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Anthony Michale Sabino

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"BIG EIGHT" BEWARE: MULTINATIONAL ACCOUNTING FIRMS AND THE INCREASING SCOPE OF SUBJECT MATTER JURISDICTION UNDER THE FEDERAL SECURITIES LAWS*

ANTHONY MICHAEL SABINO**

PREAMBLE

In the recent decision of Department of Economic Development v. Arthur Andersen & Co. (U.S.A.),¹ ("DED") the Southern District of New York found subject matter jurisdiction over a suit commenced by an agency of the British government against the accounting firm Arthur Andersen & Company and certain of its European affiliates. The court thus added a further and quite possibly dangerous extension to the reach of the United States securities laws over predominantly foreign parties and transactions, particularly when accountants and accounting firms have been named defendants.

The crucial timing of the DED decision cannot be minimized. For several years, the largest accounting firms in the United States, commonly known as the "Big Eight," have greatly expanded the depth and breadth of their overseas operations. More importantly, the Big Eight in America are now closely bonded with their international branches and affiliates, making them truly multinational. This has resulted in increased vulnerability to attack in American courts, even for participation in essentially foreign transactions. The dilemma is exacerbated by the profession's need to

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** The author is a graduate of St. John's University School of Law (J.D. 1983) and St. John's University College of Business Administration (B.S. Accounting 1980). He was formerly Judicial Law Clerk to the Honorable D. Joseph DeVito, United States Bankruptcy Court for the District of New Jersey. He is admitted to the bars of New York and Pennsylvania, and is presently associated with the firm of LeBoeuf, Lamb, Leiby & MacRae. He is also an adjunct Professor of Law, St. John's University College of Business Administration.

The author dedicates this article to Ernest Honecker, Esq., Ernst & Whinney, with deepest thanks for his encouragement and support in this and other endeavors.

maintain high standards of quality control on a uniform, worldwide basis. This critical need forces the firms to be even more cohesive and interdependent, and thus even less likely to escape the imposition of subject matter jurisdiction under federal securities laws for engagements primarily foreign in nature.

This Article will first examine the DED opinion and its historical significance. Secondly, it will analyze the complex evolution of the subject matter jurisdiction issue, with an emphasis on the application thereof to accountants. This analysis will be followed by commentary on how the increasingly multinational practices of the major accounting firms create peculiar problems in maintaining the quality control standards demanded by the accountants' own comprehensive professional codes. Lastly, this article will explore the new outer boundaries of subject matter jurisdiction established by the DED decision and the potentially great burden this puts upon the multinational accounting firms to balance the demands of a transnational economy with the inherent standards of the profession.

DEPARTMENT OF ECONOMIC DEVELOPMENT V. ARTHUR ANDERSEN & CO.

DED is at first blush a straightforward decision denying the defendants' motion to dismiss, finding that issues of material fact existed which precluded summary judgment as to the liability of the defendants under the federal securities laws. However, the factual discussion and the ruling on the issue of subject matter jurisdiction at the outset of the memorandum opinion indicate that this case has an impact far greater than its opening pages suggest.

The parties in the proceeding were the Department of Economic Development ("DED"), a British governmental agency created to promote industrial development in Northern Ireland, Arthur Andersen & Company (U.S.A.) ("AA-US"), Arthur Andersen & Company (Republic of Ireland) ("AA-Ireland") and Arthur Andersen & Company (United Kingdom) ("AA-UK"). At the outset, the court classified the defendants as "affiliated accounting firms" and parenthetically discussed the conflicting assertions of the parties on this issue.

2 Id. at 1468.
3 Id.
The plaintiff alleged that the defendants were part of a "unitary worldwide partnership," while the defendants, in turn, claimed each partnership was a separate entity. Finding that an issue of material fact existed as to whether the defendants were part of one global partnership, an issue unresolvable on a motion for summary judgment, the court nevertheless declared that the instant decision did not depend on whether the defendants were separate firms or a single partnership.

The memorandum opinion explained that the predecessor agency of the DED had contracted with corporate entities controlled by auto builder John DeLorean. The agreement called for DeLorean to manufacture his ill-fated gull-wing sports car in an economically depressed section of Northern Ireland. Manufacturing was to be undertaken by the DeLorean Motor Company ("DMC"), a Michigan corporation, through Delorean Motor Cars Limited ("DMCL"), a subsidiary in Northern Ireland.

The financial backing was to be provided by the DED's predecessor agency, which agreed to purchase all of the over 17 million preferred shares of the Northern Ireland subsidiary. The subsidiary's common stock would have been owned by DMC. Pursuant to the master agreement between the British agencies and DMC, DMC and its holding company parent had promised to provide financial statements describing DMC and its subsidiaries, including DMCL. It was the defendants herein, as DMC's auditors, who cer-

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4 Id. at 1468 n.1; see G. Weinstein, The Bottom Line: Inside Accounting Today 213 (1987) ("Arthur Andersen, for example, is a centralized worldwide entity. This has advantages, says AA, because in a 'truly cohesive international organization...the parts are treated as segments of the whole...not as individual operations with a loose tie to the larger organization."); see also J. Arpan & L. Radebaugh, International Accounting and Multinational Enterprises 317 (2d ed. 1985) ("Arthur Andersen & Company is fairly centralized; its chairman and vice-chairman have worldwide responsibility, and there is profit sharing among its international partners").

5 DED, 648 F. Supp. at 1468 n.1. Of major interest here is the recent decision in CL-Alexanders Laing & Cruickshank v. Goldfeld, 709 F. Supp. 472 (S.D.N.Y. 1989), wherein Arthur Andersen-U.S. and Arthur Andersen-U.K. were named as defendants in a lawsuit alleging violations of the federal securities laws. In Goldfeld, District Judge Mukasey denied the defendants' motions to dismiss the complaint for lack of subject matter jurisdiction, but under factual circumstances quite dissimilar to the matters that are the focus of this writing. Id. at 473-75. However, note that "the parties [had] stipulated that Andersen-U.S. and Andersen-U.K., for purposes of this case only, may be considered part of a single international organization." Id. at 479 n.4. One can only guess as to what impact the DED holding of a year ago had upon the parties in reaching this understanding.

6 Id. at 1468.
7 Id. at 1469.
8 Id. at 1469.
tified and issued these financial statements from either the New York or Detroit offices of AA-US.9

By virtue of this certification, the plaintiff alleged that the defendants committed primary violations of section 10(b) of the Securities Exchange Act of 193410 and Rule 10b-5, as well as violations through aiding and abetting.11 The court stated that the gravamen of the complaint was “that DMC's Consolidated Financial Statements were false and misleading, and that by issuing reports certifying these statements, defendants substantially assisted DeLorean and others in the execution of a fraudulent securities scheme.”12 The opinion's factual dissertation concluded with a brief notation of the collapse and ensuing bankruptcy of the DeLorean enterprises, and the plaintiff's estimate that it suffered damages of $80 million.13 The court noted that the defendants' motion to dismiss was grounded upon: (1) lack of subject matter jurisdiction; (2) failure to state a claim upon which relief could be granted; and (3) forum non conveniens.14 The court first addressed the question of subject matter jurisdiction.

Acknowledging the lack of guidance in both the legislative history and the text of the federal securities laws as to when United States courts have subject matter jurisdiction over extraterritorial transactions, the court turned to Second Circuit precedent for its formulation of a standard.15 The Second Circuit, stated Judge Stewart, has declined jurisdiction over federal securities laws claims when the domestic conduct alleged to be the “ostensible basis of jurisdiction” was merely preparatory or amounted to a failure to act when the bulk of the allegedly fraudulent activity occurred abroad. Conversely, if conduct in the United States directly

9 Id.
10 Id. at 1468. Section 10(b) is codified at 15 U.S.C. § 78(b) (1982).
12 DED, 683 F. Supp. at 1469.
13 Id. at 1469-70. The plaintiff's claim of damages did not end with the $80 million estimate. Utilizing the Racketeer Influenced and Corrupt Organizations (“RICO”) statutes in its complaint, the plaintiff actually demanded some $260 million after trebling and additional damages, thus adding a further element of notoriety to this litigation. See Harrison, Look Who's Using RICO, 75 A.B.A. J. 56, 57 (1989).
14 DED, 683 F. Supp. at 1470. The court first stated that “[t]he parties agree that the purchase of securities in this case occurred abroad.” The defendants claimed the court lacked subject matter jurisdiction under the federal securities law because the plaintiff failed to demonstrate that the defendants' acts in the United States directly caused the alleged losses. Id.
15 Id.
caused losses to foreign investors, subject matter jurisdiction will lie in an American forum. The court held that it had subject matter jurisdiction over these claims, based first upon activity in this country by AA-US with respect to the financial statements, and second, on "the interdependent nature of the DeLorean entities."

Focusing on the consolidated financial statements and their preparation, the court admitted that most of the field work for the audit was conducted in the United Kingdom and the Republic of Ireland by AA-UK and AA-Ireland. Nonetheless, the court found ultimate engagement partner responsibility resided in AA-US's Detroit and New York offices. The court found that AA-US had a greater supervisory role "than mere ratification of the overseas audit work." For example, AA-US issued specific audit instructions from this country, some of which were "very detailed." Upon the completion of the field work abroad, the U.K. and Ireland-based entities would send material to AA-US's offices in Detroit and New York in order for the U.S. offices to issue certification reports on the consolidated financial statements. Of crucial importance was the court's finding that AA-US "did more than synthesize this information," as it often conducted additional investigations spurred by the communications received from across the ocean.

Interestingly, the court further stated that even if the evidence indicating heavy supervisory involvement was not as strong as it appeared, "AA-US still may have subjected its conduct to this court's jurisdiction simply by incorporating AA-UK's and AA-Ireland's audits of DMCL into its reports on the Consolidated Financial Statements. By incorporating these audits, AA-US created a duty to supervise under generally accepted auditing standards."

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16 DED, 683 F. Supp. at 1470.
17 Id. Reinforcing its decision to exercise subject matter jurisdiction, the court turned to the close relationship between the DeLorean Motor Company in America and its Northern Ireland subsidiary. Id. Essentially, the court found a high degree of identity between the foreign subsidiary and its domestic parent, based in part on the subsidiary's dependence on its parent for management and capital. Id. Citing an interoffice memorandum written by employees of AA-US, the court found that "[t]he interdependency of the two companies was recognized by Andersen itself." Id. at 1471.
18 Id.
19 Id. at 1470-71. The court summarily disposed of AA-US's claim that its supervision of the foreign auditors was minimal and that all significant audit activity took place not in the United States but overseas by declaring that the documentary evidence contradicted that assertion. Id.
20 Id. at 1471. The auditing standards cited by the court relate to professional standards to be followed by principal auditors in deciding whether or not to make reference to
Based on the foregoing statement, it would appear that the district court found another independent basis for subject matter jurisdiction, grounded in the duty to supervise professional standards imposed upon AA-US when AA-US incorporated the AA-UK and AA-Ireland audit work into its report.

Recognizing that the existence of this duty to supervise would depend upon additional factual evidence, the court did not decide the issue. Nonetheless, the court did acknowledge that the plaintiff had thus raised an issue of material fact: whether AA-US's alleged breach of its supervisory duty might have directly caused the plaintiff's losses.21

Judge Stewart concluded that the plaintiff had brought forth evidence tending to show that domestic conduct in formulating the consolidated financial statements was a direct cause of its alleged losses.22 The court held that “[s]tanding alone, this conduct is sufficient to activate subject matter jurisdiction.”23 Additional justification for this exercise of jurisdiction was found in the “high degree of symbiosis” between the DMC and its foreign subsidiary.24 For the foregoing reasons, the defendants' motion to dismiss was denied.25

The following pages will begin to reveal the extent to which DED represents an innovative decision which broke new ground in an area of great concern to the accounting profession. Certain crucial points need to be borne in mind as the key issues emerge herein. First, the court emphasized the fact that ultimate responsibility for this engagement resided with the offices of AA-US, notwithstanding the fact that the bulk of the actual audit work was conducted overseas. Also critical was the court's finding that AA-US played a significant supervisory role in this engagement. The district judge was impressed by the domestic partnership's "de-

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22 Id. at 1471.
23 Id.
24 Id.
25 Id. The district court denied the defendants' motion to certify the instant decision for interlocutory appeal. Id. at 1487. Since the Second Circuit standard demands live testimony and detailed evidence for determining the materiality of acts giving rise to subject matter jurisdiction under the securities laws, "the fact-finding job [is] to be performed at nisi prius, . . . a task ill-suited for an appeals court on an interlocutory appeal." Id.
tailed" instructions regarding the overseas offices' conduct of the audit. The role of AA-US in performing additional work was also important to the court's analysis.

Lastly, and possibly of greatest interest, is the court's finding that AA-US created a duty to supervise its foreign counterparts by incorporating their audits into its own. Looking to the accounting profession's own standards of conduct, the court seemed to imply that the utilization of the foreign audit work created a duty to supervise which may bring about subject matter jurisdiction under the federal securities laws. The importance of this reliance on the professional standard of supervision as a potential ground for subject matter jurisdiction will be demonstrated.

THE SECOND CIRCUIT TRILOGY

In embarking on an analysis of the parameters of subject matter jurisdiction under the federal securities laws, one must first reflect upon the key decisions: a trilogy of cases decided by the Court of Appeals for the Second Circuit. As stated by the Supreme Court, the Second Circuit is truly the matriarch of the foremost jurisprudence in this field and therefore due deference must be accorded to its central rulings.26

Before reviewing the well-known trilogy, we must examine the cornerstone of the Second Circuit's reasoning, developed over two decades ago in Schoenbaum v. Firstbrook.27 In Schoenbaum, the court was faced with fairly straightforward facts. Banff Oil Limited was a Canadian corporation which conducted all of its business in Canada and registered its common stock with the Securities and Exchange Commission ("SEC"), trading on both the American Stock Exchange and the Toronto Stock Exchange. Schoenbaum, an American shareholder, brought a derivative action pursuant to section 10(b) and Rule 10b-5.28

On the issue of subject matter jurisdiction, the court held that the Securities Exchange Act of 1934 had extraterritorial application, and that liability arose thereunder with regard to these transactions which took place in Canada between foreign buyers and

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26 See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting) (the Second Circuit is "regarded as the 'Mother Court' in this area of the law").
28 Id. at 204.
sellers. Writing for the panel, Chief Judge Lumbard stated that "Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities." The court acknowledged that this view was contrary to the presumption against extraterritorial application of legislation, but nevertheless found justification in the need to protect American investors.

By dint of this holding, Schoenbaum is considered the leading decision with regard to finding subject matter jurisdiction under the federal securities law where activity, albeit foreign, has an effect upon investors and markets in the United States.

Having laid the foundation with Schoenbaum, the Second Circuit established the first of its three famous benchmarks with its decision in Leasco Data Processing Equipment Corp. v. Maxwell. As in Schoenbaum, the Second Circuit found subject matter jurisdiction existed, but on the ground that significant fraudulent activity had taken place in the United States. Thus the "conduct" test was established, whereby a court measures domestic conduct, as opposed to foreign activity, in deciding whether there was subject matter jurisdiction under the federal securities laws.

The complaint in Leasco alleged that the defendants violated section 10(b) and rule 10b-5 by conspiring to cause Leasco to buy stock in Pergamon Press Limited, a British corporation controlled by defendant Robert Maxwell, at prices far beyond its value on the London Stock Exchange. While much of the fraudulent activity perpetrated by Maxwell and his cohorts was conducted in England, the court found that "abundant misrepresentations" were made in the United States. Principally, the court looked to initial misrep-

29 Id. at 206.
30 Id.
31 Id. The court stated that the anti-fraud provisions of section 10(b) reach "beyond the territorial limits of the United States" when a violation thereof "is injurious to United States investors." Id. As a precursor to later rulings, a footnote mentioned that "a transaction conducted entirely outside of the United States would not violate section 10(b) since the requisite use of interstate commerce or the mails would be lacking." Id. at 207 n.2.
32 See 4 A. Bromberg & L. Lowenfels, Securities Fraud & Commodities Fraud §11.2 (1986).
33 468 F.2d 1326 (2d Cir. 1972).
34 Id. at 1330.
35 Id. at 1335.
resentations by Maxwell seeking to interest Leasco in a joint venture, further representations by Maxwell's lieutenants at several meetings, and telephone calls and mail directed to the United States.\textsuperscript{36}

Judge Friendly wrote that if every alleged misrepresentation had occurred in England, the court "would entertain most serious doubt[s]" as to the applicability of Schoenbaum simply because of the adverse effect upon an American corporation, caused by the fraudulently induced purchase of stock in an English corporation not traded on American exchanges.\textsuperscript{37} The court noted that section 10(b) was meant to protect against fraud in the sale or purchase of securities regardless of where the stock was traded.\textsuperscript{38} The Leasco court thought Congress' intention was to guard against foreigners traveling to the United States to fraudulently induce American investors to purchase foreign securities, and thus held that section 10(b) and rule 10b-5 apply if "substantial misrepresentations were made in the United States."\textsuperscript{39}

The Second Circuit, less than three years after Leasco, developed the second and third branches of the trilogy simultaneously. Leading the development was Bersch v. Drexel Firestone, Inc.,\textsuperscript{40} a class action by predominantly foreign plaintiffs, which included Arthur Andersen & Company as a defendant.\textsuperscript{41}

The securities transactions giving rise to the litigation in Bersch concerned common stock of the ill-fated mutual fund organization, I.O.S. Limited, headed by international financier Ber-

\begin{itemize}
\item[\textsuperscript{36}] Id. The opinion relates sordid details of the numerous fraudulent misrepresentations made by Maxwell and his agents both here and abroad, in furtherance of their scheme to induce Leasco into purchasing the Pergamon Press Limited stock. Id. at 1330-33.
\item[\textsuperscript{37}] Id. at 1334. The court distinguished this case from Schoenbaum, stating that Schoenbaum held section 10(b) applicable, even where the fraud was committed outside the United States involving a foreign company's securities, because the transactions involved a stock registered and traded on American markets and thus impacted on American investors. Id. at 1333. The court stated that:
\begin{quote}
T]he 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.
\end{quote}
Id. at 1334.
\item[\textsuperscript{38}] Id. at 1336.
\item[\textsuperscript{39}] Id. at 1337.
\item[\textsuperscript{40}] 519 F.2d 974 (2d Cir.), cert. denied, 423 U.S. 1018 (1975).
\item[\textsuperscript{41}] Id. at 977-78.
\end{itemize}
nard Cornfeld. The I.O.S. stock was sold outside the United States to foreign nationals residing abroad. Prospectuses were printed and delivered outside of the United States. I.O.S. stock was not to be sold to Americans or offered for sale within the borders of the United States, nor was it listed on the American exchanges. The I.O.S. prospectuses contained financial statements accompanied by a report issued by Andersen. The complaint alleged that defendant Andersen had failed to observe generally accepted accounting principles in connection with its audit, with the result that the financial data in the prospectuses were false and misleading.

The appeal before the tribunal dealt with the district court's finding that subject matter jurisdiction existed based upon three factors: (1) activity in the United States connected to the I.O.S. stock offering by defendant Drexel; (2) stock sales to Americans, despite attempts to prevent such occurrences; and (3) generally adverse effects upon the American stock exchanges attributable to the subsequent collapse of I.O.S.

Judge Friendly, writing for the court, expressed the belief that the activities within the United States were sufficient to activate subject matter jurisdiction. The court, however, expressed doubt as to "whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to [transactions which are predominantly foreign] rather than leave the problem to foreign countries."

The court observed that while Bersch did not fall within the ambit of either Schoenbaum or Leasco, the absence of certain elements present in those cases did not necessarily preclude a finding of subject matter jurisdiction.

The Second Circuit then turned to the substance of the juris-

42 Id. at 978.
43 Id. at 980.
44 Id. at 980-81.
46 Bersch, 519 F.2d at 985. The opinion parenthetically enumerated the district court's findings that numerous meetings were held in New York City between I.O.S., underwriters, attorneys, and accountants with respect to the offering. Id. Also, the Securities and Exchange Commission was conferred with and parts of the prospectus were drafted in the United States. Id. at 985 n.24.
47 Id. at 985.
48 Id. at 986.
dictional question. Postulating a hypothetical, the court noted that if no Americans had purchased stock and the underwriting related to a clearly identifiable foreign company, then the activities in the United States previously described would not justify the taking of jurisdiction. If there was fraud in Bersch, it was committed by the release of a false and misleading prospectus which emanated from a foreign source. Unlike Leasco, a substantial part of the misrepresentations was not made in the United States.

In short, the Bersch court refused to extend subject matter jurisdiction “where the United States activities are merely preparatory or take the form of culpable nonfeasance and are relatively small in comparison to those abroad. [The court] thus conclude[d] that the action and inaction which occurred in the United States alone could not confer subject matter jurisdiction.”

The circuit court also rejected the district court’s finding of subject matter jurisdiction based on the adverse effect of the I.O.S. collapse on American markets. Judge Friendly concluded that subject matter jurisdiction over fraudulent acts relating to securities which are committed abroad is limited to acts which result in injury to purchasers or sellers in whom the United States has an interest. He emphasized that acts which “simply have an adverse affect [sic] on the American economy or American investors generally do not fall in this class of activities.”

The court did, however, find jurisdiction for the relatively small group of American purchasers of I.O.S. stock since there was a direct effect in the United States by the receipt of prospectuses, which included the Andersen report on the financial statements. Significantly, the court held that the anti-fraud provisions of the federal securities laws “[d]o not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpa-

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49 Id. at 987.
50 Id.
51 Id.
52 Id. at 988. While not doubting the “unfortunate financial effect in the United States,” the court nevertheless held that such “generalized effects” would be insufficient to confer subject matter jurisdiction over a damage suit by a foreigner under the anti-fraud provisions of the American securities laws. Id.
53 Id. at 989.
54 Id.
55 Id. at 991. Furthermore, the court included defrauded Americans residing abroad in its jurisdiction, finding that even preparatory activities in the United States were adequate to make the American securities laws applicable to injured Americans residing overseas. Id. at 992.
ble failures to act) within the United States directly caused such losses."

The final leg of the triad was the Second Circuit's decision in *IIT v. Vencap, Ltd.* This action, for fraud, conversion, and corporate waste, was another product of the I.O.S. debacle. The transaction in *IIT* involved an investment in the defendant Vencap by the plaintiff IIT, an I.O.S. mutual fund. With one exception, all of the meetings leading to the investment by IIT took place outside the United States. These meetings led to the creation of a memorandum of understanding, which the court found was drafted in the Bahamas. With respect to the agreement which stated that the investment was to take the form of a purchase of preferred shares, there was a material disagreement between the parties as to where it was finalized. The defendants claimed that the memorandum's essential terms and conditions were finalized in the Bahamas, while the plaintiffs asserted that the stock purchase agreement was formulated, drafted and negotiated in New York. The transaction itself was closed in the Bahamas.

On appeal from the district court's order granting a preliminary injunction against the defendants, the Second Circuit once again grappled with the issue of subject matter jurisdiction. Initially addressing the fact that one defendant, who owned and controlled other defendants, was a United States citizen, the court held that this alone would not bestow subject matter jurisdiction. The court stated that "[i]t is simply unimaginable that Congress would have wished the anti-fraud provisions of the securities laws to apply" if an American citizen, while overseas, committed fraudulent acts abroad and defrauded only foreigners.

The court then applied the effects test, and found little factual support for the view that the defendants' activities "had a signifi-

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56 Id. at 993.
57 519 F.2d 1001 (2d Cir. 1975).
58 Id. at 1003.
59 Id. at 1004-05.
60 Id. at 1005.
61 Id. at 1006.
62 Id. at 1007.
63 Id. at 1015-18. Unlike District Judge Stewart, who found jurisdiction on a number of diverse grounds, the Second Circuit stated that "[w]e think it plain that the only possible bases for subject matter jurisdiction" would lie within the federal securities laws. Id. at 1015. The district court found subject matter jurisdiction based on the 1933 Act, the 1934 Act and diversity of citizenship. Id.
64 Id. at 1016.
While some Americans did own stock in IIT, notwithstanding IIT's prohibition on sales to United States citizens or residents, the court found it dispositive that such American ownership constituted less than one percent of IIT's fundholders. Even if one were to assume that the instant action was derivative in nature and was asking to pierce the corporate veil, the court found that "the result would be almost wholly non-American," given the de minimis domestic ownership interests.

The court then turned to the third ground for subject matter jurisdiction: conduct within the United States. The court tacitly acknowledged that the underpinnings for subject matter jurisdiction, as exposited in Schoenbaum and Leasco, were not present in IIT. The tribunal, however, noted that this did not necessarily preclude a finding of subject matter jurisdiction in the instant case. The Second Circuit then proceeded to set forth the crux of its holding that there was subject matter jurisdiction in IIT. Judge Friendly opined:

We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners. This country would surely look askance if one of our neighbors stood by silently and permitted misrepresented securities to be poured into the United States. By the same token it is hard to believe Congress meant to prohibit the SEC from policing similar activities within this country.

The court reasoned that if subject matter jurisdiction could be exercised over a suit by the SEC to prevent such exportation of fraud, then jurisdiction would also be found over a suit, such as the one here, brought by a defrauded individual.

The Second Circuit explicitly limited its holding "to the perpetration of fraudulent acts themselves and [did] not extend [it] to mere preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign coun-

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\(^{65}\) Id.
\(^{66}\) Id.
\(^{67}\) Id. at 1016-17. Judge Friendly believed that the decision was not within the formulation of Schoenbaum, "even though Schoenbaum does not necessarily set the outmost reaches for subject matter jurisdiction with respect to foreign activities having effect within the United States." Id. at 1017.
\(^{68}\) Id.
\(^{69}\) Id. at 1017.
\(^{70}\) Id. at 1017-18.
Applying this reasoning to the instant facts, the court agreed with the defendants that there was no significant activity in the United States with respect to the agreement itself, which was formulated in the Bahamas. Vencap's utilization of a New York City location as a base of operations once IIT had invested its money, however, could be regarded as fraudulent activity in the United States giving rise to subject matter jurisdiction.

In brief, the Second Circuit, in \textsc{IIT}, imposed subject matter jurisdiction over activity in the United States which entailed the "export" of fraudulent securities and related schemes. However, in so doing, the court created self-imposed constraints, limiting its holding to cases where the allegedly fraudulent acts were more than merely preparatory. The court thus expanded the boundaries of subject matter jurisdiction, but carefully delineated the boundaries of this new territory.

\footnote{Id. at 1018. The court acknowledged the worthiness of the distinction, and its need for making it by stating that: \[T\]he position we are taking here itself extends the application of the securities laws to transnational transactions beyond prior decisions and the line has to be drawn somewhere if the securities laws are not to apply in every instance where something has happened in the United States, however large the gap between the something and a consummated fraud and however negligible the effect in the United States or on its citizens. \textit{Id.}}

\footnote{Id. However, although there was an abundance of American activity, the court could not determine whether the district judge considered such activity to be within rule \textsc{10b-5}, and therefore required further findings on this issue. \textit{Id.}}

\footnote{\textsc{See id.} Most recently, the Second Circuit issued an opinion which may very well become another landmark decision on this issue. In \textsc{Consolidated Gold Fields, PLC v. Anglo American Corp. of South Africa Ltd.}, 698 F. Supp. 487 (S.D.N.Y. 1988), \textit{aff'd in part, rev'd in part sub nom., Consolidated Gold Fields, PLC v. Minorco, S.A., 871 F.2d 252 (2d Cir. 1989)}, the district court was confronted with an injunctive action alleging violations of both the antitrust laws and the antifraud provisions of the federal securities laws, all in connection with a tender offer involving foreign entities. \textit{Id. at 490}. District Judge Mukasey preliminarily enjoined the tender offer on the basis of the alleged antitrust violations, but dismissed the securities laws claims. \textit{Id. at 497}. The dismissal was predicated on a lack of domestic activity that was "anything but incidental to the alleged fraud," and, with United States residents holding no more than 2.5\% of the target company's stock, there were no "effects" within this country. \textit{Id. at 496-97}. The plaintiff below cross-appealed on the dismissal of the securities laws claims. Significant on the appeal was the filing of an \textsc{amicus curiae} brief by the Securities and Exchange Commission. Brief of Securities and Exchange Commission, \textsc{Consolidated Gold Fields, PLC, v. Anglo American Corp. of South Africa Ltd.} (2d Cir. 1988) (Nos. 88-7932-34) [Hereinafter \textsc{Brief}]. The Commission submitted the brief "to address important questions involving the antifraud provisions of [the federal securities] laws in an international context." \textit{Brief at 2}. The agency asserted that the "effects" test...}
MULTINATIONAL ACCOUNTING FIRMS

OTHER SIGNIFICANT CIRCUIT COURT DECISIONS

While undisputedly the standard bearer of the appellate courts on the issue of subject matter jurisdiction under federal securities laws, the Second Circuit is not alone in setting meaningful precedents. Other circuit courts have spoken on the transnational reach of our securities laws, and these decisions are not always in accord with the Second Circuit's philosophy.

In SEC v. Kasser, the Third Circuit was confronted with the issue of whether the SEC may invoke federal court jurisdiction over defendants who allegedly engaged in fraudulent conduct within the United States, if the sole victim was a foreign corporation and the alleged fraud had little, if any, domestic impact. The single victim was the Manitoba Development Fund, a corporation wholly owned by the Province of Manitoba, Canada, and created to interest private enterprise in forestry development within that region. It was alleged that the defendants induced the entity to purchase debenture securities in two corporations, which were ostensibly engaged in the forestry industry.

postulated by the Second Circuit was satisfied here, due to the fact that the American victims were substantially affected by the allegedly fraudulent misrepresentations made in connection with the tender offer. Brief at 11. "[T]he presence and greater number of foreign victims cannot deprive the court of subject matter jurisdiction." The Commission concluded by requesting the court to abstain from exercising jurisdiction here because enjoining the tender offer worldwide would overwhelm the effect in the United States and would be unwarranted under these circumstances. Brief at 22. In deciding the appeal, the Second Circuit concluded that "the tender offer had sufficient effects within the United States to warrant application of American securities laws and that the District Court should have asserted subject matter jurisdiction." Consolidated Gold Fields, PLC v. Minorco, S.A., 871 F.2d 252, 255 (2d Cir. 1989). Writing for the panel, Circuit Judge Newman ruled that District Judge Mukasey's analysis could not be reconciled with the Second Circuit's prior holding in Bersch and that the district court should have asserted jurisdiction for reason of foreign nominees forwarding the tender offer documents to American shareholders. Id. at 262. This "effect," held the court, "was clearly a direct and foreseeable result of the conduct outside the territory of the United States." Id. To be sure, Judge Newman looked to the fact that the "American residents representing 2.5% of [the target company's] shareholders owned 5.3 million shares with a market value of about $120 million." Id. Turning to the request of the SEC for the appellate court to find subject matter jurisdiction but to nevertheless direct the lower court to abstain, the tribunal declined that suggestion and instead remanded the securities laws claims for further proceedings. Id. at 263. The instant decision would, at first blush, appear to be an unremarkable application of the established holdings of the Second Circuit. Yet given the remand and the assertion of jurisdiction, it is well within the realm of possibility that this opinion or its progeny will set a key precedent as to the extent of subject matter jurisdiction under the federal securities laws.

76 471 F.2d 110.
77 Id. at 110-11.
Writing for the panel, Judge Adams found that the alleged fraud was "transnational in character," but that a number of fraudulent acts also took place in the United States. The district court found that this conduct included negotiations, the execution of an investment contract, the use of the telephone and mail systems, and the establishment of corporate offices, all in the United States. However, in light of the fact that the securities in question were neither traded on any American exchange nor sold to United States citizens, the court questioned whether the alleged fraud had any effect on domestic markets, especially since the plaintiffs did not so claim. Nevertheless, the Third Circuit found that jurisdiction did indeed exist. Judge Adams referred to the court's prior holding that "conduct within the United States is alone sufficient" to apply subject matter jurisdiction under the federal securities laws when transnational securities fraud was perpetrated with respect to an American over-the-counter stock.

Judge Adams stated that "the conduct of the defendants here cannot be deemed to be 'merely preparatory' to fraudulent acts committed outside this country." Finding the defendants' activity in the United States more substantial than the activity in IIT or Bersch, the court questioned "whether it can be convincingly maintained that such acts within the United States did not directly cause any extraterritorial losses." The panel recognized its decision to be in large measure a policy decision, designed not to embolden those who would use the United States as a base for defrauding foreign investors.

The Court of Appeals for the Fifth Circuit had less difficulty

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78 Id. at 111.
79 Id. The court stated that "[i]n short, there was significant conduct which formed part of the defendants' scheme that did not occur within this country." Id. at 110-11.
80 Id. at 112.
81 Id.
82 Id. at 112-13 (quoting Straub v. Vaisman & Co., 540 F.2d 591, 595 (3d Cir 1976)). Unlike the Second Circuit, the Kasser court was not faced with a "predominantly foreign" transaction. Kasser, 548 F.2d at 113. In Straub, "[t]he fraudulent scheme was conceived in the United States by American citizens, involved stock in an American corporation traded on American over-the-counter exchange, and an American securities broker from his office in New Jersey was responsible" for the fraudulent acts. Straub, 540 F.2d at 595; see Kasser, 548 F.2d at 113.
83 Id. at 115.
84 Id.
85 Id. at 116.
in finding subject matter jurisdiction in *United States v. Cook.* Cook, the appellant, claimed that the trial court, which had convicted him of securities fraud, lacked jurisdiction because "the alleged fraud was committed solely upon foreign investors and . . . had no impact upon either the domestic markets or domestic investors." Cook and his confederates operated a "Ponzi" scheme out of Dallas, Texas, selling interests in oil and gas wells located in the United States to Europeans. Writing for the court, Judge Thornberry concluded that "[t]he present scheme is so far within the jurisdiction of the American courts as to give us little pause." The panel found Cook's operations out of Dallas were "hardly preparatory": the foreign investors purchased American securities, funds were repatriated into the United States and some investors were actually defrauded, in part, in the United States. The court noted that this conduct was an adequate basis for jurisdiction, and did not address the possibility of subject matter jurisdiction based upon effects in the United States.

The Court of Appeals for the Eighth Circuit established its own precedent for subject matter jurisdiction in *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.* In *Continental Grain,* the plaintiff had purchased all the stock in an Australian seedstock corporation from the defendant, a California corporation, and two other vendors, one an Australian and the other a Californian. The plaintiff, an Australian corporation, was a wholly-owned subsidiary of a Delaware corporation. The contract for the sale of stock was executed by the defendants in California, with the closing intentionally held in Australia for tax reasons. The initial payment was made in Australian dollars, thereafter converted

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87 Id. at 282.
88 Id. at 282-83. The purchase agreements were executed in Europe but recorded in the United States. Potential investors also visited the oil wells in Texas. Id. at 283.
89 Id. The Fifth Circuit determined that it could "leave for another day an attempt to formulate the outer perimeter of American jurisdiction." Id.
90 Id.
91 Id. at n.4. The court opined that it would be absurd to believe that Congress did not intend subject matter jurisdiction where the alleged fraud involved domestic securities simply because the victims were not Americans. Id. at 283. Like its brethren, the Fifth Circuit found jurisdiction to prevent the United States from being a haven for swindlers and confidence men victimizing foreigners. Id. at 284.
92 592 F.2d 409 (8th Cir. 1979).
93 Id. at 411.
to United States currency and wired to California.\textsuperscript{94}

The principal asset of the corporation which the plaintiff purchased was a seedstock license agreement. The defendants failed to disclose that the licensor of that agreement had made known its refusal to renew the license some weeks before the closing.\textsuperscript{95} The gravamen of the complaint was the plaintiff’s allegation that this failure to disclose the expiring license constituted a violation of section 10(b) and rule 10b-5.\textsuperscript{96}

The Eighth Circuit acknowledged that the securities transaction at issue was international in scope, the victim was a foreign corporation, the securities were not traded on any American market and there was no significant effect on domestic markets or in the United States.\textsuperscript{97} Nevertheless, the court was persuaded that the fraudulent nondisclosure, devised in the United States, was “at least some activity” in this country in furtherance of a fraudulent scheme.\textsuperscript{98} The court found the use of the mail and other instrumentalities of interstate commerce determinative, ruling that such use was “significant enough to establish subject matter jurisdiction.”\textsuperscript{99}

The court made it clear that jurisdiction may be established by meeting the requirements of either the conduct test or the effects test.\textsuperscript{100} In the instant case, the effects test was not satisfied, since any effect within the United States was insubstantial and too remote. The court rejected the plaintiff’s contention that harm to it, even as an Australian entity, would be reflected adversely in its American parent’s financial condition.\textsuperscript{101} Since the effects test did not give the court jurisdiction, the court examined the conduct test.\textsuperscript{102}

\textsuperscript{94} Id. at 413.
\textsuperscript{95} Id. at 411-13.
\textsuperscript{96} Id. at 413.
\textsuperscript{97} Id.
\textsuperscript{98} Id. at 415.
\textsuperscript{99} Id.
\textsuperscript{100} Id. at 417.
\textsuperscript{101} Id. The court also found that the domestic status of the defendants had no “independent significance for jurisdictional purposes.” Id.
\textsuperscript{102} Id. Interestingly, the court stated its belief that the Third Circuit in Kasser “extended the boundaries of the necessary domestic conduct required to find subject matter jurisdiction” as defined previously in the Second Circuit cases. Id. at 418. Indeed, the panel found the Third Circuit analysis was consistent with the Eighth Circuit’s own previous decision finding subject matter jurisdiction attaching whenever significant conduct occurs in the United States. Id. at 419 (citing Travis v. Anthes Imperial Ltd., 473 F.2d 515, 524 (1973)).
In applying the conduct test, the court first addressed the defendants' argument that jurisdiction was not proper because the securities transaction was “predominantly foreign: a foreign corporate plaintiff, foreign securities neither registered nor traded on a national securities exchange, no impact or effect in the United States, and negotiations and conduct largely outside the United States.”

Notwithstanding these extraterritorial factors, the court found subject matter jurisdiction under the federal securities laws did exist in this case. Judge McMillian wrote that the failure to meet the effects test was not fatal to a consideration of subject matter jurisdiction and instead, “we examine the relationship between defendants’ conduct in the United States and the alleged fraudulent scheme, specifically whether defendants’ conduct in the United States was significant with respect to the alleged violation, and whether it furthered the fraudulent scheme.”

The defendants’ conduct, according to the court, included the use of the mails and the telephone necessary to further the fraudulent scheme and to organize and complete the fraud. Facilities of interstate commerce were also used to transmit the proceeds of the stock sale and transport corporate representatives of the defendants from America to Australia and back. The court concluded that the conduct here was significant and not merely preparatory, in that the fraud “was devised and completed in the United States.”

In sum, the Eighth Circuit, in a policy-based ruling, held that subject matter jurisdiction under the federal securities laws is found “where defendants’ conduct in the United States was in furtherance of a fraudulent scheme and was significant with respect to its accomplishment, and moreover necessarily involved the use of the mails and other instrumentalities of interstate commerce.”

In *Travis*, Judge Heaney ruled that “subject matter jurisdiction attaches whenever there has been significant conduct with respect to the alleged violations in the United States... The essential issue is whether the defendants’ conduct in the United States was of such significance to subject them to the jurisdiction” of American courts. *Travis*, 473 F.2d at 524.

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103 *Continental Grain*, 592 F.2d at 420.
104 *Id.* (citations omitted).
105 *Id.*
106 *Id.*
107 *Id.* at 421. The court stated:

Like the Second Circuit, we are reluctant to conclude that Congress would have intended the securities laws to have a global reach when the domestic conduct is insubstantial or the domestic impact is too generalized or insignificant. The range of significant conduct should, however, be fairly inclusive. This is consistent with
The Ninth Circuit examined the issue of subject matter jurisdiction under the federal securities laws in Grunenthal GmbH v. Hotz.\(^{108}\) In Grunenthal, each party to the action was either a foreign citizen or foreign corporation, and the negotiations for the securities purchase in question occurred outside the United States, save for a single meeting.\(^{109}\) Acknowledging that the court had spoken infrequently on the subject, Judge Reinhardt noted that the Ninth Circuit previously exercised subject matter jurisdiction over transnational securities cases where the transactions produced effects within the United States. He emphasized, however, that the court had never held "that the absence of such effects precludes the exercise of jurisdiction or that conduct alone is not enough."\(^{110}\)

After reviewing the tests advanced in Continental Grain and Kasser, the tribunal found that those benchmarks advanced the underlying policies of the federal securities laws, primarily because they discouraged those who wished to defraud foreign purchasers of securities from using the United States as a base of operations.\(^{111}\) Moreover, Judge Reinhardt concluded that the views espoused in Continental Grain and Kasser were consistent in fulfilling the congressional intent to maintain high ethical standards for those conducting securities transactions, thus encouraging American lawyers, accountants and underwriters to "behave responsibly."\(^{112}\)

Adopting the rationale of Continental Grain, the court found that the misrepresentations that took place in the United States were significant and furthered the fraudulent scheme. Moreover, the court determined that the conduct in this country was not "merely preparatory," since it was material to inducing the plaintiff to enter into the transactions.\(^{113}\) Judge Reinhardt noted that the execution of the agreement regarding the stock purchase, which was executed in Los Angeles, "constituted an act that strongly supports our assertion of jurisdiction."\(^{114}\)

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the general purpose of the securities laws to mandate the highest standards of conduct in securities transactions.

\(^{108}\) 712 F.2d 421 (9th Cir. 1983).
\(^{109}\) Id. at 422-23.
\(^{110}\) Id. at 424.
\(^{111}\) Id. at 424-25.
\(^{112}\) Id. at 425.
\(^{113}\) Id.
\(^{114}\) Id.
Mindful that the parties were all foreign entities who allegedly conducted this transaction in the United States merely as a convenience, the court emphasized that a contrary result in the case would make it convenient for foreigners to use the United States and American "lawyers, accountants and underwriters to further fraudulent securities schemes."115

Reviewing the jurisprudence of the appellate courts other than the Second Circuit, it is clear that they have interposed less stringent requirements to a finding of subject matter jurisdiction under the federal securities laws. In Kasser, the Third Circuit opined that the "conduct" test would be met if there was "at least some activity" furthering a fraudulent scheme occurring in this country. The Continental Grain decision tracked Kasser for the most part, but clearly the Eighth Circuit fully intended to extend the jurisdictional boundary. The Continental Grain court was apparently faced with even less activity in the United States than was the Third Circuit in Kasser, yet it likewise found subject matter jurisdiction. It is worth noting that the Eighth Circuit holds that the term "conduct" should be "fairly inclusive." Both cases entailed domestic conduct easily interpretable as sufficient to activate subject matter jurisdiction under the federal securities laws, even if ruled upon by the more circumspect Second Circuit. But the Kasser and Continental Grain courts swept beyond the frontiers previously delimited by their brethren, and made it clear that they would broaden the "conduct" test by finding subject matter jurisdiction where some, though not necessarily significant, activity took place in the United States. Indeed, the holding in Continental Grain that the court would take a more inclusive view of conduct established a new benchmark. Finally, both opinions spoke significantly of policy aspects. Undeniably, the lack of legislative guidance in this area has intensified the courts' difficulties in decision-making. However, whether this justifies rulings based on policy is a complex question.

In sum, many circuit courts of appeal have availed themselves of the Second Circuit's leading decisions, whereas other courts have struck out on their own, and in so doing, have widened the scope of subject matter jurisdiction under the federal securities laws.

115 Id. The court also implied that jurisdiction could be found in this case because activity in the United States directly caused the plaintiff's losses. Id. at 426.
Subject Matter Jurisdiction and Accountants

Having examined the basic precepts of subject matter jurisdiction in the application of the federal securities laws in the foregoing sections, we may now turn to the ramifications of the exercise of that jurisdiction over accounting firms involved in transnational securities transactions.

F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Co., written shortly after the Bersch decision, relied heavily on the reasoning of the Second Circuit therein. F.O.F., a Canadian mutual fund and a subsidiary of the I.O.S. organization, purchased debentures of a Delaware corporation which made the offering for the purported purpose of funding its overseas operations. This offering was strictly conditioned on prohibiting sales of the debentures in the United States or to American citizens. Ironically, the same stricture applied to Canadian citizens and corporations as well.

The court found that F.O.F. purchased its debentures from a Luxembourg bank, which was also an I.O.S. subsidiary. Consequently, F.O.F.'s purchase was made in violation of the underwriting restrictions.

In its complaint, F.O.F. alleged that the debenture offering materials contained materially misleading statements, and also alleged that defendant Arthur Young & Company, a “Big Eight” accounting firm, caused a misleading “comfort letter” to be delivered to the underwriters in connection with the offering, which closed in London. When F.O.F. moved to amend its complaint, the court directed the parties to brief the issue of subject matter jurisdiction. In its subsequent decision, the court addressed F.O.F.’s contention that its claims arose out of a transaction that was “predominantly American,” primarily because the defendant American entities, operating from the United States, devised and implemented a fraudulent securities scheme. This allegedly included the drafting and reviewing of the aforementioned “comfort

117 Id. at 1220-21.
118 Id. at 1221. The condition was necessary in order for F.O.F. to comply with the federal securities law, since the debentures were not registered under the Securities Act of 1933. See id. at 1220.
119 Id. at 1221.
120 Id.
121 Id. at 1222.
In his opinion, Judge Bonsal concluded that F.O.F., a Canadian corporation, was not within the intended or lawful group of offerees of the debentures, since its purchase violated the underwriting conditions. Furthermore, its purchase was indeed predominantly foreign, as F.O.F., an alien itself, purchased the debentures overseas from a foreign source and thereby "incurred its losses outside the United States." Applying Bersch, the court decreed that a foreign entity such as F.O.F. might invoke the protection of the federal securities laws "only if it suffered loss from [securities] transactions involving . . . 'acts . . . within the United States [which] directly caused such losses.'" The court ruled that the conduct which allegedly caused the losses of F.O.F. occurred entirely abroad. The fact that there were American defendants was "of little independent significance." The court thus found that the standards for subject matter jurisdiction under the federal securities laws had not been met and dismissed the complaint.

In *IT v. Cornfeld*, a proceeding which included Arthur Andersen & Company as a named defendant, "vexing questions with respect to the reach of the anti-fraud provisions of our securities laws with respect to transactions having substantial foreign elements" were raised. The litigation arose from the plaintiff's three series of acquisitions of companies controlled by John King, an American entrepreneur, whose companies owned numerous foreign subsidiaries. *IT* purchased significant interests in King's domestic and foreign companies; the transactions took place in both the European Eurodollar market and in the United States over-the-counter market. In its complaint against Arthur Andersen & Company, *IT* alleged that Andersen aided and abetted the fraud, "partly because of its accounting work on the false and mis-

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122 Id. Specifically, F.O.F. alleged that the offering circulars failed to reveal "the major intended uses of the proceeds of the offering," and that the defendants participated in the closing "without revealing . . . the true circumstances surrounding the transaction." *Id.* at 1221.

123 *Id.* at 1222-23.

124 *Id.* at 1223. (quoting Bersch, 519 F.2d at 993).

125 *Id.*

126 *Id.*

127 619 F.2d 909 (2d Cir. 1980).

128 *Id.* at 912.

129 *Id.* at 914.

130 *Id.*
leading prospectus.” Arthur Andersen acted as the independent certified public accountants for King's principal company, King Resources Company. Working out of its Denver office, Andersen audited and certified the financial statements utilized in both the domestic and foreign debenture offering prospectuses.

The circuit court approved of the district court's rejection of subject matter jurisdiction under rule 10b-5, a rejection based on the finding that the transactions in question lacked the "necessary effect" within the United States. The lower court rejected jurisdiction based on conduct within the United States as well, reasoning that the alleged deception was perpetrated by foreigners on foreign investors residing outside of the United States. It was on this point that the court of appeals diverged from the district court.

The court first addressed the plaintiff's securities purchases of King's American entities. "Apart from the fact that these were securities of American corporations, the transactions were fully consummated within the United States." However, Judge Friendly expressly stated:

[W]e do not mean to suggest that either the American nationality of the issuer or consummation of the transaction in the United States is either a necessary or sufficient factor, but rather that the presence of both these factors points strongly toward applying the anti-fraud provisions of our securities laws.

The Second Circuit was swayed by the facts that the American securities at issue were purchased in the domestic over-the-counter market and were then held by a New York custodian. The panel saw "nothing foreign" in the transactions, except for the foreign status of the purchaser and the transmission of its purchase orders from abroad.

The court's analysis focused next on the securities of King's foreign company. The court, distinguishing the case from Bersch,

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131 Id. at 915.
132 Id.
133 Id. at 916-17. The circuit court upheld the lower court's finding that the transactions involved were not sufficient to warrant the exercise of subject matter jurisdiction in light of the Bersch and Vencap effects tests. Id. at 917.
134 Id.
135 Id. at 918.
136 Id. (citation omitted).
137 Id.
which dealt totally with foreign securities, found the foreign offerings “closely coordinated” with the domestic offerings, especially in light of the fact that the foreign debentures were convertible into common stock of King’s American company.138

Thus, the court reaffirmed its holding in ITT that the United States should not be used as a base for exporting fraud, especially when the securities in question are American.139 The fact that the offering was conditioned on the stock not being sold within the United States or to Americans does not indicate that, if fraud had been committed in the United States, our courts would look away.140

The Second Circuit closed by stating that such a determination “depends not only on how much was done in the United States but also on how much (here how little) was done abroad.”141

In the first of two significant decisions by Judge Stewart, author of the DED opinion, Fund of Funds, Ltd. v. Arthur Andersen & Co. (“F.O.F. I.”),142 the plaintiff sought “to recover damages resulting from a fraudulent scheme orchestrated by John M. King and his cohorts involving a series of natural resource transactions.”143 Andersen defended, inter alia, on the ground of lack of subject matter jurisdiction under federal securities laws.144 Andersen and its affiliated firms, Arthur Andersen & Company (Switzerland) and Arthur Andersen & Company S.A., allegedly participated in the fraud.145

Judge Stewart stated in his opinion that the court “must de-

138 Id. at 919. The court refused to allow “the interposition of a foreign subsidiary of this kind” to deter it away from the real facts, and stated that:

The fact that we are dealing here with debentures which in substance were American rather than foreign securities has bearing of several sorts. The first goes back to the effects test. We think Congress would have been considerably more interested in assuring against the fraudulent issuance of securities constituting obligations of American rather than purely foreign business.

Id. at 920.

139 Id.

140 Id. The court also noted that there was greater relative American participation than in other cases. Id. Of particular importance was the panel’s finding that “all the accounting work was and had to be done in the United States.” Id. Combined with the utilization of an American underwriter, and the entire drafting and printing of the prospectuses in America, it is little wonder the tribunal noted “the lack here of . . . foreign activity.” Id. at 920-21.

141 Id.


143 Id. at 93,877.

144 Id. at 93,878.

145 Id. at 93,881.
determine whether the transactions were predominantly foreign,” and, if so, whether Congress’s intent could have been to allocate the resources of American laws and courts to such disputes, or instead to leave the problem to foreign countries.\[146\] Recognizing that no single factor is dispositive in this matter, the court stated that it would look to the “location and citizenship of the purchasers and sellers, the locus of the fraudulent activity and the extent of American participation,” if any.\[147\] The trial court assumed the purchasers were foreign, and sought to determine if there was sufficient conduct in the United States to confer subject matter jurisdiction. On this point it found that “Andersen performed a substantial portion of the accounting work concerning the relevant transactions in the United States where the documents of title to the natural resource assets were located,” and also that payments by the plaintiffs for the purchases were remitted in the United States as well.\[148\] The district judge weighed “these significant American contacts” against foreign activity and found the foreign nature of the purchase was not controlling.\[149\] For these reasons, Andersen’s motions to dismiss and for summary judgment were denied, and Judge Stewart decreed that “subject matter jurisdiction over the complaint [had] been established.”\[150\]

In the second decision rendered in Fund of Funds, Ltd. v. Arthur Andersen & Co. (“F.O.F. II”),\[151\] approximately 18 months later, the same district court was confronted with the claims of the plaintiffs pertaining to its investments in natural resource assets which they had purchased from the King family of companies.\[152\] After a jury trial that resulted in a verdict assessing liability under the federal securities laws, the Andersen defendants moved for a new trial and a judgment notwithstanding the verdict.\[153\] Since the court had previously addressed the question of subject matter jurisdiction in F.O.F. I, the court made short shrift of it in F.O.F. II.\[154\]

\[146\] Id.

\[147\] Id.

\[148\] Id. at 93,881-82.

\[149\] Id. at 93,882.

\[150\] Id. at 93,884.

\[151\] 545 F. Supp 1314 (S.D.N.Y. 1982).

\[152\] Id. at 1326-29.

\[153\] Id. at 1325-26.

\[154\] Id. at 1345-51. Judge Stewart noted his previous consideration of the defendants’ claim of lack of subject matter jurisdiction, and declined to rehash the rationale of the prior
The court concluded that the purchases of natural resource assets herein "had few foreign elements." To support this opinion, the court looked to the American citizenship of both King and some of his companies, negotiations conducted in the United States concerning the transaction, domestic transfers of funds, and, interestingly, certain revaluation services "worked out" by [Andersen] in Denver, Chicago and New York. The thrust of the court's rationale for exercising subject matter jurisdiction seemed to focus on Andersen's activity within the United States.

Recently, the Court of Appeals for the District of Columbia Circuit decided a case which represents an important juncture in the evolution of subject matter jurisdiction under the federal securities laws. In Zoelsch v. Arthur Andersen & Co., the plaintiff sued on behalf of himself and some thirty other citizens of the Federal Republic of Germany alleging, inter alia, violations of the federal securities laws by Andersen. While it was the sole defendant, Andersen's presence in the litigation stemmed from its relationship with Arthur Andersen & Company, GmbH ("Andersen GmbH"), its West German affiliate.

The transactions which caused the instant suit were the plaintiffs' investments in a West German limited partnership, which, in turn, funded an American limited partnership that invested in real estate in Tennessee and Georgia. The complaint alleged that these decisions, but stated that "the present procedural context requires that we elaborate somewhat on our earlier opinion." Id. at 1350.

155 Id.
156 Id.
157 Id. at 1351. The court stated:

An issue in this case even more critical than the conduct of the King entities was the conduct of AA [Arthur Andersen] in providing accounting services to parties intimately involved in all phases of the case on both sides of every relevant transaction. AA audited KRC, TCC, and John King personally, and performed substantial services for FOF, IOS, and NRC in Denver, Chicago, and New York. . . . The Denver office performed substantial work on the natural resource interests, in coordination with the Swiss office of AA, which reviewed matters at IOS headquarters and FOF's executive office in Ferney-Voltaire, France. . . . While AA's activities could not provide subject matter jurisdiction where none previously existed, they are among the weighty United States contacts which support the exercise of jurisdiction in this case.

Id. This led to the court's decision to deny a motion for a new trial, and to award a judgment notwithstanding the verdict only on limited parts of the allegations of violations of the federal securities laws. Id. at 1382.

158 824 F.2d 27 (D.C. Cir. 1987).
159 Id. at 28.
160 The plaintiffs also had an action pending against Andersen in West Germany. Id.
investors relied on numerous misrepresentations and material omissions made by Andersen GmbH, in an audit report which analyzed the West German limited partnership and its American investments. It was undisputed that this report was prepared in West Germany and distributed only to West German investors in West Germany.\textsuperscript{161} Andersen was not directly involved in the solicitation of investors or in the preparation of any materials used in the transactions. The action against Andersen was predicated on only one link—the German audit report which had a single reference to Andersen. The report stated in German that with respect to certain data in the prospectus regarding economic fundamentals, “we [Andersen GmbH] have made inquiries thereabout by way of our branch-establishment Arthur Andersen & Co., Memphis.”\textsuperscript{162}

Judge Bork, writing for the court, commenced by noting that this was a question of first impression for the D.C. Circuit.\textsuperscript{163} Recognizing the lack of legislative or congressional guidance, the court observed that they had to meet the unavoidable task of discussing a purely hypothetical legislative intent.\textsuperscript{164}

The court surveyed the case law of its sister circuits, noting first that the plaintiff relied on Andersen’s “domestic conduct” as the alleged jurisdictional basis.\textsuperscript{165} “The Second Circuit has set the most restrictive standard,” the court found, by declining jurisdiction where the conduct within the United States was “merely preparatory” and not the direct cause of losses elsewhere.\textsuperscript{166}

The court rejected the test of the Eighth Circuit, finding that it diverged significantly from the Second Circuit standard, by “explicitly repudiat[ing]” the requirement that domestic conduct constitute the elements of a rule 10b-5 violation.\textsuperscript{167} Similarly, the Zoelsch court deemed the Third Circuit formulation, which allows

\begin{footnotes}
\item[161] Id.
\item[162] Id. at 29.
\item[163] Id.
\item[164] Id. at 30.
\item[165] Id.
\item[166] Id. Distilling the Second Circuit’s decisions, the Zoelsch court posited its brethren’s rule as finding subject matter jurisdiction where the domestic conduct comprises all of the necessary elements of a violation of section 10(b) and rule 10b-5. These elements would include fraudulent statements or misrepresentations originated in the United States, the presence of scienter, in connection with the sale or purchase of securities, and actual harm, although reliance and damages may occur outside of the United States. Id. at 31.
\item[167] Id.
\end{footnotes}
for subject matter jurisdiction where at least some activity furthering the fraud occurs within American borders, "more permissive." In rejecting these standards, the tribunal stated that "[t]he consequence of these approaches has been a loosening of the jurisdictional requirements: any significant activity undertaken in this country—or perhaps any activity at all—that furthers a fraudulent scheme can provide the basis of American jurisdiction over the domestic actor."169

The Zoelsch court then opted for "a more restrictive test," such as the Second Circuit's.170 Deciding not to assert jurisdiction, the panel grounded its decision on essentially three points.171

First, finding it "quite clear that the purpose of the Securities Exchange Act of 1934 was the protection of American investors and markets," the court inferred that the federal securities laws do not apply to transactions outside of the United States that do not harm such domestic investors or markets.172 Second, American judicial resources should be conserved for the resolution of domestic disputes and the enforcement of domestic law.173 Third, the court refused to extend subject matter jurisdiction based on policy considerations, as had the Third and Eighth Circuits, and expressed its disagreement with courts that did so; the court stated its preference for Congress to act if there is a need to address the problem.174

The court acknowledged that it too was reluctant to allow the

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169 Id.
169 Id.
170 Id.
171 Id.
172 Id. The court stated an "established canon of construction" that Congressional legislation, unless stated otherwise, is intended to apply within the territorial boundaries of the United States. Id.
173 Id. at 32. The court stated that "[i]t is far from clear that these resources would be well spent on all the potential disputes in which domestic conduct makes a relatively small contribution to securities fraud elsewhere." Id.
174 Id. The court expressed its stance of judicial deference in holding that: Congress did not think about conduct here that contributes to losses abroad in enacting the Securities Exchange Act of 1934; it could easily provide such jurisdiction if that seemed desirable today. . . . We are not persuaded by the reasoning of those circuits that have broadened federal court jurisdiction for reasons that are essentially legislative. In Continental Grain, the court said, "[w]e frankly admit that the finding of subject matter jurisdiction in the present case is largely a policy decision." 592 F.2d at 421. Yet Congress is available to make any policy decisions that are required. Id. (citations omitted).
United States to become a “Barbary Coast” for securities “pirates,” but disavowed any interest to indulge in what it no doubt considered judicial legislation.\textsuperscript{176} The court held that jurisdiction existed over proscribed acts done in this country.\textsuperscript{176}

Applying this test to the facts before it, the court stated that “it is clear that any actual defrauding of investors took place in West Germany, so that reliance and damages would have occurred there.”\textsuperscript{177} Therefore, it was left to consider whether Andersen committed acts in the United States that satisfied the other elements of section 10(b) or rule 10b-5 liability.\textsuperscript{178}

The court acknowledged that “[o]ne possible theory of liability that can be gleaned from the complaint is that [Andersen] and GmbH are ‘branch establishments,’ parts of a single world-wide organization,” which would open the possibility of concurrent liability. However, the plaintiff had not raised this on appeal, and according to the court, it was undisputed that the two accounting firms were “completely separate legal entities.”\textsuperscript{179} “The only other theory of liability” that the court found in the complaint was the allegation that Andersen acted willfully or recklessly in responding to inquiries made by Andersen-GmbH. The plaintiff contended that Andersen’s misrepresentations or omissions made in said responses could foreseeably affect securities purchasers and indeed had caused his and the other investors’ damages.\textsuperscript{180} However, the court believed that, even supposing their truth, these allegations alone would be insufficient to support jurisdiction under the circuit’s newly-recited test. Even if Andersen made misrepresentations to Andersen-GmbH, its statements were neither made for distribution to the public nor were transmitted to the public.\textsuperscript{181} Andersen was “merely one of the sources” that the West German accountants utilized in compiling their audit report, a report “prepared and certified by GmbH alone.”\textsuperscript{182}

In sum, Andersen was not alleged to have prepared or certified

\textsuperscript{175} Id. at 33.
\textsuperscript{176} Id. In a footnote, the panel noted that it would find jurisdiction whenever an individual was defrauded in this country, “for the actual consummation of securities fraud in the United States in and of itself would constitute domestic conduct.” Id. at n.4.
\textsuperscript{177} Id. at 34.
\textsuperscript{178} Id.
\textsuperscript{179} Id.
\textsuperscript{180} Id.
\textsuperscript{181} Id.
\textsuperscript{182} Id.
any part of the audit report that was distributed to investors and the statements that it made never reached those investors. Moreover, Andersen's "alleged misrepresentations to GmbH were 'merely preparatory' to any fraud perpetrated on West German investors, and did not 'directly cause' their losses."\(^{183}\) The court found that the plaintiff's claim of jurisdiction was weaker still because Andersen did not even prepare or audit the financial statements that were distributed to West German citizens.\(^{184}\) Thus, the D.C. Circuit declined to find subject matter jurisdiction.\(^{185}\)

To summarize briefly, where courts have found subject matter jurisdiction under the federal securities laws, the acts of the accounting firm defendants were found to be plainly domestic in nature. In *Cornfeld*, the Second Circuit found that "all the accounting work" was performed in the United States, and the opinions in both *F.O.F. I* and *F.O.F. II* reveal that substantial activity took place in the Denver, Chicago and New York offices of Arthur Andersen. Implicit in these rulings is a view that the acts in question were not only domestic, but were sufficiently extensive to simply overwhelm the foreign aspects of the transactions.

*Zoelsch* occupies the opposite end of the spectrum, where the accounting firm in the United States played at best a *de minimis* role. The D.C. Circuit made it plain that subject matter jurisdiction would not be imposed absent a showing of something well beyond mere tertiary involvement by the domestic accountants. More importantly, *Zoelsch* signifies a key milepost in the continuing evolution of the standards delineating the scope of subject matter jurisdiction under the federal securities laws.

\(^{183}\) *Id.* at 35 (quoting Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 992-93 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975)).

\(^{184}\) *Id.*

\(^{185}\) *Id.* at 36. Lastly, the panel rejected Zoelsch's final argument that all activity surrounding a securities transaction be deemed "a single mass," and that jurisdiction should be exercised over any individual defendant if the sum of all domestic activities by all participants in multiple transactions would be sufficient to support American jurisdiction. *Id.* The court summarily dismissed this proposal: "It is obvious that this suggestion is completely antithetical to the approach we have adopted here. It bears no relation to the tests for determining jurisdiction that have been adopted by any of the federal appellate courts. . . . There seems nothing to recommend it." *Id.* at 36.
ST. JOHN'S LAW REVIEW

SUBJECT MATTER JURISDICTION AND QUALITY CONTROL—THE CHALLENGE TO MULTINATIONAL ACCOUNTING FIRMS

The potential changes wrought by the DED decision's latest permutation of the subject matter jurisdiction question undeniably offer a number of numerous and diverse challenges to the accounting profession. In this author's view, the greatest challenge for internationally expanding multinational accounting firms is to be found in the area of quality control.

In seeking to become more transnational, each accounting firm aims to spread its own sphere of influence on a global basis, to develop a multinational grid for servicing clients worldwide and, of course, to perpetuate its own growth. In the process, accounting firms are also "facing anew the festering issues" of, among other areas, quality control. To be sure, "[t]his is an area of real concern because the reputation of the [accounting] firm depends on the quality of the work it does. The decision reached in DED may substantially increase the legal significance of the accounting firms' efforts to maintain and improve quality control.

The Necessity of Quality Control

The American Institute of Certified Public Accountants ("AICPA") has devoted considerable effort to formulating rules on quality control. Seminal in this regard is the AICPA's Statement on Auditing Standards No. 25, entitled "The Relationship of Generally Accepted Auditing Standards to Quality Control Standards." Basically, this edict demands that "a firm should establish quality control policies and procedures to provide it with reasonable assurance of conforming with generally accepted auditing standards in its audit engagements."

The doctrine of quality control may be found in the AICPA's pronouncement of a "System of Quality Control for a CPA

187 J. ARPAN & L. RADEBAUGH, supra note 4, at 319.
189 Id. at § 161.02; see also CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, CODE OF PROFESSIONAL CONDUCT § 56.05 (JUNE 1, 1987) ("[D]ue care requires a member to plan and supervise adequately any professional activity for which he or she is responsible").
The preamble notes that the Statement mandates that a CPA firm shall have a system of quality control, and continues by describing elements of the system. Thus an American firm is required to provide reasonable assurance that work "performed by its foreign offices or by its domestic or foreign affiliates" will be performed in accordance with professional standards prevailing in the United States.

These quality control standards "relate to the conduct of a firm's audit practice as a whole." The most crucial words therein are those that relate quality control to the firm in its entirety, which poses special problems for firms such as the Big Eight whose practices span the globe.

It would seem that the system requirement established by the AICPA was formulated in the context of assuring quality control over work performed by foreign branch offices or affiliates as part of an American-based engagement. However, with the shift toward truly international undertakings, the Statement impliedly takes on an even more powerful meaning in demanding that non-domestic units strictly adhere to the quality control programs promulgated by their American counterparts.

**Supervision—A Global Task**

The AICPA Statement on Quality Control Standards states that "[p]olicies and procedures for the conduct and supervision of work at all organizational levels should be established to provide the firm with reasonable assurance that the work performed meets the firm's standards of quality." It is interesting to note the requisite supervision "at all organizational levels," which would seem to include supervision of routine work performed through the

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191 *Id.*

192 *Id.* at § 10.05.

193 1981 CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, *supra* note 188, at § 161.03.

194 Quality control, as a general matter, imposes a complex burden on multinational accounting firms. Each firm must establish standards relating to the whole of its practice. In a transnational firm, this creates vast problems of devising, implementing and enforcing those standards across the globe. Yet this is what the profession demands, notwithstanding a firm's concomitant expenditures to ensure quality control on a multinational scale.

chain of command. It is open to conjecture whether this supervision would also integrate work performed by similarly structured offices of far-flung organizations, the structure of so many of the larger, international firms today. For instance, one could easily conclude that supervision at “all organizational levels” in a multinational accounting firm would entail individual foreign offices being supervised by regional or national offices, which in turn would be under the supervision of a higher office overseeing the firm on an international scale.\footnote{198}

The Concurring Review—A Further Entanglement?

The quality control process has a further refinement known as the concurring review of the accountant’s final work product, which would typically be the audit report. This entails a person having no relationship to the engagement conducting a comprehensive, “cold” review for the purpose of independently ensuring that quality control is maintained.\footnote{197} Thus, additional assurance of compliance with professional standards, particularly the standard of supervision, is gained by an independent review of the underlying documentation, financial statements and the accountant’s report.

The concept of the concurring review takes on even greater significance in the realm of international accounting engagements. In such an engagement the International Accounting Guidelines of the International Federation of Accountants specify that “[r]eview procedures may be augmented, particularly in the case of large complex audits, by requesting personnel not otherwise involved in the audit to perform certain additional review procedures before

\footnote{196} Multinational accounting firms are again called to task. Supervision is demanded from the lowest rung of the firm’s structure to the penultimate point of its hierarchy. In a global organization, this undoubtedly means that offices of different nationalities will at some point share in the supervision of an ultimate authority with international responsibilities.

\footnote{197} PATTILLO, QUALITY CONTROL AND PEER REVIEW: A PRACTICE MANUAL FOR CPAs at 112-13 (1984). The Statement of Quality Control Policies and Procedures for CPA Firms contains a subsection specific to the topic of the concurring review. 1979 CODIFICATION OF ACCOUNTING STANDARDS AND PROCEDURES, supra note 190, at § 90.16.3.b.(iii). The application of the concurring review concept in the transnational area was no doubt inspired by its status as a long-standing requirement in domestic SEC related practice. Within the body of the AICPA itself is the SEC Practice Section, a group encompassing the major accounting firms with auditing clients who file financial statements with the Securities and Exchange Commission.
issuance of the auditor’s report.”

The SEC Practice Section places its own stringent requirements on members. It is worth noting the review process imposed for S.E.C. engagements. Each member firm must establish policies and procedures “for a concurring review of the audit report and the financial statements by a partner other than the audit partner-in-charge of an SEC engagement before issuance of an audit report.”

It seems that the importance of the concurring review is bound to increase. Commentators note that the concurring review “contributes to providing the firm with reasonable assurance that the audit was performed in accordance with the profession’s standards.” There is a crucial need to maintain such quality controls, given the public need for reliable data, the extent of losses when an “audit failure” occurs and the ever-present threat of government intervention by way of increased regulation. Advocates of the concurring review visualize it as a quality control measure which should be strengthened since it makes a great contribution to maintaining professional standards. As the tasks put to the profession become more complex, the concurring review becomes a more vital step in the quality control process.

Let us contemplate a situation where the concurring review calls for the involvement of unrelated members of the firm in the engagement of a particular office. Suppose for reasons of staffing, experience, personnel availability, or any other cause, the concurring review must be undertaken by a member of another office. The reviewer may be from an office foreign to that of the principal accountant. Thus, the necessity of the concurring review may result in the entanglement of offices foreign to each other within the structure of a multinational accounting firm.

In sum, the multinational accounting firms are confronted with a number of issues, each falling under the rubric of quality control. First, they must establish pervasive, firm-wide quality con-

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199 Div. FOR CPA Firms SEC Practice Section Manual §1, Art. IV at 3 [hereinafter SECPS Manual].
200 Id. at 3.f.
202 Id. at 63.
203 Id.
trol standards and systems. Second, supervision at all levels must be maintained, including the supervision of entire geographic regions. Third, the concurring review must be utilized to ensure quality control in any given engagement. Each of the three points raised above points to the conclusion that the standards of the profession strictly require the multinational accounting firms to create and foster a strong interdependency and interrelationship among all of their constituent units around the globe. However, DED cautions that supervision by a U.S. accounting firm over its foreign affiliates may expose the actions of the firm to the subject matter jurisdiction of the federal courts. Thus, an increasing international practice combined with the crucial requirements of quality control raise the spectre of potential liability for those firms which cannot keep pace with the ever more rigorous standards of the profession.

One leading observer has noted that some multinational firms relish transnational engagements “for the belief that they will distance their firm from the class action lawsuits” and other such entanglements of our litigious society. Yet, as the same commentator notes, this is an illusion. “Global expansion compounds the perils of high-visibility public practice by complicating the efforts to establish and implement uniform quality controls. The broader an accounting firm’s sweep of practice, the greater the challenge” to ensure the same standards are met wherever they may be applied. In addition, as shall be demonstrated, the DED decision may very well cause a vast increase in the exposure of multinational accounting firms to subject matter jurisdiction under the federal securities laws as a result of these efforts to maintain quality control.

Discussion

From the day of its issuance, the DED opinion was viewed by the business and legal communities as “a potentially far-reaching decision for the accounting profession.” Undeniably, expansion of subject matter jurisdiction under the federal securities laws would create a new layer of exposure for the multinational accounting firms, particularly the Big Eight. As noted by one author-

205 Id.
206 Berton, Accounting Firms Can Be Sued in U.S. Over Audit Done Abroad, Judge Rules, Wall St. J., Mar. 10, 1988, at 10, col. 3.
ity, "[t]his decision could have a serious impact upon the international accounting firms which may find themselves defending actions in the U.S. courts under our more stringent laws for participating in predominately foreign engagements."\textsuperscript{207} The extent to which \textit{DED} represents a bold, new venture into previously uncharted territory will be examined in light of the foregoing discussion of subject matter jurisdiction.

\textbf{The Unanswered Questions of \textit{DED}}

In the court's view, subject matter jurisdiction in \textit{DED} was predicated on an application of the "conduct" test, it being certain that the events therein could not pass muster under the "effects" test.

\textit{DED} dealt with a governmental agency of a foreign sovereign, purchasing interests in a subsidiary wholly situated within its own borders. Domestic investors and markets felt no effects from this transaction whatsoever, and the effects were so generalized and minimal that the requisite threshold to active jurisdiction was not reached. The court was left with the "conduct" test. While Judge Stewart's factual findings were by no means inadequate, they were of course bound by limitations inherent in any adjudication of a preliminary motion; subsequent proceedings at the trial and appellate levels will probably expand and refine the pertinent points.

The \textit{DED} court found subject matter jurisdiction under the federal securities laws where an accounting firm's foreign affiliates undertook an overseas audit engagement of a foreign entity and reported back their results, subject to some supervision from the domestic offices. A number of difficulties immediately come to the fore under these facts.

The \textit{DED} court purposely did not fully address the degree of affiliation among the accounting firms involved. For this reason, it is unclear what the ultimate outcome should be on that discrete point. As the opinion itself discusses, there is a question as to whether AA-US, AA-UK and AA-Ireland were distinct entities or parts of a more unified structure. If the latter is found, in this case or others, it is unclear whether the question of subject matter jurisdiction shall be determined, at least in part, by the operational structure of multinational accounting firms. The impact of this determination on the overall management of accounting firms that

\textsuperscript{207} Goldwasser, Accountants' Liability 1988 27 (1988).
are already unified into one organization, or otherwise bound to-
gether as they become more transnational in the scope of their
practice, remains to be seen.208

The DED court admitted that most of the audit field work was
carried out by AA-UK and AA-Ireland in Europe. Nevertheless, the
fact that ultimate engagement partner responsibility resided in the
offices of AA-US was dispositive. Will the nomenclature of the ac-
counting profession take on an entirely new significance in light of
DED or subsequent opinions like it? To what extent will the inter-
nal distribution of responsibility levels widen the potential liability
of the multinational accounting firms under the federal securities
laws?

For example, the world’s largest accounting firm, Klynveld
Peat Marwick Goerdeler (“KPMG”),209 has stated, “for legal pur-
poses, on audit documents, it will be KPMG Peat Marwick Main &
Co.”210 Will this usage of the international firm title on transna-
tional engagements impose legal responsibility on a domestic affili-
ate whose name is included therein? It is uncertain if the DED
rationale will compel other courts to find such internal policies to
be influential factors in activating subject matter jurisdiction
under the federal securities laws.

The DED court raised other serious questions when it consid-
ered the fact that AA-UK and AA-Ireland communicated with the
domestic offices of AA-US for guidance and support in determining
whether the court had subject matter jurisdiction. The impact on
the management procedures of a multinational accounting firm
cannot yet be adequately measured. But in light of DED, at what
level shall the interplay between a transnational accounting firm’s
domestic offices and its foreign counterparts be deemed “conduct,”
rising above the “merely preparatory” threshold? The uncertainty

208 See J. of Acct. 15, 16 (March 1989). Arthur Andersen & Company recently an-
nounced that its practice shall now be divided into only three regional operating areas.
These regions shall be the Americas, Europe-Middle East-Africa and Asia-Pacific. A board
of partners will represent the regions. This action is intended to recognize the global growth
of the firm’s business and its expansion beyond the traditional accounting firm structure.
Interestingly, critics claim that the new structure still does not address the key issue of
liability exposure stemming from audit-related litigation. Id.

209 See 1988 GUINNESS BOOK OF WORLD RECORDS 337-38 (“The largest firm of account-
ants worldwide is that resulting from the merger of Peat Marwick International and
Klynveld Main Goerdeler of the Netherlands announced on September 3, 1986 with a com-
bined annual revenue of $2,700 million and a total of 58,000 employees”).

could have a debilitating "chilling" effect on interoffice contact in the future.

The opinion also made reference to professional standards that the court deemed important in finding that AA-US had a duty to supervise. The standards cited by the court in this regard are quite different from those professional benchmarks discussed elsewhere in this text. This finding may portend a foray by the judiciary into standards of the accounting profession previously unexplored in this context. If so, it is suggested that the danger in pursuing such a course arises from reliance on certain standards that may not be completely applicable, at the expense of other professional requisites of equal, if not overriding, importance. Specifically, DED did not delve into the quality control and supervision requirements that were elaborated upon earlier. This creates a most dangerous situation for the accounting profession, because while each firm must be guided by the larger framework of its professional standards, DED and subsequent opinions like it may prioritize those standards in divergent and conflicting ways.

DED—An Unwarranted Detour from the Second Circuit Trilogy?

The next point of discussion is a comparative analysis of the Second Circuit precedents and the DED ruling. The DED opinion may manifest itself as a breakthrough into previously uncharted territory for subject matter jurisdiction, if indeed it does not represent an unwarranted diversion from the carefully crafted guideposts devised by that tribunal.

A number of the elements utilized in previous jurisdictional tests were ignored in the DED opinion. Unlike Schoenbaum, there was no need in DED to protect domestic investors and markets from improper foreign transactions. The "conduct" test offers a more complex set of questions. In Leasco, the Second Circuit based its findings upon "abundant misrepresentations" made in the United States that were actionable under the anti-fraud provisions of our federal securities laws. Would that court today find the domestic activity of AA-US, as noted in DED, "abundant" enough in light of Leasco to find subject matter jurisdiction under

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211 The DED case is more like IIT, where the minimal American ownership of the stock in question was not a sufficient basis for a finding of subject matter jurisdiction under the federal securities laws. In DED the securities were wholly owned by a foreign entity (and a governmental one at that) and not traded on any domestic market. Id.

212 See supra notes 35-36 and accompanying text.
the federal securities laws? Or would that tribunal, upon considering the far greater role of AA-UK and AA-Ireland in the engagement and the more secondary participation of the American accounting firm, deem the activity not to be substantial enough to invoke subject matter jurisdiction?

The refinements offered in the Bersch case are even more illuminating in this regard. Bersch declared that domestic acts that are "merely preparatory" and relatively insignificant compared to activity abroad do not give rise to subject matter jurisdiction. It is suggested that if an appellate panel reviewed DED, it might find the domestic activity therein to be nothing more than "merely preparatory" and quite insignificant in comparison to its foreign elements.

The conservative tone of Bersch indicates that the Second Circuit intended that caution be exercised in labelling domestic occurrences more than "merely preparatory" for the purpose of activating subject matter jurisdiction. By instructing lower courts to determine whether "predominantly foreign" transactions warranted the intervention of the "precious resources" of American courts and regulators, the Second Circuit warned that findings of subject matter jurisdiction under the federal securities laws require ample justification. "Moderation is all," cautioned the great Judge Friendly. Was the DED court properly mindful of this admonition?

This theme carried over into the IIT decision. While the court refused to allow the United States to be utilized as a base for exporting securities fraud, it still maintained that "merely preparatory" activities in this country could not give rise to subject matter jurisdiction. This strict limitation was necessary in order to establish some boundaries for subject matter jurisdiction under the federal securities laws. Once again, did DED accord proper respect to this restriction? Or did DED transgress the explicit mandate of IIT that a line must be drawn somewhere to prevent an unlimited application of subject matter jurisdiction, especially with respect to predominantly foreign transactions?

The jurisprudence of the Second Circuit does posit a recurring theme, i.e., that the absence of certain elements present in earlier cases would not necessarily preclude a finding of subject matter jurisdiction in later cases. The tribunal might eventually rule that DED contained aspects warranting a finding of subject matter jurisdiction, notwithstanding the lack of attributes found vital to
such a holding in prior cases.

The Influence of Kasser and Continental Grain

The more revolutionary aspect of DED is the fact that its reasoning is more akin to the ratio decidendi utilized by the Third Circuit in Kasser and the Eighth Circuit in Continental Grain. Both of those circuit courts moved away from the more restrictive formulations of the Second Circuit, choosing to exercise subject matter jurisdiction since some domestic activity was found in the foreign transaction at issue.

Kasser and Continental Grain found subject matter jurisdiction under the federal securities laws where there was some activity in the United States, notwithstanding the presence of arguably stronger foreign elements. Indeed, Continental Grain pushed to the very edge of the scope of subject matter jurisdiction. While few would argue that the domestic conduct was significant, the Eighth Circuit insisted that the conduct should be measured by the more vague and nebulous standard of "at least some activity" in the United States. Moreover, the panel emphasized that this was a policy decision, motivated by its desire to prevent the overseas exportation of American fraud.

In many ways, one might view DED as traveling to the brink of the issue in that the finding of subject matter jurisdiction was predicated on domestic conduct similar to the "some activity" in Continental Grain rather than the more substantial activity for which the Second Circuit has searched. Furthermore, while DED does not hold itself out as a policy decision, was it nevertheless influenced by the policy considerations which were so important in Kasser? Is it implicit in DED that the district court sought to emulate the Third Circuit and prevent the "pirates" of the accounting profession from employing this nation as a "Barbary Coast" for securities fraud? If indeed DED is more consistent with the holdings of the Third and Eighth Circuits, then it shall be interesting to see how the Second Circuit reconciles the errant opinion from below with its own longstanding parameters.

Zoelsch—A Reawakened Conservatism

The possibility of a widening rift among already established schools of legal theory magnifies the importance of the Zoelsch de-

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212 See supra notes 75-85 and 92-106 and accompanying text.
cision. To the extent it exposits the differing camps and then places itself squarely on one side of the issue, it is a landmark which might very well determine the future course of the case law. As in Arthur Young, the domestic accounting firm in Zoelsch was found to have acted insubstantially as compared to the more egregious conduct perpetrated abroad. In contrast, Zoelsch can be readily distinguished from Cornfeld and F.O.F. I and F.O.F. II, where the domestic conduct of the American accounting firms was so pervasive that it simply overpowered the otherwise predominantly foreign elements of the transactions at issue.

No appellate court has yet analyzed the type of activity addressed in DED. It is asserted here that the domestic conduct of the accounting firm in DED did not rise to the overbearing level found in Cornfeld and both of the F.O.F. decisions. Thus the foreign elements, in particular the more significant undertakings of the overseas accountants, should control and thereby negate any inference of subject matter jurisdiction. DED is more like Zoelsch in that the tasks performed by the American accounting firm were too small in comparison to the foreign activity to justify the imposition of subject matter jurisdiction under the federal securities laws. It is also noteworthy that the Zoelsch court issued its opinion at a time when the reality of the global economy and the international scope of the accounting profession could not be denied.

No doubt the Zoelsch court looked to the long history of the issue of subject matter jurisdiction and foreign securities transactions and realized that Congress has had ample time to address it. Given the lack of Congressional initiative, the Zoelsch court stated that it would be wrong to judicially mandate remedial measures, and strongly disagreed with the circuit courts that had done so.

Quality Control—A Trigger for Jurisdiction?

Finally, there remains the matter of the growing tension between the multinational accounting firms’ need to maintain quality control guidelines and the increased exposure to jurisdiction arising from any attempt to implement those standards globally. Having examined the relevant legal benchmarks, one can easily discern the paradox which transnational accounting firms may face.

On one hand, the rigorous professional standards that the accounting firms must abide by demand a comprehensive quality control system that is installed and maintained on a transnational basis. However, this creates an inevitable collision with the
precepts of subject matter jurisdiction, for as such a system becomes more intricate and encompassing, it shall no doubt give rise to domestic conduct which may activate subject matter jurisdiction under the federal securities laws.

It is here that DED and decisions like it create the greatest danger to the profession. Since a firm unavoidably acts on a global scale, can one deny that the creation and maintenance of such a system would entail domestic conduct, and probably significant conduct at that? Consider the focus in DED on the contact between AA-US and its foreign affiliates. What if it were found that any such contact and the concomitant domestic conduct was purely related to the quality control function? Seemingly, DED would still activate subject matter jurisdiction.

Clearly, the modern transnational accounting firm must establish a quality control system that interlocks all of its far-flung offices into a comprehensive network, which necessitates establishing a strata of supervising levels. Furthermore, greater reliance shall be placed on the concurring review, which is yet another opportunity for intervention between domestic and foreign offices.

Domestic conduct to maintain quality control will undoubtedly have some impact on the overseas offices of accounting firms as they participate in predominantly foreign transactions. Under the DED analysis, there is a strong possibility that subject matter jurisdiction under the federal securities laws would be found, especially if DED represents a shift to the more permissive standards of Kasser and Continental Grain.

In sum, we can see the quandary that the multinational accounting firms face. To establish and maintain quality control, they must act globally and thereby evoke domestic conduct pertaining to foreign engagements. Yet to do so raises a clear and present danger that such domestic activity shall be found a sufficient basis for a court to impose subject matter jurisdiction under the federal securities laws. To be sure, to sacrifice one for the other would simply leave the accounting firms open to attack on the opposite front. This is the prodigious challenge to the accounting profession which the DED decision beckons.

CONCLUSION*

In conclusion, it is asserted here that the DED opinion breaks

* As this article went to press, "[t]he Big Eight accounting firms took a giant step
new ground and extends the limits of subject matter jurisdiction under the federal securities laws to a point hitherto unknown. This is a clear diversion from the carefully restrained view of the Second Circuit in its well-established trilogy, and a shift towards the more relaxed standards of the Third and Eighth Circuits. Moreover, it conflicts with the reaffirmance of the conservative view recently propounded by the D.C. Circuit in Zoelsch.

The multinational accounting firms are now faced with an even greater risk of being embroiled in litigation relating to predominantly foreign transactions. Most importantly, \textit{DED} creates an atmosphere where that danger is exacerbated by the need of the accounting firms to maintain quality control on an international scale.

There is no denying the fact that the accounting profession is now global and shall always remain so. Likewise, professional standards of quality control must be followed religiously, lest the firms face danger on that front as well.

Given this conflict, the multinational accounting firms, especially the Big Eight, must realize that in seeking to maintain high professional standards as they grow internationally, they risk imposition upon themselves of subject matter jurisdiction under the federal securities laws. Truly, it is time for the Big Eight, and indeed the entire accounting profession, to beware.

toward becoming the Big Five.” Wall St. J., July 7, 1989, at 3, col. 1. On the same day, Arthur Andersen & Co. and Price Waterhouse stated they had commenced merger talks, while Deloitte, Haskins, & Sells and Touche Ross & Co. announced an agreement in principle to combine. These developments followed the disclosure some weeks before that Ernst & Whinney and Arthur Young & Co. had agreed in principle to merge and form Ernst & Young. For the present, the new Ernst & Young would eclipse KPMG Peat Marwick as the world's largest accounting firm. However, if the proposed Andersen-Price merger comes to pass, it could produce a still larger firm. \textit{Id.}

Such events emphasize two themes contained in this writing. First, a major motivation for these combinations is the desire of the large accounting firms to become completely international in scope by strengthening practice abilities in Europe and Asia. \textit{Id.} at col. 1-2. Second, creation of such far-flung organizations accentuates the need to maintain quality control.

Clearly, as stated herein, the multinational accounting firms are now inexorably committed to wide-ranging international practices, increasing their exposure on a global scale. And as they expand globally, the firms shall find it only more difficult to maintain the very quality control so essential to minimizing that exposure.