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Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.

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COMMENT

Securities Regulation—Extraterritorial Application—Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc. — In this era of transnational investment and acquisition, the courts have had to address, with increasing frequency, the troublesome boundaries of the extraterritorial application of United States securities laws, because investment in domestic markets and corporations is not limited to domestic investors.¹ Fraudulent actions, initiated by and perpetrated upon American citizens, have caused the courts to consider appropriate guidelines for the granting of subject matter jurisdiction in applying the antifraud sections of federal securities laws to transnational securities dealings. Although regulations governing the issuance and sale of securities within the United States are extensive, neither the statutes nor the rules promulgated by the Securities and Exchange Commission (SEC) provide adequate guidance as to how they should be applied transnationally.² Indeed, it was long presumed that absent


2. See Loss, Extraterritoriality in the Federal Securities Code, 20 HARV. INT’L L. J. 305 (1979). The SEC has not exercised rulemaking authority granted in § 30(b) of the Securities Exchange Act of 1934. Securities Exchange Act of 1934, § 30(b), 15 U.S.C. § 78 dd(b) (1976) [hereinafter cited as the ‘34 Act]. This section “makes the ‘34 Act inapplicable ‘to any person insofar as he transacts a business in securities without the jurisdiction of the United States unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to
an expression of congressional intent, federal legislation was to apply solely within the territorial limits of the United States. In order not to thwart the remedial purpose of the securities acts, the courts have begun to evolve standards for determining circumstances where extraterritorial applications of the law are both appropriate and necessary.

Beginning with the landmark case of Schoenbaum v. Firstbrook, the courts have evolved two tests for the granting of subject matter jurisdiction over the conduct of foreign persons and entities. The first test is predicated on conduct within the United States and the second is based on effects within the United States of conduct occurring largely abroad. In Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Ltd., the Court of Appeals for the Eighth Circuit recognized that in the case of a fraudulent scheme of nondisclosure of material

prevent the evasion of this title.'” Loss at 305 (emphasis added).

3. See, e.g., American Banana Co. v. United Fruit Co., 213 U.S. 347 (1909). “The foregoing considerations would lead in case of doubt to a construction of any statute as intended to be confined in its operation and effect to the territorial limits over which the lawmaker has general and legitimate power.” Id. at 357. Accord Foley Bros., Inc. v. Filardo, 336 U.S. 281 (1949); Blackmer v. U.S., 284 U.S. 421 (1932).

4. See, e.g., Des Brisay v. Goldfield Corp., 549 F.2d 133, 135 (9th Cir. 1977).

5. 405 F.2d 200 (2d Cir.), rev’d on other grounds, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied sub nom. Manley v. Schoenbaum, 395 U.S. 906 (1969). Stressing the importance of the protection of American interests, the Second Circuit extended the application of the ‘34 Act regarding securities transactions on United States stock exchanges, whenever “necessary to protect American interests.” 405 F.2d at 206. In this case, an American stockholder of a Canadian oil company brought an action against the controlling shareholders, who were the company directors, alleging that they had conspired to defraud the company by forcing it to sell treasury shares at a market price which the directors knew did not reflect true value. Id. at 204. The shareholders’ derivative suit alleged that this failure to disclose and the subsequent action on the basis of the inside information constituted violations of § 10(b) and Rule 10b-5. Id. Subject matter jurisdiction was based upon the fact that although the sale was transacted entirely in Canada, the corporate stock was traded on the American Stock Exchange. Noting that the intent of the ‘34 Act is to protect investors and the markets against improprieties, the court focused not on the conduct itself, but rather on the effects. Id. at 206, 209. See also Hacker & Rotunda, supra note 1, at 645. Although the fraud was committed outside the United States, its effects were felt within and, consequently, the court held that jurisdiction properly existed. 405 F.2d at 209. See also Strassheim v. Dailey, 221 U.S. 280 (1911); United States v. Aluminum Company of America, 148 F.2d 416 (2d Cir. 1945).


8. 592 F.2d 409 (8th Cir. 1979).
facts, devised in the United States and then "exported" to Australia, jurisdiction based solely on conduct could be granted, despite the difficulty of actually assigning a situs to the fraud involved. The culmination of the actual sales transaction occurred in Australia, but the heart of the plaintiffs' claim was that prior to the sale, the defendants, who were the stockholders of Pacific Oilseeds, Inc., had organized and perpetuated a scheme to withhold material information from the plaintiffs, the purchasers of all of the stock. Although the effect of these transactions on domestic American interests was minimal, the conduct involved in the fraud did occur within the United States and was deemed significant enough to warrant the intervention of an American court.

Continental Grain Pty. Ltd. (Continental) was the Australian subsidiary of an American company. In August 1974, Continental purchased all the stock of Pacific Oilseeds, Ltd. (PacSeeds) from its three stockholders, Australian Chemical Holdings Ltd. (Australian Chemical), POI, a California corporation and Carl Ernest Classen, president of POI. At the time of this transaction, PacSeeds was a party to a ten year licensing agreement with Northrup, King and Co. (Northrup), a Minnesota corporation, whereby Northrup supplied PacSeeds with Hybrid sorghum parental materials. This licensing agreement, which provided for the continued availability of hybrid seedstock, constituted the primary asset of PacSeeds.

9. Id. at 420. By "exported" the court means that the scheme to defraud was essentially developed and carried out in the United States and then later perpetrated on the foreign defendants. While formulated in one country, the actual fraud was felt abroad, hence the "exportation." Id.
10. Id. at 420 n.17.
11. Id. at 420.
12. Id. at 411-12.
13. Both Continental Grain (Australia) Pty. Ltd. and Pacific Oilseeds (Australia) Pty. Ltd. were Australian corporations. Id. at 411.
14. Id. The parent company, a Delaware corporation, had an accounting system whereby any losses experienced by the subsidiary were reflected in the parent's financial picture. Continental argued that a loss suffered by it constituted a domestic effect under the effects test, thus requiring the grant of subject matter jurisdiction. While jurisdiction was granted, the effect of this accounting was held by both the district court and the Eighth Circuit to be too remote to provide an adequate jurisdictional basis. Id. at 417.
15. Id. at 411. PacSeeds was an Australian corporation. Id.
16. Id. Australian Chemical held 51% of PacSeeds' stock. Id.
17. Id. POI, a subsidiary of PVO Int'l, another California corporation, held 48% of PacSeeds' stock. Id.
18. Id. Claussen held 1% of PacSeeds' stock. Id.
19. Sorghum is a grass, cultivated as a grain or as a source of syrup. Northrup cultivated and provided the basic seedstock. Id.
20. Id. Prior to the acquisition, Continental obtained a copy of this agreement and
The entire acquisition was negotiated between Continental and Peter Leech, the managing director of Australian Chemical, who acted as an agent for the three vendors. The purchase proposal was premised on the vendors' guarantee that PacSeeds would retain use of the seedstock currently held after the termination of the license agreement. Leech, who believed the use to be unrestricted, forwarded the offer to Claussen at POI. Prior to receiving the offer, Claussen was aware of Northrup's intention to reclaim the seedstock at the termination of the license. Informing Leech of this development, Claussen and POI indicated that PacSeeds would not guarantee the seedstock's use and that it would be "Continental's problem." In addition, Claussen requested of Northrup that they not "spoil the deal with Continental by telling Continental of Northrup King's intention to reclaim the seedstock upon the termination of the license agreement."

Northrup formally terminated the license agreement in June 1974, notifying Claussen that the license was not transferable and that Northrup did not intend to renew it with Continental. The letter also specified that Northrup intended to reclaim the seedstock and that PacSeeds could not dispose of it. At no time during the course of the negotiations did any one of the vendors or Northrup inform Continental of Northrup's intentions. Although the contract for the sale of PacSeeds was executed in California, the actual closing was held in Sydney, Australia in August 1974. The initial payment was made in Australian dollars and the balance was paid after a post-closing audit

sought legal advice from two law firms, one in New York and the other in Australia. Both firms assured Continental that the seedstock would remain available to PacSeeds after the end of the agreement with Northrup. This legal advice led the court to question "causation in fact," meaning that the legal advice may have been the basis of Continental's purchase. Causation is a necessary element of a private action under § 10(b) and Rule 10(b)-5 of the '34 Act. This reliance, however, was not established.

21. Id. at 411. None of the POI representatives, including defendant Claussen, had any direct contact with Continental.

22. Id.

23. Id.

24. Id.

25. Id. at 411-12.

26. Id. at 411. This statement gave rise to a claim by Continental that Northrup was a part of the "conspiracy of silence" and led to the institution of a suit against Northrup in the District Court of Minn. Id. at 412 n.2.

27. Id. at 412.

28. Id. The materiality of this so-called "scheme of nondisclosure" was the basis of Continental's claim of securities fraud.

29. The closing was held in Australia, rather than in the United States, in order to avoid certain tax consequences.
in November 1974. In the interval between the two payments, the license agreement expired and was not renewed.

Continental brought an action in the United States District Court for the District of Minnesota alleging violations by POI and Claussen of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The complaint further asserted common law fraud, breach of contract and material misrepresentations in the warranty language of the contract. The district court dismissed for lack of both subject matter and personal jurisdiction against POI and Claussen. The district court considered activities such as the negotiations between Claussen, Aust. Chem., POI and Northrup King and found that "POI and Claussen had engaged in no actionable conduct within the United States to enable the court to exercise jurisdiction under § 10(b) and that the alleged effect (the decreased value of the PacSeeds stock as reflected in the financial records of Continental's parent company, Continental

30. Id. at 413.
31. Id. In response to Continental's actions against Northrup, a counterclaim was filed by Northrup for an accounting, return of the hybrid seedstock and punitive damages. Id. at 412 n.2 (citing Pacific Oilseeds (Australia) Pty. Ltd. v. Northrup, King and Co., No. 4-47 Civ. 602 (D. Minn. dismissed with prejudice, July 26, 1978)).
32. Australian Chemical was not joined because its inclusion would have defeated diversity jurisdiction. Id. at 414 n.5.
33. 15 U.S.C. § 78j(b)(1976). The provision states that:
   It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange . . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
34. 17 C.F.R. § 240.10b-5 (1975). This rule provides that:
   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,
   a) To employ any device, scheme or artifice to defraud,
   b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements, made in the light of the circumstances under which they were made, not misleading, or
   c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.
35. 592 F.2d at 413.
36. Id.
Grain Corporation) was too remote.”

On appeal, the Eighth Circuit held that the scheme of fraudulent nondisclosure devised in the United States and perpetrated by the use of the mails and other instrumentalities of interstate commerce was conduct sufficient to establish subject matter jurisdiction. Recognizing the significance of the conduct, the court reversed and remanded the case to the district court, stating that although the ultimate effect was felt in Australia, the scheme of nondisclosure was devised and completed in the United States and was then “exported” to Australia.

International law recognizes the principle that every state retains the ability to establish standards of conduct within its borders for any actor, whether citizen or alien. By attaching consequences to conduct, the state is permitted jurisdiction over acts committed within its territorial boundaries. Thus, although five possible bases for jurisdiction exist in international law, American courts deciding transnational se-

37. Id. (emphasis added).
38. Id. at 415. See also Travis v. Anthes Imperial Ltd., 473 F.2d 515, 524 (8th Cir. 1973); Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326, 1335 (2d Cir. 1972); but see Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir. 1975).
39. 592 F.2d at 420. The court cited IIT v. Vencap, Ltd., 519 F.2d 1001, 1017 (2d Cir. 1975), which stated: “We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.” Id.
40. See, e.g., RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 (1965) [hereinafter cited as RESTATEMENT]. § 17 provides:
A state has jurisdiction to prescribe a rule of law (a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and (b) relating to a thing located, or a status or other interest localized, in its territory.
Id. See also Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 423 (1964); Research in International Law Under the Auspices of the Faculty of the Harvard Law School: Jurisdiction with Respect to Crime, 29 AM. J. INT’L L. 435, 480-81 (Supp. 1935) [hereinafter cited as Research in International Law].
41. Buschman, supra note 1, at 242.
42. The four other principles of jurisdiction are the nationality principle (provides states jurisdiction over its citizens regardless of where the conduct occurred), the protective principle (states have the power to prescribe rules of law attaching consequences to extraterritorial conduct that threatens national security or governmental operations), the universality principle (permits jurisdiction over a person who has committed an act and who is held in custody) and the passive principle (states may exert jurisdiction over conduct injurious to its citizens). See generally Research in International Law, supra note 40, at 445. The passive principle is expressly rejected by § 30(2) of the RESTATEMENT: “A state does not have jurisdiction to prescribe a rule of attaching legal consequences to conduct of an alien outside its territory merely on the ground that the conduct affects one of its nationals.” RESTATEMENT, supra note 40, § 30(2).
curities cases have utilized and developed only one of these—the terri-
torial principle. In an attempt to address the maximum range of situa-
tions, courts have developed two corollaries of this principle. The first
development is the objective territorial principle, more commonly
known as the effects doctrine, which permits subject matter jurisdic-
tion over conduct which has occurred abroad but which has produced a
foreseeable and substantial effect within the territory. Thus, jurisdic-
tion is established over actions initiated outside a state, but are con-
summated within its territorial boundaries. This principle was upheld
by the United States Supreme Court in Strassheim v. Daily. The
Court stated that “acts done outside a jurisdiction, but intended to
produce and producing detrimental effects within it, justify a state in
punishing the cause of harm as if he (the perpetrator) had been pre-
sent at the effect, if the State should succeed in getting him within its
power.”

The second development is the subjective territorial principle,
known as the conduct doctrine. This permits jurisdiction over acts
commenced within a state, but consummated elsewhere. Thus, a state
will be able to address conduct carried out within its territorial bound-
aries even if the effects are felt exclusively abroad. The locus of the

43. Section 18 of the Restatement provides:
A state has jurisdiction to prescribe a rule of law attaching legal consequences to
conduct that occurs outside its territory and causes an effect within its territory, if . . . (b)(i) the conduct and its effect are constituent elements of activity to
which the rule applies; (ii) the effect within the territory is substantial; (iii) it
occurs as a direct and foreseeable result of the conduct outside the territory; and
(iv) the rule is not inconsistent with the principles of justice generally recognized
by states that have reasonably developed legal systems.

44. See Research in International Law, supra note 40, at 487-94. See also People v.
Adams, 3 Denio 190 (1848), in which the accused in Ohio made false representations
through an innocent agent in New York whereby money was fraudulently obtained from a
New York firm. The New York Supreme Court granted jurisdiction, finding that:
The fraud may have originated and been concocted elsewhere, but it became
mature and took effect in the city of New York, for there the false pretenses
were used with success. . . . The crime was there. . . . Personal presence, at the
place where a crime is perpetrated, is not indispensable to make one a principal
offender in its commission.

Id. at 206-07.

45. 221 U.S. 280 (1911).

46. Id. at 285.

47. See Research in International Law, supra note 40, at 484-87. See also Hacker &
Rotunda, supra note 1, at 643.

48. See Restatement § 17, supra note 40.
crime is considered to be wherever the act or omission itself occurred.49

Either one of these principles or a combination of the two may be used as a basis for subject matter jurisdiction over claims resulting from securities transactions.60 If the transaction in question satisfies only one of these tests, it is still possible that the court will grant subject matter jurisdiction. Any transaction directly or indirectly affecting or involving American citizens or interests, arguably, should come under the jurisdiction of American courts. The enforcement of this standard, however, would involve the American judiciary in all but a minority of securities transactions taking place in various parts of the world. In an attempt to impose limitations, especially with respect to the consideration of conduct, courts have required a showing of “significant impact.”61 Understandably, the mere incidental use of the means and instrumentalities of interstate commerce, specifically telephones and the mails, will not provide a sufficient basis for the grant of jurisdiction. If a court has decided that redress must be given to the plaintiff, it may be willing to employ a less stringent standard in the evaluation of the significance of the impact.

In Continental Grain, the Eighth Circuit found that jurisdiction may be based solely on the application of the conduct test.62 Given the troublesome task of assigning a situs to an act of nondisclosure, this case illustrates the difficulty of predicting which arrangement of facts will cause a court either to apply one test or another, or merely to decide that jurisdiction is proper and then seek an appropriate categorization. Although the landmark case of Schoenbaum v. Firstbrook63 relied on the effects doctrine, this note focuses instead on those cases relying on the conduct doctrine. This examination will place the decision of the Eighth Circuit in context, and will show that the decision of that court to grant subject matter jurisdiction was largely a policy decision, although it was not inconsistent with previous decisions.

49. See Research in International Law, supra note 40, at 487.
50. See Continental Grain, 592 F.2d at 416-17. This court notes, however, that it agrees “jurisdiction may be established by meeting the requirements of either, not both, the conduct or effects test.” Id. at 417.
51. Hacker & Rotunda, supra note 1, at 648-49. These authors argue that tests developed for the transnational application of the antifraud provisions of the federal securities laws should not be uniformly extended throughout the '34 Act to cover proxy fights or short-swing profits, because to do so would impose regulation on the internal affairs of foreign companies seeking access to United States securities markets. Id. at 648, 663-66.
52. 592 F.2d at 417.
In *Leasco Data Processing Equipment Corp. v. Maxwell*, the Second Circuit found subject matter jurisdiction appropriate where the alleged fraudulent conduct involved allegations that misrepresentations were made to the officers of a United States corporation, and these misrepresentations prompted the Americans to purchase a British corporation's stock at a price in excess of its actual value. Plaintiffs claimed that the purchases were induced by a series of statements communicated both to and from the United States by telephone and mail. Judge Friendly characterized these actions as conduct "within the U.S.," which was an essential link in Leasco's purchase of the securities. It was not necessary for the shares purchased to be listed on a domestic stock exchange for the 1934 Act to apply extraterritorially.

The *Leasco* court refrained from making a sweeping application of the 1934 Act based solely on the detrimental effect on American investors of a transaction largely taking place abroad. Judge Friendly found that subject matter jurisdiction was proper, not only because of the impact of this transaction on an American corporation, but also because the purchases were induced by conduct occurring in this country. The Second Circuit did not have to go as far as the Eighth Circuit in *Continental Grain*. Because it found both "significant conduct within the United States [misrepresentations in U.S. territory] and a direct impact on U.S. investors, the [Leasco] court was not required to decide whether one or both facts—conduct and effects—would be enough to support subject matter jurisdiction." The *Continental* court, in comparison, found no measurable or significant domestic effect of the fraud and premised its finding of subject matter jurisdiction solely

54. 468 F.2d 1326 (2d Cir. 1972).
56. 468 F.2d at 1330.
57. The purchases took place on the London Stock Exchange and were affected by Leasco's foreign subsidiary, which ultimately invested 22 million dollars. *Id.* at 1332.
58. *Id.* at 1335.
60. *Id.* at 1336. "Since Congress thus meant 10(b) to protect against fraud in the sale or purchase of securities whether or not these were traded on organized United States markets, we cannot perceive any reason why it should have wished to limit the protection to securities of American issuers." *Id.*
62. The court was not convinced by Continental's argument that "its loss as reflected in the financial statements of its parent American corporation, constitute[d] a domestic effect under the effects test." 592 F.2d at 417.
upon conduct within the United States.\textsuperscript{63}

Written and telephonic communications were also adequate grounds to support subject matter jurisdiction in \textit{Travis v. Anthe Imperial Limited}.\textsuperscript{64} Travis, a Canadian corporation, made a tender offer to the shareholders of another Canadian corporation for the purpose of merger.\textsuperscript{65} Plaintiffs, American citizens who were shareholders in the target company,\textsuperscript{66} alleged that the two corporations had led them to believe that if they retained their stock until after the expiration of the tender offer to Canadian stockholders, a separate offer would be made to American stockholders.\textsuperscript{67} Having relied on a series of communications made both by mail and by telephone,\textsuperscript{68} the plaintiffs eventually sold their holding for less than they would have received at the beginning of the tender offer.\textsuperscript{69} Reversing the district court, the Eighth Circuit held that subject matter jurisdiction “attaches whenever there had been conduct with respect to alleged violations in the United States,” even if the stock in question was not listed on an American exchange.\textsuperscript{70} The appeals court, viewing the communications between the parties in their totality, found that the communications were “an essential element in a slowly unfolding scheme to defraud the plaintiffs” through the use of the implements of interstate commerce. This view required a finding of jurisdiction.\textsuperscript{71} The use of the instrumentalities was important even though some of the communication took place after the plaintiffs became aware of the defendants true intent.\textsuperscript{72}

When the victim of a securities fraud is an American citizen and resident, courts may be more amenable to the exercise of transnational jurisdiction.\textsuperscript{73} Courts may, however, employ different or more stringent standards of inquiry when the victim resides abroad. The Second Circuit has attempted to address the question of what conduct or effects,

\begin{itemize}
\item 63. The mere reflection on the books of Continental’s American parent of the loss caused by this transaction was found to be too remote an effect to provide an adequate jurisdictional basis. \textit{Id.}
\item 64. 473 F.2d 515 (8th Cir. 1973).
\item 65. \textit{Id.} at 519.
\item 66. Of the 200,640 shares of Anthes common stock held by 100 shareholders of record in the United States, the plaintiffs owned nearly 80%. \textit{Id.}
\item 67. \textit{Id.}
\item 68. \textit{Id.} at 526. The court focused not on the quantity of the communications between the parties, but rather on the quality—whether the use of the mails and the telephones was instrumental in the misleading of the plaintiffs. \textit{Id.}
\item 69. \textit{Id.} at 519-20.
\item 70. \textit{Id.} at 524.
\item 71. \textit{Id.} at 526.
\item 72. \textit{Id.} at 527.
\item 73. \textit{See Note, American Adjudication of Transnational Securities Fraud}, 89 \textit{Harv. L. Rev.} 553, 557 (1976) [hereinafter cited as \textit{American Adjudication}].
\end{itemize}
within the United States, would result in a finding of subject matter jurisdiction. Bersch v. Drexel Firestone, Inc.,74 and its companion case, IIT v. Vencap, Ltd.,75 provided the court with the opportunity to clarify the extent to which § 10(b) could be applied to transnational securities fraud. In Bersch, a class action was brought on behalf of the purchasers of stock of Investors Overseas Services (IOS), a Canadian corporation.76 The actual public offering did not take place in the United States and was made pursuant to an allegedly misleading prospectus.77 The class consisted of three categories of plaintiffs; United States citizens, both resident citizens and those residing abroad, and foreign nationals. The prospectuses, which were prepared in the United States, were sent to potential investors, regardless of their domicile.78 The Court found that the preparatory acts committed in the United States were an insufficient basis for the grant of subject matter jurisdiction to the claims of the foreign plaintiffs,79 because they failed to make the required showing that the acts within the United States directly caused their losses.80 The court required a showing from the Americans residing abroad, that the acts committed within the United States were “of material importance.”81 A much higher showing of materiality is required for jurisdiction to be granted to these classes of


76. 519 F.2d at 977-78. IOS was an international investment enterprise managed by Bernard Cornfeld. IOS controlled offshore mutual funds, banks and several financial entities. See Bukovac, Subject Matter Jurisdiction in Transnational Securities Fraud, 9 N.Y.U. J. INT’L L. & POL. 113, 114 (1976).

77. The plaintiffs alleged that the underwriters and the accountants, Arthur Anderson & Company, knew or should have known of the misrepresentations contained in the prospectus regarding IOS’s financial condition. 519 F.2d at 985 n.24.

78. The prospectuses were mailed from foreign post offices to potential investors. Id. at 987. While the majority of the purchasers were not United States citizens, a certain number of shares were purchased, pursuant to the receipt of the prospectuses, by Americans residing both in the United States and abroad. Id. at 977-78. “The mailing of prospectuses into the United States was ‘assume[d]’ by the court of appeals.” American Adjudication, supra note 73, at 558 (quoting Bersch, 519 F.2d at 991).

79. 519 F.2d at 993. In contrast, the court found that the anti-fraud provisions of the federal securities laws applied to the losses of the American plaintiffs residing in the United States, “whether or not acts [or culpable failures to act] of material importance occurred in this country.” Id.

80. Id. The securities laws “[d]o not apply to losses from sales of securities to foreigners outside the United States unless acts [or culpable failures to act] within the United States directly caused such losses.” Id.

81. Id.
plaintiffs. The acts must not be merely preparatory. 82

Vencap was another case based upon the IOS collapse. The liquidators of IIT, a Luxembourg investment trust owned by IOS, sued Vencap, a Bahamian "venture capital firm" of which IIT was a preferred stockholder. 83 Vencap was formed by an American citizen, Richard Pistell, 84 and incorporated in the Bahamas, where the closing of IIT's investment took place. 85 During September 1972, a draft of a subscription agreement for three million dollars of Vencap stock to be purchased by IIT was prepared by Vencap's New York law firm, although the closing took place in the Bahamas. 86 After the investment was made, Pistell caused a large amount of the funds to be diverted to his own personal use and he maintained a New York office as a base from which mail was received and the transactional records were maintained. 87 Although there were some Americans involved, they constituted only 2% of the total investors and their total investment represented only .5% (of $15,000), because it had been intended that Vencap shares were not to be offered to American residents or citizens. 88 The court did not deem the existence of American investors significant enough to use this fact as the basis of subject matter jurisdiction. The court instead focused on the transactions; the conduct which took place within the United States after the closing. The diversion of the Vencap funds was viewed as the end-product of the entire fraud and "had such misuse of IIT's invested funds not occurred, there would have been no violation of Rule 10b-5's standards." 89

Although other courts have followed the Bersch-Vencap analysis, that to afford jurisdiction to the plaintiff's claim, domestic conduct must be the direct cause of losses, 90 the Third Circuit in SEC v. Kasser 91 focused instead on the quality of the activities in the United

82. 519 F.2d at 992. "While merely preparatory activities in the United States are not enough to trigger application of the securities laws for injury to foreigners located abroad, they are sufficient when the injury is to Americans so resident." Id.
83. 519 F.2d at 1003-07.
84. Id. at 1004. See also American Adjudication, supra note 73, at 560 n.76.
85. See American Adjudication, supra note 73, at 560.
86. Bukovac, supra note 76, at 122.
87. 519 F.2d at 1016-17.
88. Id. at 1018. See also American Adjudication, supra note 73, at 560-61.
89. American Adjudication, supra note 73, at 562.
90. See, e.g., FOF Proprietary Funds, Ltd. v. Arthur Young & Co., 400 F. Supp. 1219 (S.D.N.Y. 1975) (drafting of misleading stock circulars within the United States not a direct cause of fraud within the United States because the misleading information was communicated to defrauded purchaser in Canada). See also American Adjudication, supra note 73, at 562.
States. In the Third Circuit proceeding, the SEC brought an injunctive proceeding against Kasser, an American citizen, alleging that he had fraudulently induced the Manitoba Development Fund to enter into an investment contract with two corporations that he controlled. The Fund was to make loans to the defendant corporations in exchange for debentures upon certification that Kasser had invested equity capital in the two corporations because both the loans and equity proceeds were to be used for forest development. In reality, the purported equity investments were made, not with new capital, but rather with the loan proceeds received from The Fund, laundered through various sources.

Although the Third Circuit found that the fraudulent activities did not have effects in the United States, (the sole victim was a Canadian corporation), the court held that the conduct taking place in this country was not merely preparatory to the fraud committed abroad. This constituted a sufficient basis for subject matter jurisdiction. The court, in making its decision, took notice of activities such as negotiations, incorporation of one defendant corporation in the United States, maintenance of books and records and the use of the instrumentalities of interstate commerce (phones and mail). Viewed as a whole, the conduct was much more substantial than that in either Vencap or Bersch. That is the reason the conduct was not dismissed as merely preparatory and consequently inadequate to support jurisdiction.

The Kasser court frankly admitted that its finding of jurisdiction was largely a policy decision, but enumerated so-called "sound-rationales" for asserting jurisdiction. In essence, the court sought to frus-

92. The Manitoba Development Fund was a corporation wholly owned by the Province of Manitoba, Canada. The Fund's purpose was to attract private sources of capital to the development and financing of a forestry complex in Manitoba. 548 F.2d at 111.
93. The two corporations named as defendants were Churchill Forest Industries (a Canadian corporation with offices in Montclair, N.J.) and River Sawmills Company (a Delaware corporation with offices in the same N.J. location). Both were owned and controlled by Kasser. Id.
94. Id.
96. The money received in the loan payments was filtered through various bank accounts and corporations in the United States, Switzerland and Canada. Some of the 45 million dollars was eventually diverted by the defendants for their personal use. 548 F.2d at 111.
97. Id.
98. Id.
99. Id. at 115. See also Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 419 (8th Cir. 1979).
100. 548 F.2d at 116. See also Johnson, supra note 95, at 915.
trate any intent to use the United States as a base of operations for the defrauding of foreign securities purchasers and sellers.\textsuperscript{101} The court felt that denial of jurisdiction could facilitate the creation of a haven for defrauders, or as the court called it, a “Barbary Coast, as it were, harboring international securities pirates.”\textsuperscript{102} The court was also concerned about potential responses of other countries and hoped to encourage effective international antifraud enforcement.\textsuperscript{103} Finally, the court emphasized that the grant of jurisdiction was consistent with the congressional intent of the antifraud provisions of the securities acts designed “to insure high standards of conduct in securities transactions within this country.”\textsuperscript{104}

The policy oriented approach articulated in \textit{Kasser} also formed the basis for the grant of jurisdiction in \textit{Continental Grain}.\textsuperscript{105} Clearly there was no effect on either American interests or securities due to the alleged fraudulent omission. The court was not convinced by the plaintiffs’ argument that jurisdiction should be granted on the basis of the effects within the United States—the loss as reflected in the books of Continental’s parent company.\textsuperscript{106} This event was held to be too remote, based upon the Second Circuit’s holding in \textit{Bersch} that generalized adverse effects are insufficient to confer subject matter jurisdiction.\textsuperscript{107}

The physical closing of the sale of PacSeeds took place in Australia, as noted above.\textsuperscript{108} Yet, the essence of the allegation of fraud, the nondisclosure of the impending reclamation of the seed stock and non-renewal of the contract for its use, was conduct devised and completed in the United States. The telephone calls and letters from Claussen urging Northrup King officials to refrain from “spoiling the deal with Continental,”\textsuperscript{109} all involved the instrumentalities of interstate commerce. Given the task of actually assigning a situs to this fraud, the Eighth Circuit found that the scheme took place in the United States and was then “exported” to Australia.\textsuperscript{110}

After having considered the precedents going back to

\begin{itemize}
\item 101. 548 F.2d at 116.
\item 102. Id.
\item 103. Id.
\item 104. Id.
\item 105. \textit{See Johnson, supra} note 95, at 916-17.
\item 106. 592 F.2d at 417.
\item 107. 519 F.2d at 989.
\item 108. \textit{See supra} note 29 and accompanying text.
\item 109. The court noted that the use of letters and telephone calls was necessary not only for the furtherance of the scheme, but also for the actual organization and completion of the fraud. 592 F.2d at 420. \textit{See also Travis v. Anthes Imperial Ltd.}, 473 F.2d 515, 524 n.16 (8th Cir. 1973).
\item 110. 592 F.2d at 420.
\end{itemize}
Schoenbaum, and having determined that the effects test could not be satisfied, the Court turned to the "direct cause" requirement of Bersch and Vencap. The conduct in this case met the materiality requirement of Vencap because it was not merely preparatory, but directly caused the losses, as required in Bersch. The test actually employed, however, was closer to that applied by the Third Circuit in Kasser. The Continental court made particular note of its belief that Kasser extended the boundaries of domestic conduct required for the grant of jurisdiction set forth in Bersch and Vencap. The test employed in Kasser was that jurisdiction was proper if, "at least some activity designed to further a fraudulent scheme occurs within this country." The Continental court extended Kasser further, finding jurisdiction proper if, "defendant's conduct in the United States was in furtherance of a fraudulent scheme and was significant with respect to its accomplishment."

After going through a rather extensive review of earlier cases and the development of this standard, the court admitted that the finding of subject matter jurisdiction in this case was basically a policy decision. Although the court conceded that this was essentially a foreign transaction with domestic conduct limited largely to the use of the mails and telephones, it strongly argued that the finding of jurisdiction was nonetheless warranted. To support its decision, the court relied upon the Kasser court's finding that the "securities acts expressly apply to 'foreign commerce' thereby evincing a Congressional intent for a broad jurisdictional scope for the 1933 and 1934 Acts." Although the Eighth Circuit concluded that the global reach of securities laws requires either significant domestic impact or conduct, the general purpose of the laws is to mandate levels of conduct in securities transactions. This court apparently used flexible standards in determining whether certain conduct is sufficiently "significant" to warrant a grant of jurisdiction. It was so anxious to prevent the United States from becoming a base for fraudulent securities schemes, that it provided few guidelines as to how minimal the effects must be before the court will find no jurisdictional basis. Indeed, had Claussen simply maintained

111. See Johnson, supra note 95, at 917.
112. See Bukovac, supra note 76, at 123.
113. 592 F.2d at 418-19.
114. Id. at 415.
115. Id. at 421.
116. Id.
117. Id.
118. 548 F.2d at 114 (footnote omitted).
119. 592 F.2d at 409.
silence with regard to the reclamation and not written or spoken to the others, it appears that jurisdiction may still have been found.\textsuperscript{120}

As the \textit{Continental} court noted, "the presence or absence of any single factor which was considered significant in other cases dealing with the question of federal jurisdiction in transnational securities cases is not necessarily dispositive" in future cases.\textsuperscript{121} Because every subsequent case adds a perhaps unanticipated and unique variation, the total scope of Rule 10b-5 may ebb and flow with the circumstances of each case and the jurisdiction in which it arises. One of the more recent variations has been with regard to the application of Rule 10b-5 in derivative actions. \textit{IIT v. Cornfeld}\textsuperscript{122} involved the question "whether because of the complicity of management there could be fraud against IIT itself unless there was an independent deception of its fundholders by its foreign management, which, if proved, could only have taken place outside the United States."\textsuperscript{123} As in the earlier Second Circuit decision in \textit{Schoenbaum},\textsuperscript{124} "the issue of subject matter jurisdiction arose in a context in which the persons managing the defrauded entity were allegedly implicated in the fraud."\textsuperscript{125}

The plaintiff, IIT, was an international investment trust organized under the laws of Luxembourg and was controlled by its parent, IIT Management Co., S.A., a Luxembourg corporation. The latter corporation was controlled by its Canadian parent, Investors Overseas Services (IOS),\textsuperscript{126} which was run by Bernard Cornfeld until 1970 and then by Robert Vesco. The complaint, brought by the liquidators of IIT, was based upon three series of acquisitions by IIT of securities of corporations run by an American oil and gas entrepreneur, John M. King.\textsuperscript{127} The first was an acquisition of debentures of a wholly-owned subsidiary of King Resources Company. These debentures were convertible into the parent corporation's stock. Although purchased mostly in Europe, the debentures were also alleged to have been purchased in the United States through one of the defendants, Arthur Lipper Corporation.\textsuperscript{128} The second purchase was of the common stock of King Resources. This acquisition was also made through Lipper. The third acquisition was the purchase of a convertible note from the Colorado

\textsuperscript{120} See also Johnson, supra note 95, at 917.
\textsuperscript{121} 592 F.2d at 414.
\textsuperscript{122} 619 F.2d 909 (2d Cir. 1980).
\textsuperscript{123} Johnson, supra note 95, at 917-18.
\textsuperscript{124} Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968).
\textsuperscript{125} 619 F.2d at 913.
\textsuperscript{126} Id.
\textsuperscript{127} Id. at 914.
\textsuperscript{128} Johnson, supra note 95, at 918.
Corporation, a private company controlled by John King. The complaint alleged that these transactions took place as part of a scheme to defraud and raid IIT by both those in charge of IOS and by King. The complaint further alleged that the scheme was perpetuated by United States accounting and brokerage firms which aided and abetted the fraud by certifying false financial statements and underwriting securities offerings with the knowledge of the fraud.

The Second Circuit found subject matter jurisdiction proper in this case. Judge Friendly, writing for the court, stated that when directors are parties to the fraud, deception can be found "by viewing this fraud as though the independent stockholders were standing in the place of the defrauded corporate entity." Using this theory, Judge Friendly found the participation of several American defendants to be of more significance than had the district court. In the opinion, great emphasis was placed on the purchase of American securities by IIT, the Luxemborg trust. While "the American nationality of the issuer or the consummation of the transaction in the United States is [n]either a necessary [n]or a sufficient factor, . . . the presence of both these factors points strongly toward applying the anti-fraud provisions of our securities laws." There was no difficulty finding subject matter jurisdiction with regard to IIT's purchase of King Resources common stock and the Colorado Corporation. These transactions were consummated completely within the United States. Although purchased on European markets, subject matter jurisdiction was found over the action arising from the purchase of the debentures because the debentures were issued by an American corporation and the court viewed them as "American" securities.

The court was able to distinguish this case from Bersch v. Drexel Firestone, Inc. on the basis of the dominance of essentially foreign activity in Bersch and on the basis of the essentially American character of the transactions involved in Cornfeld. Moreover, in Cornfeld, the work occurred predominately within the United States, therefore, the district court's order dismissing the case for lack of subject matter jurisdiction was reversed.

129. Id.
130. Hacker & Rotunda, supra note 1, at 654.
131. 619 F.2d at 918 (citing Pappas v. Moss, 393 F.2d 865, 869 (3d Cir. 1968)).
132. 619 F.2d at 918.
133. Id.
135. 619 F.2d at 920-21. As the court noted, "[d]etermination whether American activities directly caused losses to foreigners depends not only on how much was done in the United States, but also on how much (or in this determination how little) was done abroad." Id.
jurisdiction was reversed.

*Continental Grain* and *IIT v. Cornfeld* viewed together indicate the contours of the application of Rule 10b-5, and to a certain extent, how broadly this rule can be extended. Although minor contacts will be overlooked, it would be hard to develop a clear rule as to how far a defendant will have to go to prevent being brought within the confines of American securities laws. Realistically, *Cornfeld* may be more easily understood because of the depth of the fraud itself as well as its effect on a great number of investors. The essence of all of these cases and of these last two cases in particular, however, is the desire on the part of American courts to prevent the United States from becoming a "Barbary Coast" harboring international securities pirates.\(^{136}\)

**CONCLUSION**

While the *Continental* court concedes that its decision is largely based on policy considerations, it recognizes that all other transnational securities decisions have been based on the same policy considerations. Yet when Congress decided to regulate the markets, the potential for transnational expansion was inherent. As securities markets and activities become more extensive and global in scope, so does the need for their regulation. As long as courts confine themselves to a rather stringent standard of domestic conduct and/or impact, there is a small chance that the application of American securities laws will infringe too much on international law. In the interests of fair markets and standards of conduct, it would appear to defeat the underlying purpose of Congress to limit "to strictly jurisdictional reasons," the determinations in these actions against "defendants who unleash from this country a pervasive scheme to defraud a foreign corporation."\(^{137}\)

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136. 548 F.2d at 116.
137. *Id.* at 114.