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**\*235 SUBJECT MATTER JURISDICTION UNDER THE FEDERAL SECURITIES LAWS: THE STATE OF  
AFFAIRS AFTER ITOBA**

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Since its enactment in 1934, the legislative acorn that is the Securities Exchange Act [FN1] has, in then-Justice Rehnquist's famous phrase, sprouted the judicial oak of private rights of action for section 10(b). [FN2] By necessity, given the myriad possibilities, the legislative acorn similarly offers little guidance on the issue of how it applies to events and people outside the United States. "We freely acknowledge," the Second Circuit's Judge Henry Friendly observed, "that if we were asked to point to language in the statutes, or even in the legislative history, that compelled these conclusions, we would be unable to respond. The Congresses that passed these extraordinary pieces of legislation the Securities Act of 1933 and the Securities Exchange Act of 1934 in the midst of the depression could hardly have been expected to foresee the development of off-shore frauds thirty years later. ... Our conclusions rest on case law \*236 and commentary concerning the application of the securities laws and other statutes to situations with foreign elements and on our best judgment as to what Congress would have wished if these problems had occurred to it." [FN3] Put another way in an earlier Friendly opinion, "we must ask ourselves whether, if Congress had thought about the point," it would have allowed the assertion of jurisdiction over particular events with foreign aspects. [FN4]

The purpose of this article is to shed light on how the judicial oak has grown on the issue of the extraterritorial application of implied private rights of action under the Securities Exchange Act. Our conclusion is that the shade created by the cases that address the subject is variable and does not offer clear lines, at least at the penumbra, of what is and what is not covered.

### I. Second Circuit Decisions Concerning Extraterritorial Application

Although the federal securities laws are silent as to their extraterritorial application, [FN5] there is a considerable body of law to help determine whether subject matter jurisdiction exists in a particular case. [FN6]

\*237 A coherent theme appears in these cases, and one can see a general test that will be applied to determine whether particular transactions or conduct will be subject to claims under the Exchange Act. In a trilogy of cases, the Second Circuit established the "conduct" test and the "effects" test to determine subject matter jurisdiction. [FN7] The two standards are usually applied separately. [FN8] Recently, however, in *Itoha Ltd. v. Lep Group PLC*, the Second Circuit announced an "admixture" of the two, using them concurrently. [FN9] This new formulation has consequences that go far beyond a seemingly innocuous combination of two old tests. [FN10]

## II. The Legislative Acorn

Section 29 of the Exchange Act sets forth its jurisdiction:

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation\*238 of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. [FN11]

15 U.S.C. 78aa.

## III. The Judicial Oak

The factual issue is who and what are covered by section 10(b) of the Exchange Act. There is no question that an American federal court has original jurisdiction over a claim by an American purchaser [FN12] for an allegedly materially misleading report filed with the SEC. [FN13] The difficulty arises in three areas: (1) when an effect but no conduct occurs in the U.S.; (2) when conduct but no effect happens in the U.S.; or (3) when some effect and some conduct occur in the U.S. [FN14]

\*239 Courts have developed two tests in considering the alternatives. One is the “effects” test, i.e. the extent to which the alleged misconduct had an “effect” in the United States. The second is the “conduct” test, which analyzes the extent to which the misconduct in question occurred in the United States.

### A. The Effects Test

The effects test is the product of *Schoenbaum v. Firstbrook*, [FN15] the first influential case regarding subject matter jurisdiction of the securities laws. The facts of *Schoenbaum* are straightforward: Banff was a Canadian corporation controlled by Aquitaine Corporation, also based in Canada. Banff shares were traded on both the American Stock Exchange and the Toronto Stock Exchange. Aquitaine purchased Banff treasury shares in Canada at then-prevailing Toronto Stock Exchange market prices at a time when it supposedly knew and withheld information concerning the value of Banff's oil holdings. An American shareholder brought a derivative action to recover the loss allegedly suffered by Banff when Aquitaine allegedly purchased Banff's treasury shares at undervalued prices due to Aquitaine's non-disclosure of the value of the oil holdings. [FN16]

\*240 The district court dismissed the action, holding that the Exchange Act did not apply to a foreign transaction between foreign buyers and sellers. [FN17] The Second Circuit reversed on the point. [FN18] The district court had jurisdiction:

Congress intended the [Securities] 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

[FN19]

As a result,

[w]e hold 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 stock registered on a national securities exchange, and are detrimental to the interests of American investors . [FN20]

The court next broadly interpreted the phrase “detrimental” impact on American investors. It was enough that the issuer (Banff) received too little for the stock it sold to Aquitaine. This reduced the equity of Banff shareholders and therefore the value of shares traded on an American stock market . “This impairment of the value of American investments by sales by the issuer in a foreign country, allegedly in violation of the Act, has in our view, a sufficiently serious effect upon United States commerce to warrant assertion of jurisdiction for the protection of American \*241 investors and consideration of the merits of plaintiff’s claim.” [FN21]

In any case, under Schoenbaum an American federal court has subject matter jurisdiction for a section 10(b) claim for foreign conduct that has a negative effect on American investors. Schoenbaum, however, proved to be an exception in this area simply because it applied a broad rule and did not, as we see in later cases, take pains to analyze the particular facts before it.

#### B. The Conduct Test

Having addressed the case where a fraud has an effect on securities bought and sold in the United States, the Second Circuit next addressed the issue of stock purchases made in the United States due to fraudulent conduct from securities trading outside the U.S. In *Leasco Data Processing Equipment Corp. v. Kernan*, [FN22] the purchase was of British stock by an American corporation on the London Stock Exchange. Although the stock was not traded in the United States, significant misrepresentations were made in the U.S., including mail sent and telephone calls made to the United States. [FN23] Accepting that constitutional jurisdiction is permitted when only conduct (and not effect) occurs in the United States, [FN24] the issue again was the extent to which the Congress had elected to exercise that jurisdiction. In *Leasco* “it was understood from the outset that all the transactions would be executed in England. Still we must ask ourselves whether, if Congress had thought about the point, it would not \*242 have wished to protect an American investor if a foreigner comes to the United States and fraudulently induces him to purchase foreign securities abroad, a purpose which its words can fairly be held to embrace.” [FN25]

Judge Friendly observed that in the “somewhat different yet closely related context of choice of law,” the Restatement (Second) of Conflict of Laws rejects the application of a “mechanical test,” the *locus delicti*, to determine what law applies to a tort. The test was no longer where “ ‘the last event necessary to make an actor liable,’ ” as in the first Restatement of Conflicts. [FN26] That standard “has given way, in the case of fraud and misrepresentation, to a more extensive and sophisticated analysis.” [FN27]

This, in turn, implies that a sophisticated analysis is necessary in the particular case, ultimately to determine whether the purpose of the statute would be furthered by applying it in a somewhat foreign situation. “The New Yorker who is the object of fraudulent misrepresentations in New York is as much injured if the securities are in Saskatchewan as in Nevada.” [FN28] Judge Friendly concluded that “ w hile, as earlier stated, we doubt that impact on an American company and its shareholders would suffice to make the statute applicable if the misconduct had occurred solely in England, we think it tips the scales in favor of applicability when substantial misrep-

representations were made in the United States.” [FN29]

Of course, this begs the question: what are “substantial misrepresentations ... made in the United States”? Earlier in the opinion, the court examined the jurisprudence derived from the “essential link” concept pronounced by the Supreme Court in *Mills v. Electric Auto-Lite Co.* [FN30] to determine whether the assertion of jurisdiction would run counter to foreign relations law. [FN31] In *Leasco*, “abundant misrepresentations” were made in the United States, including meetings in New York and telephone calls and letters to New York that were an “essential link” in inducing the plaintiff to sign (in the United States) the merger documents which, in turn, were an “essential link” in leading the plaintiff to make \*243 the market purchases. It did not matter where the damages were felt. [FN32]

Where an American [FN33] is injured in the purchase or sale of a security abroad when an “essential link” to the defendant's fraud occurred in the United States, an American district court has jurisdiction to apply section 10(b) of the Exchange Act. [FN34]

#### \*244 IV. Foreign Plaintiffs

In *Leasco*, the Second Circuit began exploring the margins of subject matter jurisdiction for section 10(b) claims, but it was limited to claims by Americans. This left open the issue of foreign plaintiffs, which was addressed in *Bersch v. Drexel Firestone, Inc.* [FN35] The stock at issue was that of IOS, a Canadian organization with its main office in Switzerland. Before 1968 its stock was held only by Bernard Cornfeld and associates and employees, and there was no organized market for the stock. The stock was used as a form of compensation, in anticipation of holders cashing in when IOS went public. Ultimately three simultaneous offerings were made of IOS stock. The largest was of newly-issued stock and was underwritten by six (including two American) firms, to be sold to foreigners in Europe, Asia, and Australia. [FN36] The second offering was a secondary offering in Canada, with no shares sold to Americans resident in Canada. The third offering, also a secondary offering, was sold by a Bahamian entity to categories of people with relationships with IOS; its prospectus provided that the shares “are not being offered in the United States of America or any of its territories or possessions or any area subject to its jurisdiction.” [FN37] The shares ultimately became worthless, and the plaintiff (an American who bought into the offering despite the restrictions on such sales) alleged a claim under section 10(b), among others for alleged false and misleading statements in the prospectuses. [FN38]

Numerous actions actually took place in New York concerning the offerings: a number of meetings were held in connection with the offerings, an American accounting firm was retained to review IOS's operations, the accountant met with the underwriters to discuss the scope of its services, preliminary discussions about discounts and commissions on the offerings were held, parts of the prospectuses were drafted, and the proceeds of the sales were deposited in an account in New York. In addition,\*245 a New York law firm represented the underwriters and met with IOS. The meetings were held between the underwriters, their counsel, and the SEC. [FN39] The issue before the court was whether Congress permitted these exercises. [FN40] These activities, the Second Circuit held, were sufficient to permit the assertion of jurisdiction under principles of foreign relations law without regard to where the effects were felt. [FN41]

Assuming the three activities could be treated as a single underwriting, Judge Friendly concluded that because the U.S. activities were merely preparatory to the offerings (assuming the three could be treated as a single underwriting) and “relatively small in comparison to those [actions that occurred] abroad,” jurisdiction over the claim of a foreign plaintiff was inappropriate. [FN42] Nor was it enough that there would be some impact in the

United States as a result of the collapse of IOS. [FN43]

The limitation was of section 10(b)'s remedy to cases where “fraudulent acts ... committed abroad ... results in injury to purchasers or sellers of those securities in whom the United States has an interest further distinguished the treatment of foreign plaintiffs from American ones.” [FN44] While a foreign citizen's claim would not be heard, that of an American citizen, even residing abroad, would be heard where any conduct, however preparatory, was committed in the United States. [FN45] Thus, Judge Friendly provided the following outline to explain the provisions of the federal 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 the country; and
- (2) Apply to losses from sales of securities to Americans resident 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) \*246 within the United States directly caused such losses. [FN46]

What, however, is the difference between conduct that “significantly contributed” to losses and conduct that “directly caused” losses? The Second Circuit attempted to answer this question in *IIT v. Vencap, Ltd.*, [FN47] decided on the same day as *Bersch*, which reference each other. *IIT* involved an extremely complicated fact pattern that we need not relate here, but two main contributions are worthy of being set forth in summary.

First, because the Second Circuit does “not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled to foreigners,” where “fraudulent acts themselves” and not merely preparatory activities or inaction with the bulk of the fraudulent acts took place abroad, a federal district court has jurisdiction over section 10(b) actions. [FN48]

Second, an American citizen does not travel the globe with obligations of the federal securities laws in his baggage; an American who commits a fraud entirely in, say, England (i.e. with English misstatements, English securities, and English victims) is not subject to a claim under section 10(b). [FN49]

*Bersch* involved only preparatory work in the United States and allowed subject matter jurisdiction over Americans only. *IIT*, however, remanded to the district court for findings on its facts and said that the mere exchange of a draft agreement by American lawyers for an agreement negotiated elsewhere was not enough to confer subject matter jurisdiction over the transaction. On remand, the issue of whether the use of funds to maintain a New York office in which hundreds of transactions and pieces of mail were generated and transactional records kept sufficed to constitute acts that “consummated the fraud,” was decided. The court ultimately exercised jurisdiction over the claims of foreigners. [FN50]

The line, then, for foreign plaintiffs was drawn: subject matter jurisdiction for a foreign plaintiff's claim exists if the U.S. conduct “directly caused” plaintiffs' losses. It was left to later decisions to define that line.

*Psimenos v. E.F. Hutton & Co.* [FN51] was a case under the Commodities Exchange Act [FN52] (the scope of subject matter jurisdiction for which is \*247 analogous to that existing under the Securities Exchange Act [FN53]) alleging that a foreigner's brokerage account at E.F. Hutton's Athens office was handled contrary to representations in company brochures. [FN54] “Although most of the fraudulent misrepresentations alleged in the complaint occurred outside the United States, the trading contracts that consummated the transactions were often executed in New York.” [FN55] Applying the conduct test, the Second Circuit focused “on the nature of conduct within the United States as it relates to carrying out the alleged fraudulent scheme.” [FN56] The fact

that the allegedly misleading pamphlet emanated from New York would not support jurisdiction; however, the additional fact that the alleged fraud was completed by trades on American exchanges did support jurisdiction. [FN57] Thus, although the trades themselves were proper, they were of American commodities and could only be consummated on an American exchange. Consistent with Congress's desire that American commodities markets not be used "as a base to consummate schemes concocted abroad, particularly when the perpetrators are agents of American corporations," jurisdiction to hear the claims existed in a federal court. [FN58] This result was consistent, the court wrote, with *Leasco*. [FN59]

Relying on *Psimenos*, the Second Circuit also found jurisdiction in *Alfadda v. Fenn*, [FN60] which involved allegations that representations in a prospectus concerning, essentially, preemptory rights and non-dilution of share interests, were false in that the defendant company later sold stock to a third party. Jurisdiction existed because the transaction - a sale of stock - that allegedly caused the injury was largely negotiated and consummated in the U.S. [FN61] In this case, the Second Circuit reversed the lower court, which had held that because the fraud was consummated \*248 when the plaintiffs bought stock pursuant to the false prospectus, that predated the sales complained of and "nothing further had to be done to complete the fraud." The court also found later acts committed in the U.S. were irrelevant. [FN62] The Second Circuit expressly rejected this conclusion. [FN63]

#### V. The *Itoba* Decision

The Second Circuit analyzed the issue of subject matter jurisdiction by applying the conduct or effects test separately. Was there sufficient conduct? Was there a sufficient effect? But even in *Bersch*, where levels of conduct were a factor - a higher level required for the foreign plaintiff - seemingly simple rules were announced. It was inevitable, then, that the court would face a case where while neither of the tests was satisfied alone and enough of both appeared to give pause. Judge Friendly had suggested that it would be wrong to be simplistic in this area, warning in *Leasco* that in this as in other areas of the law "mechanical tests" do not suffice for analyzing foreign transactions.

*Itoba Ltd. v. Lep Group PLC* [FN64] would provide the Second Circuit with a vehicle for analyzing and acknowledging a mixed fact situation. The corporate defendant, Lep Group PLC, was a London-based holding company with subsidiaries in thirty countries. [FN65] Lep's ordinary shares were registered in the United Kingdom and traded on the London Stock Exchange. [FN66] Nine and one quarter percent of these ordinary shares (the equivalent of common stock shares for American companies) were deposited in an American depository, which issued one American Depository Receipt (ADR) for each five ordinary shares deposited with it. [FN67] The ADRs, in turn, traded as American Depository Shares (ADSs) on the Nasdaq, subjected Lep to the reporting requirements of the U.S. securities\*249 laws. [FN68]

The plaintiff, *Itoba*, was a Channel Islands company whose parent was A.D.T. Limited ("ADT"), a Bermuda company. ADT's shares traded on the New York Stock Exchange, and approximately half of its shareholders of record resided in the United States. [FN69] ADT was also the parent of A.D.T. Securities Systems, Inc., ("A.D.T. Securities") a Delaware corporation engaged in the security services industry. [FN70]

One of the largest competitors of A.D.T. Securities was National Guardian, which was a subsidiary of Lep. ADT owned shares in Lep and thus had an indirect interest in National Guardian. [FN71] It also considered acquiring National Guardian as a way to expand its subsidiary, A.D.T. Securities. After a possible joint venture to acquire Lep was abandoned, ADT began to purchase Lep ordinary shares (and therefore National Guardian) on the London Stock Exchange. [FN72] ADT relied on ADT's chief financial officer's review of an Lep SEC filing

and a report prepared by the financial adviser to the potential joint venturer in making its decision to purchase the stock. [FN73] The company used Itoba to make its actual stock purchases. While this creeping acquisition was in progress, Lep's stock price collapsed, and the value of Itoba's (and ADT's) \$114 million investment in Lep dropped by nearly \$111 million. [FN74] Itoba asserted a claim against Lep and Lep's insiders under section 10(b) of the Exchange Act. [FN75]

**\*250** In summation, the key facts, then, are that (i) a foreign company (ADT, through an off-shore subsidiary) was (ii) defrauded in purchasing (iii) another foreign company's stock (Lep) (iv) on the London Exchange (v) in part in reliance on the latter's required SEC filings. Although a foreign company, the buyer's stock was traded on the New York Stock Exchange and half of its shareholders of record were residents of the U.S. But the loss complained of was felt in the loss in the value of the stock bought in London.

The question before the Second Circuit was whether either of the two tests be satisfied based on these facts. Although a large number of ADT's shareholders were American and although its stock traded on the New York Stock Exchange, Itoba, the victim, was a foreign company. [FN76] Under Schoenbaum, there was an insufficient effect in the United States to justify the assertion of jurisdiction.

The closer question was whether the defendant's conduct enough. In other words, was the loss in London "directly caused" by the filing of the false report with the SEC? The purchase of the stock ("transaction causation" [FN77] ) was caused by the false report. [FN78] But was the loss caused by the false report? [FN79] The Second Circuit held that it was because of the nature of ADRs.

The ADRs were simply a grouping into one security of five ordinary shares. Inevitably, there was a direct linkage between the prices of the ADRs representing five ordinary shares and the prices of the single ordinary shares themselves. If the ordinary share price fell on the London Exchange, the market price of an ADR would decrease in similar manner, and vice versa.

**\*251** 54 F.3d at 123.

The court would not say that the conduct involved was enough to confer subject matter jurisdiction. Instead it melded the conduct and effects tests. "There is no requirement that these two tests be applied separately and distinctly from each other. Indeed, an admixture or combination of the two often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court ." [FN80] Using this formulation, the court found there was subject matter jurisdiction because "Lep's uncorrected nondisclosure in SEC filings played as much a role in Itoba's purchase as the price listings on the London Exchange and NASDAQ. In view of the deleterious effect this continued nondisclosure had on the thousands of ADT shareholders in the United States, it cannot be described correctly as incidental or preparatory to the fraud ." [FN81]

## VI. The Effect of Itoba on Purchasers on Foreign Exchanges

The impact of the flexible approach dictated by Itoba can be seen in contrasting it to an earlier case, The Nathan Gordon Trust v. Northgate Exploration Ltd., [FN82] which Itoba sought to distinguish, unsuccessfully from this article's viewpoint. Northgate involved a Canadian company whose common stock was listed on the New York Stock Exchange as well as the Toronto, London, and Montreal Exchanges. The class action complaint alleged that the price of the company's stock was inflated by misleading statements made in materials filed with the SEC concerning the development of a gold mine in Canada. The jurisdictional issue arose on the plaintiff's

motion for class certification, in which it sought to represent all purchasers who bought Northgate common stock on any exchange, domestic or foreign, during the proposed class period. The defendants objected to the inclusion of a class of purchasers other than those on the New York Stock Exchange. The defendants' objection was based on the ground that the court could not assert jurisdiction over their claims, and the district court agreed. [FN83]

The plaintiff in Northgate argued that, since a change in price on a domestic exchange would be reflected in a similar change on a foreign exchange, the filing of materially misleading reports with the SEC established conduct enough for subject matter jurisdiction over all purchasers' \*252 claims. [FN84] The court rejected such a rule, holding that "the relevant 'conduct' in the present case occurred in Canada where the alleged misleading information was authored. The mere filing of reports with the SEC and the dissemination of some materials to shareholders in the United States were merely incidental to the authorship, preparation and dissemination of the allegedly false information, all of which occurred in Canada." [FN85] Thus the conduct test was failed, and those for whom no effect was felt in the U.S. - i.e. all those who did not purchase on the NYSE - could not assert claims in the district court. [FN86] Insofar as Northgate \*253 pronounced a situs-of-preparation rule, it was rejected by *Itoba* :

[W]e hold that the situs of preparations for SEC filings should not be determinative of jurisdictional questions. Otherwise, the protection afforded by the Securities Exchange Act could be circumvented simply by preparing SEC filings outside the United States. We find no support in the Act for such a result. 54 F.3d at 124.

Finding that the mere filing of a misleading SEC report prepared abroad was not conduct enough to sustain jurisdiction for foreign purchasers meant that the Northgate court would not assert jurisdiction over the claims of such buyers. This pre-*Itoba* approach did not allow the court to weigh other factors that might compel a different result, and it is allowing for this possibility that makes *Itoba* significant.

Northgate did not address the argument that the filing of misleading SEC reports and the corresponding effect this would have (on an efficient exchange) on the price of domestic securities actually injured purchasers on non-American exchanges. *Itoba*, however, found that "[i]nvariably, there was a direct linkage between the prices of the ADRs representing five ordinary shares and the prices of the single ordinary shares themselves. If the ordinary share price fell on the London Exchange, the market price of an ADR would decrease in similar manner, and vice versa ." [FN87] Thus, if the price of an ADR falls or rises in the United States, it will also fall or rise abroad. Also, conduct in the United States that inflated the price on a domestic stock exchange would directly cause injury to purchasers abroad.

Still, *Itoba* refused to allow the facts surrounding the SEC filing at issue and especially the injury that directly flowed from it to be completely dispositive of the subject matter jurisdiction. [FN88] It would not hold that such U.S. conduct alone was enough to justify the assertion of jurisdiction notwithstanding that the inflation in the price of ADRs (in the United States) inflated the price of ordinary shares on the London Exchange.\*254 Instead, *Itoba* considered who was injured by this U.S. conduct, i.e. the effect: "In view of the deleterious effect this continued nondisclosure had on the thousands of ADT shareholders in the United States, it cannot be described correctly as incidental or preparatory." [FN89] While the effect felt in the United States certainly buttresses the finding of subject matter jurisdiction, it would seem that the conduct alone described in *Itoba* should be sufficient to confer subject matter jurisdiction, regardless of any application of the effects test. It remains to be seen whether any courts will so hold.

## VII. Subject Matter Jurisdiction **After Itoba**

Itoba, in a sense, hearkened back to a theme in Bersch that has been somewhat ignored. The Bersch three-prong scenario in essence announced different conduct tests based on the effect felt in the United States: (1) no conduct is necessary for a U.S. resident; (2) some conduct is necessary for a U.S. citizen residing abroad; and (3) much conduct is necessary for foreigners. [FN90] Thus the “admixture” of the tests in Itoba should come as no surprise. Itoba did blur the strict three-prong Bersch test so that the categories no longer fit as neatly. It is more appropriate to think of the subject matter jurisdiction test as a graph.

\*255 Subject matter jurisdiction would lie in cases outside the shaded area. [FN91] While the conduct axis is very case-specific, one thing that makes the graph manageable is the limited nature of the effect axis. The plaintiff is either a citizen, a citizen residing abroad, a foreigner, or a foreign corporation with significant U.S. shareholders. [FN92] The question is where the foreign corporation falls on the axis. We suggest it belongs between the foreigner and the U.S. citizen residing abroad.

## VIII. Conclusion.

Itoba will not affect a finding of subject matter jurisdiction in a case that satisfies either the conduct or the effects test. [FN93] What Itoba does is reinvigorate what was perhaps implicit in Bersch : that the reach of the \*256 federal securities laws is not an either/or proposition but a more flexible one in which cases where the facts do not support one or the other of the tests support a finding of subject matter jurisdiction where the elements of conduct and effects together, as an “admixture,” make it reasonable to conclude that Congress intended to have federal securities laws apply.

[FN<sub>a</sub>]. Mr. Garland, B.A., Manhattanville College (1978); J.D., Columbia University (1981), is a sole practitioner in Mount Vernon, New York. Mr. Murray, University of Notre Dame (1983); M.A., University of Notre Dame (1986); J.D., St. John's University (1990), is an associate at Rabin & Peckel LLP. They specialize in securities and antitrust litigation.

[FN1]. 15 U.S.C. 78a-78kk.

[FN2]. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975). Section 10(b) provides:

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. 78j(b). Although some courts and practitioners equate SEC Rule 10b-5 with section 10(b) and refer to actions under rule 10b-5, the two are not equivalent. See, e.g., *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 121 (2d Cir. 1995), cert. denied, \_\_\_ U.S. \_\_\_, 116 S. Ct. 702 (1996). The former was promulgated pursuant to authority granted in the former and therefore the rule's reach cannot exceed the statute's. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976) (to the extent that rule 10b-5 allowed finding of liability without scienter,

it exceeded the statutory authorization and was invalid). The better practice is to refer to actions as being brought under section 10(b).

[FN3]. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir.), cert. denied, 423 U.S. 1018 (1975). This approach to interpreting the Exchange Act was most recently endorsed by the Supreme Court in *Central Bank of Denver, N.A. v. First Interstate of Denver*, 114 S. Ct. 1439, 1448 (1994). The Court wrote, “When the text of 10(b) does not resolve a particular issue, we attempt to infer how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act.”

[FN4]. *Leasco Data Processing v. Kernan*, 468 F.2d 1326, 1337 (2d Cir. 1972).

[FN5]. See *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir.), cert. denied, 501 U.S. 1005 (1991). See also *MCG, Inc. v. Great Western Energy Corp.*, 896 F.2d 170, 173 (5th Cir. 1990).

[FN6]. At the outset we wish to emphasize one point. We, and the courts generally, refer to “subject matter jurisdiction” in the context of the Exchange Act as raising the issue of whether Congress elected to extend the protection of that Act to particular types of transactions or parties. It is important to distinguish between the extent to which a country may assert its judicial authority as discussed in both the *Restatement (Second) of Foreign Relations Law 18* (1995) and applied by the courts under the principles of due process, see *Leasco*, 468 F.2d at 1333-34 (referring to *U.S. v. Aluminum Co. of Amer.*, 148 F.2d 416, 443 (2d Cir. 1954) - and the extent to which it elects to - referred to as “competence” in the *Restatement (Second) of Conflicts of Law 97* (1971). The latter phrase has not garnered widespread use, and for purposes of this article we refer to competence as “subject matter jurisdiction” and we refer to the Restatement’s “jurisdiction” as “constitutional jurisdiction.” The easiest way to appreciate the distinction is the situation where a defendant has engaged in some conduct in the United States in connection with an offering. The Second Circuit, in *Bersch*, held that in that case an American court could constitutionally exercise its power and hear a section 10(b) claim (i.e. constitutional jurisdiction), 519 F.2d at 985, but that Congress has elected only to allow such claims if made by an American citizen, even if residing abroad (i.e. competence or subject matter jurisdiction). *Bersch*, 519 F.2d at 985, 987, and 992 (emphasis added). See also *infra* notes 43-45 and accompanying text. Those courts that have considered the scope of the Exchange Act have held that Congress has not extended subject matter competence to the extent permitted by foreign relations law. *Leasco*, 468 F.2d at 1334. In sum, we use the more common term “jurisdiction” as a shorthand for subject matter jurisdiction, i.e. the extent that Congress has elected to exercise its authority.

[FN7]. See *Bersch v. Drexel Firestone*, 519 F.2d 974 (2d Cir. 1975), cert. denied, 423 U.S. 1018 (1975); *Leasco Data Processing Equipment v. Kernan*, 468 F.2d 1326 (2d Cir. 1972); *ITT v. Vencap*, 519 F.2d 1001 (2d Cir. 1995).

[FN8]. See, e.g., *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir. 1991), cert. denied, 501 U.S. 1005 (1991).

[FN9]. *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 122 (2d Cir. 1995), cert. denied, \_\_\_ U.S. \_\_\_, 116 S. Ct. 702 (1996).

[FN10]. The recently enacted amendments to the Exchange Act, Private Securities Litigation Reform Act of 1995, 109 Stat. 7373 (1995) (codified, *inter alia*, by adding sections 21D and 21E, 15 U.S.C. 78uD (“Private Securities Litigation”) and 78uE (“Application of Safe Harbor for Forward-Looking Statements”) to Securities Exchange Act of 1934, as amended), do not alter our analysis. They do not address jurisdictional issues.

[FN11]. Section 1337(a) of the United States Judicial Code, 28 U.S.C. 1337(a), which confers jurisdiction over

“any civil action or proceeding arising under any Act of Congress regulating commerce,” is irrelevant because it “adds nothing” to a federal statute that has its own jurisdictional provision. [IIT v. Vencap, Ltd ., 519 F.2d 1001, 1015 \(2nd Cir. 1975\)](#).

This article does not address the issue of in personam jurisdiction. It is generally held that due process concerns are met in a securities case if a defendant has minimum contacts with the United States as a whole. See, e.g., [Kidder, Peabody & Company, Inc. v. Maxus Energy Corp., 925 F.2d 556, 562 \(2nd Cir. 1991\)](#) (“Section 27 confers personal jurisdiction over a defendant who is served anywhere within the United States.”), cert. denied, [501 U.S. 1218 \(1991\)](#). See also [Busch v. Buchman, Buchman & O'Brien, 11 F.3d 1255, 1258 \(5th Cir. 1994\)](#) (“when a federal court is attempting to exercise personal jurisdiction over a defendant in a suit based upon a federal statute providing for nationwide service of process, the relevant inquiry is whether the defendant has had minimum contacts with the United States”). This is consistent with the subject matter analysis, which looks to conduct or effect in the United States as a whole.

[FN12]. Section 10(b) requires a “purchase or sale” of securities. [Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731-32 \(1975\)](#). For ease, we focus on purchases, which is the more common predicate act. But the analysis applies equally to a claim by a seller.

[FN13]. See [Reisch v. Drexel Firestone, 519 F.2d 974, 993 \(2nd Cir. 1975\)](#), cert. denied, [423 U.S. 1018 \(1975\)](#). Likewise, there is no jurisdiction for a claim by a foreign plaintiff for misleading reports prepared abroad concerning foreign securities. See [Butte Mining PLC v. Smith, 76 F.3d 287, 290-91 \(9th Cir. 1996\)](#).

[FN14]. In [Leasco Data Processing Equipment Corp. v. Kernan, 468 F.2d 1326 \(2nd Cir. 1972\)](#), Judge Friendly wrote:

It is true, as Judge L. Hand pointed out in the [ [U.S. v. \] \[Aluminum \\[ Co. of Amer. \\] case, 148 F. 2d \\[416\\] at 443 \\[\\(2d Cir. 1954\\)\\]\]\(#\), that if Congress has expressly prescribed a rule with respect to conduct outside the United States, even one going beyond the scope recognized by foreign relations law, a United States court would be bound to follow the Congressional direction unless this would violate the due process clause of the Fifth Amendment. However, the language of 10\(b\) of the Securities Exchange Act is much too inconclusive to lead us to believe that Congress meant to impose rules governing conduct throughout the world in every instance where an American company bought or sold a security. When no fraud has been practiced in this country and the purchase or sale has not been made here, we would be hard pressed to find justification for going beyond Schoenbaum .](#)

Id . at 1334.

[FN15]. [405 F.2d 200 \(2nd Cir. 1968\)](#) (hereinafter Schoenbaum I ), rev'd with respect to holding on merits, [405 F.2d 215 \(2d Cir. 1968\)](#) (en banc) (hereinafter Schoenbaum II ), cert. denied, [395 U.S. 906 \(1969\)](#).

[FN16]. The decision by the initial panel to affirm summary judgment for the defendants on the merits for failing to state a claim under section 10(b) was reversed (except as to one defendant) by the in banc panel. [Schoenbaum II, 405 F.2d 215, 220](#). The jurisdictional issue was not presented to the in banc panel. The en banc court held that where a controlling shareholder causes a corporation to issue stock for “a wholly inadequate consideration” a claim under section 10(b) is made out. [Id . at 219-20](#). The Second Circuit's holding that section 10(b) does not support a state law claim where conduct at issue is “neither deceptive or manipulative” does not alter this conclusion. See also [Goldberg v. Meridor, 567 F.2d 209, 217-18 \(2nd Cir. 1977\)](#), cert denied, [434 U.S. 1069 \(1978\)](#). See also [Frankel v. Slotkin, 984 F.2d 1328, 1333-34 \(2nd Cir. 1993\)](#).

[FN17]. [405 F.2d at 206](#).

[FN18]. The nature of federal appellate practice makes it unlikely that a court of appeals will consider a district court's denial of a motion to dismiss for want of subject matter jurisdiction. The final judgment rule requires permission to file an interlocutory appeal. 28 U.S.C. 1291. Hence only cases dismissed by a district court for lack of jurisdiction will likely be considered by a court of appeals. Therefore, the fact that a number of major Second Circuit opinions are reversals of district court's finding that they lack jurisdiction is not a realistic measure of how, if at all, district judges interpret the scope of their jurisdiction. See, e.g., *Alfadda v. Fenn*, 935 F.2d 475, 478 (2nd Cir. 1991); *Consolidated Gold Fields PLC v. Minorca, S.A.*, 871 F.2d 252, 255 (2nd Cir. 1989).

[FN19]. 405 F.2d at 206.

[FN20]. *Id.* at 208 (emphasis added).

[FN21]. *Id.* at 208-09. But Judge Friendly, in *Bersch*, would later refuse to allow too large a net for what is an "American effect." "Moderation is all," he wrote, and it would not suffice to have a general effect on the American economy. Section 10(b)'s remedy is limited to cases where "fraudulent acts ... committed abroad ... result in injury to purchasers or sellers of those securities in whom the United States has an interest," presumably securities sold in the United States. *Bersch v. Drexel Firestone*, 519 F.2d 974, 989 (2d Cir.), cert. denied, 423 U.S. 1018 (1975) (footnote omitted). As will be seen below, "those securities" was defined as "either the very securities sold or bought or other securities of the same issue as in *Schoenbaum* ." *Id.* at 983 n.34.

[FN22]. 468 F.2d 1326 (2d Cir. 1972) (Friendly, J.).

[FN23]. The negotiations were held over an extended period in New York, as well as in England. They were in the context of a possible merger transaction in which the defendants, including Robert Maxwell, allegedly made misstatements about the financial condition and performance of Pergamon. That transaction was never completed because the plaintiff learned of the falsity during pre-consummation due diligence. The plaintiff had heard rumors - allegedly instigated by the defendants - of a competing suitor. To thwart a competing tender, the plaintiff began buying stock of Pergamon on the London Stock Exchange, ultimately spending some \$22,000,000 for it. It was for these purchases that the plaintiff sued. *Id.* at 1330-33.

[FN24]. *Id.* at 1334.

[FN25]. *Id.* at 1337 (emphasis added).

[FN26]. *Id.* (quoting *Restatement of the Conflict of Laws* 377 (1934)).

[FN27]. *Id.* (citing *Restatement (Second) of the Conflict of Laws* 148 (1971)).

[FN28]. *Id.* at 1336.

[FN29]. *Id.* at 1337 (emphasis added).

[FN30]. 396 U.S. 375, 385 (1970).

[FN31]. 468 F.2d at 1335. While the U.S. may have the authority to "prescribe the conduct of its nationals everywhere in the world," Congress has not done so. This is an example of the jurisdiction versus competence issue referred to *supra* at note 6. *Leasco* noted that the ultimate, outside assertion of power was determined by due process. *Id.* at 1334.

[FN32]. *Id.* at 1335. Judge Friendly analyzed the issue on a pre-trial record and according the plaintiff “every favorable inference.” 468 F.2d at 1330. He “add [ed] that if a trial should disclose that the allegedly fraudulent acts of any of the defendants within the United States were nonexistent or so minimal as not to be material, the principles announced in this opinion should be applied to the proven facts.” *Id.* In other words, if the facts that support the assertion of jurisdiction at the pre-trial stage are not borne out at trial, a judgment dismissing the action for lack of jurisdiction would be appropriate.

But a motion to dismiss for want of jurisdiction under Fed. R. Civ. P. 12(b)(1) does not require that all inferences be taken in favor of the party opposing the motion (as would a Fed. R. Civ. P. 12(b)(6) motion). A district court may resolve factual disputes that go to its subject matter jurisdiction. As one treatise explains, [b]y contrast [to a Fed. R. Civ. P. 12(b)(6) motion], subject matter jurisdiction deals with the power of the court to hear the plaintiff's claims in the first place, and therefore imposes upon courts an affirmative obligation to ensure that they are acting within the scope of their jurisdictional power. Accordingly, upon a challenge to the court's jurisdiction by a party, the court should conduct a careful inquiry and make a conclusive determination whether it has subject matter jurisdiction or not, or at least defer the inquiry if it is intertwined with the merits of the case.

5A Charles A. Wright and Arthur R. Miller, *Federal Practice and Procedure, Civil 2d 1350*, at 77 (2d ed. 1995); see also *Thornhill Pub. v. General Tel. & Elec.*, 594 F.2d 730, 733 (2d Cir. 1979) (court may consider evidence presented on jurisdictional issues and render factual findings on Rule 12(b)(1) motion).

[FN33]. The court rejected the defendants' argument that there was no subject matter jurisdiction because the purchaser of the shares was a Netherlands Antilles subsidiary of the plaintiff (an American corporation). This argument, the court concluded, “elevate(s) form over substance” given that the subsidiary was “part and parcel of Leasco [the American company] in every realistic sense.” 468 F.2d at 1338.

[FN34]. The court addressed the issue of what substantive law should be applied to a claim where the purchase was of foreign securities abroad. Judge Friendly wrote that section 17 of the Restatement of Foreign Relations Law provides that “the nation where the conduct has occurred has jurisdiction to displace foreign law and to direct its courts to apply its own.” *Id.* at 1334. Application of section 10(b) of the Exchange Act where conduct that is an “essential link” to a fraud in the purchase or sale of a security occurs in the United States is therefore permitted. Section 17 of the Restatement of Foreign Relations Law provides that “A state has jurisdiction to prescribe a rule of law (a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory.” Restatement (Second) of the Foreign Relations Law of the United States 17. This section has been amended slightly in the latest Restatement:

Subject to 403, a state has jurisdiction to prescribe law with respect to (1)(a) conduct that, wholly or in substantial part, takes place within its territory;

(b) the status of persons, or interest in things, present within its territory;

(c) conduct outside its territory that has or is intended to have substantial effect within its territory;

(2) the activities, interests, status, or relations of its nationals outside as well as within its territory; and

(3) certain conduct outside its territory by persons not its nationals that is directed against the security of the state or against a limited class of other state interests.

Restatement (Third) of the Foreign Relations Law 402.

[FN35]. 519 F.2d 974 (2d Cir.), cert. denied, 423 U.S. 1018 (1975).

[FN36]. The prospectuses were to be delivered in those countries. *Id.* at 980.

[FN37]. 519 F.2d at 978-80 (quoting prospectus).

[FN38]. *Id.* at 980-81. The prospectuses for the three offerings were essentially the same insofar as alleged misstatements are concerned.

[FN39]. *Id.* at 985 n.24. The defendants disputed the weight to be given to these U.S. activities. *Id.*

[FN40]. *Id.*

[FN41]. *Id.* at 985.

[FN42]. *Id.* at 986-87.

[FN43]. *Id.* at 988.

[FN44]. *Bersch v. Drexel Firestone*, 519 F.2d at 989 (footnote omitted).

[FN45]. *Id.* at 992. *Bersch* was a class action. *Id.* at 993. As a result of its holding on jurisdiction and the distinct treatment for foreign as opposed to American plaintiffs, the Second Circuit ordered that the class not include those who were neither citizens nor residents of the United States. *Id.* at 995-97.

[FN46]. *Bersch*, 519 F.2d at 993.

[FN47]. 519 F.2d 1001 (2nd Cir. 1978).

[FN48]. *Id.* at 1017-18.

[FN49]. *Id.* at 1016-17.

[FN50]. *Id.* at 1018.

[FN51]. 722 F.2d 1041 (2d Cir. 1983).

[FN52]. 7 U.S.C. 1-24.

[FN53]. See *Psimenos*, 722 F.2d at 1044 (citations omitted).

[FN54]. *Id.* at 1043-44.

[FN55]. *Id.* at 1044.

[FN56]. *Id.* at 1045.

[FN57]. *Id.* at 1046.

[FN58]. *Id.*

[FN59]. *Id.* at 1046-47. The Second Circuit rejected the district court's conclusion that because the American trades were themselves not fraudulent they did not support jurisdiction. The test, the appellate court wrote, was not whether the American activity was fraudulent but whether the American activity " 'directly caused' the loss." *Id.* at 1046 (quoting *Bersch*, 519 F.2d at 993).

[FN60]. [935 F.2d 475 \(2d Cir.\)](#), cert. denied, 501 U.S. 1005 (1991).

[FN61]. *Id.* at 179. The court of appeals noted that although the buyer of the stock was a foreign company, it was merely a shell for an American company, formed for the purpose of holding the stock. This did “not detract from the import of the United States meetings and negotiations which preceded the sale.” *Id.*

[FN62]. *Alfaada v. Fenn*, [1990-91 Transfer Binder] Fed. Sec. L. Rep. (CCH) < para>95,652, at 98,040 (S.D.N.Y. Nov. 26, 1990) (relying on *Bersch* ), rev'd, [935 F.2d 475 \(2d Cir.\)](#), cert. denied, 501 U.S. 1005 (1991).

[FN63]. [935 F.2d at 479](#).

[FN64]. [54 F.3d 118, 120 \(2d Cir. 1995\)](#), cert. denied, 116 S. Ct. 702 (1996).

[FN65]. *Id.* The Second Circuit's opinion does not state whether one of those countries was the United States.

[FN66]. *Id.*

[FN67]. *Id.* “ADR's are, in substance, ‘receipts’ issued by a domestic bank for shares of foreign corporations that have been deposited in an overseas bank. The ‘receipts’ can then be traded in the United States without any of the complications that ordinarily arise because of currency conversions and customs requirements.” *In re Nomura Secs. Int'l, Inc. v. Citibank, N.A.*, 81 N.Y.2d 614, 616, 619 N.E.2d 385, 386, 601 N.Y.S.2d 448, 448 (N.Y. 1993).

[FN68]. *Itoba*, [54 F.3d at 120](#). Although the opinion does not announce it, the stock was traded on the Nasdaq National Market System, which can be a significant fact for an efficient market analysis.

[FN69]. *Id.* The court does not specify what percentage of outstanding shares was held by U.S. residents.

[FN70]. *Id.*

[FN71]. *Id.*

[FN72]. *Id.* at 121.

[FN73]. *Id.* The particular filing was an annual report on Form 20-F, which is the foreign issuer's equivalent of a Form 10-K.

[FN74]. *Id.*

[FN75]. *Id.* According to the Second Circuit, claims were also asserted under section 12(2) of the Exchange Act. *Id.* This is probably a typo which should read “20(a)” ([15 U.S.C. 78t\(a\)](#)), which imposes vicarious liability on “control persons” of violators of the Exchange Act. There is no section 12(2) of the Exchange Act.

The case also has an interesting discussion of liability for selling in an exchange transaction when in possession of material inside information even when the sale is on a foreign exchange. *Itoba* bought 7.5 million ordinary shares on the London Stock Exchange on the same day that an insider (Berkeley) sold 7.3 million ordinary shares on that Exchange, and most of the shares bought were later found to have been those sold by Berkeley. Although the Second Circuit declined to rule on whether a claim was stated on these facts-it remanded because the district court had dismissed the claim without discussion-it wrote that “it would seem” to be a violation of the “disclose or abstain” rule; “Because antifraud provisions are designed to prevent corporate insiders from tak-

ing unfair advantage of uninformed outsiders, [Shapiro v. Merrill Lynch](#), 495 F.2d 228, 235 (2d Cir. 1974) (citing [Radiation Dynamics, Inc. v. Goldmuntz](#), 464 F.2d 876, 890 (2d Cir. 1972)), [the defendant] Berkeley alleged nondisclosure during a sales transaction executed by two parties within the United States - Berkeley and his broker - is the type of conduct that should trigger jurisdiction.” 54 F.3d at 125.

[FN76]. Ignoring that its subsidiary actually bought the stock.

[FN77]. [Schlick v. Penn-Dixie Cement Corp.](#), 507 F.2d 374, 380-81 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1975).

[FN78]. [Itoba](#), 54 F.3d at 121. This was the case although Itoba's board did not read the report because Itoba was merely the tool of ADT, which did read the report. Such derivative reliance was adequate. Id . at 122 (citing, inter alia, [Austin v. Loftsgaarden](#), 675 F.2d 168, 177-78 & n.19 (8th Cir. 1982), appeal after remand, 768 F.2d 949 (8th Cir. 1985), rev'd on other grounds sub nom. [Randall v. Loftsgaarden](#), 478 U.S. 647 (1986)).

[FN79]. [Schlick v. Penn-Dixie Cement Corp.](#), 507 F.2d at 381.

[FN80]. Id . at 122 (emphasis added).

[FN81]. Id . at 124 (emphasis added).

[FN82]. 148 F.R.D. 105 (S.D.N.Y. 1993) (Griesa, C.J.). Both of the authors represented the plaintiff in Northgate .

[FN83]. Id . at 108.

[FN84]. This precise view was accepted in an unreported decision, [Holtz v. National Business Systems](#), Civ. No. 88-1755 (D.N.J. May 22, 1989). The court accepted the plaintiff's argument on a class certification motion that a unitary market existed for the stock at issue in Canada and the United States. In another case, the subject matter jurisdiction issue was not raised, but the court seemed to assume it subject matter jurisdiction over the foreign purchases. See [In re Laidlaw Sec. Litig.](#), 1992 WL 68341 (E.D. Pa. March 31, 1992). However, the Court refused to certify a class which included purchasers on the Toronto and Montreal exchanges, on the grounds that the plaintiff would have no interest in proving the efficiency of these markets since he purchased on the NYSE. Id . at \*14.

[FN85]. It is difficult to reconcile this holding with [Itoba](#), which held that the filing of reports with the SEC was relevant conduct, at least in part. [Itoba](#), 54 F.3d at 124. Moreover, the SEC reports at issue in [Itoba](#) were authored in England. Id .

[FN86]. In theory, the court should have allowed the claim of Americans that bought Northgate stock on foreign exchanges during the class period because this would seem to fall within the second prong of the Bersch test. See supra note 44 and accompanying text. In a class context, however, such a finding would have created significant complications in the notice process. Ultimately, notice was sent to those who the Company could identify as having bought on the NYSE. Including foreign purchasing Americans would have greatly enhanced the class notice obligation in that efforts would have to be made to contact all purchasers in Toronto, London, and Montreal would have been contacted on the chance that some were Americans.

[Itoba](#) sought to distinguish Northgate as being a motion on class certification, but that distinction does not stand. It wrote:

Northgate involved a motion for class certification. The defendant was a Canadian corporation

which owned an interest in a gold mine located in northern Canada, concerning which the defendant filed allegedly false SEC statements. The proposed class was to consist of all persons who purchased Northgate stock on the Toronto, Montreal, London and New York Exchanges. The defendant requested that the class be limited to those who purchased on the New York Exchange, and the district court granted its request. In contrast to the discretionary nature of the district court's class certification ruling and the "fraud on the market" class issues of Northgate, the instant case involves a single plaintiff asserting direct individual fraud.

54 F.3d at 123. Bersch, after all, was also a class action and the Second Circuit did not find that that element of the case altered its analysis, pursuant to which it decided that certain stock purchasers could not be members of a class because the district court lacked jurisdiction over their claims.

[FN87]. 54 F.3d at 123 (emphasis added). The "direct linkage" exposes a flaw in *In re Laidlaw Sec. Litig.*, 1992 WL 68341 (E.D. Pa. March 31, 1992), in which only purchases on the NYSE were included in a certified class and purchases on the Toronto and Montreal Exchanges were excluded. The Laidlaw court reasoned that the class representative, a purchaser on the NYSE, would have "no interest in demonstrating how the alleged fraud may have affected prices on the Montreal or Toronto Exchanges." *Id.* at \*6. With a "direct linkage" between domestic and foreign exchange prices, a domestic purchaser would necessarily prove inflation on the foreign exchange when he proved inflation on the domestic exchange on his direct case.

[FN88]. *Id.* at 124.

[FN89]. *Id.* (emphasis added).

[FN90]. *Bersch v. Drexel Firestone*, 519 F.2d 974, 993 (2d Cir.), cert. denied, 423 U.S. 1018 (1975).

[FN91]. The only case so far to apply the admixture test is *Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, 940 F. Supp 528 (S.D.N.Y. 1996). The Banque Paribas court found no effect at all and very little conduct, placing it in the lower left quadrant of the graph. *Id.* at 535.

[FN92]. There is seemingly no reason to distinguish between foreign corporations whose stock or ADRs are traded on American exchanges and foreign corporations whose stock or ADRs are not traded on American exchanges. Under *Itoba*, the relevant inquiry seems to be the level of U.S. stock ownership, regardless of where the stock trades.

[FN93]. See, e.g., *Carr v. Equistar Offshore, Ltd.*, 1995 WL 562178, \*5 (S.D.N.Y. Sept. 20, 1995) (finding subject matter jurisdiction using only conduct test).

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