NEWS

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"EXTRATERRITORIALITY IN AN ERA OF INTERNATIONALIZATION OF THE SECURITIES MARKETS: THE NEED TO REVISIT DOMESTIC POLICIES."

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I. Introduction

It is a great pleasure for me to be here today among such distinguished friends and colleagues. I am particularly pleased to have this opportunity to address an area of major import to us all -- the internationalization of the securities markets and the need to revisit our policies with respect to the extra-territorial application of the U.S. securities laws.

As global commerce has expanded and multinational corporations have flourished, securities transactions have become increasingly international in scope. Indeed, there has been a meteoric rise in such transactions over the past decade.

I strongly believe that the explosion of international securities transactions is a very positive development that will promote the free flow of capital and the efficient allocation of world resources. Whether such a trend continues, however, is very much dependent upon the attitude of individual nations with respect to the perceived benefits of internationalization and their willingness to share their domestic resources.

It will also be important for nations to to re-examine the approach of their domestic courts and their regulators with respect to the transnational interaction of their citizens with foreign entities. In this regard, while there may be a tendency to rigidly apply in an international context, laws and regulations that historically have effectively controlled domestic transactions, there will be a much greater need in the 80's, and beyond, to recognize the interests of other nations, and to factor notions of comity and foreign sovereignty into the governance of transactions that traverse national borders.

Today, with these thoughts in mind, I will first discuss how the United States courts are currently applying the federal securities laws extraterritorially, and will suggest an alternative judicial approach to establishing subject matter jurisdiction in connection with international securities transactions. I also will discuss some recent initiatives of the SEC in the international arena, and will conclude with a report on a project on which I have been working for nearly two years -- the creation of an international committee of securities regulators.

II. The Extraterritorial Scope of the United States Securities Laws

Most of the cases that have addressed the extraterritorial reach of the U.S. securities laws have focused in large part on the scope of Rule 10b-5, the antifraud provision promulgated under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"). Because neither the language nor the legislative history of Section 10(b) clearly speaks to its extraterritorial scope, courts have had difficulty under this provision in defining the parameters of subject matter jurisdiction, a necessary predicate to a court's assertion of power.

In delineating the extraterritorial scope of Section 10(b), most U.S. courts have determined that under this provision, Congress intended, or would have intended if it considered the issue, to protect United States investors from the effects of fraudulent activity abroad, and to prevent the United States from being used as a base for fraudulent securities transactions where U.S. or foreign investors were defrauded outside the U.S. Thus, to effectuate this Congressional intent, U.S. courts have generally applied two different tests -- referred to as

the "conduct" and "effects" tests -- to establish subject matter jurisdiction in a transnational fraud case. While I do not want to delve too deeply into the factual nuances of the case law today, I believe a brief discussion of a few leading cases applying the conduct and effects tests may be instructive.

In Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972), the Second Circuit employed the conduct test and applied the U.S. securities laws in an extra-territorial manner when officers of a publicly held U.S. corporation were fraudulently induced within the United States to purchase securities of a British corporation. Although the defendants in Leasco were British and the shares were purchased in England, Judge Friendly opined that because a significant part of the fraudulent scheme occurred inside the United States -- including planning, meetings, and initial misrepresentations -- sufficient conduct within the United States was alleged to establish jurisdiction.

Following the Leasco decision, the Second Circuit in Bersch v. Drexel Firestone, Inc., 519 F.2d 974(2d Cir. 1975), went one step further in applying the conduct test by holding that the type of conduct occurring within the United States that is necessary to support subject matter jurisdiction will vary, depending upon whether a plaintiff is an American or a foreigner. With respect to the American plaintiffs resident abroad, who allegedly bought stock outside the United States in an offering by IOS, a Canadian company, the court held that conduct within the United States that was not fraudulent, but

that was "merely preparatory to", or "of material importance to," the fraudulent transaction, such as the drafting of documents, would support subject matter jurisdiction. On the other hand, with respect to the defrauded foreign plaintiffs, the court stated that more than mere preparatory conduct -- such as actual fraud or acts that "directly caused" the alleged losses -- must have taken place within the United States to support jurisdiction and extraterritorial application of Rule 10b-5.

Accordingly, Leasco, Bersch, and their progeny tend to indicate that courts, in determining whether subject matter jurisdiction exists under the conduct test, will evaluate the type and amount of conduct that takes place in the U.S., and the nationality of the defrauded plaintiff.

In contrast, under the effects test, courts have not focused on the type of conduct occurring within the United States to establish subject matter jurisdiction. Rather, courts look to the effects within the U.S. of activity taking place abroad. Thus, applying this test, U.S. courts have asserted jurisdiction under the antifraud provisions of the securities laws, when a fraudulent transaction that occurred in another country substantially effected investors or securities markets within the United States.

A leading case relying on the effects test to establish subject matter jurisdiction is Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1969), where the Second Circuit found jurisdiction under Section 10(b) of the Exchange Act when plaintiffs alleged that directors of a Canadian corporation authorized the sale

of a Canadian company's stock at an unfairly low price. The court stated that although all of the alleged fraud took place abroad, the fraud upon the foreign corporation would dilute the equity interest of American shareholders that had traded the company's securities on an American exchange, and thus, there was "a sufficiently serious effect upon United States commerce to warrant assertion of jurisdiction for the protection of American investors..."

In applying either the conduct or the effects tests to determine the extraterritorial application of the U.S. securities laws, U.S. courts have appropriately attempted to effectuate the intent of Congress in protecting U.S. interests. I would suggest, however, that Congressional intent is too vague to carve out rigid boundaries in this area, and that the conduct and effects tests are too simple and mechanistic to adequately balance the important policy considerations that should precede assertion of jurisdiction over international transactions.

I believe that the laws, regulatory practices, and national policies of all foreign nations interested in a specific transnational securities transaction, rather than just minimum contacts, should be carefully and explicitly balanced before the U.S. laws are applied extraterritorially. Specifically, the relevant factors to be weighed by a court in the balance could include the location of the transnational transaction, the domicile of the parties, the importance to each interested country of having its own laws applied in a given situation and the public policies that would be furthered by the application

of its laws, the likelihood that a country's laws would be applied to a transaction, and the expectations of the parties with respect to the applicable governing laws.

The balancing approach that I endorse is derived from conflict of laws principles, and would result in application of domestic law only when the interest of the United States in extending its laws to the transaction is not superseded by the interests of other nations also affected. For example, courts may on balance decide to apply the antifraud provisions of the securities laws to a foreign party that has induced a U.S. investor in New York to purchase a security abroad, after finding that the U.S. had a strong interest in protecting its citizen from being defrauded, that the application of U.S. laws would merely control the conduct connected with an isolated transaction, and that the legal system of the foreign nation which also had an interest in the transaction would not itself countenance such fraudulent conduct.

I submit that adopting a conflict of laws approach before applying U.S. laws extraterritorially will respond to the realities of a shrinking world, and will benefit our country in the long run by demonstrating a due sensitivity to the interests and sovereignty of foreign countries, by encouraging international comity, and by fostering mutual respect among nations.

III. Recent Developments In Transnational Insider Trading Investigations

Deference to the interests of foreign nations will also, I believe, enhance international cooperation in the law enforcement area and will increase the ability of nations to successfully apply

their laws extraterritorially once subject matter jurisdiction has been properly established. The need for such cooperation has been boldly underscored by the formidable obstacles we at the Commission have encountered in our war against insider traders who use the shield of foreign accounts, secrecy laws and blocking statutes to keep their identities hidden.

One important development in this area was the Commission's stunning victory in the Banca Della Svizzera case, which involved the purchase of options and stock in St. Joe Mineral Corporation by foreign purchasers through a Swiss bank prior to a public announcement of a tender offer for St. Joe by Seagram's, and the Swiss bank's refusal to respond to a request for information by the SEC, citing as a defense the Swiss secrecy laws.

Fortunately, Judge Milton Pollack of the Southern District of New York was unpersuaded by the bank's reliance upon this Swiss law, and in a monumental decision, ordered the bank to answer the Commission's interrogatories after determining that the Swiss secrecy laws must yield to our "vital national interest in maintaining the integrity of our securities markets...."

Inspired by both the result in the St. Joe discovery litigation and the pendency of the equally significant Sante Fe case, the governments of the U.S. and Switzerland determined that there was an urgent need to work together to arrive at a solution to the Commission's problems in investigating international insider trading.

On August 31 of this year, after only six months of negotiations, we executed a Memorandum of Understanding that

represents a landmark achievement in international cooperation which will greatly aid us in discovering and thwarting insider trading through Swiss bank accounts. As part of this historic accord, the Swiss Bankers' Association has agreed to submit a proposed "private convention" to its members that would permit signatory banks, without violating Swiss secrecy laws, to furnish information to the Commission in connection with customers suspected of trading on inside information.

Another major accomplishment of our Swiss negotiations is the agreement of the Swiss to enact a statute, anticipated within the year, that would make insider trading a criminal offense in their country. Significantly, such enactment will allow us to invoke the 1977 Treaty of Mutual Assistance between the United States and Switzerland, pursuant to which both nations have agreed to exchange information relative to activity considered criminal in both countries.

Our success in the Swiss negotiations demonstrates that nations can reconcile historic legal and policy differences and improve the enforceability of their own laws in other countries through direct communication and negotiation.

IV. Recent SEC Initiatives Regarding Foreign Issuers

In addition to its recent efforts that culminated in the historic working agreement with the Swiss government, I believe that the SEC has set a good example for regulators around the world in accomodating the special needs of foreign issuers that seek to raise capital in the U.S. markets.

The adoption in 1979 of Form 20-F -- an annual report form for foreign issuers reporting under the Exchange Act that is somewhat similar to the Form 10-K used by domestic issuers -- was one of the most significant efforts in this regard. In response to the concern of foreign issuers that various proposed SEC requirements were in direct conflict with disclosure practices and accounting principles in their own countries, the Commission decided to promulgate certain requirements for foreign issuers that are somewhat less rigorous than those applicable to domestic issuers. These modified requirements pertain to segment reporting, the disclosure of management remuneration and the interests of management in certain transactions with an issuer, the use of foreign accounting principles in the preparation of financial statements, and the amount of time issuers are provided to file their 20-F report.

Another major initiative by the SEC to accomodate the needs of foreign issuers is the Commission's recently proposed foreign integrated disclosure system, which will soon come before the Commission for final consideration. As many of you know, in March of this year the SEC adopted an integrated disclosure system for domestic issuers that permits these issuers to incorporate by reference into a Securities Act prospectus, information already filed with the Commission in Exchange Act documents. This system, which is predicated upon the assumption that information contained in Exchange Act documents is widely followed by financial analysts, and is substantially equivalent to the disclosure in a Securities Act

prospectus, attempts to streamline duplicative disclosure requirements, reduce costs, and facilitate access to the U.S. capital markets.

In order to provide foreign issuers many of the benefits accorded domestic issuers, the Commission proposed a foreign integrated disclosure system which in many ways resembles the streamlined domestic system in that it permits substantial incorporation by reference of Exchange Act reports into Securities Act filings. The Commission's proposals attempt to accomodate the special needs of foreign issuers by permitting certain "world class" issuers that issue non-convertible high grade debt securities -- that is, very large foreign companies with a substantial worldwide following by financial analysts -- and all foreign issuers that make certain offerings to their shareholders or employees, for the first time, to report in their prospectuses some of the modified disclosures permitted in the Form 20-F that I have just described.

The Commission has also sought to facilitate foreign entry into the U.S. markets in other significant ways. In September of this year, the Commission authorized for the first time a foreign investment company -- a West German mutual fund named Unifonds -- to register and sell its shares in the U.S. To do so, the Commission had to work closely with the company to overcome various regulatory obstacles. For example, to ensure compliance with the statutory standard that it will be "legally and practically feasible" to enforce the Investment Company Act against the company, it was agreed that a pool of

assets would be made available in the form of an irrevocable letter of credit equal to 5% of the value of the outstanding shares of Unifonds held by U.S. residents in the event of law suites by U.S. shareholders.

The Commission has also expressed its concerns to Congress with respect to impending legislation that would unduly infringe upon the sovereignty of foreign nations. In February of 1981, the Commission submitted testimony on H.R. 1294, which would have made both foreign lenders and foreign borrowers subject to the U.S. margin provisions in connection with substantial acquisitions of, or tender offers for, certain U.S. securities. After determining that subjecting foreign borrowers only, and not lenders, to the U.S. margin requirements would adequately serve the U.S. interest in providing equal access to our capital markets by investors, the Commission recommended that extension of margin requirements to foreign lenders would be an unnecessary assertion of U.S. power, and hence, inadviseable. H.R. 4145, the successor bill to H.R. 1294, adopted our recommendation. The bill was subsequently passed by the House of Representatives and is currently pending in the Senate Banking Committee.

V. International Committee of Securities Regulators

Although the SEC has made great strides in promoting the internationalization of the world's capital markets by demonstrating how a regulator can both serve the interests of its constituency and at the same time recognize the sovereignty of other nations, I believe a forum is needed for the securities regulators of the world to communicate on an informal basis to better understand their differing systems and to facilitate

interpersonal solutions to international problems. Accordingly, I recently announced that a project for which I have been working for the last two years has now come to fruition -- that is, the formation of an international securities committee.

While the composition of the Committee is as yet unclear, it will begin on a very small scale with members from a few of the world's developed capital markets, and as its organization and functioning takes shape, it will be slowly expanded. As contemplated, the committee would be sponsored by a country other then the U.S. and the first meeting will take place in Europe. Subsequent meetings will then be rotated each year among member countries, and the new countries that join the Committee as it develops. I strongly believe that non-U.S. sponsorship is important because my preliminary contacts in Europe persuaded me that if the U.S. is the sponsor, the Europeans would be reluctant to engage in the exchange out of fear of U.S. domination and the heavy hand of U.S. regulation. In light of the success of the Basle Committee, an international working group of bank supervisory authorities originally led by Peter Cooke, head of Banking Supervision at the Bank of England, with whom I consulted at the beginning of my efforts, I am extremely optimistic about the future role of such a securities committee.

Conclusion

In closing, I submit that in a world that becomes smaller and more interdependent each day, it is imperative for courts and regulators to respect the policies and practices of other nations when considering the extraterritorial application of

their own laws. I firmly believe that U.S. courts should apply a conflict of laws approach to subject matter jurisdiction when adjudicating transnational problems, and that the SEC should continue to demonstrate a sensitivity to the needs of foreign issuers seeking to enter the U.S. markets. Such an approach will improve significantly our nation's rapport with the international financial community, and will put forth a workable model for other nations to emulate. Moreover, I am sanguine that implementation of an international committee of securities regulators will generate a constructive dialogue on possible approaches to regulatory problems encountered by many nations, and will be an important tool as the internationalization of the securities markets continues.