

# Northwestern Journal of International Law & Business

---

Volume 17

Issue 1 *Winter*

---

Fall 1996

## The Dangerous Extraterritoriality of American Securities Law

Stephen J. Choi

Andrew T. Guzman

Follow this and additional works at: <http://scholarlycommons.law.northwestern.edu/njilb>



Part of the [International Trade Commons](#)

---

### Recommended Citation

Stephen J. Choi, Andrew T. Guzman, The Dangerous Extraterritoriality of American Securities Law, 17 Nw. J. Int'l L. & Bus. 207 (1996-1997)

This Article is brought to you for free and open access by Northwestern University School of Law Scholarly Commons. It has been accepted for inclusion in Northwestern Journal of International Law & Business by an authorized administrator of Northwestern University School of Law Scholarly Commons.

# The Dangerous Extraterritoriality of American Securities Law

*Stephen J. Choi\**

*Andrew T. Guzman\*\**

## I. INTRODUCTION

The capital markets within the United States are among the largest in the world. Today, the combined volume of the New York Stock Exchange (NYSE), American Stock Exchange (AMEX) and Nasdaq market system reaches approximately \$4 trillion dollars annually.<sup>1</sup> With the size of the U.S. markets has come an understandable pride in the success of the American regulatory system.<sup>2</sup> Possessing one of the most complex and intricate of regimes, the regulatory system in the United States, as administered and monitored by the Securities and Exchange Commission (SEC), is often praised.<sup>3</sup> Not surprisingly, per-

---

\* Assistant Professor, University of Chicago Law School.

\*\* Clerk to the Honorable Juan Torruella, Chief Judge of the United States Court of Appeals for the First Circuit. J.D., Harvard Law School and Ph.D., Harvard Economics Department.

We would like to thank Lucian Bebchuk, Howell Jackson, Un Kyung Park and Jeannie G. Sears for their helpful comments and suggestions. All errors are, of course, our own. Financial support from the Russell Baker Scholars Fund, the Arnold & Frieda Shure Research Fund, and the John M. Olin Foundation is gratefully acknowledged.

<sup>1</sup> See Gerald S. Backman and Stephen E. Kim, *From Disclosure to Registration*, 5 BUS. L. TODAY 53, 54 (1996).

<sup>2</sup> See William E. Decker, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From the Issuer's Perspective*, 17 FORDHAM INTL. L.J. 10, 10 (1994) ("Our markets are very attractive; the capital is here."); see also Richard C. Breeden, *Foreign Companies and U.S. Securities Markets in a Time of Economic Transformation*, 17 FORDHAM INTL. L.J. 77, 85 (1994) ("[I]f you're scoring a touchdown every time your team gets its hands on the ball, is that the time to radically change the rules of the game?").

<sup>3</sup> See Breeden, *supra* note 2, at 82 ("From the ruins of the Crash of 1929 and the Great Depression we have managed to build arduously a system . . . of extraordinary confidence in the fundamental integrity of the U.S. market").

haps, the United States has frequently attempted to extend the reach of its regime. Through international negotiations, for example, the United States has successfully exported portions of its insider trading prohibitions – at least formally – to Japan and Switzerland in recent years.<sup>4</sup> More directly, the United States often applies its own domestic laws extraterritorially to transactions in other countries, justifying its actions as necessary to protect American investors and the integrity of U.S. capital markets.

This Article calls into question the desirability of applying American securities laws extraterritorially. Certainly the goals of protecting investors and ensuring capital market integrity are laudable. However, the use of extraterritoriality to accomplish these goals is both unnecessary and ineffective. Extraterritoriality results in frequent conflicts between the United States and other nations. Furthermore, the application of extraterritoriality limits the ability of investors and issuers to select the securities regime of their own choosing. As a result, countries applying extraterritorial rules are insulated from competitive pressures to tailor rules toward the joint interests of investors and issuers. Rather, countries so insulated may craft regulatory regimes that satisfy the interests of either government bureaucrats or special interest groups.<sup>5</sup>

This Article argues that investors and American capital markets are served best through clear jurisdictional rules that strictly limit the application of U.S. laws and provide unambiguous means for both investors and issuers to opt-out of the domestic regulatory system. Regulation S of the Securities Act of 1933 (the “Securities Act”), which governs exemptions for overseas transactions from Section 5 of the Securities Act’s registration requirements, accomplishes this goal in part. The application of the antifraud rules, however, remains extraterritorial in nature. The Article proceeds as follows. Part II sets forth the extraterritorial elements in the current securities regulatory regime. Part III analyzes and critiques the conventional justifications for extraterritoriality, arguing that in fact most of these justifications support greater investor and issuer mobility. Part III discusses the proper role for extraterritoriality and offers some alternatives to extraterritoriality. The Article then concludes in Part IV.

---

<sup>4</sup> See generally B. Rider, D. Chaikin & C. Abrams, *Guide to the Financial Services Act* 704-718 (1986); see also Patrick F. Wallace, *Who is Subject to the Prohibition Against Insider Trading: A Comparative Study of American, British and French Law*, 15 Sw. U.L. REV. 217 (1985).

<sup>5</sup> See Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909, 914 (1994) (describing the incentive of agencies to engage in overregulation).

## II. EXTRATERRITORIALITY AND SECURITIES REGULATION

Transactions which may raise extraterritorial concerns from the perspective of the U.S. securities regime occur in a number of different contexts. This Article focuses on two of the more important areas: (A) the issuance of securities and (B) the application of antifraud rules.<sup>6</sup>

### A. The Reach of the Securities Act

Section 5 forms the lynch-pin of the Securities Act, covering all offers and sales of securities. Under Section 5, an issuer must file a registration statement containing numerous information disclosure items relating to the issuer and the securities transaction and must distribute a prospectus, under certain circumstances,<sup>7</sup> containing a portion of this information to investors before sales are allowed.<sup>8</sup> Most non-issuer sales of securities, however, are exempt from Section 5 under Section 4(1) of the Securities Act.<sup>9</sup> As a result, the primary impact of the Securities Act is to regulate the sale of securities by issuers,<sup>10</sup> for whom the Securities Act has a broad reach. By its terms, Section 5 covers all offers and sales of securities that makes use of "any means or instruments of transportation or communication in interstate commerce."<sup>11</sup> The definition of interstate commerce, provided in Section 2(7) of the Securities Act,<sup>12</sup> includes transportation or communication "between any foreign country and any State, Territory, or the District of Columbia."<sup>13</sup> Taken literally, this provision extends U.S. jurisdiction over all offerings, anywhere in the world, that have some connection with the United States, no matter how remote.

---

<sup>6</sup> Rule 15a-6 of the Securities Exchange Act of 1934 (the "Exchange Act") covers the extension of broker-dealer registration requirements to foreign brokers and dealers. 17 C.F.R. 240.15a-6 (1994). The extraterritoriality of Rule 15a-6's application is beyond the scope of this Article.

<sup>7</sup> For example, under the Securities Act, a section 10(a) prospectus must accompany or precede any additional written materials sent to potential investors after the effective date of the registration statement. *See* 15 U.S.C. § 77(b)(1) (1994).

<sup>8</sup> *See* 15 U.S.C. § 77e (1994). Section 5 contains numerous other requirements relating to the registration process and the delivery of the prospectus to investors.

<sup>9</sup> Section 4(1) exempts all "transactions by any person other than an issuer, underwriter, or dealer" from the registration requirements of Section 5. *See* Section 4(1), Securities Act.

<sup>10</sup> Because anyone selling for a control person is considered an underwriter under Section 2(11) of the Securities Act, control persons generally are prohibited from using Section 4(1)'s exemption from Section 5. *See* Section 2(11), Securities Act. As a result, control persons must find some other exemption to Section 5 or else have their securities registered by the issuer.

<sup>11</sup> 15 U.S.C. § 77e (1994).

<sup>12</sup> 15 U.S.C. § 77b(7) (1994).

<sup>13</sup> *Id.*

For example, transactions that make use of telephone calls into the United States either in the course of selling the securities or in preparation for the sale may fall under Section 5's jurisdiction.

Despite the expansive coverage the Securities Act takes on its face, the SEC has not sought to push the jurisdictional limits of Section 5, choosing instead to adopt a more restrained approach through Regulation S.<sup>14</sup> Enacted after a period of confusion and uncertainty that ran from 1964 to 1990,<sup>15</sup> Regulation S provides guidance on which securities transactions conducted outside the United States may come under the reach of Section 5. Rules 901 through 904 of the Securities Act form the body of Regulation S and take a primarily territorial approach to jurisdiction. Issues made "outside" the United States are exempt under Rule 901 from the registration requirements of Section 5.<sup>16</sup> In particular, Regulation S establishes two safe harbors from Section 5: one for issuers<sup>17</sup> under Rule 903 and one for resales under Rule 904.<sup>18</sup> An offer or sale that satisfies either Rule 903 or 904 is deemed to occur "outside" the United States for the purposes of Rule 901 and is, therefore, exempt from Section 5.<sup>19</sup>

For any section in Regulation S to apply, parties must meet two basic requirements. We briefly outline these basic requirements be-

---

<sup>14</sup> See Regulation S Rules 901-904, 17 C.F.R. 230.901-904 (1994).

<sup>15</sup> This confusion was caused by Securities Act Release No. 4708 (Release 4708) which attempted to limit the reach of United States law by exempting from the registration requirements of Section 5 offerings that were sold in a manner reasonably designed to preclude distribution or redistribution in the United States or to nationals of the United States. Registration of Foreign Offerings by Domestic Issuers, Securities Act Release No. 33,4708, Fed. Sec. L. Rep. (CCH) ¶ 1361 (July 9, 1964). In the wake of Release 4708 came a large number of SEC no-action letters which failed to give shape to the policy. "[M]ost companies were compelled to seek an individualized determination of the Commission's staff that their particular offerings would not be deemed to occur in the United States." Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927, 939 (1994). One of the consequences of the law prior to Regulation S was that U.S. investors found it difficult to invest in issues made by foreign issuers (which were not discussed in Release 4708, and whose status was uncertain). These foreign issuers feared that the presence of a U.S. investor would trigger a registration requirement in the United States. *Id.* at 941.

<sup>16</sup> Regulation S Rules, 17 C.F.R. 230.901 (1994).

<sup>17</sup> Regulation S Rules, 17 C.F.R. 230.903 (1994).

<sup>18</sup> Regulation S Rules, 17 C.F.R. 230.904 (1994).

<sup>19</sup> Foreign issuers, in particular, care about escaping the financial information disclosure items of Section 5's registration statement that relate to accounting disclosures pursuant to the Generally Accepted Accounting Principles (GAAP). See, e.g., Nicholas G. Demmo, U.S. Securities Regulation: The Need for Modification to Keep Pace with Globalization, 17 U. PA. J. INT'L ECON. L. 691, 693 (1996).

low. We then discuss the specific requirements of the issuer safe harbor under Rule 903.<sup>20</sup>

### *1. General Requirements of Regulations*

The application of Regulation S turns on whether a transaction is deemed to occur outside the United States.<sup>21</sup> Regulation S has two basic requirements which ensure that exempted transactions take place territorially outside the United States. First, a transaction is deemed to occur outside the United States only if “an offer or sale is made in an offshore transaction.”<sup>22</sup> Under Rule 902(i) of the Securities Act, in order for an offer or sale of securities to be an offshore transaction, (i) the offer must not be made to a person in the United States<sup>23</sup> and (ii) either (a) the buyer must be outside the United States (or the seller must reasonably believe that the buyer is outside the United States) at the time of sale or (b) the transaction, for the purposes of Rule 903, must be “executed in, on or through a physical trading floor of an established foreign securities exchange that is located outside the United States” and the seller must not have reason to believe that the transaction has been prearranged with a buyer in the United States.<sup>24</sup>

In pure geographic terms, the offshore transaction requirement works to ensure that the core of the transaction – the actual offer and sale of securities – occurs outside the physical borders of the United States. The first basic requirement of Regulation S, therefore, embodies the territorial basis of the exemption. Sales occurring within the United States, for example, may not take advantage of Regulation S and, in the absence of some other exemption, come squarely within the grasp of Section 5.

Not all offers and sales which occur physically outside the United States are exempt under Regulation S, however. The second basic re-

---

<sup>20</sup> For more detailed discussion of the details of Regulation S, see Guy P. Lander, *Regulation S — Securities Offerings Outside the United States*, 21 N.C. J. INT'L L. & COM. REG. 339, 341 (1996); Testy, *supra* note 15; Marc I. Steinberg & Daryl L. Lansdale, Jr., *Regulation S and Rule 144A: Creating a Workable Fiction on an Expanding Global Securities Market*, 29 INT'L LAW. 43 (1995); Samuel Wolff, *Recent Developments in International Securities Regulation*, 23 DENV. J. INT'L L. & POL'Y 347 (1995).

<sup>21</sup> See Regulation S Rules, 17 C.F.R. 230.901 (1994).

<sup>22</sup> Regulation S Rules, 17 C.F.R. 230.903(a) (1994); 17 C.F.R. 230.904(a) (1994).

<sup>23</sup> Regulation S Rules, 17 C.F.R. 230.902(i)(1)(i) (1994).

<sup>24</sup> Regulation S Rules, 17 C.F.R. 230.902(i)(1)(ii) (1994). Rule 902(a) defines “designated offshore securities market” to include the Eurobond market, the Tokyo Stock Exchange, and the Toronto Stock Exchange among other markets. See Regulation S Rules, 17 C.F.R. 230.902(a) (1994).

quirement of Regulation S requires that sellers cannot make any "directed selling efforts" within the United States.<sup>25</sup> "Directed selling efforts" is defined in Rule 902(b) as "any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the securities being offered. . . ."<sup>26</sup> Although the offer and sale portion of a transaction may take place outside the territorial borders of the United States, other preliminary steps may actually occur within its borders. The ban on directed selling attempts to limit such preliminary steps. Out of a fear that such selling efforts may adversely impact non-related transactions within the United States, only those extraterritorial transactions with a minimal effect on the U.S. capital markets are exempted from the second basic requirement. The definition of "directed selling efforts" in Rule 902(b), for example, excludes certain tombstone advertisements as well as placements in an advertisement required to be published under U.S. or foreign law.<sup>27</sup>

## 2. *Requirements of Rule 903 (the Issuer Safe Harbor)*

Rule 903 sets out the core of Regulation S: the issuer safe harbor.<sup>28</sup> In addition to the two basic requirements described above, Rule 903 requires that issuers satisfy certain conditions based on the nature of the issuer and the securities involved in the transaction. Three categories of transactions are contemplated, based on the likelihood that the securities from an issue will flow back into the United States and on the level of reporting to which the issuer is subject in the United States.

The first category is outlined in Rule 903(c)(1) and represents those securities with the least likelihood of flowback into the United States.<sup>29</sup> Both domestic and foreign issuers may take advantage of this category to the extent the two basic requirements are also met. Foreign issuers that reasonably believe no "substantial U.S. market interest"<sup>30</sup> exists at the start of the offering for the class of securities to

---

<sup>25</sup> Regulation S Rules, 17 C.F.R. 230.903(b) (1994); 17 C.F.R. 230.904(b) (1994).

<sup>26</sup> Regulation S Rules, 17 C.F.R. 230.902(b) (1994).

<sup>27</sup> See Regulation S Rules, 17 C.F.R. 230.902(b) (1994).

<sup>28</sup> This safe harbor applies to "the issuer, a distributor, any of their respective affiliates, or any person acting on [their] behalf. . . ." 17 C.F.R. §230.903 (1994). For convenience we will use the term issuer to refer to these parties collectively.

<sup>29</sup> The category also includes securities backed by the full faith and credit of a foreign government, and employee benefit plan securities, which we will not discuss here. 17 C.F.R. §230.903(c)(i) (1994).

<sup>30</sup> The definition of this term is given by Rule 902(n). With respect to equity securities, there is a substantial United States interest if U.S. exchanges constituted the largest market for such

be offered or sold may qualify under Rule 903(c)(1) for treatment as outside the United States.<sup>31</sup> Because these issues are undertaken by foreign issuers and purchased primarily by foreign investors, the risk of a flowback into the United States is considered small.

Likewise, both foreign and domestic issuers that engage in "overseas directed offerings" can benefit from the safe harbor of Rule 903(c)(1). The term "overseas directed offering" is defined in Rule 902(j) as (1) "an offering . . . of a foreign issuer that is directed into a single country other than the United States to the residents thereof" and that complies with the laws of that country; or (2) "an offering of non-convertible debt securities . . . of a domestic issuer that is directed into a single country other than the United States to the residents thereof" that complies with local law and that is not denominated in U.S. dollars and whose securities are "neither convertible into U.S. dollar-denominated securities nor linked to U.S. dollars . . . ."<sup>32</sup> Because the risk of securities sold within one targeted foreign country flowing back to the United States is assumed to be low, such transactions are accorded an exemption from Section 5. Furthermore, to the extent the issue is primarily within the borders of one country, the potential conflict between U.S. regulations and the foreign country's own regulations would otherwise be at its greatest.

The second category of issuers exempt through Rule 903 are those classified under Rule 903(c)(2). Under Rule 903(c)(2), so long as the two basic requirements of Regulation S are fulfilled, all Exchange Act reporting companies that undertake specified transactional and offering restrictions are considered engaged in a transaction outside the United States and therefore eligible for Rule 901's safe harbor. The transactional restrictions of Rule 903(c)(2), in turn, state that no offer or sale may be made to a U.S. person or for the account or benefit of a U.S. person during a 40 day restricted period.<sup>33</sup> Furthermore, prior to the expiration of the 40 day restricted period, each distributor of the securities must send a confirmation notice with all securities sold to another distributor or dealer stating that the pur-

---

securities in question or if at least 20% of all trading in the class of securities took place in U.S. exchanges and inter-dealer quotation systems and less than 55% took place through the facilities of any one foreign securities market. 17 C.F.R. §230.902(n)(1) (1994). With respect to debt securities, a substantial market exists if U.S. persons hold a sufficiently large quantity of the debt securities and if 20% or more of the debt outstanding is held in the United States. 17 C.F.R. §230.902(n)(2) (1994).

<sup>31</sup> 17 C.F.R. §230.903(c)(i)(A-D) (1994).

<sup>32</sup> 17 C.F.R. §230.902(j) (1994).

<sup>33</sup> See 17 C.F.R. §230.903(c)(2)(iii) (1994).



chaser is subject to the same restrictions on offers and sales that apply to a distributor.<sup>34</sup> Section 903(c)(2)'s offering restrictions, in turn, require that each distributor agree in writing that all offers and sales of the securities prior to the expiration of the restricted period will be made only in accordance with the provisions of Rule 903 or Rule 904, under Section 5 registration or pursuant to another exemption from Section 5.<sup>35</sup> The offering restrictions also require that all offering materials and documents (except press releases) contain legends detailing the securities' restricted status.<sup>36</sup> Non-Exchange Act reporting foreign companies making sales of non-convertible debt securities and meeting the same restrictions may similarly make use of Rule 903(c)(2).

The third and final category of issuers relevant to Rule 903 includes all issuers that do not belong to either of the other two categories. This category includes non-Exchange Act reporting foreign companies issuing equity securities and all non-Exchange Act reporting domestic issuers. Securities in this category have the greatest chance of flowback into the United States with no concomitant source of information on the securities within the United States. As a result, pursuant to Rule 903(c)(3), such issuers can take advantage of the Rule 901 safe harbor only if they comply with the two basic requirements,<sup>37</sup> the same offering restrictions as in Rule 903(c)(2) and additional transactional restrictions more severe than those in Rule 903(c)(2).<sup>38</sup> The transactional restrictions of Rule 903(c)(3), for example, include, among others, a requirement that the purchaser agrees to resell the securities only in accordance with Regulation S<sup>39</sup> or in compliance with registration requirements or another available exemption from registration. The SEC justifies the greater transactional restrictions within Rule 903(c)(3) as necessary "to protect against an unregistered U.S. distributor when there is little, if any, information

---

<sup>34</sup> 17 C.F.R. §230.903(2)(iv) (1994). The definition of a restricted period is given in Rule 902(m). The period starts on the later of the day the securities were first offered to persons other than distributors or the date of closing of the offering.

<sup>35</sup> See 17 C.F.R. §230.903(c)(2)(ii) (1994); *see also* 17 C.F.R. §230.902(h)(1) (1994).

<sup>36</sup> See 17 C.F.R. §230.902(h)(2) (1994).

<sup>37</sup> See 17 C.F.R. §230.903(c)(3)(i) (1994).

<sup>38</sup> More specifically, equity is subject to a one year restricted period and debt is subject to a 40 day restricted period. See 17 C.F.R. §230.903(c)(3)(ii)(A), (iii)(A) (1994).

<sup>39</sup> See 17 C.F.R. §230.903(c)(3)(iii)(B)(2) (1994).

available to the marketplace about the issuer and its securities and there is a significant likelihood of flowback.”<sup>40</sup>

## B. The Reach of the Antifraud Rules

Although not completely territorial-based, Regulation S does grant issuers of securities into foreign markets some measure of protection from the Securities Act’s registration requirements. With this exemption also comes relief from the transaction-specific antifraud rules that apply to the public offering documents. Section 11,<sup>41</sup> which applies only to the registration statement, does not apply to transactions exempt under Regulation S. Similarly, Section 12(a)(2),<sup>42</sup> which covers only prospectuses pursuant to a public offering under Section 5, also lacks force.

At least one antifraud provision, however, continues to apply. Rule 10b-5, under Section 10(b) of the Exchange Act, covers all transactions “in connection with the purchase or sale of any security.”<sup>43</sup> Although other exempt transactions from Section 5, including intrastate offerings and private placements, avoid Section 11 and Section 12(a)(2) liability, they remain subject to Rule 10b-5. The question remains, therefore, how far does the reach of Rule 10b-5 extend to cover exempt overseas transactions.

As is the case with the Securities Act’s registration requirements under Section 5, the Exchange Act restricts the reach of Section 10(b) and Rule 10b-5 only through its requirement that there be some use of interstate commerce.<sup>44</sup> The exact extent of this reach, however, is ambiguous. Section 10(b) of the Exchange Act only makes it unlawful to employ “any manipulative or deceptive device or contrivance . . . by the use of any means or instrumentality of interstate commerce or of the mails” in “the purchase or sale of any security . . . .”<sup>45</sup> Section 3(a)(17) of the Exchange Act, in turn, defines interstate commerce as “trade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place or ship outside thereof.”<sup>46</sup> Unlike Regulation

---

<sup>40</sup> Lander, *supra* note 20, at 369 (citing Offshore Offers and Sales, Exchange Act Release No. 6863 [1989 – 1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,670, at 80675 (May 2, 1990)).

<sup>41</sup> See 15 U.S.C. §77k (1994).

<sup>42</sup> See 15 U.S.C. §77l(a)(2) (1994).

<sup>43</sup> See 17 C.F.R. §240.10b-5 (1994).

<sup>44</sup> *Id.*

<sup>45</sup> 15 U.S.C. § 78j(b) (1994).

<sup>46</sup> See 15 U.S.C. §78c(a)(17) (1994).

S, however, the SEC has not clarified the reach of Rule 10b-5 outside the United States. Instead, the reach of Section 10(b) has been left to the courts, which have grappled with the issue of extraterritoriality on a case-by-case basis.<sup>47</sup>

Today, therefore the question remains unanswered: To what extent can American laws govern activity that takes place outside its borders? Courts have applied two primary tests to answer this question: the conduct test and the effects test. Each are described below.<sup>48</sup>

### 1. *The Conduct Test (Territoriality)*

Under the conduct test, a primarily territorial-based rule, jurisdiction is conferred on events based on their location. In the case of securities, therefore, the issuer and investor can avoid the jurisdiction of a country simply by moving their transaction abroad. The rule of territoriality is the simplest of the possible jurisdictional rules because it partitions the world neatly into mutually exclusive legal regimes. Every country legislates with respect to its own geographic territory and imposes its own rules.

The general principle of territoriality was bluntly expressed by the Supreme Court in *American Banana Co. v. United Fruit Co.*,<sup>49</sup> a case in which an American plaintiff sought damages in an antitrust claim against an American defendant for actions alleged to have occurred in Costa Rica.<sup>50</sup> For the Court, Justice Holmes held that American courts lacked jurisdiction over the dispute, stating that "the character of an act as lawful or unlawful must be determined wholly by the law of the country in which the act is done."<sup>51</sup> This rule is known as the "conduct test" because jurisdiction is exercised based on the location of the parties' conduct.

One difficulty with the conduct test is defining what actions count as "conduct" for purposes of determining territoriality. In a securities transaction, for example, many actions may lead up to the ultimate transaction; telephone calls may cross jurisdictional boundaries, attorneys may conduct cross-border investigations and funds may flow in-

---

<sup>47</sup> See 15 U.S.C. § 78dd(b) (1994).

<sup>48</sup> Additionally, the Restatement Third of Foreign Relations Law of the United States provides guidance on extraterritoriality. See RESTATEMENT (Third) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §416 (1987); see also Gary A. Born, *A Reappraisal of the Extraterritorial Reach of U.S. Law*, 24 LAW & POL'Y INT'L BUS. 1, 37 (1992) (analyzing the Third Restatement).

<sup>49</sup> *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1909).

<sup>50</sup> *Id.* at 354-55.

<sup>51</sup> *Id.* at 356.

ternationally. A workable conduct test, therefore, must specify the amount and type of conduct that is necessary in order to trigger jurisdiction. U.S. circuit courts are split on exactly how much conduct is necessary. The Second Circuit established a very restrictive requirement in *Bersch v. Drexel Firestone, Inc.*<sup>52</sup> In *Bersch*, Judge Friendly held that the antifraud provisions of the securities laws:

- (1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country;
- (2) Apply to losses from sales of securities to American residents abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but
- (3) Do 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.<sup>53</sup>

Thus, “merely preparatory” acts are insufficient to trigger jurisdiction when the injury is to foreigners located abroad, but may be sufficient when the injury is to resident Americans.<sup>54</sup> The Second Circuit test in *Bersch* was later adopted by the D.C. Circuit in *Zoelsch v. Arthur Anderson*.<sup>55</sup> Other circuits, including the Third, Eighth and Ninth, however, have adopted a broader standard for the assertion of jurisdiction.<sup>56</sup> They have held that jurisdiction exists “where at least some activity designed to further a fraudulent scheme occurs within this country.”<sup>57</sup> Under this broader form of the conduct test, therefore, even preparatory acts such as making initial phone calls and soliciting potential foreign investors in the United States may trigger jurisdiction.

---

<sup>52</sup> *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975).

<sup>53</sup> *Id.* at 993.

<sup>54</sup> *Id.* at 992. See also *IIT v. Cornfeld*, 619 F.2d 909, 920-921 (2d Cir. 1980) (clarifying the distinction between acts that are merely preparatory and those that directly cause injury).

<sup>55</sup> *Zoelsch v. Arthur Anderson*, 824 F.2d 27, 33-34 (D.C. Cir. 1987) (interpreting the Second Circuit’s test to mean that jurisdiction will lie in American courts where the domestic conduct satisfies the requisite elements for liability under Section 10 or Rule 10b-5).

<sup>56</sup> See *SEC v. Kasser*, 548 F.2d 109, 114 (3d Cir. 1977) (granting jurisdiction “where at least some activity designed to further a fraudulent scheme occurs within this country”), *cert. denied*, 431 U.S. 938 (1977); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 420 (8th Cir. 1979) (granting jurisdiction where defendants’ conduct “furthered the fraudulent scheme” and was “significant with respect to the alleged violation”); *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 424-25 (9th Cir. 1983) (adopting the Eighth Circuit’s test in *Continental Grain*). For more detail on the conduct test in the context of securities regulation, see Testy, *supra* note 15, at 934-35.

<sup>57</sup> *Kasser*, 548 F.2d at 114.

Problems exist with the implementation of either form of conduct test, however. Where significant conduct occurs in more than one jurisdiction, conflict may exist between jurisdictions applying a conduct-based rule. Two countries, for example, may both have enough activity within their borders to trigger conduct-based jurisdiction under the *Zoelsch* rule. This is particularly true for transactions involving securities, an essentially intangible product. Offers and sales of securities may occur simultaneously across the borders of two countries; a seller located in the United States, for example, may telephone buyers located in Sweden to complete a sales transaction. Furthermore, the conduct-test provides little guidance in determining which acts are central to the transaction and which are merely preparatory.

## 2. *The Effects Test (Extraterritoriality)*

Many countries, including the United States, do not apply a true version of territoriality in the application of their antifraud rules. Jurisdiction for antifraud rules is often aggressively asserted.<sup>58</sup> Within the United States, the seminal case dealing with antifraud securities regulation is *Schoenbaum v. Firstbrook*.<sup>59</sup> In that case, an American plaintiff and shareholder of Banff Oil Ltd., a Canadian corporation, alleged a violation of Section 10(b) of the Exchange Act, claiming that the company's controlling shareholders had arranged to purchase shares from the corporation for a price below fair market value.<sup>60</sup> Despite the fact that the transaction took place entirely within Canada, the Second Circuit held that

the district court has subject matter jurisdiction over violations of the Securities Exchange Act although the transactions which are alleged to violate the Act take place outside the United States, at least when the transactions involve stocks registered and listed on a national securities exchange, and are detrimental to the interests of American investors. . .<sup>61</sup>

The *Schoenbaum* court argued that the sale of undervalued stock in Canada would unduly depress stock listed on the American Exchange,

---

<sup>58</sup> See, e.g., John C. Maguire, *Regulatory Conflicts: International Tender and Exchange Offers in the 1990s*, 19 PEPP. L. REV. 939, 949 (1992); Offshore Offers and Sales, Securities Act Release No. 33,6779 [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,242, at 89,128-30 (June 10, 1988).

<sup>59</sup> *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969).

<sup>60</sup> Specifically, the plaintiff alleged that the insiders had purchased the shares based on information not yet disclosed to the public.

<sup>61</sup> *Schoenbaum*, 405 F.2d at 208.

thereby generating enough effect on the U.S. market to justify U.S. jurisdiction.<sup>62</sup>

*Schoenbaum*, therefore, applied jurisdiction, not based on any conduct which occurred within the United States, but rather based on the effect of the transaction on the American capital markets. Note, however, that though *Schoenbaum* is cited as an example of the effects test, the court did not state that an effect on American investors alone was a sufficient basis for jurisdiction. Rather, the court suggested that a listing on a U.S. exchange is an important element in generating enough of an effect on the U.S. capital markets to justify jurisdiction. Nevertheless, the principle of *Schoenbaum's* effects test has been followed in several other cases.<sup>63</sup>

### III. THE NECESSITY OF EXTRATERRITORIALITY

Despite the current extraterritorial reach of Regulation S and the various extraterritorial tests that have been applied to extend the reach of Rule 10b-5 internationally, it remains unclear why U.S. laws should apply to transactions occurring mostly in other countries. This section (1) analyzes the goals of securities regulation conventionally used to justify extraterritoriality; (2) outlines a more appropriate role for extraterritoriality; (3) presents alternatives to the American extraterritoriality regime; and finally, (4) discusses the multiple listing problem.

#### A. The Goals of Extraterritoriality

The purposes of extraterritorial application of disclosure requirements and antifraud liability are rarely stated clearly. This may be because, as this paper argues, the justification for such practices is not entirely satisfactory. Nevertheless, this section will attempt to review the reasons behind extraterritoriality.

##### 1. *Conventional Goals*

Several conventional goals are commonly put forth in defense of extraterritoriality. The most common justification for the application

---

<sup>62</sup> *Id.* at 208-209.

<sup>63</sup> See, e.g., *SEC v. Unifund SAL*, 910 F.2d 1028, 1033 (2d Cir. 1990) (stating that trading, "on the basis of inside information, options of a United States corporation listed exclusively on a United States stock exchange . . . create[s] the near certainty that United States shareholders . . . [will] be adversely affected . . ."); *Des Brisay v. The Goldfield Corp.*, 549 F.2d 133, 136 (9th Cir. 1977) ("[T]he transaction in question . . . involved the improper use of securities . . . listed on a national exchange and adversely affected not only the plaintiffs but the American market . . .").

of U.S. laws to transactions that take place abroad is the protection of American investors. For example, in Regulation S's predecessor, Securities Act Release No. 33-4708,<sup>64</sup> the SEC stated:

[T]he Commission has traditionally taken the position that the registration requirements of Section 5 of the Act are primarily intended to protect American investors. Accordingly, the Commission has not taken any action for failure to register securities of United States corporations distributed abroad to foreign nationals . . . . [I]t is immaterial whether the offering originates from within or outside the United States, whether domestic or foreign broker-dealers are involved and whether the actual mechanics of the distribution are effected within the United States, so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States.<sup>65</sup>

Regulatory protection of investors, however, may not always advance investor welfare. Certainly, other areas of the U.S. securities regime recognize that at least some investors are able to negotiate for information and make informed investment decisions without such protections.<sup>66</sup> For instance, Regulation D allows issuers to make private placements to certain sophisticated, accredited investors without any mandatory information disclosure.<sup>67</sup> Allowing investors able to fend for themselves to select the amount of regulatory protection they desire through investments in other jurisdictions may, in fact, increase social welfare. To the extent that extra regulatory protections are costly to issuers and not valued by sophisticated investors, global capital market efficiency is increased by allowing such issuers and investors to bypass these regulatory protections through their selection of an alternate securities regime.

Moreover, American investors are sufficiently well-protected if they understand that they are purchasing securities under a legal regime that differs from that of the United States. With this knowledge, investors can decide whether the risks are worth taking and how much they are willing to pay for a particular security. Investors in securities

---

<sup>64</sup> See Testy, *supra* note 15.

<sup>65</sup> Registration of Foreign Offerings by Domestic Issuers, Securities Act Release No. 33,4708, Fed. Sec. L. Rep. (CCH) ¶ 1361, at 2124 (July 9, 1964).

<sup>66</sup> Note that some argue that companies will voluntarily release information to alleviate the problem of asymmetric information. Otherwise, investors may choose not to purchase the securities or else discount the price heavily for the risk of purchasing a lemon. See Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 673-74 (1984). But see John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 722 (1984) (arguing that the incentive of managers to profit from insider-trading, among other reasons, may result in less than optimal company voluntary disclosure).

<sup>67</sup> See Rules 501-508, Regulation D, Securities Act of 1933, 17 C.F.R. §230.501-508 (1994).

markets world-wide price securities based on the information available and the regulatory structure in place. Investors as a group (i.e., the market) are able to assess the value of the securities they are receiving and adjust the price they will pay such that they receive a normal return, on average, adjusted for non-diversifiable risk. Americans entering foreign markets can therefore purchase securities under the rules in place in that market and can expect the same returns and risks that other participants in the market expect. Investors who prefer to purchase only those issues that are subject to the American regulatory system can, of course, choose to invest accordingly. It may be costly for the investor to retain American regulatory protections to the extent that issuers who do not wish to shoulder the expense of compliance with American disclosure laws exclude investors from issues that offer an attractive risk-return profile.

Finally, in order to protect all American investors, the United States may need to extend its regulatory protection to the rest of the world. Today, U.S. investors use international means of communication to purchase securities around the globe. An investor located in Aurora, Illinois, for example, may use her computer to track securities prices in London and to purchase or sell such securities – through her broker – in real-time on the London Stock Exchange. The United States, however, lacks both the informational resources and international influence to force all other countries to comply with its vision of securities regulation. Practically, without the acquiescence of other countries, the United States faces an absolute limit on how far it may extend its jurisdiction.

In recognition of these limits, the SEC promulgated Regulation S to govern exemptions for overseas transactions from Section 5's registration requirements. As outlined in Part II, Regulation S marked a change in emphasis by the SEC from the protection of American investors, wherever they may be located, to the protection of American capital markets.<sup>68</sup> In the words of the SEC, "[a]s investors choose their markets, they choose the laws and regulations applicable in such markets."<sup>69</sup>

The protection of American markets, as opposed to individual investors, is consistent with the apparent objectives of the Exchange

---

<sup>68</sup> See Arbie R. Thalacker, *Reproposed Regulation S*, 683 PLI/CORP. 799, 805 (1990); Marc I. Steinberg & Daryl L. Lansdale, Jr., *Regulation S and Rule 144A: Creating a Workable Fiction on an Expanding Global Securities Market*, 29 INT'L LAW. 43, 47 (1995).

<sup>69</sup> Offshore Offers and Sales, Securities Act Release No. 33,6863, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,524, at 80,665 (April 24, 1990).



Act. Section 2 of the Exchange Act states that one of its goals is to "insure the maintenance of fair and honest markets . . . ." <sup>70</sup> A similar view is expressed by Judge Lumbard in *Schoenbaum v. Firstbrook*, who seemed to accept both justifications for extraterritoriality, stating that:

Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities. <sup>71</sup>

Careful analysis, however, demonstrates that foreign transactions do not generally represent a significant threat to American capital markets. To see why this is so, it is important to keep in mind that the securities regime governing a transaction of a security impacts the security's price. Thus, a security may be worth more under one regime than it is under another regime, assuming that arbitrage is not possible. <sup>72</sup> Suppose, for example, that an American investor purchases a security governed by the law of a foreign country. Suppose further that the law of that country allows transactions to take place in a manner that would be considered fraudulent under American law. Obviously, the investor will pay less, all else equal, for that security in the foreign country than she would in the United States. The price will be lower because the investor faces a greater probability of being defrauded. If she is, in fact cheated, however, there is no direct effect on American capital markets. Investors who purchase shares in the American market need concern themselves only with the risks inherent in that market. Transactions of this sort do not impose a negative externality on American capital markets.

Extraterritoriality, therefore, provides little protection to U.S. capital markets. Imagine, for example, that the United States eschewed the effects test and instead followed a strictly territorial rule of jurisdiction under a conduct-based test. Under such a rule, any transactions occurring within a U.S. exchange or market would be governed by U.S. laws while those occurring in another jurisdiction would follow the law of that jurisdiction. It is true that transactions in

---

<sup>70</sup> 15 U.S.C. 78b (1994). See also *Des Brisay v. Goldfield Corp.*, 549 F.2d 133, 135 (9th Cir. 1977) (stating that it was Congress's intent "to protect the integrity of domestic securities markets in a particular stock").

<sup>71</sup> *Schoenbaum*, 405 F.2d at 206.

<sup>72</sup> Obviously, if it is possible to buy a security under one regime and then sell it under a different regime, thereby changing the protections afforded the buyer, the security would have to sell for the same price in both markets.

other jurisdictions may have an indirect "effect" on the U.S. market. For example, U.S.-based investors purchasing securities overseas in a market without any antifraud protection may very well get duped and lose all their funds; such investors, in turn, may default on their margin payments and invest less in American markets as a result, reducing the overall liquidity of those markets. Similarly, American companies seeking to raise capital may encounter jurisdictions with more desirable – from the companies' standpoint – regimes, leading them to exit the American market, again reducing the size and liquidity of the American capital market.

However, the mere fact that other countries impose such an indirect effect on the United States is no reason to extend extraterritoriality. In fact, this effect often results in competitive pressures between regimes, leading to beneficial results as countries compete for both issuers and investors.<sup>73</sup> In cases where a beneficial effect does not arise, but rather countries impose a negative externality on one another – for example, where a country allows itself to become a safe harbor for insider trading – countries should seek to employ either bilateral or multilateral agreements to achieve mutual cooperation over these issues or search for more direct solutions at home.<sup>74</sup>

Finally, extraterritoriality is conventionally justified as a means of protecting the impression foreign investors have of American companies. This view assumes foreign investors identify the actions of U.S. companies with the application of U.S. laws. Therefore, to the extent U.S. laws do not actually apply and, as a result, American companies go overseas and commit fraud, the world's impression of the U.S. se-

---

<sup>73</sup> See James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition*, 55-AUT LAW & CONTEMP. PROBS. 157, 174-75 (1992) (setting forth the possibility that countries may either race-to-the-top or race-to-the-bottom in their securities regulatory regimes); Stephen J. Choi and Andrew T. Guzman, *National Laws and International Money: Securities Regulation in a Global Capital Market*, 65 FORDHAM L. REV. (forthcoming April 1997) (setting forth a framework to analyze regulatory competition among countries and concluding that competition can lead to desirable diversity among regimes).

<sup>74</sup> Even here, it is unclear whether insider trading actually imposes a negative externality between countries. For example, suppose company 1 is located in country A. Assume further that company 1 has securities listed in both country A and country B. Now suppose executives from company 1 choose to engage in insider trading within the borders of country B's securities markets. Only investors in country B's market stand to lose directly from such trades, reducing the confidence of investors in country B's markets. Country A, however, is not affected in any direct manner. Note that two negative externalities are nevertheless possible. First, managers of company 1 may choose to engage in projects more suitable for insider trading – e.g., projects involving confidential information – not because such projects are the highest value projects available but because the managers may gain more through insider trading. Second, managers may also delay information disclosure in both countries, or engage in misleading practices, to increase the value of their ability to conduct insider trading in country B.

curities system will decline. In turn, this hurts the ability of American companies to raise capital abroad and reduces the amount of funds foreign investors place in the U.S. capital market.<sup>75</sup>

In response, it is difficult to see why rational investors would mistakenly – on a systematic basis – associate American companies with U.S. laws even where the companies trade abroad and U.S. laws do not apply. Through arbitrage, at the least, investors armed with the correct information would place pressure on securities prices to incorporate the true regulatory rights possessed by securities around the world. For example, if an American company's securities issued in South Africa lack the protection of American antifraud rules, then the prices of those securities would reflect this lack of protection. If, instead, some investors mistakenly believe that American laws do apply and overvalue the securities as a result, other investors will sell short the securities, placing downward pressure on the securities price until it reflects the lack of antifraud protection.

Furthermore, even where systematic mistakes regarding the application of U.S. laws to American companies exists, extraterritoriality is not the best means of combating this false impression. Rather, correcting this impression is better accomplished through a more direct approach. For example, clearly establishing when U.S. laws apply and when other countries' laws apply will work to educate investors about the scope of U.S. laws. To the extent that foreign investors have a false impression about U.S. laws, rather than extending the reach of the American securities regime, educating investors and implementing clear jurisdictional lines will prove both more cost-effective and more workable.

## 2. *Capital Mobility and the Securities Goals*

Before we can assess the desirability of a particular set of jurisdictional rules, we must step back and ask ourselves what goals the securities regulatory regime should seek to achieve. Traditionally, extraterritoriality has been justified as a means to protect U.S. investors and the integrity of the U.S. capital markets. However, as discussed above, extraterritoriality is neither necessary nor effective in accomplishing these goals.

Extraterritoriality brings with it several costs. For instance, regulations that limit the ability of American investors to purchase securities issued abroad have a direct and harmful impact on capital

---

<sup>75</sup> See *Bersch*, 519 F.2d 974, 987-88 (summarizing the arguments of Professor Morris Mendelson).

mobility. Although extraterritoriality does not directly prohibit overseas transactions, by forcing participants to accept American laws, it imposes extra costs on such transactions. To avoid these regulations, for example, some foreign issuers may simply restrict their offerings to investors who are not residents of the United States. Extraterritoriality, therefore, may exclude certain issues from the set of options available to American investors.<sup>76</sup> Foreign issuers also lose the liquidity provided by the participation of American investors. This reduction in capital mobility is harmful to all parties in the market. For the issuer, a smaller pool of potential investors makes it more difficult to sell-out its offering. Because the United States is one of the largest sources of capital in the international market, an issuer that cannot tap the American market faces a much larger challenge than an issuer that can. A smaller market implies that at any given price, the demand for a particular security will be lower. In order to sell a particular volume of securities, therefore, the issuer may have to lower the price of its securities.

Furthermore, a reduction in the liquidity of the international capital market is harmful to overall global welfare. A reduction in the number of investors will drive down the price of securities issues, making it unprofitable for certain projects to be funded in this manner. If these projects cannot be financed in some other way (e.g., through a private loan), they are lost; to the extent that with adequate financing these projects had a positive net expected value, society loses. Among those securities that are available to Americans, the opposite may occur. Because American investors have fewer options, they may bid up the price of those securities that comply with American law.<sup>77</sup>

---

<sup>76</sup> See *supra* section II.

<sup>77</sup> It is, of course, possible that extraterritorial application of U.S. law will merely result in a shift of investments. That is, U.S. investors will invest in those projects that satisfy U.S. law and, in doing so, will displace foreign investors who will then invest in securities that do not comply with U.S. law. This result, however, is very unlikely. In order for the international capital market to be unaffected, every dollar that U.S. investors spend on offerings that satisfy U.S. law and that they would otherwise spend on other offerings in the absence of an extraterritorial law must be offset by exactly one dollar from a foreign investor who would have invested in those securities but chooses not to because of the greater presence of U.S. investors. Even under an assumption of perfect capital markets, this result will not be obtained if only because compliance with U.S. securities laws is expensive. A firm that must decide whether to comply with U.S. law in order to gain access to U.S. investors will factor into the decision the cost of compliance. Therefore, even if it would be possible to raise more capital by fulfilling the requirements of U.S. law, the issuer may nevertheless choose not to do so because the additional funds are outweighed by the cost of compliance. This means that in a perfect capital market, the extraterritorial application of U.S. law will make selling to U.S. investors more expensive than excluding them. There-

Finally, extraterritorial jurisdiction reduces the range of investments available to American investors. Rather than being able to choose from the full array of securities issued around the world, American investors are limited to those that comply with American disclosure requirements. In other words, U.S. law travels with the investor. As a result, the investor will be less able to diversify her portfolio internationally.<sup>78</sup>

Given the problems with extraterritorial jurisdiction, it is important first to re-think exactly what it means to "protect" investors and the market. With respect to the protection of investors, we suggest that an appropriate goal is to ensure that investors are able to understand and anticipate the legal regime that will apply to them when they invest. Investors with such knowledge will make rational decisions about whether or not to invest in a particular market and, if they do so, how much to discount the price of securities in that market. If, for example, an investor wishes to invest in securities abroad, under the legal regime of a foreign country, they should be allowed to do so. If that legal regime lacks certain protections that exist in the United States, the investor is able to anticipate the lack of protection and adjust the price she is willing to pay accordingly. There is no injustice or inefficiency if, after purchasing a security with an understanding of the relevant legal regime, the investor suffers a loss. It is in the nature of securities that they are risky, and it is up to the investor to assess the risk prior to investing.

With respect to protecting the American market, securities regulation should seek to promote a well-informed and efficient capital market. This can be done through disclosure and antifraud requirements for transactions occurring within the United States. In the global arena, however, extending these provisions extraterritorially does not necessarily work to further the goals of capital market integrity. In fact, extraterritoriality may simply close the U.S. market off to regulatory competition. In an international context, the most effective protection for investors and for the integrity of the U.S. capital mar-

---

fore, the market will find an equilibrium at which, compared to the outcome in the absence of U.S. extraterritorialism, the ratio of offerings to potential investors in the non-U.S. market is higher and the ratio in the U.S. market is lower. The result will be that the expected return on the purchase of a security will be lower in the U.S. market than in either the non-U.S. market or the global market that would exist in the absence of U.S. extraterritorialism.

<sup>78</sup> For an analysis of the benefits investors obtain from diversification, see Richard A. Brealey & Stewart C. Myers, *Principles of Corporate Finance*, 129-174 (4th ed. 1991).

kets derives from one source: greater capital mobility.<sup>79</sup> Where extra-territoriality forces investors or issuers to carry the American regulatory regime with them even when they choose to conduct business outside the United States, capital is not truly mobile.

Limited application of U.S. laws, as a result, translates directly into greater choice for investors and issuers. In turn, greater mobility leads to more competition between jurisdictions to attract both issuers and investors. In selecting a jurisdiction, issuers will take into account the cost of the securities regulatory regime and the price investors are willing to pay for securities. Investors, in turn, will pay based on the chance of fraud and other risks in the offering. Regulations, for example, that increase the expense to issuers by less than they increase the willingness of investors to pay for securities, will raise the number of issuers seeking to offer securities. Competition among countries for securities transaction volume, therefore, will result in countries racing to adopt regulations that maximize the joint welfare of investors and issuers.<sup>80</sup> Within the United States, therefore, international mobility restrains the ability of regulators to pursue their own bureaucratic goals or cater to specific industry interests.

In a world where countries, investors, and issuers differ in their size and preferences for information disclosure and risk, a range of different regimes tailored to the different groups may arise. This range of regimes, in turn, provides investors with information on the types of issuers that select to issue securities in any particular regime. Issuers, for example, that choose to issue securities in a regime specializing in minimizing disclosure costs will be viewed by investors as carrying a higher risk of fraud; investors will discount these issues appropriately, shifting the cost of fraud back to the issuers. Moreover, only investors confident in their ability to assess companies operating under a regime lacking strong securities regulatory protection will choose to make purchases. Greater mobility works to increase the range of these different regimes by raising the ability of issuers and investors to separate themselves according to their preferred regimes. More mobility, therefore, results in a greater separation among issuers

---

<sup>79</sup> For a more detailed discussion of the benefits of capital mobility, *see* Stephen J. Choi and Andrew T. Guzman, *supra* note 73.

<sup>80</sup> On the other hand, where managers control the selection of a jurisdiction and the managers seek to maximize their own welfare, some racing-toward-the-bottom may occur. However, even to the extent this occurs somewhat, in a world where a range of companies, investors, and countries exist, increased mobility – by leading to a separation among different types of regimes – still benefits investors worldwide through the increase in information such separation provides investors. *See* Choi and Guzman, *supra* note 73.

and investors of different types, leading to more information for investors and, thereby, more efficient capital allocation.<sup>81</sup>

### B. Reforming Extraterritoriality

Taking the goals of protecting the capital markets of the United States and American investors as a given, we now turn to consider the proper role for securities regulation in an international environment. We argue that the current application of U.S. securities laws to transactions that take place abroad is unnecessary and, in light of the fact that it imposes costly limitations on capital mobility, should be significantly curtailed.

For many transactions, no issue of extraterritoriality exists. Both buyer and seller reside in the same country, and all communication and information flow occurs within that same country. The laws of the domestic country, therefore, unambiguously apply to the transaction. Not all transactions are as clear-cut, however. For example, information on a transaction between two Canadian parties may travel through internet lines via connections in the United States. Similarly, transactions may occur between parties physically located in different countries. For transactions that spillover into several countries, some sort of extraterritorial application of laws is inevitable. Because the transaction is simply not located completely within one country, to the extent any individual country attempts to assert jurisdiction, it affects the markets of the other countries.

Because some extraterritoriality is inevitable in the global marketplace, the true question is how far should any one country's extraterritorial reach extend. As discussed in Part II. B., the United States takes a mixed conduct/effects test approach in determining this reach for its antifraud rules. This Article proposes two reforms to this approach to further the ability of investors and issuers to choose their own regime. First, the rule of extraterritoriality should be a bright-line rule that offers parties the opportunity to make a clear *ex ante* choice. Second, some choice should exist; in other words, parties that desire to avoid their own domestic country laws should – at a reasonable cost – be able to do so.

For example, the conduct-based test – although embodying a territorial rule of sorts – suffers from both uncertainty and an overly broad reach. The conduct-based test tends to sweep within its reach

---

<sup>81</sup> For a discussion of how such a separating equilibrium may come about see Choi & Guzman, *supra* note 73, at *passim*.

actions taken by domestic investors and issuers seeking to execute a transaction abroad. To the extent that preparatory actions are included as conduct sufficient to trigger jurisdiction and to the extent that such preparatory actions in the United States are hard to avoid, the conduct-test artificially restricts mobility. As discussed above, mobility allows issuers and investors to choose which regime should govern their actions. Through such "votes," issuers and investors are able to apply competitive pressure on individual country regulators. Therefore, even where investors and issuers take preparatory action within one nation's boundaries, so long as they signal their desire to be part of another country's regime, only that other country's laws should apply. Investors and issuers can signal this desire by executing their transaction abroad. Furthermore, because the conduct-based test's notion of what actions count as "conduct" differs across the various circuit courts and is far from a bright-line rule, parties seeking to elect another jurisdiction's securities laws face the cost of uncertainty in their election. This uncertainty, in turn, may chill such an ex ante election.

Bringing a clear-definition of what counts as conduct to the conduct-based test and excluding preparatory acts done in the United States increases the mobility of investors and issuers. With a clear-rule, investors and issuers may rely ex ante on their election of regimes; furthermore, to the extent preparatory acts in the United States are not counted, such parties do not incur a substantial cost-penalty from their election. In fact, so long as the two principles of clarity and cost equality are met, the exact nature of the extraterritorial rule does not matter. A clear rule gives parties the ability to structure their transaction ex ante and, thereby, take the necessary actions to select the jurisdiction of their choice. With relative cost equality, parties will not be unduly biased in this selection but rather will select based on which regulatory regime provides the parties, as a group, with the greatest net benefits.

What does matter, however, is that the rule of extraterritoriality that is adopted creates the least amount of conflict with other jurisdictions' rules.<sup>82</sup> Ideally, in any given transaction, only one jurisdiction's rules would apply. If this were not the case, then parties lose the ability to select ex ante the jurisdiction of their choice. At the very least, a relatively inexpensive method should exist for parties to structure

---

<sup>82</sup> Indeed, some commentators argue that one defect of the conduct and effects tests is the lack of concern for principles of comity between nations. See Philip R. Wolf, *International Securities Fraud: Extraterritorial Subject Matter Jurisdiction*, 8 N.Y. INT'L L. REV. 1, 13-14 (1995).



their transactions to elect the jurisdiction of their choice. One method of reducing the cost of this election is the "connection" test of jurisdiction. Under the connection test, the country with the *greatest* amount of contact with the transaction obtains territorial jurisdiction. This approach is supported by many commentators.<sup>83</sup> Although it avoids problems of duplicative jurisdiction, the connection test as applied today is somewhat vague. For example, it leaves unclear what connections are relevant and what to do if two countries both have equally strong connections. Therefore, this article argues for a modified version of the connection test.

Specifically, the connection test should attempt to further the ability of investors and issuers to select their own regimes. In addition, the test should make the choice of controlling jurisdiction as clear as possible to potential issuers and investors. We suggest that the connection test focus on the location with the most relation to the actual matching of the buyer and seller. Such a rule both provides clarity and minimizes the cost to parties seeking to switch jurisdictions. Note, for example, that this implies that all offshore transactions – as defined in Rule 903(a) under Regulation S – would be considered beyond the reach of American courts. For transactions which occur on exchanges or are otherwise executed through an exchange system located within one country, the application of this test is straightforward. All transactions which occur within the London Stock Exchange, for example, regardless of the nationality of the participants should be considered under the exclusive jurisdiction of Great Britain. For transactions that take place off-exchange, a more factor driven connection test may be necessary, taking into account the nationality of the parties and the location of their communications and payments. Any residual ambiguity will be mitigated to the extent such parties may simply choose to enter into exchange or market system based transactions to place themselves unambiguously under the rules of one particular jurisdiction.

---

<sup>83</sup> See, e.g., Maguire, *supra* note 58, at 960 n.86 (citing Meridith B. Brown & Simon MacLachlan, *Legal Headaches for Buyers going into Foreign Lands*, INT'L MERGERS & ACQUISITIONS 57, 60 (Mar./Apr. 1991)); Edward F. Greene, *Regulation of Multinational Tender Offers*, 4 INSIGHT 25, 27 (1990); Douglas B. Spoors, Comment, *Extraterritorial Application of Securities Regulation, Territorialism in the Wake of the October 1987 Market Crash*, 1 TRANSNAT'L LAW. 307, 337 (1988); Deborah A. Demott, *Comparative Dimensions of Takeover Regulation*, 65 WASH. U.L.Q. 69, 69 (1987)).

### C. Other Alternatives to Extraterritoriality

Of course the connection test is not the only means of achieving capital mobility. Two more radical approaches are presented below.

#### 1. *Portable Reciprocity*

Reciprocity agreements typically provide that foreign issuers may both list their stocks in domestic exchanges as well as raise capital within the domestic market so long as they comply with securities laws in their home country. The multi-jurisdictional disclosure agreement with Canada, for example, allows certain Canadian issuers to make offerings in the United States while complying only with the regulatory provisions of Canada.<sup>84</sup> Reciprocity agreements, therefore, leave it up to the individual company whether to be governed by the host country's or its own country's laws.<sup>85</sup>

This Article argues that regulators may wish to go one step further than mere reciprocity to what we term "portable reciprocity." Portable reciprocity embodies the notion that issuers may follow the law of a country other than the country where the securities are actually being traded. Thus, investors gain the benefit of choosing among different securities regimes while saving on transaction costs. Rather than having to deal with investing money abroad, for example, investors may simply look to companies on their own domestic exchanges to obtain the benefit of another regime's securities protection.<sup>86</sup> Portable reciprocity, however, adds one additional element to reciprocity. Rather than requiring that companies adhere to the regime of their home country, companies would be allowed to select the regime of

---

<sup>84</sup> See Multijurisdictional Disclosure and Modification to the Current Registration and Reporting System for Canadian Issuers, Securities Act Release No. 6902, Exchange Act Release No. 29,354, 56 Fed. Reg. 30,036, 30,036 (July 1, 1991).

<sup>85</sup> See Edward F. Greene, Daniel A. Braverman, and Sebastian R. Sperber, *Hegemony or Deference: U.S. Disclosure Requirements in the International Capital Markets*, 50 BUS. LAW. 413, 433-38 (1995) (arguing for greater deference within the United States to the home-country disclosure provisions of foreign issuers meeting certain size and market following requirements so long as the disclosure provisions function in a manner comparable to U.S. regulations). Related to reciprocity are proposals to allow certain well followed foreign companies to issue in the United States under Section 5 while complying only with their own-country financial accounting standards. See James L. Cochrane, *Are U.S. Regulatory Requirements For Foreign Firms Appropriate?*, 17 FORDHAM INT'L L.J. 58, 63 (1994) (summarizing a NYSE proposal to allow "world-class" foreign companies to issue without compliance to GAAP so long as a written explanation describing material differences in accounting practices is supplied).

<sup>86</sup> Investors may face considerable transaction costs investing in securities abroad. See, e.g., Demmo, *supra* note 19, at 713 (detailing the higher brokerage fees, higher bid-ask spreads and higher clearance, settlement, and custody costs investors must pay to purchase securities abroad).

any country of their choosing. Such a system would add increased issuer mobility in addition to investor mobility. To the extent an issuer disliked the regulations of a particular regime, they could simply choose another country's regime. Under a regime of portable reciprocity, so long as the issuer notified all countries of this choice, its securities would be governed by the laws of the selected country.

Portable reciprocity, moreover, would solve the problems embodied in extraterritoriality. Under portable reciprocity, all the securities of a company would be governed by one consistent law. Essentially, reciprocity eliminates the notion of geographic or territorial application of laws. Rather, the issuers and investors themselves choose which laws should govern in which markets. Through such mobility, issuers and investors would apply pressure on countries to tailor regulations in the joint interests of issuers and investors. Under a worldwide system of portable reciprocity, countries gain to the extent more parties elect to be governed under their regimes. Greater numbers of filing parties, for example, would increase the filing fees within those countries; furthermore, to the extent a tendency exists for issuers and investors to conduct securities transactions within the markets of countries under whose regime they are regulated, countries will gain through increased securities volume. Such a tendency may exist, for example, because a country's securities regulatory regime may more closely monitor securities located within the country's geographic borders.

Some, including former SEC chairman Richard C. Breeden, criticize reciprocity. Breeden argued that reciprocity places domestic companies at a potential competitive disadvantage relative to foreign issuers seeking to raise capital and that such agreements increase investor confusion and reduce the ability of investors to compare different issuers.<sup>87</sup> Portable reciprocity eliminates any disadvantage faced by American firms because they could choose, if they wish, a less demanding regime. With respect to Breeden's second concern – investor confusion – portable reciprocity is problematic. Investors, however, already face a large choice of investments across foreign markets, each with a different securities regime. Providing foreign companies and their accompanying foreign regulatory regimes with easier access to

---

<sup>87</sup> See Breeden, *supra* note 2, at 90 (stating "if the SEC were to adopt a system of home country exemptions, then U.S. investors would be confronted even today with financial statements prepared under at least forty different sets of accounting principles. That approach actually has been tried in the past, and the results are chronicled in the Bible in the story of the Tower of Babel.").

the United States simply reduces the transaction cost for domestic investors to actually purchase foreign securities. United States investors already may invest directly in German companies within the German capital market system, for example. However, taxes and an unfamiliarity with the German capital markets may hinder this mobility. Reciprocity simply reduces this transaction cost and thereby increases investor mobility. Moreover, to the extent U.S. regulations are in fact superior and therefore result in investors willing to pay a higher price, foreign companies will voluntarily elect to comply with U.S. securities laws.<sup>88</sup>

Furthermore, reciprocity may not result in a myriad of different regimes all trading in the same country and marketplace. Some regulatory regimes are better suited for particular markets. Certain exchanges, for example, already possess strong, market-based antifraud mechanisms and, therefore, may require less stringent antifraud legal regimes. Moreover, there will exist a natural tendency for issuers and investors to comply with the regimes of their home countries. These regimes are more familiar to such parties and require the least amount of resources to understand and apply. Finally, to the extent certain regimes maximize the joint welfare of certain subgroups of issuers and investors, these regimes will form focal points and become prevalent world-wide.

## *2. International Company Registration*

Another alternative to today's regulatory regime would involve a complete shift in the method of regulation. Currently, the Securities Act takes a transaction based approach to regulation. Section 5's requirements focus on each individual offer or sale of a security. Similarly, Regulation S exempts specific transactions from Section 5's reach. From the point of view of investor protection and the integrity of the capital markets, however, what matters is not the information delivered during any particular transaction, but rather the information available to investors about the company. For example, Regulation S makes a distinction between foreign companies that issue debt or equity securities. However, what really is important is not the exact security involved in the transaction but how much readily available information exists.

---

<sup>88</sup> Reciprocity also may lead to problems of enforcement. To the extent a U.S. company issues securities fraudulently under U.S. laws in Germany, for example, German investors would have to file suit in U.S. courts to obtain civil judgment.

A possible reform, therefore, would be to register companies rather than transactions.<sup>89</sup> Switching to a company based registration system rationalizes the approach to securities regulation by more completely taking into account the needs of investors. To the extent investors trade the securities of well followed companies – for example, companies trading in an efficient market with adequately disclosed company information<sup>90</sup> – these investors are protected in all transactions in the companies' securities. In contrast, where little market information exists on the companies' securities, investors are at risk in all transactions of the companies' securities. Given the importance of the companies' status to investors, moving to a regulatory system that focuses more on this status may result in better investor protection.

A company based registration system would also provide investors and issuers the benefits of both a clear choice of regimes and a relatively inexpensive means of exercising this choice. Under the company based registration system, any company – foreign or domestic – that registered as a company within the United States would be subject to American laws. Companies that failed to register, in contrast, would be forbidden from having their shares ever traded in the United States. For both issuers and investors, therefore, the choice of whether American laws apply would be clear. Furthermore, investors would bear no extra burden when investing in the securities of companies not registered in the United States. They could engage in all the preparatory work they desired in the United States. The consummation of the transaction, however, would have to occur outside the United States.

---

<sup>89</sup> Recently, the SEC initiated an investigation into the possibility of shifting toward a company-registration system. The Advisory Committee on the Capital Formation and Regulatory Processes to the SEC produced a report this past July advocating a movement toward a more formal company registration system in the United States. See Advisory Comm. on the Capital Formation and Regulatory Processes, SEC, *Report of the Advisory Committee on the Capital Formation and Regulatory Processes* (July 24, 1996). See also Stephen J. Choi, *Company Registration: Toward a Status-Based Antifraud Regime*, 64 U. CHI. L. REV. (forthcoming Spring 1997)(arguing that many substantive aspects of company registration already exist within the current securities regime).

<sup>90</sup> In a semi-strong efficient market, all publicly traded information is incorporated through market pressure into the secondary market price. See Ronald J. Gilson and Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 569-72 (1984). For the purposes of this Article, the "efficient market" refers to markets which exhibit properties of a semi-strong efficient market.

## D. The Multiple Listing Problem

In determining the proper role for extraterritoriality, one additional problem exists: the multiple listing of securities by the same company across several jurisdictions. This section (1) discusses the problem; (2) analyzes jurisdictional rules which avoid the problem; and (3) concludes that the multiple listing problem, in any case, presents no major hurdles to extraterritoriality reform.

### 1. Multiple Listings

Under the current extraterritoriality regime, companies – at least from the United States – may issue multiple “batches” of securities and list them across several different jurisdictions. Each batch, in turn, may face a different regulatory regime depending on the jurisdictional rule of each country. For example, under a strict rule of territoriality, as embodied within the proposed connection test described above, even securities of the same class issued in different countries could very well face different disclosure and antifraud provisions. Multiple listing, therefore, presents regulators with at least two distinct problems.

Companies, first of all, may choose not to raise capital in different jurisdictions in order to avoid the duplicative cost of complying with several different regimes.<sup>91</sup> Strong business reasons may exist, however, to raise capital in more than one country. Where no individual market contains enough capital or liquidity to satisfy a company’s capital needs, companies may choose to list in more than one market. Having securities listed in a particular country may also raise the consciousness of residents in the country to the company’s products. Furthermore, building a base of domestic shareholders increases a company’s clout with domestic politicians. On a more cynical note, managers may seek multiple listings to spread their shareholders across countries as a means to raise the cost of coordinated shareholder action. To the extent the added expense of complying with the securities regimes of multiple countries deters multiple listing, therefore, society may lose as the cost of capital to companies rises and companies find it more difficult to compete on an international scale.

Second, through flowback, securities issued in one country under a different set of regulatory rules may make their way back to another

---

<sup>91</sup> See also Lisa K. Bostwick, *The SEC Response to Internationalization and Institutionalization: Rule 144A Merit Regulation of Investors*, 27 LAW & POL’Y INT’L BUS. 423, 438 (1996) (noting that different regulatory standards in different jurisdictions results in additional delay and compliance costs of multinational issuers).

country with a different set of rules. Flowback, therefore, provides transacting parties a potential means of arbitraging away unwanted securities regulations of one country while physically staying within the capital markets of that country. For example, company 1, located in country A, may issue securities within country B under B's relatively lax antifraud and disclosure laws. Investors may then resell these securities back into country A without either additional disclosures from company 1 or antifraud liability on company 1. Collapsing these transactions, company 1 has, in effect, issued securities in country A without following country A's regulatory requirements.<sup>92</sup>

As the next section discusses, extraterritoriality provides one, but by no means the only, means of combating the multiple listing problem.

## 2. *Avoiding Multiple Listing Problems*

For now assume that multiple listing is, in fact, a problem. Extraterritoriality provides only a partial solution. Under the United States' transaction oriented system, extraterritoriality works to reach issuer driven transactions that occur outside the United States. On its face, this approach alleviates some of the multiple listing problem. To the extent that extraterritoriality causes the same disclosure and antifraud rules to apply to transactions occurring in multiple jurisdictions, the problem of flowback is alleviated. Again assume company 1 issues securities in countries A and B. With a rule of extraterritoriality, country A need not worry that shares issued in country B may enter country A without having been issued with the antifraud and disclosure rules of country A.

Note, however, the extraterritoriality does not eliminate all of the problems of multiple listing. Specifically, should one country apply its laws extraterritorially, this does not ensure consistent treatment of all securities of the same issuer. Other countries, for example, that also have an interest in at least some of company's securities may choose to apply their laws. Country B, for instance, may enforce its own, different set of disclosure rules on shares issued within country B. Shares issued in country A, therefore, would face only the regulations of country A; whereas shares issued in country B would face the regu-

---

<sup>92</sup> See Josh Futterman, Note, *Evasion and Flowback in the Regulation S Era: Strengthening U.S. Investor Protection While Promoting U.S. Corporate Offshore Offerings*, 18 FORDHAM INT'L L.J. 806, 852-53 (noting that flowback is a serious problem in the United States and proposing reforms to Regulation S designed to reduce flowback, including for example, lengthening the restricted period).

lations of both country A and B. Companies, as a result, may still face the burden of having to comply with multiple regimes.<sup>93</sup>

A better solution exists. Employing either of the two alternatives in Part III. C. would both alleviate the multiple listing problem more completely than a broad extraterritorial rule, while also providing for increased capital mobility. First, employing a portable reciprocity notion of jurisdiction would provide each issuer with a consistent regulatory regime. To the extent all other countries recognized and applied the disclosure and antifraud provisions of the issuer's country-of-choice, the issuer avoids the problem of multiple disclosure and antifraud requirements and the associated additional expense. Furthermore, a rule of portable reciprocity would provide consistent treatment for all the securities of the issuer, eliminating the problem of flowback. As discussed above, portable reciprocity also encourages capital mobility by reducing the cost to investors of selecting issuers under different regimes while providing issuers an inexpensive means of selecting a regime.

Second, a company registration system would also reduce the multiple listing problem. Under company registration, flowback problems are eliminated. If the company is registered in the United States, for example, securities issued worldwide would be tradeable in the United States without additional disclosures. Conversely, where the company is not registered in the United States, securities would be banned from entering the United States. Because only securities where enough information exists may be traded, U.S. investors are protected where flowback occurs. Note, however, that company registration may still result in different batches of securities facing various regulatory requirements around the world; problems of multiple jurisdictional costs, therefore, may still exist. As the next section discusses, however, the magnitude of this expense may be overstated.

### *3. The Non-Problem of Multiple Listing*

Even without reforms to institute portable reciprocity or company registration, the multiple listing problem may be more illusory than real for both flowback securities and the cost to issuers of complying with several securities regimes.

Flowback is really only a problem for companies without an active investment following in the United States. Take, for example, Exchange Act reporting companies. For such companies – particularly to

---

<sup>93</sup> Furthermore, because the securities in the two countries face different overall levels of disclosure and liability, their securities prices may differ.



the extent large, institutional investors follow the companies in an efficient market – the capital markets in the United States already possess a large amount of information on the companies, which is reflected in the secondary market prices. Flowback, therefore, will not necessarily result in any harm to American investors. So long as the secondary market price incorporates the publicly available information on the company, investors are protected.

Now consider non-Exchange Act reporting companies. Such small, low capitalized companies typically are not followed by many, if any, investment analysts. Their stocks, as well, are often illiquid, rarely trading more than once a day. Non-Exchange Act reporting companies, moreover, may not release any public information on their operations, finances, or business plans.<sup>94</sup> To the extent flowback occurs for such companies' securities, therefore, investors in the United States may be at risk. However, for two reasons, this risk is relatively minor. First, although such companies may lack disclosure in the United States, they may have made disclosures to meet the securities regime of other countries in which they issued securities. American investors, therefore, may turn to these alternative sources of information to judge the investment merits of flowback securities. Note, however, that such information is not a perfect substitute for U.S. disclosure. Often the information will not consist of the same quality or type of disclosure, the information may also be in a foreign language, and the foreign disclosures may not be readily accessible within the United States.

Second, despite the fact that the SEC finds flowback transactions troubling, there is little reason for the United States to discourage them. As long as investors are aware of the legal regime that they are "purchasing" along with the shares, they are not defrauded in any way. Even where no information exists with respect to the flowback securities, investors in the United States may still protect themselves through discounts to the securities' price. No one forces U.S. investors to purchase the flowback securities. Those who do so presumably understand the risks involved. Where such risks are understood, rational investors will price down the securities to take these risks into account. Furthermore, companies, to avoid such a price down, may voluntarily choose to comply with U.S. registration requirements.

Moreover, although the expense of complying with multiple jurisdictions is a real cost, the magnitude of this expense is overstated for

---

<sup>94</sup> See Toddi Gutner, *How to Keep the Little Guy in the Loop*, Bus. Wk., July 29, 1996, at 32.

several reasons. First, in response to the need to reduce the cost of capital for companies, countries possess a natural incentive to coordinate their regimes. Companies, in turn, may find that issuing securities within the markets of these coordinating countries provides them with enough capital and liquidity at an acceptable cost. Canada and the United States, for example, in recent years brought their own securities systems in line with one another. Second, even given a range of different regimes, companies may find that business reasons lead them to countries that also happen to have similar securities regimes. This may occur, for example, because countries with similar business infrastructures and markets possess similar securities regimes.

In summary, the ability of companies to engage in multiple listings provides an additional level of complexity in thinking about the ideal system of extraterritoriality. However, the problems associated with multiple listing are often overstated and, in any case, are not best solved through extraterritorial extensions of jurisdiction.

#### IV. CONCLUSION

The U.S. securities regime presides over a thriving and successful capital market. Instituted during the 1930s, the major portions of this regime are found in the Securities Act and Exchange Act. Together the two Acts regulate almost all securities offerings and secondary market transactions. For several decades after the 1930s, the current system proved robust. Most Americans transacted in securities of U.S. companies; similarly, most U.S. companies sought to raise capital solely in the United States. Today, however, the rapid expansion of the global marketplace has changed the U.S. capital markets dramatically. The increasing volume of international transactions has placed strains on the current system of extraterritoriality. Some transactions are initiated in the United States but are consummated abroad; other transactions involve parties from two different countries; still other transactions take place as part of a company's effort to raise capital in multiple countries. The challenge to the U.S. securities system today is how to effectively and rationally take into account the pressure of international capital markets.

In response, this Article presents a critical analysis of extraterritoriality. Current extraterritoriality doctrine extends U.S. jurisdiction to foreign securities transactions under a number of different rationales. Through tests based on conduct or effect, jurisdiction often is applied in the name of protecting U.S. investors or the integrity of U.S. markets. Extraterritoriality is also used to combat problems aris-

ing from companies engaging in multiple listings of securities across several different jurisdictions. This Article, however, argues that the current doctrine around extraterritoriality is both unnecessary and outdated.

Instead, this Article argues that investors and issuers as a group are best protected through increased capital mobility. Investors that dislike a particular country's regime may vote with their feet and switch to another country's markets. Issuers that desire a different set of regulations, similarly, may also issue their securities elsewhere. Where both investors and issuers have such mobility, countries will compete to provide the regime which maximizes the wealth of investors and issuers jointly. More than any one country's extraterritorial application of laws, therefore, issuers and investors are best protected through jurisdictional rules which give parties an ability *ex ante* to opt clearly for a particular regime without much transaction cost.

Securities regulation in the United States and elsewhere is premised on certain assumptions about the ability of investors to select investments. The SEC, for example, does not screen directly for bad investments; rather, the SEC only ensures that deceptive practices are prevented and that the information on the market is as accurate as possible. This is a suitable role for the government only if we assume that investors both receive adequate investment information and rationally consider this information when making decisions. Furthermore, it is assumed that investors are aware of their legal rights when they invest. In other words, the underlying assumption behind the current domestic securities regime is that individuals are able to consider the risks and returns offered by a security in light of the information available and the regulatory regime in place and that the investor is able to identify and pursue his own interests based on that information.

The proposals of this paper require no stronger assumptions about the behavior of investors than does the current regulatory structure of the domestic market. Admittedly, regulations would have to be installed to ensure that buyers are put on notice when they invest in foreign securities, but beyond this protection, investors must accept the risk of their investments.

This Article, therefore, argues for jurisdictional rules which enhance the ability of issuers and investors to choose among different countries' securities regimes. Three such rules are presented here. First, countries may employ strict rules of territorial jurisdiction based on the connection the transaction has with the capital markets of the

country. Where a transaction takes place on the NYSE, for example, the law of the United States should apply. This is the rule we advocate. Second, countries may consider adopting a rule of portable reciprocity to providing investors and issuers the maximum amount of mobility. Finally, a shift within the United States toward a company based registration system would remove many of the ambiguities and complexities surrounding overseas transactions while rationalizing protection for U.S. investors.