme is quite thorough, there are a number of instances where it does not make conduct illegal that would be illegal in the United States. *See* Shen-Shin Lu, *Japanese Regulation of Insider Trading*, 24 REV. SEC. & COMMOD. REG. 133 (July 1991). *See also* K. OKAMURA & C. TAKESHITA, LAW AND REGULATION RELATING TO INSIDER TRADING IN JAPAN (1989); Tomoko Okashi, Note, *Regulation of Insider Trading in Japan*, 89 COLUM. L. REV. 1296 (1989). By way of example, under the Japanese regulatory system, there is no effort to reach the misappropriation of information outside the traditional insider context; there is no effort to reach recipients of confidential information except "primary tippees;" and the list of information that can be deemed material is limited and well-defined, not open-ended as it is in the U.S.

37. *See, e.g.*, Zoelsch v. Arthur Andersen & Co., 824 F.2d 27 (D.C. Cir. 1987); SEC v. Kasser, 548 F.2d 109 (3d Cir. 1977), *cert. denied*, 431 U.S. 938 (1977).

can courts are somewhat divided on how much conduct must occur in the United States—whether it is any significant conduct or whether the constituent elements of fraud must have occurred here. In any event, there is the possibility that trips to the United States during which an investment is discussed[38] and/or the use of American professionals (accountants, law firms, etc.) or American markets could trigger the exercise of jurisdiction.[39]

Like the effects test, the conduct test is potentially broad. In an electronically linked marketplace and an age of easy cross-border travel, claiming jurisdiction on the presence of some U.S.-based conduct could gradually become easier (i.e., more transactions will have some U.S. link). On the other hand, there is also the significant possibility that honest business people will consciously steer away from American contacts to minimize the risk of U.S. jurisdiction, thus placing American securities and related firms at a competitive disadvantage.

C. Is There an Alternative?

While there are hints of discomfort in the United States with the potential overbreadth of our extraterritorial application of rule 10b-5 and the law of insider trading,[40] little is likely to change as long as we adhere to the notion that American law will apply in a protective manner roughly coextensive with the interests of American investors. In today's globalized markets, American investors can be defrauded, according to the American definition of the term, by a variety of sources worldwide.

While its protective virtue from an American standpoint is undeniable, the problem with this approach is two-fold. First, it imposes a philosophy unique to American culture in foreign settings. Therefore, there is strong potential for the violation of a sense of comity. Second, to the extent that similar jurisdictional claims could be made by other nations, there is strong potential for multiple, overlapping standards of conduct being applied to the same transactions, substantially burdening the processes of planning and dispute resolution with duplication and

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38. *See* AVC Nederland B.V. v. Atrium Investment Partnership, 740 F.2d 148 (2d Cir. 1984); Grunenthal GmbH v. Hotz, 712 F.2d 421 (9th Cir. 1983).

39. *See* Psimenos v. E.F. Hutton & Co., 722 F.2d 1041 (2d Cir. 1983)(commodities law).

40. Most notably, a greater emphasis on comity is reflected in the RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 401, 416 (1986); *see* Harold G. Maier, *Resolving Extraterritorial Conflicts, or "There and Back Again"*, 25 VA. J. INT'L L. 7 (1984). In the academic and practitioner literature, there is a similar call for restraint. *See, e.g.*, Barbara S. Thomas, *Extraterritorial Application of the United States Securities Laws: The Need for a Balanced Policy*, 7 J. CORP. L. 189 (1982); Note, *Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction*, 98 HARV. L. REV. 1310 (1985).

uncertainty.[41]

Conceptually, there is really only one alternative. The United States should move towards a world-wide understanding whereby subject matter jurisdiction—at least regarding corporate disclosure policy—is based not on the alleged violation's impact but on its source.[42] The consequences of issuer misrepresentation or nondisclosure with respect to secondary marketplace trading would be set presumptively by the country with the strongest claim over the issuer of the securities. Investors would be told clearly that, when making an investment in a foreign-based issuer, they will be left largely to the antifraud remedies and enforcement mechanisms provided by the home country. Presumably, investors will avoid or demand a risk premium for investment in countries that do not have an efficient protective mechanism.

I do not mean to suggest that we will, or should, move completely to such a system. The United States would never be comfortable leaving American investors completely without remedy in cases of blatant frauds initiated abroad but directed here. But there are steps short of complete effects-based jurisdiction that could operate as effective compromises. The new multi-jurisdictional disclosure system begun by the SEC is a possible model.[43] Deference to foreign antifraud law could be based on some threshold judgment as to its adequacy and/or reciprocity. Substantive compromises are also possible. For example, effects-based jurisdiction could be limited to core forms of fraud and manipulation, where corruption is clear and implicit regulatory conflicts are unlikely. While I do not wish to understate the definitional difficulties of building such a system, it does seem to be the only alternative to conflict and overlap. Importantly, deference to the law of the site of incorporation is already the prevailing choice of law approach in corporate law and the primary source of post-purchase investor protection.

41. *See* Mary K. Kane, *Dispute Resolution in the United States: Concerns and Opportunities in an Era of Globalization of Securities Markets*, 14 HASTINGS INT'L & COMP. L. REV. 405 (1991).

42. For a call for such an emphasis in tender offer regulation, see Arthur R. Pinto, *The Internationalization of the Hostile Takeover Market: Its Implications for Choice of Law in Corporate and Securities Law*, 16 BROOK. J. INT'L L. 55 (1990). Under this approach, there would still be plenary regulatory authority over broker-dealers and investment advisers who have U.S.-based customers and who are often the primary source of information (or misinformation) about foreign issuers.

43. As recently adopted with respect to Canada, disclosure documents qualified under Canadian law will be acceptable for use in the United States. *See* Securities Act Rel. No. 6902, Fed. Sec. L. Rep. (CCH) ¶ 84,812 (June 21, 1991). However, under this new system—which no doubt will be extended to other countries—antifraud regulation remains completely Americanized.

V. CONCLUSION

Since we are at a relatively early stage in the globalization process, it is too early to say precisely how strong the potential for implicit conflict in antifraud regulation really is. Maybe the American courts will come to embrace comity as a value and place self-imposed limits on the exercise of jurisdiction, largely obviating the concern. If not, however, this field will be increasingly problematic, and there will be growing pressure to search for other strategies.

Over time, it is possible that the cultural differences among nations that affect the process of securities regulation may erode sufficiently so that true harmonization of regulatory approaches will be realistic. In the meantime, however, regulatory conflict or regulatory cooperation are the only possibilities. In the end, any dispassionate look at the relative costs and benefits associated with each of the two possibilities will make clear that the latter is preferable,[44] even if it involves abandoning some claim to the protection of domestic interests.

44. Besides the points made earlier, there is a growing awareness that a sensible system of international securities enforcement requires cooperation, information sharing, and investigatory assistance among national regulators. For a cooperative system to evolve, there must be some incentive for nations to provide adequate resources to the task of securities regulation and to look at the process in terms of mutual interest. Those conditions are undercut by an American approach that implicitly assumes the inferiority of other regulatory systems.