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COMMENT

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I. INTRODUCTION

Although modern exchanges have existed since Elizabethan England, until recently the purchase and sale of securities was largely unregulated.[1] As a result, investors were only protected from fraud and other misbehavior by the oftentimes inadequate common law.[2] However, for the past sixty years, Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act") has protected US investors from securities fraud and prevented wrongdoers operating in this country from defrauding the purchasers of securities, both at home and abroad.[3] Although no other nation has enacted legislation of such massive scope and sweeping coverage, many countries have passed laws with the same general purpose—to eliminate fraud and protect investors from unfair trade practices in domestic securities markets.[4]

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1. See Frank S. Shyn, *Internationalization of the Commodities Market: Convergence of Regulatory Activity*, 9 Am U J Intl L & Pol 597, 604 (1994).
2. For an analysis of the inadequacy of common law fraud with regard to securities transactions, see, for example, Richard A. Posner, *An Economic Analysis of Law* 588–90 (Aspen 5th ed 1997).
3. See 17 CFR § 240.10b-5 (2000), as promulgated under the Securities Exchange Act of 1934, 15 USC § 78j(b) (1994).
4. See, for example, Gerhard Wegen, *Congratulations from Your Continental Cousins, 10b-5: Securities Fraud Regulation from the European Perspective*, 61 Fordham L Rev S57, S58 (1993) (detailing various European securities fraud regimes).

Perhaps not surprisingly, the original drafters of the Exchange Act did not directly address the applicability of their law to transnational securities transactions.[5] At the time, the "web of international connections in the securities market was then not nearly as extensive or complex as it has become," and as a result, commonplace transnational transactions were simply not contemplated by the legislature of the 1930's.[6] Since the passage of the Exchange Act, however, the world securities market has changed dramatically, perhaps in more ways than even the courts a decade ago could have hypothesized.

First, the increasing number of multinational corporations with only nominal nationality has resulted in companies that issue stocks in scores of countries and are listed on multiple foreign exchanges.[7] Due to advances in telecommunications, international travel and shipping, and global financial liberalization, what were once a large number of relatively isolated markets have, to a large extent, merged into an interconnected marketplace. Many corporations are no longer associated with only one nation; instead, they are really global citizens.[8] Thus, any fraud will affect investors and markets in potentially dozens of nations.[9]

Second, the Internet has recently emerged as a popular way to buy and sell securities for an enormous number of investors.[10] Anyone with access to a computer, modem, and telephone line can instantly access information submitted by authors throughout the world at a negligible cost. As such, the medium is ideally suited for many types of securities transactions. Internet posters can publish corporate reports (both official and unofficial), investment "tips," and other information on the Web, and then simultaneously solicit investors based on that information. In many countries (including, to some extent, the United States), the laws governing securities regulation have yet to match these gains in technology.[11] Because of the increasingly international character of securities markets, domestic enforcement officials must now

5. See, for example, *Kauthar SDN BHD v Sternberg*, 149 F3d 659, 663–64 (7th Cir 1998), citing *Zoelsch v Arthur Anderson & Co*, 824 F2d 27, 30 (DC Cir 1987). But consider Margaret V. Sachs, *The International Reach of Rule 10b-5: The Myth of Congressional Silence*, 28 Colum J Transnatl L 677, 681 (1990) (arguing that transnational securities transactions were commonplace in the 1920's, a fact of which Congress was fully aware when it enacted the 1934 Act).

6. *Zoelsch*, 824 F2d at 30.

7. See Amir Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 Va J Intl L 563, 564–66 (1998).

8. Id at 564–68.

9. See generally Amir Licht, *Games Commissions Play: 2 x 2 Games of International Securities Regulation*, 24 Yale Intl L J 61, 62 (1999) (examining Royal Dutch/Shell).

10. See Joseph F. Cella and John Reed Stark, *SEC Enforcement and the Internet: Meeting the Challenge of the Next Millenium*, 52 Bus Law 815, 821 (1997).

11. See Jane Kaufman Winn, *Regulating the Use of the Internet in Securities Markets*, 54 Bus Law 443, 444–45 (1998).

choose either to extend the reach of their antifraud laws to largely foreign transactions or to deny much-needed protection to their own citizens and markets.

Due to the lack of legislative guidance, American courts have tried to "fill in the gaps" when deciding whether to enforce 10b-5 extraterritorially.[12] In practice, this has resulted in US courts sometimes adjudicating securities fraud claims that have little impact on the United States itself. Because American securities fraud laws are perhaps the most plaintiff-friendly in the world, their extraterritorial application has resulted in US courts becoming almost a worldwide forum for many parties seeking redress not offered by their own countries. This situation has two undesirable consequences: first, US courts are forced to spend their limited judicial resources on matters that do not invoke substantial domestic interests, and second, American antifraud laws are superseding the oftentimes intentionally less strict foreign regulations that govern the same transactions, thereby creating an American hegemony in the field of transnational securities regulation.

This comment will introduce the international antifraud enforcement problems created by the increasingly transnational securities markets. It will state and analyze existing American law and the likely path the law will take, especially with regard to the Internet. The piece will examine the implemented and proposed solutions to this global dilemma, and it will suggest that these measures are either ineffective or incomplete. Finally, the comment will propose a new solution—the creation of a set of binding international regulations for transnational transactions that will give investors and markets sufficient protection from fraud while eliminating the current American hegemony.

II. Problems Arising from Domestic Regulation of Transnational Securities Transactions

When plaintiffs make allegations of securities fraud, they potentially invoke the laws of all remotely interested nations. First, if shareholders are injured, all nations with domestic stockholders have an interest in protecting their citizens from fraud. Second, the nations of residency or incorporation have an interest in deterring their own citizens from committing fraud in the world market.[13] Finally, any nation that served as a staging point for the allegedly fraudulent activity has an interest in

12. See, for example, *Robinson v TCI/US West Communications, Inc*, 117 F3d 900, 905 (5th Cir 1997).

13. Some commentators suggest that if the nation of residency is able to completely externalize the effects of fraud committed by its citizens, then it will not condemn the behavior. While this observation is certainly true, the costs of fraud often are assigned to the market as a whole, and not just the nominal victim. Wary of these costs, domestic regulatory agencies usually have a keen interest in deterring their own citizens from committing fraud on the world market.

preventing wrongdoers from using their shores as a "base for effectuating the fraudulent conduct of foreign companies."[14]

This would not present a significant problem if all securities antifraud laws throughout the world were uniform. Unfortunately, they are not; depending on the national regulatory scheme, investors may receive varying degrees of protection.[15] When creating a securities regulation regime, the legislatures must balance the transaction costs associated with strict regulation against the lack of protection afforded by more relaxed schemes.[16] As a result, dissimilar regulatory philosophies have emerged.

Because several nations may have an interest in regulating a single transaction with their externally inconsistent laws, serious problems may arise. Allegedly defrauded investors will certainly forum-shop and look to the interested nation with the most favorable law to render a verdict. Therefore, all other interested nations with laws calculated to be less costly (and less protective) will have their legislative judgment thwarted. Furthermore, the country with the most stringent laws will be forced to expend significant judicial resources adjudicating the suit, even though there may be a more interested nation.[17] In today's world, the United States is this nation with the most plaintiff-friendly securities fraud laws. As a major world economic leader, US interests are invoked in a disproportionate number of international transactions. This gives the United States the opportunity to adjudicate a vast portion of the world's transnational fraud disputes.[18] In addition to taxing the courts' resources, this situation creates an unwarranted US hegemony in the field of securities regulation.

III. THE AMERICAN APPROACH

A. *Existing Law.* In response to the relatively large number of transnational fraud claims brought in the United States, courts have devised two approaches to determine whether claims fall under the Exchange Act. In general, courts will apply 10b-5 if (1) foreign actions have negative effects on US investors or markets; or (2) significant conduct in this country causes or facilitates fraud, no matter where the consequences are felt.[19] Additionally, although either requirement, if satisfied, will be enough to

14. *Tamari v Bache & Co (Lebanon) SAL*, 730 F2d 1103, 1108 (7th Cir 1984).
15. See, for example, Wegen, 61 Fordham L Rev at S57 (cited in note 4) (detailing the degrees of protection awarded by various European laws).
16. See Stephen J. Choi and Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S Cal L Rev 903, 916 (1998).
17. Id (discussing the substantial costs imposed on the judicial system).
18. US courts have long recognized this dilemma and they have accordingly decried becoming the "host for the world's victims of securities fraud." *Butte Mining PLC v Smith*, 76 F3d 287, 291 (9th Cir 1996).
19. *Kauthar*, 149 F3d at 665 (cited in note 5).

invoke application of American law, the recent trend in a few circuits has been to apply the two tests in an "admixture or combination [which] often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court."[20]

1. *The Effects Test.* Although the Exchange Act is silent on the subject, US courts will traditionally apply US antifraud laws to fraudulent activity that has sufficiently adverse effects on US investors or markets.[21] To satisfy this requirement, alleged securities fraud must cause "foreseeable and substantial harm to interests in the United States."[22] Courts typically divide the effects analysis into two prongs. First, to satisfy the "interests in the United States" requirement, the plaintiffs usually must be US residents.[23] Second, the plaintiffs must show that the fraud was targeted at Americans and that US residents were actually injured—the mere fact that investors included US residents is usually not enough to meet the substantiality requirement.[24] Generally, courts tend to construe the effects test in a relatively conservative manner—perhaps because American investors own at least a small part of so many predominantly foreign companies, they are usually wary to allow a claim to proceed based solely on this fact.[25]

2. *The Conduct Test.* While the effects test has been applied fairly restrictively, the conduct test allows the American judiciary to exert a more extraterritorial power over transnational securities transactions. Even absent an effect on US investors, courts will sustain a claim if domestic conduct contributes to the commission of fraud overseas.[26] This conduct must be an "essential link" in the chain of causation and not "merely preparatory" to the fraud.[27] Exactly where to draw the line between an essential and a preparatory act has been the subject of debate between the courts, but many circuits construe the conduct test quite liberally.[28] In real terms, the courts may

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20. *Itoba Ltd v Lep Group PLC*, 54 F3d 118, 121 (2d Cir 1995). In addition to the Second Circuit, the Seventh Circuit has also adopted the "admixture" approach. See *Kauthar*, 149 F3d at 665 n8.

21. See, for example, *Schoenbaum v Firstbrook*, 405 F2d 200, 206–09 (2d Cir 1968).

22. *Tamari*, 730 F2d at 1108 (cited in note 14).

23. See, for example, *Europe and Overseas Commodities Traders, SA v Banque-Paribas London*, 147 F3d 118, 128 (2d Cir 1998).

24. See *IIT v Vencap, Ltd*, 519 F2d 1001, 1016–17 (2d Cir 1975) (holding that even though American investors owned 0.5 percent of a foreign trust fund, the impact of the alleged fraud was not substantial); *Interbrew SA v Edperbrascan Corp*, 23 F Supp 2d 425, 430 (SD NY 1998) (holding that even though US investors owned 25 percent of a Canadian corporation, they were neither the intended nor actual victims of the fraud).

25. The effects test is usually applied especially restrictively when used as justification for a class action. Consider *Bersch v Drexel Firestone, Inc*, 519 F2d 974 (2d Cir 1975).

26. See *Leasco Data Processing Equipment Corp v Maxwell*, 468 F2d 1326, 1334 (2d Cir 1972).

27. Id at 1335, quoting *Mills v. Electric Auto-Lite Co*, 396 US 375, 385 (1970).

28. See Michael J. Calhoun, Comment, *Tension on the High Seas of Transnational Securities Fraud: Broadening the Scope of United States Jurisdiction*, 30 Loy U Chi L J 679, 700–19 (1999) (detailing the approaches on a circuit-by-circuit basis). The most conservative approach, used by the DC Circuit,

hear a securities fraud allegation if the domestic behavior constitutes the bulk of the fraudulent conduct and directly causes the loss.[29]

Although the requirements for the conduct test sound severe, in practice they are usually much less formidable for plaintiffs to overcome. Generally, courts have concluded that most forms of communication, if directly related to the fraud, will satisfy the conduct test.[30] In fact, at least one circuit has held that simply sending communications to the United States from abroad is sufficient to invoke application of 10b-5.[31] This view has not been rejected by most of the other circuits, indicating that if a person sends a communication into the US soliciting a person to enter a transaction that later appears to be fraudulent, that behavior alone may by sufficient to satisfy the conduct test.

B. *Applicability of American Antifraud Laws to the Internet.* By considering the requirements for extraterritorial application of American securities fraud laws and the essential character of the Web, one can easily see why the Internet threatens to extend the reach of 10b-5 to a substantial number of transnational transactions throughout the world. Although much of the law is undecided, the tentative consensus is that the United States is beginning to treat the Internet expansively as a non-unique form of communication.[32]

According to the best guesses of most commentators, any Internet communication transmitted to the United States (in other words, any Web page accessed from American shores), regardless of the location or intent of the publisher, may potentially invoke American securities fraud laws.[33] Because an Internet communication will likely contain elements of both the conduct and effects

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allows only conduct that is an independent fraud violation to satisfy the conduct test. See *Zoelsch*, 824 F2d at 30–31. In direct contrast, the lenient view of the Third, Eighth, and Ninth Circuits merely requires "some lesser quantum of contact." *Robinson*, 117 F3d at 906 (explaining the view of these circuits). Somewhere between these two extremes, the remaining circuits that have addressed the issue allow fraud claims under the conduct test when "substantial acts in furtherance of the fraud were committed within the United States." *Psimenos v. EF Hutton & Co, Inc*, 722 F2d 1041, 1045 (2d Cir 1983), citing *Vencap*, 519 F2d at 1018.

29. See *Psimenos*, 722 F2d at 1046.

30. See *EOC Traders*, 147 F3d at 129 (dismissing for lack of subject matter jurisdiction, but remarking that phone calls are typically sufficient to satisfy the conduct test).

31. See *Consolidated Gold Fields PLC v Minorco, SA*, 871 F2d 252, 262 (2d Cir 1989). See also *Continental Grain (Australia) Pty Ltd v Pacific Oilseeds, Inc*, 592 F2d 409, 421 n18 (8th Cir 1979) ("Both the place of sending and the place of receipt constitute locations in which conduct takes place.").

32. See Winn, 54 Bus Law at 444–45 (cited in note 11). The SEC recently has brought dozens of actions against alleged infringers based on existing 10b-5 liability theories. See Thomas C. Newkirk, John S. Markle, and Jill M. Peterson, *Recent SEC Enforcement Cases*, 1138 PLI/Corp 755, 771–75 (1999).

33. See John C. Coffee, Jr., *Brave New World? The Impact(s) of the Internet on Modern Securities Regulation*, 52 Bus Law 1195, 1227–32 (1997).

approaches, it may satisfy the *Itoba* "admixture" test, even if it would not meet either of the traditional requirements independently. By expanding the coverage of US law to the Internet, the US courts are effectively legislating antifraud protection for the quickly growing class of online transnational securities transactions and excluding other nations from enacting less costly regimes.

IV. EXISTING AND PROPOSED SOLUTIONS

A. *The IOSCO.* The problem of regulating transnational securities transactions, while a relatively recent development, is not an entirely unencountered dilemma. For over two decades, securities regulators around the world have constituted the International Organization of Securities Commissions ("IOSCO"), a body intended to facilitate discussion and global compatibility of regulatory schemes.[34] This body makes recommendations and proposes guidelines pertaining to disclosure requirements, record-keeping, information-collecting, and enforcement powers for its more than one hundred members.[35] Theoretically, the members of the IOSCO would heed the recommendations of the body, and a substantially uniform world regime would result.

The system, however, looks better on paper than it does in practice. First, as a loose confederation of national regulatory agencies, substantive agreements among the dozens of representatives cost significant amounts of time and money.[36] Second, compliance is often difficult or impossible to monitor and enforce.[37] Finally, because the recommendations are nonbinding, member states do not even need to enact the proposals. Although direct defiance is rare, national regulatory bodies do retain the power to amend the guidelines, potentially creating entirely different regulatory regimes than IOSCO intended, thus thwarting its purpose.[38] For these reasons, the existing attempt at homogenizing the world securities market has not proven successful; another solution is needed.

B. *Reforming American Law.* One common proposal to alleviate the problems caused by the increasing number of transnational securities transactions is to simply amend US laws to promote a more fair and less extraterritorial regime. Generally, most commentators argue that the United States should scale back the extraterritorial

34. See Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 Ala L Rev 927, 932 n27 (1994).

35. See <http://www.iosco.org/gen-info.html> (visited Sept 16, 2000). See also Note, *You Cannot Fight What You Cannot See: Securities Regulation on the Internet*, 22 Fordham Intl L J 612, 625–26 (1998).

36. See Choi and Guzman, 71 S Cal L Rev at 915 (cited in note 16).

37. Id. For example, initial evidence indicates less than enthusiastic enforcement of insider trading regulations by Japan and Switzerland.

38. Id at 916.

application of US regulatory schemes, especially with regard to the Internet.[39] These proposals, while potentially effective in the short term from a US perspective, are not adequate solutions to the true problem at hand.

The dilemma produced by the increasingly international character of securities transactions is not fundamentally caused by the application of US law to transnational transactions. Instead, the main problem is that these transactions often invoke the regulatory jurisdiction of many countries, and the nation with the most plaintiff-friendly regime will likely emerge as the primary adjudicator of disputes, contrary to the policies of other interested nations. Certainly, the United States is currently this "most plaintiff-friendly" nation, but that does not have to be the case. Reducing the extraterritorial application of US law will only serve to catapult some other nation into the very same position the United States finds itself in today. The proposals to reform American law may eliminate the American hegemony in transnational securities regulation, but they will only be effective until another regulatory hegemony emerges in some other part of the world.

C. *Regulatory Competition—Portable Reciprocity.* A second ambitious solution to the problems produced by the increasingly international securities market is to attack the application of possibly inconsistent regulatory measures while simultaneously shedding the traditional concepts of domestic-based regulation.[40] In their article, Choi and Guzman argue that uniform regulations are not necessarily preferable to nonuniform measures, so long as the nonuniform laws cannot be enforced simultaneously and investors can be informed about the protection afforded under various regulatory schemes.[41] The authors propose a system in which only one regulatory body would govern an individual security, but that particular regulatory scheme could be one of potentially dozens of regimes unique to different nations.[42] Under this scheme of "portable reciprocity," issuers could choose a nation—and thus a regulatory scheme—under which they want to operate, regardless of their nationality, the physical location of the offering, or the intended domestic market for the securities. Investors could then shop around and purchase stocks based on the level of protection awarded by the particular regulatory regime; they could either

39. See, for example, Roberta C. Karmel, *Changing Concepts of Extraterritoriality*, NY L J 3 (Jan 30, 1998); Trotter Hardy, Symposium, *The Proper Legal Regime for "Cyberspace,"* 55 U Pitt L Rev 993, 995–96 (1994). One common proposed reform is to allow issuers to "opt out" of US regulatory schemes by placing a disclaimer on their Web page announcing their intention not to sell stock in US jurisdictions. See, for example, Paul Hamilton, Note, *The Extraterritorial Reach of the United States Securities Laws Towards Initial Public Offerings Conducted Over the Internet*, 13 St John's J Leg Commen 343, 370 n156 (1998).

40. See Choi and Guzman, 71 S Cal L Rev at 903 (cited in note 16).

41. Id at 916–17.

42. Id.

choose safe stocks with a lower rate of return due to higher regulatory costs, or they could choose stocks with a higher rate of return but a greater risk of fraud.[43]

Obviously, the potential problems typically associated with liberal choice-of-law rules are apparent on the face of the proposal. The authors, however, do an adequate job of minimizing the impact of these problems.[44] Because the efficiency gains of this "portable reciprocity" scheme would likely be substantial, the benefits of the system would far outweigh the costs imposed. Even assuming their arguments to be persuasive, however, the authors simply do not address one important concern—the interest all nations have in deterring wrongful behavior within their borders. According to one of the most revered tenets of international law, a nation must have the power to identify actions contrary to public policy and then prohibit this conduct within its borders without consideration of the wishes of the regulated parties.[45] Antifraud laws are more than just a mechanism to redistribute wealth from issuers to investors; they are also intended to prevent behavior judged to be wrongful and contrary to public policy.[46] The entire point of the current conduct test in US securities fraud law is to prevent wrongdoers from using America as a base for their fraudulent behavior, regardless of whether or not the injured parties are US residents.[47] Choi and Guzman's proposal does not take this aspect of antifraud prevention into account, and as such, it is incomplete.

V. A GLOBAL SOLUTION

Although the existing attempt to solve the problems caused by the increasingly international securities markets (IOSCO) has not been successful, even critics concede that in theory, global cooperative measures could be an effective solution to the current dilemma.[48] The failure of IOSCO is a product of poor implementation,

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43. Id at 922–24.

44. Id at 924–27. First, the proposed scheme might produce confusion among investors, who would be forced to know the protection awarded by countless domestic regulatory schemes. Second, unsophisticated investors may have no way of balancing the costs and the level of protection when deciding whether to invest. The authors answer these criticisms by arguing that in today's world of multiple classes of stock, the extra confusion created by multiple regulatory regimes would only be marginal and that the incremental risk to unsophisticated investors (a rapidly declining class) is only a marginal increase in the already risky securities market.

45. The intended beneficiary of most of these public laws is society as a whole and not the regulated participants in a particular transaction, and as a result, the regulations are mandatory and cannot be waived by private parties. See Philip J. McConnaughay, *Reviving the "Public Law Taboo" in International Conflict of Laws*, 35 Stan J Intl L 255, 304–05 (1999).

46. In fact, the SEC will often impose criminal penalties on those who violate 10b-5. See, for example, *US v O'Hagan*, 521 US 642 (1997). Additionally, many other nations (China and the European Union, for example) classify securities fraud as a crime.

47. See *Itoba*, 54 F3d at 121–22 (cited in note 20); *Psimenos*, 722 F2d at 1045 (cited in note 28); *Vencap*, 519 F2d at 1017 (cited in note 24).

48. See Choi and Guzman, 71 S Cal L Rev at 915 (cited in note 16).

not of the conceptual solution itself. Any international solution that remedies the two main flaws of IOSCO—the high costs associated with cooperative measures (including monitoring costs) and the advisory nature of the regulations—and allows nations to enforce their own public law by punishing domestic behavior they feel to be contrary to the public good will have a good chance of success.

An international agreement that defines a common standard of protection from fraud in the world securities market and authorizes private actions for damages by allegedly defrauded investors would solve these problems. In essence, this new regime would prohibit certain fraudulent behavior in any transnational securities transaction. The agreement, drafted by IOSCO, would give investors a significant degree of protection from fraud in the international securities market. As the result of negotiation between national regulatory bodies with differing regulatory schemes, the specific level of protection would probably be substantially less than that afforded by 10b-5 and other highly protective domestic laws, but it should also be significantly higher than that awarded by the more lenient nations. The agreement would only be applicable to signatories, and in light of the existing antifraud laws and regulatory regimes in most nations, the agreement probably would not be self-enforcing.[49] As a result, participants would likely need to amend their domestic laws and regulations to reflect the replacement of national laws by the international standard.

A. *Would Nations Want to Adopt the Proposal?* For most nations, this agreement would be reduced to a simple trade-off: by agreeing to some minimum standard of antifraud protection in transnational transactions, these countries would escape the sometimes arbitrary application of extremely strict US antifraud law. The nations that currently opt for a low cost/low protection regulatory regime would be very likely to agree to such a proposal; due to the issuer-friendly regulatory schemes in these countries, plaintiffs already usually bring suit in other interested nations with more protective laws. For these countries, this new international agreement would simply set an "upper bound" on the level of protection investors would be entitled to in transnational transactions involving their citizens.

Nations with antifraud laws currently more protective than the proposed international standard would likely favor the measure for two main reasons. First, because plaintiffs would (theoretically) not gain any advantage by bringing their action in these countries, the new agreement would relieve the pressure caused by the number of transnational claims brought in the plaintiff-friendly courts. Second, even though these nations do have relatively protective regimes, their laws are still being subordinated by the even more protective US antifraud measures. Thus, these nations would not really be losing any existing power to hear transnational fraud allegations;

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49. See, for example, *Vencap*, 519 F2d at 1015 (cited in note 24) (emphasizing that securities fraud laws are not part of the "law of nations" and do not fall under the Alien Tort Claim Act, 28 USC § 1350 (1994)).

instead, an international agreement would simply govern many of these claims in place of US law. In addition, all nations with strict securities fraud measures must realize that by applying their laws to transnational fraud claims, they are overriding the policy of those nations that may want to opt for less costly regulations. In the interest of comity, these protective regimes (especially the United States) may want to relax their grip on the transnational securities market.

B. *Defining a Transnational Transaction.* The classification of individual transactions as transnational or domestic is an obvious concern in the proposed scheme. Clearly, if any international or domestic regulatory bodies are forced to examine every communication involving a proposed securities transaction and label it as transnational or domestic, the administrative costs will be prohibitive. Therefore, the proposed agreement would require these communications to be self-identified. Because most potential defendants would want to avoid the application of US (and other relatively strict) antifraud laws, it is likely that they would be eager to comply. All but the most unsophisticated investors could then easily recognize that a proposed transnational exchange awarded less (or more, depending on the particular domestic regulatory scheme) protection than their own national laws. Without a disclaimer identifying the transaction's transnational character, the laws of all interested nations would apply.

In nations with more protective antifraud regimes, wrongdoers might be likely to label domestic transactions as transnational in an attempt to escape the application of the more protective national regulatory laws. Accordingly, the agreement should allow courts to reserve the power to classify specific transactions as domestic regardless of any transnational identification. In the United States, for example, the courts could modify the current conduct and effects tests to accomplish this task. If a particular allegation of fraud involved predominately domestic conduct and the effects impacted US investors, a court could apply the more stringent US law to those US investors despite the fact that the transaction identified itself as transnational.

C. *Reduced Costs.* Once enacted, the measure would impose administrative costs on members only when amendments were needed.[50] Because the regulation would be enforced by private parties seeking damages, the monitoring costs would be thrust upon the plaintiffs, who could then collect them from defendants in the event of a favorable verdict. The agreement would be enforceable by any court willing to hear the dispute.[51] Admittedly, plaintiffs would be likely to bring an action in the court

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50. Accordingly, this comment envisions a smaller committee in IOSCO being formed to periodically examine and amend the agreement.

51. Using national tribunals to adjudicate violations of private international law is not a new phenomenon. For example, under the Alien Tort Claims Act, foreign plaintiffs are currently able to sue foreign defendants in US courts if those defendants violate the "law of nations" or a US treaty and avail themselves of US jurisdiction. See 28 USC § 1350; see also *Filartiga v Peña-Irala*, 630 F2d 876 (2nd Cir 1980). In a recent decision, the Second Circuit also held that alien plaintiffs could

with the most plaintiff-friendly procedural rules; therefore, the agreement could require that a lawsuit be brought in the nation of domicile of either party. If these fora refused to proceed with the action, the suit could be brought elsewhere. If the law was being enforced inconsistently by different nations in favor of the forum party, subsequent amendments could guarantee review by an independent body (either an international tribunal or an international arbitrator).

Another obvious concern is that nations hostile to individual applications of the proposed international agreement will refuse to enforce the judgment of a foreign court against their own citizens. Therefore, although a plaintiff may be able to obtain a favorable verdict under international law, the decision would be meaningless because the winning party would have no way of collecting damages. This concern, although legitimate, is not fatal to the proposal. Because international law will be enforceable throughout the world and complying nations receive a tangible benefit from the agreement, instances in which a plaintiff cannot collect damages should be rare.

First, in many (if not most) securities fraud claims, the defendant is a deep-pocket multinational corporation or an underwriter with offices and resources throughout the world. Usually, the plaintiff will be able to garnish the assets of the defendant in some other part of the world if a particular national tribunal is hostile to the claim. Second, the proposal would penalize nations that refuse to enforce foreign judgments by denying the protection of the international law to their citizens. This would have a tremendous negative impact on most renegade nations; although the citizen with no extraterritorial assets might escape foreign judgment in a particular instance, these nations would likely have other citizens with substantial foreign holdings who would then be subject to the more plaintiff-friendly laws in subsequent fraud suits. Finally, in the cases where hostile nations are undeterred by the consequences of refusing to enforce a foreign judgment, these suits will have a positive impact even if no damages are collected.[52] These actions will raise public awareness that investing in securities connected to these renegade countries is a high risk transaction and investors will be likely to avoid these dangerous transactions.

D. *Enforcing Public Law.* The biggest remaining concern is that by adopting this agreement, nations will surrender their ability to punish domestic behavior judged to be contrary to public policy. Admittedly, because international fraud laws will apply in some cases previously governed by the conduct prong of 10b-5, the United States will be forced to relinquish some of its power to enforce its own public law. However, this

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bring an action against a private party not acting under color of state law. See *Kadic v Karadzic*, 70 F3d 232 (2d Cir 1995).

52. Consider John F. Murphy, *Civil Liability for the Commission of International Crimes as an Alternative to Criminal Prosecution*, 12 Harv Hum Rts J 1, 2 (1999) (cataloguing the benefits of international civil suits, even when no judgment is collected).

will only occur in rare instances, and the purposes of the Exchange Act will not be significantly affected. The proposed international law will not apply to any domestic transaction, even if part of a larger transnational offering. Because it will be rare that conduct in a particular nation produces solely extraterritorial effects, wrongdoers will still be deterred from acting in nations with relatively strict antifraud laws.[53] Additionally, the proposed agreement could make an exception in any situation where the fraudulent behavior constituted a criminal violation. For example, if the SEC determined that conduct was criminal in nature, it could prosecute the wrongdoer under US criminal law regardless of the location of the effects of the transaction.

VI. CONCLUSION

The antifraud provisions of the Securities and Exchange Acts unquestionably provide invaluable protection for millions of US investors. However, the trend towards a globalized economy has rendered the application of these laws problematic in many situations. Unlike the United States, many nations have determined that they can achieve a more efficient and prosperous economy by allowing their issuers, brokers, and securities advisors a far greater freedom to err. When private parties who are injured in transactions involving these nations subsequently seek recourse in the US courts under American law, several negative consequences result. First, these cases clog the already overcrowded court system with matters that have little or no impact on this country. Second, and perhaps more importantly, these plaintiffs invite the United States to implicitly overrule the policy judgments of the more interested nations. Although our courts have devised mechanisms to dispose of many of these claims, these legal tests simply cannot match the gains in technology that influence world securities markets and are therefore outdated. Some other solution is needed.

Unilaterally reducing the number of transnational securities fraud claims allowed to proceed in American courts is a reasonable but incomplete answer. From a global perspective, it makes no difference whether 10b-5 or some other national antifraud law is usurping the regulatory judgments made in other countries. Simply cutting back the extraterritorial application of US fraud laws will only result in the elevation of another nation to the same position the United States finds itself in today, and the world (if not the United States) will be in the same situation.

Enacting a more *laissez-faire* system that allows issuers to choose a particular regulatory regime is an even more inadequate answer. Under the proposed system of portable reciprocity, nations will be impotent to punish and deter conduct they feel to

53. This is most obvious with respect to Internet communications. For example, if a US investment service promotes a security on its Web site, it will be strongly encouraged to comply with both US and international law. The publishers of the information will have no way of restricting access to only foreign investors and will fear that noncompliance with 10b-5 may invoke US regulatory jurisdiction for at least some of the allegedly defrauded investors.

be contrary to public policy. Securities fraud laws are designed to do more than regulate the relationship between a particular buyer and seller; instead, these measures, enacted in a time of tremendous financial catastrophe, are intended to protect national markets as a whole by inspiring investors to be confident that they are getting accurate information when purchasing a stock. Introducing a system that would seriously undermine this desired market stability would have disastrous effects. A portable reciprocity scheme would substantially undo much of the progress that sixty-five years of highly regulated securities markets have accomplished.

The best solution is to recognize that today's economy is a global one. As such, nations with large interests in the transnational securities markets must band together and treat these global transactions like the unique creatures they are. The regime proposed in this comment is an attempt to accomplish this goal. Although not perfect, this proposal would address most of the concerns that have emerged with a global economy, and accordingly, it merits consideration.