# Securities Law: Understanding Foreign Subject Matter Jurisdiction Under Section 10(B) of the Exchange Act of 1934



## I. INTRODUCTION

Canadian and American plaintiffs brought a class action lawsuit in the United States District Court for the Eastern District of Texas.[1] Plaintiffs sought relief from the court for defendant Bre-X Minerals, Ltd.'s (Bre-X) violation of § 10(b) of the Securities Exchange Act of 1934 (the Exchange Act or Act) (15 U.S.C. § 78j(b)).[2] Bre-X is a publicly traded Canadian corporation headquartered in Calgary, Alberta.[3] At some point between 1993 and 1997, Bre-X stock was traded publicly on the Toronto and Alberta stock exchanges in Canada, and on the National Association of Securities Dealers Automated Quotations (NASDAQ) exchange in New York City, New York.[4] In 1993, Bre-X purchased the rights to mine in the Busang area (Busang) of East Kalimantan province of Indonesia.[5] Bre-X commenced primary drilling at Busang in an attempt to estimate the gold resources at the site.[6] Plaintiffs, all shareholders at one time or another in Bre-X, alleged that Bre-X and its codefendants played a

1. McNamara v. Bre-X Minerals, Ltd., 32 F. Supp. 2d 920 (E.D. Tex. 1999).
2. *Id.* at 922. Bre-X is one of several defendants named by the plaintiffs in this class action lawsuit. The other defendants include Bresea, a Canadian holding company that at one time owned a 25% share of Bre-X. Also included are P.T. Kilborn Paka Rekayasa, Kilborn Engineering Pacific, Ltd., and SNC-Lavin, Inc., geostatistical companies that conducted surveys and issued reports regarding the claims of the gold deposits at the Busang site. Other defendants are J.P. Morgan & Company, an American corporation that acted as a financial advisor to Bre-X, and Lehman Brothers, Inc., an American corporation that issued positive reports regarding gold deposits at Busang. *See id.* at 921-22.
3. *See id.* at 921.
4. *See id.*
5. *See id.*
6. *See id.*

role in misrepresenting the potential amount of gold located at the Busang site in an attempt to raise its stock value to an artificially high level.[7] In March 1997, an independent mining consultant conducted its own survey and concluded that the gold supply at the Busang site had been overstated due to improper testing and invalid samples.[8] Upon word of the miscalculation of the gold supply at Busang, the stock price began to fall, leading to the plaintiffs' alleged losses.[9]

Defendants filed a motion to dismiss for, inter alia, lack of subject matter jurisdiction.[10] The court dismissed those claims brought by the Canadian plaintiffs who purchased their stock on Canadian exchanges *holding* that because the Canadian plaintiffs "failed to show that the *domestic conduct* of any defendant *directly* contributed to the losses of which they complain, the Court lacked subject matter jurisdiction over their Exchange Act claims."[11] *McNamara v. Bre-X Minerals, Ltd.*, 32. F. Supp. 2d 920 (E.D. Tex. 1999).

## II. HISTORICAL BACKGROUND

The Securities Exchange Act of 1934 arose from the economic rubble of Wall Street after the Crash of 1929 and the Great Depression which followed in its wake.[12] Popular feeling after the crash was that stock speculation contributed, in large part, to the Nation's hardships and that some form of legislation was needed to prevent such an occurrence from happening again.[13] From the fall of 1929 until the election of Franklin Delano Roosevelt in 1932, many bills to regulate

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7. *Id.* In 1994, Bre-X claimed the site had the potential of producing three million ounces of gold. That number reached a level as high as two hundred million ounces by the spring of 1997. The value of Bre-X stock, as it was traded on the various exchanges at different times, rose in correspondence to the estimates given by Bre-X at different times. *See id.* "Plaintiffs are persons who purchased common stock of Bre-X Minerals, Ltd. . . . and/or Bresea . . . between January 17, 1994 and May 2, 1997." *Id.*

8. *See id.* at 921-22.

9. *See id.* at 922. Bre-X is currently in bankruptcy. *See id.*

10. *See id.*

11. *Id.* at 925 (emphasis added). The court's holding does not apply specifically to any one named Plaintiff in the class, but rather to any plaintiff who is both: (1) a Canadian resident and (2) purchased their stock on a Canadian exchange. *See id.* at 922 n.2.

12. *See generally* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 407-13 (1990) (providing a brief history of the enactment of the Exchange Act and the rationale that led to its inception).

13. *See id.* at 409. It was thought that the rise and precipitous fall of stock prices during the 1920s were due, in some degree, to the practice of speculation, rather than long-term investing, by those who played the market. Speculation carries with it high potentials for loss and gain. The practice of "short-selling" became a norm on the New York Stock Exchange (NYSE) during the profitable market of the 1920s, and it was considered by many as one of the precipitating causes of the crash. *See id.* at 410-11.

the stock market were proposed, but it was not until 1934 that Congress passed the Securities Exchange Act.[14]

With the election of Roosevelt, came the strong push for federal regulation of the securities markets.[15] The Exchange Act created vehicles to prevent the recurrence of the events that led to the Crash of 1929.[16] One of those vehicles included requiring full disclosure of information to investors and regulation of securities transactions to "promote the integrity of the marketplace."[17] The Supreme Court has held that one of the purposes of enacting the Exchange Act was to prevent nondisclosure, misrepresentation and fraud in the securities industry.[18]

The Exchange Act proscribes certain activities and provides remedies for those who are injured by such prohibited actions.[19] Section 10 of the Exchange Act addresses "manipulative and deceptive devices" and prohibits the use of such devices in the buying and selling of securities.[20] Pursuant to section 10(b) of the Exchange

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14. *See generally id.* at 424-61 (providing the legislative history of what began as the Fletcher-Rayburn Bill in Congress and subsequently became the present day Exchange Act). The Securities Exchange Act underwent many revisions prior to its enactment on June 6, 1934. On February 9, 1934, President Roosevelt stated to Congress that "it should be our national policy to restrict, as far as possible, the use of (securities and commodities) exchanges for purely speculative operations." President Franklin D. Roosevelt's Message to Congress (Feb. 9, 1934), *in* 3 PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 90-91 (1938). That same day, Senator Duncan Fletcher and Representative Sam Rayburn introduced what would become the Exchange Act to their respective houses of Congress. *See* Thel, *supra* note 12, at 425-26.

15. *See* Thel, *supra* note 12, at 414. The "Democratic Party advocated 'regulation to the full extent of federal power, of . . . exchanges in securities commodities.'" *Id.* (quoting 7 HISTORY OF AMERICAN PRESIDENTIAL ELECTIONS 2742-43 (A. Schlesinger, Jr. ed., 1985)).

16. *See* Thel, *supra* note 12, at 407-11.

17. Louise Corso, *Section 10(b) and Transnational Securities Fraud: A Legislative Proposal to Establish a Standard for Extraterritorial Subject Matter Jurisdiction*, 23 GEO. WASH. J. INT'L L. & ECON. 573, 577 (1990). Section 2 of the Exchange Act states as its purpose: "[T]o provide for regulation and control of such transactions by officers, directors, and principal security holders . . . in order to protect interstate commerce, the national credit, the Federal taxing power . . . and to insure the maintenance of fair and honest markets in such transactions . . . ." 15 U.S.C. § 78b (1997) (corresponding to the Securities Exchange Act of 1934, § 2).

18. SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963). The Court held that "a fundamental purpose [of the Securities Exchange Act of 1934] was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *Id.* at 186 (citing Silver v. N.Y.S.E., 373 U.S. 341, 366 (1962)).

19. 15 U.S.C. § 78j(b) (1997) (section 10(b) of the Exchange Act) and 15 U.S.C. § 78t (section 20 of the Exchange Act), respectively.

20. 15 U.S.C. § 78j; *see also* Corso, *supra* note 17, at 578. Section 10 of the Exchange Act provides, in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so

Act, the Securities and Exchange Commission (SEC) promulgated Rule 10b-5.[21] Section 10(b) and Rule 10b-5 are the predominant antifraud provisions.

The Supreme Court has given broad interpretation to both section 10(b) and Rule 10b-5.[22] The Court has held that since the legislation is *remedial in design*, it should be construed broadly to effectuate its purpose.[23] The Court continued by holding that "[s]ecurity embodies a flexible rather than static principle, one that is capable of adaptation to meet the countless variable schemes devised by those who seek the use of the money of others on the promise of profits."[24]

### *A. Making a Section 10(b) Cause of Action*

The Supreme Court has established hurdles that must be overcome in order to establish prima facie liability under section 10(b) and Rule 10b-5. A plaintiff must prove that "in connection with the purchase or sale of security the defendant, *acting with scienter*, made a material misrepresentation (or a material omission if the defendant had a duty to speak) or used a fraudulent device."[25]

The Supreme Court "expressly adopted" its standard for establishing a "misrepresentation or omission" of material fact in *Basic v. Levinson*.[26] Quoting *TSC Indus. v. Northway*,[27] the Court

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> registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (corresponding to the Securities Exchange Act of 1934, § 10).

21. 17 C.F.R. § 240.10b-5. The rule is, essentially, a restatement of 15 U.S.C. § 78j, continuing the statute's theme against misrepresentation in the securities industry. It forbids:

> (a) [the] employ [of] any device, scheme, or artifice to defraud, (b) . . . mak[ing] any untrue statement of a material fact . . . or (c) engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase of any security.

*Id.*

22. Tcherepnin v. Knight, 389 U.S. 332 (1967) (holding that "[e]ven a casual reading of . . . the 1934 Act reveals that Congress did not intend to adopt a narrow or restrictive concept of security"). *Id.* at 338.

23. *See id.* at 336.

24. *Id.* at 338 (quoting SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946)); *see also* Superintendent of Ins. of N.Y. v. Bankers Life and Casualty Co., 404 U.S. 6, 11 n.7 (1971) ("[W]e believe that § 10(b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities." (quoting A.T. Brod & Co. v. Perlow, 375 F.2d 393, 397 (2d Cir. 1967)).

25. SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1467 (2d Cir. 1996) (emphasis added); *see also* Cooke v. Manufactured Homes, Inc., 998 F.2d 1256, 1260-61 (4th Cir. 1993); Gray v. First Winthrop Corp., 82 F.3d 877, 884 (9th Cir. 1996).

26. 485 U.S. 224, 232 (1988).

held: "[A]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[28] The Court applied this standard to all 10b-5 causes of action and was careful to set the standard at a level that would ensure that investors and other stock market participants would be sufficiently protected from fraud, yet at the same time not be deluged with an "overabundance of information."[29]

The second element of a 10b-5 cause of action is the showing of *scienter*. The preeminent definition of "*scienter*" is derived from *Ernst & Ernst v. Hochfelder*.[30] The Court resolved a split in the circuits. Previously, some courts held that simple negligence was sufficient to establish liability, whereas others required a scienter.[31] Considering the legislative history of the Exchange Act, the Court found that "§ 10(b) was addressed to practices that involve some element of scienter and cannot be read to impose liability for negligent conduct alone."[32] The Court determined that the term "scienter" "refer[red] to a mental state embracing intent to deceive, manipulate, or defraud."[33]

The final element of a 10b-5 cause of action is one of reliance and causation. In *Basic*, the Court set out the prima facie standards that must be met for reliance and causation to be proved.[34] The Court distinguished between those old-fashioned transactions which occur face-to-face and those involving the modern securities markets.[35] For face-to-face transactions, the Court gave as an example of an investor's reliance upon "the subjective pricing of that information by that investor."[36] In market transactions, the standard for reliance was distinguished due to the presence of a market between buyer and seller.[37] The Court held that in all cases of Rule 10b-5 litigation, the existence of reliance would be presumed.[38] Having held that reliance

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27. 426 U.S. 438, 449 (1976).
28. *Basic*, 485 U.S. at 231.
29. *Id.*
30. 425 U.S. 185 (1976).
31. *Id.* at 193 n.12.
32. *Id.* at 201.
33. *Id.* at 193 n.12; *see also First Jersey Sec., Inc.*, 101 F.3d at 1467; Cooke v. Manufactured Homes, 998 F.2d 1256, 1261 (4th Cir. 1993); Gray v. First Winthrop Corp., 82 F.3d 877, 884 (9th Cir. 1996); BLACK'S LAW DICTIONARY 1347 (6th ed. 1990).
34. *See* Basic v. Levinson, 485 U.S. 224, 243-49 (1988).
35. *See id.* at 243-45.
36. *Id.* at 244 (citation omitted).
37. *See id.*
38. *See id.* at 245-47 ("An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price.").

would be presumed in all 10b-5 causes of action, the Court further held that "[r]eliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury."[39]

Jurisdiction in a case involving 10b-5 has been delegated to the federal district courts by section 27 of the Exchange Act.[40] Section 30 of the Exchange Act covers the area of foreign securities jurisdiction.[41] Section 30 states that the Exchange Act will not apply to business transacted outside the jurisdiction of the United States, unless such acts were done so in order to violate the express provisions of the Act.[42] In such a case, the SEC has the power to create rules in order to regulate such actions.[43]

When the Exchange Act was written, the economies of the world's nations were not as interwoven as they are today.[44] As a result, the Act does not go into great depths regarding the issue of jurisdiction over foreign entities and transactions. The lack of specificity in the language of the Act with regard to extraterritorial subject matter jurisdiction has led to questions of congressional intent on the issue.[45] The point at which the actions of individuals, corporations, securities brokers, and all manner of actors in the

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39. *Basic*, 485 U.S. at 243; *see also* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1978). "Positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might consider them important in the making of this decision." *Id.* at 153-54.

40. "The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." 15 U.S.C.A. § 78aa (1999).

41. Subsection (a) states that it is unlawful for an actor within the United States to violate the provisions of section 10(b) of the Exchange Act "on an exchange not within or subject to the jurisdiction of the United States." 15 U.S.C.A. § 78dd(a). Subsection (b) explicitly states that the Exchange Act "shall not apply to any person insofar as he transacts 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." *Id.* § 78dd(b).

42. *See id.*

43. *See id.*

44. *See* Corso, *supra* note 17, at 573-74 ("[T]he legislation establishing regulation of the securities market and the Security Exchange Commission was written in the 1930s and did not anticipate the technological advances . . . and the impact these advances [have], and will continue to have in the international arena.").

45. *See* Schoenbaum v. Firstbrook, 405 F.2d 200, 208 (2d Cir. 1968); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1334-36 (2d Cir. 1972); IIT v. Vencap, 519 F.2d 1001, 1017-18 (2d Cir. 1975); SEC v. Kasser, 548 F.2d 109, 114 (3d Cir. 1977).

securities industry meet the requirement of section 27 has been left strictly in the hands of federal judicial interpretation and case law.[46]

### *B. Judicial Interpretation of Foreign Subject Matter Jurisdiction*

The first case to address the issue of extraterritorial jurisdiction was *Kook v. Crang*.[47] The contacts between the plaintiff, a New Jersey resident, and the defendant Canadian company were minimal and conducted primarily in Canada.[48] The court held that because the stock was that of a Canadian corporation, purchased exclusively on a Canadian exchange by a Canadian brokerage house with all orders and payments received in Canada, they were Canadian transactions outside the jurisdiction of the United States.[49] They were, therefore, not within the realm of the Securities Exchange Act.[50] The court gave further rationale by specifically holding that the intent of Congress was to keep the reach of the Exchange Act within the United States' borders.[51] Early application of the Exchange Act generally followed this narrow approach.[52] According to this early judicial interpretation, Congress had passed this legislation in response to domestic concerns and its reach should, therefore, remain domestic.[53]

Federal courts, since the time of *Blackmer* and *Foley Bros.*, have instituted two methods through which they have constructed foreign or extraterritorial subject matter jurisdiction in Exchange Act causes of action. The first test is whether the fraudulent activity complained of, which was performed abroad, has had significant or substantial

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46. *See* Corso, *supra* note 17, at 578-79. The SEC has yet to implement the power granted it by 15 U.S.C. § 78dd(b) to make rules affecting foreign actors in the U.S. securities markets. *See id.*

47. 182 F. Supp. 388 (S.D.N.Y. 1960).

48. *See id.* at 389. Defendants in the case were copartners of J.H. Crang & Company. The firm was listed as a member of the Toronto Stock Exchange. All of the Defendants were residents of Canada. The Plaintiff's only contact with the Defendant was through a few phone calls, a visit to the Defendant's New York office, and a few trips to Canada. The only exchange of money took place in Toronto. *See id.*

49. *See id.* at 390.

50. *See id.* at 390-91.

51. *See id.* at 390 (stating, "It is a canon of construction that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States . . . . Section 30(b) (15 U.S.C. § 78dd(b)) specifically restricts the Act to the transaction of business within the United States.") (quoting Foley Bros. v. Filardo, 336 U.S. 281, 285 (1948)).

52. *See* Blackmer v. United States, 284 U.S. 421, 437 (1931) (stating, "The legislation of the Congress . . . is construed to apply only within the territorial jurisdiction of the United States . . . .").

53. *See Kook*, 182 F. Supp. at 390.

*effects* on United States securities markets (the "effects test").[54] The second way courts have determined subject matter jurisdiction in section 10(b) actions is by examining whether a significant amount of *conduct*, affecting persons or markets abroad, occurred in the United States (the "conduct test").[55]

The first case to elucidate the effects test was *Schoenbaum v. Firstbrook*.[56] One of the issues the court was asked to decide upon was whether or not subject matter jurisdiction existed in the case.[57] The Second Circuit rejected the lower court's summary judgment for lack of subject matter jurisdiction.[58] The court held that Congress did, in fact, intend extraterritorial application of the Exchange Act.[59] As part of its rationale, the court cited to section 2 of the Exchange Act, noting the purposes which Congress intended to attain by passing the Act.[60] According to the court, the Exchange Act's purpose was to regulate stock exchanges, transactions and the relationships of the investing public to corporations that invite public investment by listing on such exchanges.[61] Addressing the foreign jurisdiction provision of the Act (15 U.S.C. § 78dd), the court found that the intent of the section was "to prevent evasion of the Act through transactions on foreign exchanges."[62] The court continued by expressly rejecting the holding of *Kook v. Crang*, stating that section 30(b) was not intended to exempt foreign transactions from the reach of the Exchange Act, but rather, "the presumption must be that the Act was

54. *See* Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968); Bersch v. Drexel Firestone, 519 F.2d 974 (2d Cir. 1975); Des Brisay v. Goldfield Corp., 549 F.2d 133 (9th Cir. 1977); Consolidated Gold Fields PLC v. Minorco, 871 F.2d 252 (2d Cir. 1988); Corso, *supra* note 17, at 581.

55. *See* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972); IIT v. Vencap, 519 F.2d 1001 (2d Cir. 1975); SEC v. Kasser, 548 F.2d 109 (3d Cir. 1977) Continental Grain v. Pacific Oilseeds, 592 F.2d 409 (8th Cir. 1978); Corso, *supra* note 17, at 581.

56. 405 F.2d 200 (2d Cir. 1968).

57. The district court, in *Schoenbaum v. Firstbrook*, 268 F. Supp. 385 (S.D.N.Y. 1967), held that "the Act has no extraterritorial jurisdiction, and . . . therefore no liability arose under the Act . . . ." *Schoenbaum*, 405 F.2d at 206. The court rejected the plaintiffs contention that subject matter jurisdiction was predicated on 15 U.S.C. § 78aa by adhering to the presumption that the Act was intended to apply solely to transactions occurring within the United States. *See id.*

58. *See id.*

59. *See id.* ("In our view, neither the usual presumption against extraterritorial application of legislation nor the specific language of Section 30(b) show Congressional intent to preclude application of the Exchange Act to transactions . . . traded in the United States which are effected outside the United States.").

60. *See id.*; *see also supra* note 18.

61. *Schoenbaum*, 405 F.2d at 206.

62.*See id.* at 207.

meant to apply to those foreign transactions not specifically exempted."[63]

The Second Circuit readdressed and clarified the effects test in *Bersch v. Drexel Firestone, Inc.*[64] The court once again held that the Exchange Act applied to foreign transactions.[65] It expressed the intent of Congress to avoid the use of the American securities market to promulgate fraudulent schemes upon foreign plaintiffs.[66] The plaintiff alleged several effects on the United States securities market which were a result of the fraudulent activities conducted abroad.[67] Nonetheless, the court found that the effects alleged were insufficient to confer subject matter jurisdiction where the plaintiff in a securities fraud action was a foreigner.[68] As its rationale for constructing the effects test out of the Exchange Act, the court stated "[a]cts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a state in punishing the cause of the harm as if he had been present at the effect, if the state should succeed in getting him within its power."[69] The Second Circuit formulated as its standard for finding subject matter jurisdiction through the effects test: "[F]r acts relating to securities which are committed abroad only when these result in injury to purchasers or sellers of those securities in whom the United States has an interest, not where acts simply have an adverse affect on the American economy or American investors generally."[70]

In a subsequent case, *Des Brisay v. Goldfield Corp.*,[71] the Ninth Circuit followed the reasoning of *Bersch*, holding that "where the securities involved in the transaction were registered and listed on a national exchange and the effect of the foreign transaction adversely

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63. *Id.* at 208. The Second Circuit's rationale focused on the existence of certain provisions already included in the Exchange Act which specifically addressed the exemption of certain foreign transactions and the fact that the SEC has been given the power to limit such exemptions (15 U.S.C. § 78j(b)). *See id.*

64. 519 F.2d 974 (2d Cir. 1975).

65. *See id.* at 986 ("It is elementary that the antifraud provisions of the federal securities laws apply to many transactions which are neither within the registration requirements nor on organized markets.") (citing Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1335-37 (2d Cir. 1972)).

66. *See id.* at 987 (citing IIT v. Vencap, 519 F.2d 1001 (2d Cir. 1975)).

67. The plaintiff's allegations included, *inter alia*, lack of confidence in the American securities market as a result of the collapse of I.O.S., Ltd., the corporation, whose stock offering and collapse led to the cause of action. *See id.* at 987-88.

68. *See id.* at 988.

69. *Id.* (quoting Strassheim v. Daily, 221 U.S. 280, 284-85 (1911)) (contributing to the Second Circuit's holding in Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968)).

70. *Id.* at 989.

71. 549 F.2d 133 (9th Cir. 1977).

affected buyers," sellers' extraterritorial subject matter jurisdiction exists.[72] As in *Schoenbaum*, the court reviewed the language of section 2 of the Exchange Act (15 U.S.C. § 78b), and found that the section expressed Congress' intent to ensure that domestic securities markets would be protected from improper foreign transactions.[73]

The use of the conduct test to establish subject matter jurisdiction in cases arising out of the Exchange Act has been the subject of greater controversy than the effects test.[74] "Under the conduct test, federal courts have jurisdiction over a case when significant misrepresentations have been made in the United States in connection with a securities transaction."[75]

The Second Circuit gave its first interpretation of a "conduct test" in *Leasco Data Processing Equipment Corp. v. Maxwell*.[76] In this case, Leasco sought damages arising from the purchase of shares of a British company purchased on the London Stock Exchange.[77] Several meetings took place between the defendants and various representatives of Leasco to effectuate a joint venture in Pergamon.[78] Leasco alleged that during these meetings the defendants continually misrepresented the current status of Pergamon's affairs in an attempt to induce Leasco to enter into a contract.[79] The negotiations between Leasco and Maxwell began with a meeting with Maxwell and the chairman of Leasco at Leasco's principal office in New York.[80] The alleged fraud and misrepresentations began at this first meeting and continued at further meetings, which took place in London.[81] Further meetings and other contacts occurred in both London and New York, resulting in the purchase by Leasco, of shares of stock in Pergamon.[82]

The court in *Leasco* began its analysis of subject matter jurisdiction by distinguishing its facts from those in *Schoenbaum v.*

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72. *Id.* at 135.
73. *See id.*
74. This controversy arises out of a split among the Circuit Courts of Appeal on the issue of the requisite amount of conduct to trigger subject matter jurisdiction under section 10(b) of the Exchange Act.
75. Corso, *supra* note 17, at 583.
76. 468 F.2d 1326 (2d Cir. 1972).
77. *See id.* at 1330. There having not been a trial prior to the decision, the facts of the case were not yet determined. *See id.* Being a ruling on subject matter jurisdiction, the alleged facts of the complaint were relied upon by the court. *See id.* The plaintiff claimed that the defendants conspired to solicit Leasco into purchasing shares of stock in Pergamon Press Limited (Pergamon), a British corporation controlled by codefendant Maxwell, a British citizen. *See id.*
78. *Id.* at 1330-33.
79. *See id.*
80. *See id.* at 1330.
81. *See id.* at 1330-31.
82. *See id.* at 1331-33.

*Firstbrook*.[83] The primary distinction between the two cases was that the use of the effects test in *Schoenbaum* was applicable "even when the fraudulent acts were *all* committed outside the United States and the security was that of a foreign company doing no business in the United States[.]"[84] Considering the language of the Exchange Act, the court interpreted it as having broad meaning.[85] The Exchange Act specifically included applicability to "securities listed on a national securities exchange . . . 'or any security not so registered.'"[86]

Having established that Congress intended some foreign transactions to fall under the purview of the Exchange Act, the court held that subject matter jurisdiction would be found where there had been "significant conduct" within the United States.[87]

The Second Circuit gave greater clarity to the conduct test in *IIT v. Vencap, Ltd.*[88] Action was brought by IIT, an international investment trust organized under the laws of Luxembourg against the defendant Vencap, a Bahamian corporation, and several individual defendants.[89] The most important element of the court's holding was that it specified the type of conduct that would establish subject matter jurisdiction through the conduct test: "Our ruling on [the] basis of jurisdiction is limited to the perpetration of fraudulent acts themselves and does not extend to *mere preparatory activities* or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries."[90] This standard set an admittedly fine line for the rest of the Second Circuit to follow, but the court rationalized its need to do so in order to prevent "every instance where something happened in the United States," in relation to a foreign securities transaction, from entering American courts.[91]

In *Bersch v. Drexel Firestone*, the court addressed the issue of the conduct test as well as the effects test.[92] The court rejected the

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83. *See id.* at 1333-34.

84. *Id.* at 1333 (emphasis added).

85. *See id.* at 1336.

86. *Id.* (quoting Section 10(b) of the Exchange Act (15 U.S.C. § 78j(b)).

87. *See id.* at 1334-35. The Court found subject matter to be valid due to the many misrepresentations occurring in the United States, in conjunction with the telephone calls, mailings and other correspondence, which occurred between the United States and England: "[C]onsiderations of foreign relations law do not preclude our reading of § 10(b) as applicable here." *Id.* at 1335.

88. 519 F.2d 1001 (2d Cir. 1975).

89. *See id.* at 1003. The details of the transactions between the plaintiff and defendants are quite extensive. The court remanded to the lower court for findings on the extent of the American activities in the transactions and whether they fell within Rule 10b-5. *See id.* at 1018.

90. *Id.*

91. *Id.*

92. *See* Bersch v. Drexel Firestone, 519 F.2d 974, 987 (2d Cir. 1975).

application of the conduct test in favor of the effects test.[93] The court held that jurisdiction would not be extended to "cases where the United States activities are *merely preparatory*[.]"[94] In its analysis, the *Bersch* court added another variable to the strict standard. The court stated that it was necessary, in the case of a foreign transaction, for the conduct in the United States to have "directly caused" the losses.[95] The element of causation thus became the threshold for meeting the strict conduct test.

The Third Circuit modified the strict approach taken by the Second Circuit into a "loose" approach.[96] In *Kasser*, the SEC brought an action on behalf of the Manitoba Development Fund (the Fund), a Canadian corporation, against defendants who had allegedly induced the Fund into investing into contracts based on fraudulent representations made by the defendants.[97] Utilizing the loose approach, the court found subject matter jurisdiction. The conduct that the plaintiffs averred ranged from negotiations which occurred in the United States to the use of instrumentalities such as telephones and mails within the United States in furtherance of the defendants' scheme.[98]

In its conduct analysis, the Third Circuit looked to the previous holdings of the Second Circuit for guidance.[99] The Court specifically focused on the Second Circuit's decisions in *Bersch v. Drexel Firestone, Inc.*[100] and *IIT v. Vencap, Ltd*.[101] The primary distinction between the cases, both of which were decided on the same day, is the language "directly caused" that can be found in *Bersch* but not in *IIT*.[102] The Third Circuit chose not to specifically address whether or not "directly caused" is the appropriate standard by stating that causation need not be considered due to the greater presence of conduct in *Kasser* as compared to *Bersch*.[103] However, to require

93. *See id.*
94. *Id.*
95. *Id.* at 992.
96. SEC v. Kasser, 548 F.2d 109 (3d Cir. 1977).
97. *Id.* at 110-11. Plaintiffs invested approximately $45,000,000 over several years with the defendants, which was supposed to be invested in two corporations (Churchill Forest Industries and River Sawmills Company). *See id.* at 111. The majority of the money the Fund had allocated for investment in the corporations was diverted away from the corporations and to the personal use of the individual defendants. *See id.*
98. *See id.* at 111.
99. *See id.* at 112 n.10.
100. 519 F.2d 974 (1975).
101. 519 F.2d 1001 (1975).
102. *See Bersch*, 519 F.2d at 993.
103. *See Kasser*, 548 F.2d at 115.

foreign conduct to "directly cause" losses within the United States posits a heightened standard from "merely preparatory," as was given in *ITT*.[104] The Third Circuit makes a clear deviation from the Second Circuit by creating as its standard for minimum conduct that it is sufficient to meet the requirements of section 10(b) of the Exchange Act to have "some activity" in furtherance of the fraud.[105] Having departed from the Second Circuit requirement of "directly causing" losses to a "substantial amount of conduct" in furtherance of the fraudulent activity, the Third Circuit loosened the test and opened subject matter jurisdiction to more potential causes of action that would not have met the Second Circuit standard.[106]

The issue of the conduct test came before the Eighth Circuit in *Continental Grain Party Ltd. v. Pacific Oilseeds, Inc.*[107] The plaintiff alleged fraudulent nondisclosure by the defendant while inducing the plaintiff to purchase all of the stock in the defendant corporation.[108] The court basically followed the "some activity" standard given by *Kasser*, by finding that where "the scheme of nondisclosure . . . is significant enough, . . . subject matter jurisdiction [will be established]."[109] The Eighth Circuit further specified its standard by holding "conduct in furtherance of a fraudulent scheme" to be sufficient to establish subject matter jurisdiction.[110]

The court admitted that, much like the Third Circuit, its finding of subject matter jurisdiction was "largely a policy decision."[111] The court found that the benefits of a broad interpretation of foreign subject matter jurisdiction are to decrease the incentive of those who might want to perpetrate foreign securities frauds from the United States.[112]

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104. *See IIT*, 519 F.2d at 1018.

105. *See Kasser*, 548 F.2d at 114. "The federal securities laws, in our view, do grant jurisdiction in transnational securities cases where at least *some activity* designed to further a fraudulent scheme occurs within this country." *Id.* (emphasis added).

106. In strongly worded dicta, the Court suggests, from a policy perspective, that to restrict foreign subject matter jurisdiction too greatly would serve as notice to potential "defrauders and manipulators" who would use the United States as a "Barbary Coast . . . harboring international securities pirates." *Id.* at 116.

107. 592 F.2d 409 (8th Cir. 1978).

108. *See id.* at 411. The Court, for the purposes of its conduct test analysis, found the allegedly fraudulent conduct in the case to be analogous to that of *Kasser*, including "use of the mail and telephones." *Id.* at 415.

109. *Id.* at 415; *see also Kasser*, 548 F.2d at 114.

110. *Continental Grain*, 592 F.2d at 421.

111. *Id.*; *see also Kasser*, 548 F.2d at 116.

112. *See Continental Grain*, 592 F.2d at 421. "The range of significant conduct should . . . be fairly inclusive . . . . This is consistent with the general purpose of the securities laws to mandate the highest standards of conduct in securities transactions." *Id.*

In *Grunenthal GmbH v. Hotz*, the Ninth Circuit Court of Appeals had the opportunity to consider the extent foreign subject matter jurisdiction could be applied based upon foreign conduct carried out in the United States, in furtherance of a foreign transaction.[113] All of the defendants and the plaintiff were either foreign citizens or foreign corporations.[114] In utilizing the Second Circuit's approach to the conduct test, the district court concluded that subject matter jurisdiction did not exist.[115] In rejecting the district court's use of the Second Circuit's approach in favor of the Eighth and Third Circuits' standard, the Ninth Circuit stated policy rationale for implementing a broader conduct rule.[116] The court found that the misrepresentations made by the defendant in the United States "were significant, material and in furtherance of the fraudulent scheme."[117]

The strict approach taken by the Second Circuit was adopted by the District of Columbia Circuit in *Zoelsch v. Arthur Anderson & Co.*[118] The court began its analysis into whether sufficient contacts existed to establish subject matter jurisdiction by considering the purposes and territorial reach of section 10(b) of the Exchange Act.[119] It found that there were "no specific indications" within the language of the statute to indicate when American jurisdiction extended to securities transactions occurring abroad.[120] The court assumed, therefore, that it was left to the courts to use "[their] best judgment as to what Congress would have wished[.]"[121]

In explaining its decision not to grant subject matter jurisdiction, the District of Columbia Circuit established its rule by stating: "[T]he

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113. 712 F.2d 421, 421-22 (9th Cir. 1983).

114. *See id.* at 422.

115. *See id.* at 423. The district court held that no subject matter jurisdiction exists where "the only nexus with the United States is conduct in this country based on convenience and the only local act of fraud alleged is a mere repetition of misrepresentation first spoken abroad and, thus, *not essential* to the consummation of the fraud." *Id.* (emphasis added) (quoting Grunenthal GmbH v. Hotz, 511 F. Supp. 582, 588 (C.D. Cal. 1981)).

116. *See id.* at 425. "Assertion of jurisdiction may encourage Americans . . . involved in transnational securities sales to behave responsibly and thus may prevent the development of relaxed standards." *Id.*; *see also Continental Grain*, 592 F.2d at 421; *Kasser*, 548 F.2d at 116.

117. *Grunenthal GmbH*, 712 F.2d at 425.

118. 824 F.2d 27 (D.C. Cir. 1987). The plaintiff, Zoelsch, alleged that Arthur Andersen & Co. (AA-USA) had provided false and misleading information to Arthur Anderson & Co. GmbH (AA-Europe). *See id.* at 329. AA-Europe was commissioned to issue a report on a potential investment and the report included the misrepresentations made by AA-USA. *See id.* at 328. Zoelsch claimed that he had relied upon these misrepresentations in his decisions to invest. *See id.* at 329. Zoelsch and coplaintiffs complained that the misrepresentations of AA-USA were incorporated into AA-Europe's audit report, and were relied upon by them as investors. *See id.*

119. *See id.* at 29-30.

120. *See Zoelsch*, 824 F.2d at 30.

121. *Id.* (quoting Bersch v. Drexel Firestone, 519 F.2d 974, 933 (2d Cir. 1975)).

fraudulent statements or misrepresentations must originate in the United States, must be made with scienter and in connection with the sale or purchase of securities, and must cause the harm to those who claim to be defrauded."[122] The court also required that the domestic conduct "directly cause" the losses claimed.[123] Accepting the Second Circuit's causation requirement to establish jurisdiction, the District of Columbia Circuit took the most restrictive approach to the conduct test.[124] Citing deference to the judgment of the Second Circuit for its expertise in securities law, the court stated: "[W]e might be inclined to doubt that an American court should *ever* assert jurisdiction over domestic conduct that causes loss to foreign investors."[125]

Finally, the Fifth Circuit recently addressed the conduct test, in *Robinson v. TCI/US West Communication*.[126] The case arose out of a dispute over the valuation of stock in a settlement deal between the plaintiff and the defendant.[127] Robinson claimed violation of Rule 10b-5 on two grounds: (1) the defendants made untrue statements of material fact and (2) the defendants employed a device, scheme, or artifice to defraud him in connection with the sale of his securities.[128] The district court dismissed the case for lack of subject matter jurisdiction.[129]

The Fifth Circuit noted the "rather nebulous issue of the extent to which the American securities laws may be applied extraterritorially" by addressing the purpose of the Exchange Act.[130] The court acknowledged that, due to the congressional silence of the Act and growth of international commerce since its passage, both the effects and conduct tests have evolved out of the statutory language.[131] Noting the split between the "loose" conduct test of the Third, Eighth, and Ninth Circuits, and the "strict" conduct test of the Second and

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122. *Id.* at 31.

123. *See id.* at 30; *see also Bersch*, 519 F.2d at 992-93.

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

125. *Id.* (opinion by Bork, J.) (emphasis added); *see also* SEC v. Kasser, 548 F.2d 109, 115 (3d Cir. 1977).

126. 117 F.3d 900 (5th Cir. 1997).

127. *See id.* at 903. Plaintiff, Robinson, relied on a calculation made at an initial settlement meeting conducted in Denver Colorado. Under that formula, Robinson calculated his stock value in the range of $9,000,000. The value that the defendants computed, using a different formula than that which was used in Denver, resulted in a value of zero for Robinson's stock. *See id.*

128. *See id.*; 17 C.F.R. § 240.10b-5 (1999).

129. *See Robinson*, 117 F.3d at 903.

130. *See id.* at 904.

131. *See id.* at 905.

District of Columbia Circuits, the Fifth Circuit chose to follow the "strict" approach.[132]

The basis for the Fifth Circuit's choice to follow the strict approach was that federal courts are courts of limited jurisdiction; therefore, they must read congressional legislation strictly.[133] The Fifth Circuit chose, as its standard, a hybrid of the District of Columbia Circuit's *Zoelsch* holding and the Second Circuit's holdings in *Bersch* and *IIT*.[134] The court found that application of the standard led to a virtually irrebuttable presumption against extraterritorial subject matter jurisdiction.[135] Maintaining a strict construction of the language of the Exchange Act, the court stated that the purpose of the securities laws was "to protect American investors and markets . . . [and] broaden . . . jurisdiction beyond the minimum necessary to achieve these goals seems unwarranted in the absence of express legislative command."[136]

## III. THE DECISION OF THE EASTERN DISTRICT COURT OF TEXAS

In the noted case, the United States District Court for the Eastern District of Texas found the effects test inapplicable and implemented the strict approach to the conduct test as first stated by the Second Circuit and followed by the Fifth Circuit in *Robinson*.[137] The court held that because the Canadian plaintiffs failed to show that the domestic conduct of any defendant *directly contributed* to their losses, subject matter jurisdiction did not exist over their section 10(b) Exchange Act claims.[138]

The court began its analysis into foreign subject matter jurisdiction by considering the plaintiffs' Exchange Act claims by looking at the language of the statute itself.[139] The court noted the lack of direction given by Congress in the Exchange Act with regard to foreign subject matter jurisdiction.[140] Quoting *Robinson*, the court stated that American securities statutes "appear to be designed to

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132. *See id.* at 906 ("We adopt the Second Circuit's test as the better reasoned of the competing positions.").

133. *See id.* ("Legislation, 'unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'") (quoting *Foley Bros.*, 336 U.S. at 285).

134. *See id.* at 906; *see also* Psimenos v. E.F. Hutton & Co., 772 F.2d 1041 (2d Cir. 1983).

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

136. *Id.* This standard seems rather close to the strict interpretation of the Exchange Act that Judge Bork mentioned in dicta but chose not to accept in the District of Columbia Circuit. *See* Zoelsch v. Arthur Anderson & Co., 824 F.2d 27, 31-32 (D.C. Cir. 1987).

137. McNamara v. Bre-X Minerals, Ltd., 32 F. Supp. 2d 920, 923 (E.D. Tex. 1999).

138. *See id.* at 925.

139. *See id.* at 922.

140. *See id.*; *see also Robinson*, 117 F.3d at 904-05; 15 U.S.C. § 78j(b).

protect American investors and markets, as opposed to the victims of any fraud that somehow touches the United States."[141]

The court acknowledged, though, that its analysis of foreign subject matter jurisdiction did not end with an examination of the statute alone.[142] The court considered the conduct and effects tests in light of the facts before it.[143] It quickly disposed of the question of the effects test, stating that "the plaintiffs would obviously not have standing to assert any adverse effect on American investors or securities markets;" therefore, the effects test was inapplicable.[144] Citing *Kaufman v. Campeau*,[145] the court found that the effects plaintiffs alleged were insufficient to meet the bar of foreign subject matter jurisdiction.[146] The Eastern District of Texas relied upon the *Kaufman* court's holding that although the alleged fraudulent actions did have an effect on the American securities markets and investors, to find subject matter jurisdiction based on the facts of the case "would not further the purpose of the Securities Exchange Act."[147] The court conceded that there were losses incurred upon the American plaintiffs due to the domestic conduct, but these losses were separated from those of the Canadian plaintiffs.[148] The court held that the Canadian plaintiffs could not "justify [their] jurisdiction by bootstrapping on independent, American losses."[149]

Having disposed the plaintiffs' assertion of subject matter jurisdiction based on an effects test claim, the court turned to an evaluation of the allegedly fraudulent conduct committed in the United States as "[the only relevant test] to determin[e] whether the Canadian plaintiffs may bring their claims in an American court."[150] Both the plaintiffs and defendants conceded that *Robinson* was the controlling case in the Fifth Circuit regarding the conduct test; however, they disagreed on the standard that *Robinson* had set for

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141. *Bre-X*, 32 F. Supp. 2d at 922 (quoting *Robinson*, 117 F.3d at 906).
142. *See id.* at 922-23.
143. *See id.*
144. *Id.* at 923.
145. 744 F. Supp. 808 (S.D. Ohio 1990).
146. *Bre-X*, 32 F. Supp. 2d at 924. The *Kaufman* court did not extend subject matter jurisdiction to Canadian plaintiffs attempting to use the Exchange Act to recover losses sustained as a result of transactions occurring on Canadian exchanges. *Kaufman*, 744 F. Supp. at 810. The *Bre-X* court held, "The mere fact that such conduct may have adversely affected American investors and markets does not justify extending the protection of the securities laws to foreign investors in this case." *Bre-X*, 32 F. Supp. 2d at 924.
147. *Bre-X*, 32 F. Supp. 2d at 924.
148. *See id.* at 923.
149. *Id.*
150. *Id.*

meeting the test.[151] The plaintiffs claimed that the only requirement to pass the conduct test was that conduct in the United States "form a substantial part of the fraud in question."[152] The court, however, found that *Robinson* required "that the conduct in question [be] both a substantial part of the fraud *and* a direct cause of the plaintiff's injury."[153] Upon consideration of the plaintiffs' assertions of domestic conduct, the court found that "the Canadian plaintiffs . . . failed to show how their losses were directly caused by [the alleged acts]."[154]

Finally, the plaintiffs made a novel argument by requesting that the court consider the effects and conduct tests *jointly*, rather than exclusively, when determining subject matter jurisdiction.[155] The plaintiffs pointed to *Itoba Ltd. v. LEP Group*,[156] a recent case from the Second Circuit, to show that such an inquiry was another way of finding extraterritorial jurisdiction. The court agreed that, in some circumstances, both tests could be combined, but held that the facts of *Bre-X* were not similar enough to those of *Itoba* to warrant such an analysis and dismissed their claims.[157]

## IV. ANALYSIS AND CRITICISM

The Eastern District Court of Texas' decision not to find extraterritorial subject matter jurisdiction and dismiss the claims of the Canadian plaintiffs is, on its face, the proper decision. The Texas district court must take its cue on matters of law from precedent set by the Fifth Circuit Court.[158] The court in the noted case relies heavily upon the analysis made by the *Robinson* court and, specifically, applies the strict conduct test to the facts of the case.[159] The court

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151. *See id.* n.3.

152. *Id.*

153. *Id.* (quoting Robinson v. TCI/US West Communication, 117 F.3d 900, 907 (5th Cir. 1997) (emphasis added); *see also id.* at 905 n.10 ("The real test is simply whether material domestic conduct directly caused the complained-of loss.").

154. *Bre-X*, 32 F. Supp. 2d at 924-25.

155. *See id.* at 923.

156. 54 F.3d 118 (2d Cir. 1995).

157. *See id.* In *Itoba*, the plaintiff, Itoba, was a subsidiary of A.D.T. Limited (ADT), a Bermudan corporation with shares listed on the New York Stock Exchange and over half of its shareholders U.S. residents. *Itoba*, 54 F.3d at 120. The defendant, LEP, is a London-based conglomerate with subsidiaries in over thirty countries. *See id.* The *Itoba* case arose out of a proposed acquisition of LEP by ADT. *See id.* In preparation for the takeover, Itoba purchased over 37 million shares of LEP worth approximately $114,000,000. *See id.* at 121. Prior to the completion of the deal, LEP disclosed business reversals, which lowered the value of its stock by 97%. *See id.* The value of Itoba's holdings in LEP declined by $111,000,000. *See id.*

158. 28 U.S.C. § 1291.

159. *See Bre-X*, 32 F. Supp. 2d at 923 (citing Robinson v. TCI/US West Communication, 117 F.3d 900 (5th Cir. 1997)).

summarily dismissed the effects test as not determinative in establishing jurisdiction.[160] Upon consideration of the conduct test, it found that the conduct occurring within the United States with respect to Bre-X's Busang mining project did not meet the threshold requirement of showing that the domestic activities "directly caused" the plaintiff's losses.[161]

Irrespective of whether the Fifth Circuit's conduct test is the "proper" test, in light of the "loose" test used in the Third, Eighth, and Ninth Circuits, the noted case fails in its flippant and dismissive analysis of the pertinent facts. When a court makes an initial review for subject matter jurisdiction, the plaintiff is given the benefit of the doubt with regard to the validity of its allegations *solely for the purposes of establishing proper jurisdiction*.[162] In the noted case, the court makes only a cursory review of the plaintiffs' allegations, while summarily rejecting them as insufficient.[163] The failure, the court asserts, is that "[n]ot a single Canadian plaintiff has alleged that he or she relied on (or was even aware of) any statements, reports or filings which emanated from the United States."[164] The first problem is that the court is imposing an element to the conduct standard that has heretofore never been considered or addressed: *reliance*. The reason that this issue is not addressed in the initial inquiries concerning subject matter jurisdiction is because reliance is generally presumed in cases of securities fraud.[165] There is no way to explain why the court chose to consider reliance as part of its analysis regarding domestic conduct and then use it as one of its rationales for dismissing the plaintiffs' claims. Neither the "strict" nor the "loose" circuits have ever given one word of analysis or consideration regarding the reliance of a party upon conduct when assessing jurisdiction.[166] One of the essential purposes of having constructed the conduct test is to prevent the United States from becoming a launch pad for foreign securities fraud.[167] By disposing of the plaintiffs' claims of fraudulent conduct within the United States

160. *See id.* at 923.
161. *Id.* at 924-25.
162. *See* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1330 (2d Cir. 1972); *see also* Steele v. Bulova Watch Co., 344 U.S. 280, 284 (1952).
163. *See Bre-X*, 32 F. Supp. 2d at 924-25.
164. *Id.* at 925.
165. *See Basic*, 485 U.S. at 245-47.
166. *See* Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968); Bersch v. Drexel Firestone, 519 F.2d 974 (2d Cir. 1975); *Maxwell*, 468 F.2d at 1326.
167. *See* SEC v. Kasser, 548 F.2d 109, 116 (3d Cir. 1977); Continental Grain Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 421 (8th Cir. 1978).

without giving more thorough rationale than simply "lack of reliance," the district court inappropriately made the conduct test overly stringent and carelessly disregarded the weight of the facts of the case.[168]

The second potential error on the part of the court is its decision not to decide jurisdiction based upon the combined conduct and effects tests. The plaintiffs in the noted case suggested that the conduct and effects tests could be combined when determining jurisdiction.[169] Historically, the effects and conduct test have coexisted apart, yet always within eyesight of each other.[170] Courts have usually considered both tests in their analysis, but have chosen one as the rationale for asserting or denying jurisdiction.[171] On a few notable occasions, however, the court has actually combined the tests without specifically stating that it has done so.[172] In *Leasco*, the Second Circuit stated that although the "impact" of foreign fraudulent conduct on American shareholders and companies alone was insufficient to confer jurisdiction, "it tip[ped] the scales in favor of applicability when substantial misrepresentations were made in the United States."[173] The inquiry into the "impact" of the fraudulent activity is, quite simply, what has heretofore been labeled the "effects test." The considerations the *Leasco* court makes of the "substantial misrepresentations" can easily be renamed a "conduct test." In *Bersch*, the Court contemplated both the domestic conduct and the effects of the fraud before deciding the issue of subject matter jurisdiction.[174] The Second Circuit held "we do not think that a combination of the [conduct and effects rationale] sufficient in itself, supports a result different from that which would be proper if each subsisted alone."[175] Even without formally creating a combined test, the court in *Bersch* implied that it is yet another option for consideration with regard to subject matter jurisdiction.

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168. *See Bre-X*, 32 F. Supp. 2d at 922-25.

169. *See id.* at 923.

170. *See Maxwell*, 468 F.2d at 1326 (considering both the effects and conduct test, the court did not find sufficient effects and chose the latter as its test for jurisdiction). *Bersch*, 519 F.2d at 974 (finding that where the adverse general effect upon the United States stock market of the collapse of a Canadian corporation is insufficient to confer subject matter jurisdiction, a conduct test should be implemented).

171. *See id.*

172. *See Bersch*, 519 F.2d at 974; *Maxwell*, 468 F.2d at 1326; Dennis R. Dumas, *United States Antifraud Jurisdiction over Transnational Securities Transactions: Merger of the Conduct and Effects Tests*, 16 U. PA. J. INT'L BUS. L. 721, 732-34 (1995).

173. *Maxwell*, 468 F.2d at 1336-37; *see also* Dumas, *supra* note 172, at 733-34.

174. *See Bersch*, 519 F.2d at 989-90; *see also* Dumas, *supra* note 172, at 734.

175. *Id.*

Because of the large presence of corporations and securities exchanges in New York, the Second Circuit has been a leader in the interpretation of securities law.[176] The Second Circuit officially adopted a combined conduct/effects test in *Itoba Ltd. v. LEP Group PLC*.[177] In justifying its decision, the court in that case held, "[t]here is no requirement that these two tests be applied separately and distinctly from each other."[178] The court went so far as to suggest that the combined test be *the preferable option* when assessing jurisdiction: "[A]n admixture or combination of the two [tests] often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court."[179] This broad language by the court indicates that the combined test is one whose applicability depends not on a prerequisite set of facts, but can be applied to any case where extraterritorial subject matter jurisdiction is at issue.

The Fifth Circuit in the noted case, however, stated that the combined test was inapplicable because the facts before it were not analogous enough to those of *Itoba*.[180] The court found that the relationship between the plaintiff, Itoba, and its American parent corporation created a sufficient nexus to determine whether "extraterritorial conduct contributed to what was, in the end, a domestic loss."[181] The district court did not have to consider combining the effects of the alleged fraudulent conduct of Bre-X and its codefendants with the alleged domestic conduct.[182] Since the Fifth Circuit has not formally adopted any type of combined test as an appropriate method of determining jurisdiction, the Eastern District of Texas is under no obligation to apply it. However, since the court does suggest the combined test as an option and cites to *Itoba* as precedential authority, it should be constrained to follow the lead set by the Second Circuit to make a full examination of the facts as was

176. *See* Zoelsch v. Arthur Anderson & Co., 824 F.2d 27, 32 (D.C. Cir. 1987); SEC v. Kasser, 548 F.2d 109, 115 (3d Cir. 1977).

177. 54 F.3d 118 (2d Cir. 1995).

178. *Id.* at 122.

179. *Id.* (emphasis added); *see also* Dumas, *supra* note 172, at 722.

180. *See* McNamara v. Bre-X Minerals, Ltd., 32 F. Supp. 2d 920, 923 (E.D. Tex. 1999). The district court held that the combined test was applicable to *Itoba* and not *Bre-X* because (1) *Itoba* involved a single, foreign plaintiff that purchased shares on a foreign exchange and (2) Itoba purchased the stock on behalf of its American parent company. *See id.*

181. *Id.*

182. *See id.* Whether or not the court makes a combined inquiry is not clearly evident. The discussion strays from effects analysis to conduct analysis and concludes without making an assertive decision on such a test. *See id.* at 923-25.

set out in *Itoba*.[183] If the court in the noted case followed *Itoba* correctly, it would have applied the combined test irrespective of a specific fact pattern. Given the allegations listed in the opinion, it is unclear whether a full analysis of the facts would lead to an assertion of jurisdiction.[184] The task falls to the district court to be thorough in its application of the Second Circuit's combined test.

Considering the number of variables and interpretations involved in determining foreign subject matter jurisdiction, error by any court is not unfathomable. The conflict between the circuits and lack of clear statutory language leads to this problem. Two solutions are readily apparent: Supreme Court review and congressional action.

The Supreme Court is the highest authority on all matters of the law in this country.[185] Whether it will decide to hear a case dealing with a particular issue is difficult to predict. Frequently, one of the Court's deciding factors is conflict within the circuits on an issue of law.[186] The split between the circuits regarding the foreign applicability of section 10(b) of the Exchange Act has obviously led to a great deal of inconsistent case law and confusion. The Second and District of Columbia Circuits have chosen to apply the statute strictly, while the Third, Seventh, and Eighth Circuits have gone with a more liberal approach.

The confusion among the circuits lends itself to problems for potential foreign plaintiffs who might want to bring an action in the United States. The Canadian *Bre-X* plaintiffs fall into this category. Unfortunately, the facts that the Eastern District of Texas gives in its opinion do not shed a great deal of light on the extent of both the fraudulent activity and the conduct which occurred in the United States regarding this alleged scheme. It is therefore difficult to determine whether an approach different from the one chosen by the district court will lead to a different result. There is sufficient evidence to question whether a different outcome is possible. Some of the co-defendants involved in this class action are American corporations. Bre-X stock was, at one point, traded on NASDAQ. There are obviously both effects upon and conduct within the United

183. *See* 54 F.3d at 124.

184. *See Bre-X*, 32 F. Supp. 2d at 924-25.

185. U.S. CONST. art. III § 1.

186. *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (adopting the definition of "scienter" to be used in establishing section 10(b) causes of action); Dooley v. Korean Air Lines Co., 524 U.S. 116 (1998) (resolving the split concerning the availability of a general maritime survival action in cases of death on the high seas); NLRB v. Curtin Matheson Scientific, Inc., 494 U.S. 775 (1990) (resolving the question of whether the NLRB must presume that strike replacements oppose the union).

States in this case. The restrictive perspective by the Fifth Circuit in its interpretation of the Exchange Act leads to a decision that might have been resolved differently in one of the less conservative circuits.

A decision by the Supreme Court, elucidating the proper rules and standards for section 10(b) foreign jurisdiction making all of the circuits uniform in their approach, would end the need for such speculation. One standard would also remove most of the guesswork in determining whether a foreign plaintiff has cleared the bar to bring a cause of action before an American court.

The Supreme Court has never chosen to grant certiorari on the issue of extraterritorial subject matter jurisdiction under the Exchange Act.[187] Previous lower court cases are not only uniform in their outcome, but each one has been without opinion.[188] The Court has made an affirmative effort not to voice an opinion on the subject. One of the reasons that the Court has chosen not to address this issue may be that it is following the same reasoning given in *Zoelsch*: that to create judicial doctrine where Congress has remained silent is improper judicial activism.[189] Bearing this in mind, the only other possible alternative to establish national uniformity on extraterritorial jurisdiction is through legislative action. The SEC has been granted by the Exchange Act the power to promulgate rules pursuant to the purposes of the Act.[190] The SEC has not used its rule-making authority yet to modify section 30 of the Act, but suggestions have been made.[191] This inertia on the part of Congress will become more significant as this nation's economy becomes increasingly dependent and interdependent on foreign corporations and foreign markets. It is unwise for Congress and the courts to ignore the strong effect that these foreign influences have upon our markets and our citizens. Until Congress decides to act and clarify the obvious ambiguity of section 30, the only remedy will be to force courts to become judicial activists and create doctrine on their own.

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187. Churchill Forest Indus. (Manitoba) Ltd. v. SEC, 518 F.2d 109 (3d Cir. 1977), *cert. denied*, 431 U.S. 938 (1977); Bersch v. Arthor Anderson & Co., 519 F.2d 974 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975); Manley v. Schoenbaum, 405 F.2d 200 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

188. *See id.*

189. *See* Zoelsch v. Arthur Andersen & Co., 824 F.2d 31, 32 (D.C. Cir. 1987).

190. *See* 15 U.S.C. § 78j(b).

191. *See* Corso, *supra* note 17, at 593-98.

## V. CONCLUSION

The decision in the noted case demonstrates the lack of direction and clarity for courts in assessing foreign subject matter jurisdiction in securities fraud cases. There is a split between the circuits as to the proper way to assess foreign subject matter jurisdiction in section 10(b) causes of action. The Second, D.C., and Fifth Circuits have adopted a strict approach in interpreting the scope of the statute. The Third, Eighth, and Ninth Circuits have chosen to cast a wider net over foreign securities transactions by applying a loose approach that does not include the direct causation requirement of the strict approach. The strict camp gives, as its primary rationale, a narrow reading of the statute, holding that congressional silence on the issue of foreign jurisdiction is an indication that the Exchange Act was written with only a limited foreign reach in mind. Absent specific legislation directed towards the issues presented regarding the extraterritoriality of the Act, these circuits feel it is not within the providence of the judiciary to act. The jurisdictions that take a broader view of section 10(b) use public policy as their rationale. In this time of an expanding, increasingly interrelated global economy, it appears that transnational securities transactions are only going to increase. The followers of the loose approach argue that without expanding the jurisdiction of the Exchange Act to cover certain foreign transactions, American markets and investors will suffer. Additionally, those planning to commit fraudulent acts abroad will find that the United States' strict jurisdictional rules make it an attractive place to plot their schemes.[192]

With the conflict between the circuits, there is a definite need for action. The difference in interpretation and attitude between the loose and the strict readers of the conduct test makes establishing jurisdiction a "gamble" for a foreign plaintiff. The gamble is based completely upon the locale of the alleged conduct. If the conduct occurs in certain circuits, the chances for subject matter jurisdiction are better than if it occurred in others. With the increasing globalization of other nations' economies and ours, such discrepancy cannot go on much longer. Resolution requires a decision from the Supreme Court or congressional legislation. The Court often grants certiorari to cases that explore a split in interpreting the law within the circuits. The Court has, however, never sought to use this tool with regard to section 10(b). The time for the Court to utilize this tool stands before us. The confusion with regard to the definition and

192. *See infra* notes 106, 112.

applications of the rules regarding 10(b) is substantial enough for the Court to finally take notice. If, however, the Court continues to ignore this ever-growing issue, the task falls to Congress to take determinative steps. Either option would be acceptable and useful towards the goal of uniformity. Either Congress or the Court must act. This issue is only gaining importance in today's economy. The lack of a national direction on subject matter jurisdiction will only lead to wider division within the circuits and the increased possibility of taking advantage of investors such as the Canadian Bre-X plaintiffs who will lose because they are not given the opportunity to be heard in an American court.

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