Misapplication of the Federal Extraterritoriality Principle In Limiting the Scope of Civil Remedies for Fraud under State Blue Sky Laws

Robert N Rapp, Case Western Reserve University

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I. INTRODUCTION

In a 2010 chapter of the complex National Century Financial Enterprises Inc., Investments Litigation,1 the United States District for the Southern District of Ohio, applied the “Extraterritoriality Principle” under the Dormant Commerce Clause of the U.S. Constitution2 to dismiss claims under an express civil remedy of rescission in the Ohio Securities Act (the “Ohio Blue Sky law”) brought by out-of-state purchasers of securities which had been offered and sold in the commission of a massive fraud.3 Plaintiffs were non-Ohio purchasers of securities issued by special purpose entities created in Ohio by National Century Financial Enterprises, Inc.

* Robert N. Rapp, B.A., J.D., Case Western Reserve University; M.B.A., Cleveland State University, is a partner with Calfee, Halter & Griswold LLP, Cleveland, Ohio, where his practice concentration is financial market regulation and related litigation. He is the author of Blue Sky Regulation (2d ed., Lexis/Nexis Matthew Bender & Co., Inc.), and Adjunct Professor of Law at the Case Western Reserve University School of Law, where he teaches “Law, Theory and Practice in the Financial Markets.” The assistance of Matthew Kucharson and Eric Zell in the preparation of this article is gratefully acknowledged.


2 The Commerce Clause, which vests authority in Congress to “regulate Commerce... among the several states,” U.S. Const. art I, §8, cl.3, also has negative or implicit consequences for state authority to regulate interstate commerce, referred to as the “dormant” Commerce Clause -- a self-executing limitation on the power of the states to enact laws imposing substantial burdens on interstate commerce. In this “dormant” form, the Commerce Clause limits the powers of states “to erect barriers against interstate trade.” Lewis v. BT Inv. Managers, Inc., 447 U.S. 27, 35 (1980).

3 Ohio, as with all other states, see, e.g., Unif. Sec. Act § 410, provides an express civil remedy for purchasers of securities in sales involving a violation of the statute. O.R.C. §1707.43 provides in pertinent part:

[Every sale or contract for sale made in violation of Chapter 1707 of the Revised Code is voidable at the election of the purchaser. The person making such sale or contract of sale, and every person that has participated in or aided the seller in any way in making such sale or contract for sale, are jointly and severally liable to the purchaser, in an action at law in any court of competent jurisdiction... for the full amount paid by the purchasers... unless the court determines that the violation did not materially affect the protection contemplated by the violated provision.]

In National Century, plaintiffs alleged fraud in the sale of the securities, which is specifically identified in the Ohio Blue Sky law as a violation, see O.R.C. §1707.44(G) (“No person in purchasing or selling securities shall knowingly engage in any act or practice that is in this chapter, declared illegal, defined as fraudulent, or prohibited”), “Fraud” is defined in the Ohio law to include any device, scheme or artifice to defraud , and any act, transaction, or course of business relating to the purchase that is fraudulent or would operate as a fraud upon a purchaser or seller, see O.R.C. § 1707.01(J).
(“National Century”), an Ohio corporation, in carrying out its fraud. The securities were distributed through Credit Suisse Securities LLC (“Credit Suisse”), a broker-dealer and investment banking firm licensed in Ohio but not located there. As an intermediary, Credit Suisse acted first as placement agent and later as a traditional underwriter engaged by National Century to carry out the distribution of securities. The securities were sold to non-Ohio institutional purchasers, and all actual transactions took place outside of Ohio. In the wake of National Century’s collapse and subsequent bankruptcy, plaintiffs sued Credit Suisse both as a seller of the securities, and as a party who allegedly aided or participated in sales of securities involving violations of the Ohio Blue Sky law.

The Ohio Blue Sky Law, as with Blue Sky Laws generally, provides a statutory remedy of rescission, or to recover damages as a rescission equivalent, for a purchaser in a sale of securities which involves a violation of registration or intermediary licensing provisions, or which involves fraud or deception. In all states, liability under the statutory rescission remedy extends to some degree beyond the actual seller of a security to secondary actors who play some role in the sale. In Ohio, secondary liability for rescission extends specifically to “every person that has participated or aided the seller in any way in making such sale.”\(^4\) In *National Century*, the plaintiff purchasers made a claim under the Ohio statutory remedy against Credit Suisse not only as an alleged seller of securities, but also as a participant or aider in the offer and sale of securities by National Century and special purpose entities it created to issue the securities. The focus in the case was on the scope of asserted secondary liability of Credit Suisse in its intermediary role in the distribution of securities carried out by National Century and the special purpose entities in the execution of a fraudulent scheme.

\(^4\) O.R.C. §1707.43, note. 3, *supra.*
Although National Century and its corporate principals, while engaged in fraud in Ohio, created Ohio special purpose entities to issue securities and engaged Credit Suisse for the purpose of structuring and marketing the securities, the court dismissed the Ohio Blue Sky Law claims of out-of-state purchasers, holding that to allow invocation of the remedy by out-of-state purchasers would violate the Dormant Commerce Clause by regulating commerce that took place wholly outside of Ohio. The court barred availability of the statutory rescission claim to out-of-state purchasers by adopting a bright line transactional test to limit the territorial reach of the civil remedy only to purchasers in transactions occurring in Ohio.

The court’s central premise was that the application of Ohio’s post-transaction civil remedy may not be applied extraterritorially to commerce or conduct occurring outside the state, and that doing otherwise would impermissibly affect interstate commerce. Barring the Ohio civil remedy, the court relied on the Extraterritoriality Principle, under which states violate the Dormant Commerce Clause by regulating or controlling commerce wholly outside of their own borders.5 The court so held in spite of the fact that the Ohio provision at issue is a post-transaction civil remedy for any purchaser aggrieved by unlawful conduct rather than a projection of regulatory or enforcement authority by the state.

5 The Extraterritoriality Principle, an outgrowth of the Dormant Commerce Clause, dates to at least 1881, when the Supreme Court, in Bonaparte v. Tax Court, 104 U.S. 592 (1881), held that “[n]o state can legislate except with reference to its own jurisdiction.” Id, at 594. The Principle constrains the reach of the laws state legislatures may enact. Professor Katherine Florey notes, however, that it is sometimes poorly understood, and that “[t]he exact scope of this limit... remains notoriously unclear.” Katherine J. Florey, State Courts, State, Territory, State Power: Reflections on the Extraterritoriality Principle in Choice of Law and Legislation, available at: http://works.bepress.com/katherine_florey/2 (Aug. 2008); see also Donald H. Regan, Siamese Essays: (1) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (2) Extraterritorial State Legislation, 85 Mich. L. Rev. 1865, 1884 (1987) (“[W]e do not understand the extraterritoriality principle... nearly as well as we should... [W]e have no acceptable account of the constitutional underpinnings of the principle”).

“Extraterritoriality” has most recently been characterized as a loosely labeled, infrequently applied strand of the Dormant Commerce Clause, and out of touch with the Supreme Court’s current dormant Commerce Clause jurisprudence, which focuses on economic protectionism, through excessive barriers to interstate trade, and state laws likely to subject entities engaged in interstate commerce to incompatible state regulatory regimes. IMS Health Inc. v. Mills, 616 F.3d 7, 28-29 (1st Cir. 2011) (“These concerns are central to the way the Supreme Court has framed the dormant Commerce Clause in its recent opinions”).
Imposition of a strict transactional test for fixing the territorial limits of the Ohio statutory remedy in *National Century* was grounded in the court’s conclusion concerning what “conduct” or “commerce” is reached by the Ohio Blue Sky law. Although it was undisputed that National Century had engaged in a massive fraud from its base in Ohio, the court concluded that the commerce or conduct reached by the Ohio Blue Sky Law is a securities transaction, not fraud or other unlawful conduct in the offer and sale of securities. Opting for a bright line transactional test to fix the territorial limit of the rescission remedy, and without regard to the nature or the scope of protection under Blue Sky laws in the offer and sale of securities, the court concluded that allowing the Ohio rescission remedy for out-of-state purchasers would, as applied, amount to regulation of commerce wholly of outside Ohio -- seen by the court as a per se violation of the Extraterritoriality Principle. Summary judgment was granted for Credit Suisse, dismissing the purchasers’ claims.

With this conclusion, the court flatly rejected application of the “balancing test” for assessing the validity of state laws under the Commerce Clause pronounced by the U.S. Supreme Court in *Pike v. Bruce Church, Inc.*, which addresses the extent of burden imposed on commerce by a state statute in relation to the local interests it serves. Under *Pike*, even when a state statute regulates interstate commerce indirectly, the burden on interstate commerce is to be weighed against the legitimate state interest. Applying the *Pike* balancing test, a state statute will be upheld if it “regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental... unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”

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6 755 F.Supp.2d, at 882.


8 *Id.* at 142 (citing *Huron Cement Co. v. Detroit*, 362 U.S. 440, 443 (1960)).
balancing test assumes that the state law under review has only incidental effect and impact on interstate activities. In National Century, application of the Pike balancing test was rejected because, in the eyes of the court, allowing the Ohio rescission remedy to out-of-state purchasers would constitute the direct regulation of commerce outside Ohio, such that the Extraterritoriality Principle is an absolute bar and no further inquiry is required.\(^9\)

The narrow transactional test embraced by the court is inconsistent with the true focus of state Blue Sky laws and the scope of their intended protection. National Century carried out a massive fraud through the creation and distribution of securities from Ohio into the hands of investors. It committed fraud in the offer and sale of those securities from Ohio through an intermediary process. Blue Sky laws are not cabined by the wooden notion of a “transaction.” They address unlawful conduct in the “offer” and “sale” of securities. They have always been accorded the broadest possible reach to address unlawful conduct and effectuate intended investor protection.\(^{10}\)

Moreover, as antifraud statutes intended to further undisputable legitimate state interests, and which are remedial in nature, antifraud protections of Blue Sky laws have specifically withstood challenges based on alleged undue burden on interstate commerce when applied to

\(^9\) As discussed in Part IV below, this conclusion rests almost entirely on a plurality opinion of the U.S. Supreme Court in Edgar v. MITE Corp., 457 U.S. 624 (1982), and the pronouncement (in dicta) by the Supreme Court in Healy v. The Beer Institute, 491 U.S. 324, 336-37 (1989), in which the Court suggested that a state law will violate the Dormant Commerce Clause if it “appl[ies]... to commerce that takes place wholly outside of the State’s borders, whether or not the commerce has effects within the State,” if its “practical effect... is to control conduct beyond the boundaries of the State,” or if it would result in “inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another State.” (citation omitted).

\(^{10}\) See, e.g., Texas Capital Securities, Inc. v. Sandefur, 58 S.W. 3d 760 (Tex. Ct. App. 2001), in which civil remedies under the Texas Blue Sky Law were applied against a broker-dealer for securities transactions that occurred in the public secondary, i.e., trading market, rather than in the distribution of securities. The court held that the Blue Sky Law was not limited in application to initial distributions of securities, and that the rescission remedy should be available against any intermediary who forms a link in the chain of a distribution of securities in which there is a violation of the law.
out-of-state purchases. For example, in Chrysler Capital Corp. v. Century Power Corp., a case challenging application of the Arizona Blue Sky law to securities transactions which took place outside the state, the federal district court emphasized that state antifraud statutes are remedial in nature, not preventative, and that they impose no additional requirements on persons engaged in interstate commerce, with the essential point being:

[L]ike any tort recovery statute [an antifraud] provision merely provides a post-hoc remedy for persons aggrieved by allegedly unlawful conduct. Thus, in no sense does it prevent or burden interstate commerce.... If anything, such legislation facilitates commerce far more than it can even be argued to "burden" in any sense... because it provides a measure of assurance that commerce will be honestly transacted.12

There are serious flaws in the reasoning by which the Ohio statutory remedy was barred in National Century, and in the court's reliance on the Extraterritoriality Principle at all, much less its rejection of the Pike balancing test when assessing any perceived burden on interstate commerce. As presented in this article, the court rejected the fundamental and universally accepted bases for defining the reach of Blue Sky Laws, and which cast territoriality in an entirely different light. This article argues that National Century unquestionably offered and sold securities in and from Ohio, and that an intermediary, whether as placement agent or underwriter, which acts as a link in the chain of distribution of securities is properly sued on allegations that it participated or aided in that process, without regard to where any ultimate "transaction" took place. The Extraterritoriality Principle presents no bar to the availability of a civil remedy for out-of-state purchasers of securities, and, as further argued in this article, was misapplied in any event.

II. NATIONAL CENTURY IN PROPER PERSPECTIVE: CREATING SECURITIES
AND THEIR DISTRIBUTION INTO THE HANDS OF INVESTORS


12 Id. at 1195.
National Century Financial Enterprises, Inc. was an Ohio corporation founded in 1991, which had its headquarters and principal place of business in Ohio. The company engaged in the business of financing healthcare providers nationwide, and at one point became the industry's largest financing company. To raise funds, National Century created Ohio subsidiaries as special purpose entities to issue promissory notes to be offered and sold to investors. National Century itself was not the issuer of the securities distributed to investors. Rather, two special purpose entities, NPF VI and NPF XII, were formed under Ohio law for that purpose.

NPF VI and NPF XII were securitization programs, through which healthcare accounts receivable were purchased. The special purpose entities issued purportedly investment-grade notes that were backed by the accounts receivable. Proceeds from the sale of notes to investors were used to purchase the accounts receivable of healthcare providers at a discount. National Century was supposed to purchase "eligible receivables," *i.e.*, those meeting certain criteria indicating they likely would be paid off. Instead, National Century used the proceeds from sales of securities to purchase worthless or non-existent receivables from health care companies which National Century or its owners controlled, or in which they had some financial interest.

In the offer and sale of the notes to investors, National Century engaged Credit Suisse, a securities broker-dealer and investment banker with its principal office in New York City, and licensed or registered to engage in business as a broker-dealer in many states, including Ohio.13 Credit Suisse played a pivotal role in connection with the note offerings, which the court described as follows:

In late 1995, Credit Suisse and National Century entered into a letter agreement whereby Credit Suisse agreed to be National Century’s "agent and financial

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13 As a licensed securities broker-dealer in the State of Ohio, Credit Suisse is subject to state regulatory and enforcement authority under the Ohio Blue Sky law for its securities activities in Ohio. See generally Robert N. Rapp, BLUE SKY REGULATION, Ch. 11, §11.06 ("Post-Licensing Intermediary Regulation and Enforcement") (LexisNexis Matthew Bender).
advisor in connection with the marketing” of two $50 million note offerings by NPF VI, one of National Century’s wholly owned, note issuing entities.... The letter agreement called on Credit Suisse to “structure, market, and place the [note] offerings.”...Shortly thereafter, in early 1996, Credit Suisse entered into a Placement Agency Agreement with National Century, NPF I, and the receivables servicer, National Premier Financial Services, Inc.... The agreement required Credit Suisse to privately place the notes with qualified institutional buyers in return for a placement fee of 1% of the principal amount of the notes sold.\(^\text{14}\)

Clearly, Credit Suisse was engaged from the outset by National Century to carry out the offer and sale of those securities, indeed, “to structure, market and place” the note offerings. This is an active intermediary role in the creation of the securities and their distribution into the hands of investors, for which Credit Suisse was paid transaction-based compensation. It is an agency role, obviously critical in the note offerings. The role changed somewhat in later offerings, when Credit Suisse assumed a traditional underwriter role, which the court described as follows:

Credit Suisse entered into a series of Purchase and Agency Agreements with National Century, the note issuing entity (either NPF VI or NPF XII), and the servicer.... These agreements defined Credit Suisse as an “initial purchaser” who would purchase the notes from the issuer at a slight discount, such as 0.6% less face value of Series NPF XII 2001-1A notes.... Credit Suisse would then work with a placement agent (Banc One Capital Markets, for example) to place the notes with qualified institutional buyers.... In no way though was Credit Suisse contractually required to sell the notes, and Credit Suisse says it lost about $130 million in notes it had on hand when National Century collapsed.\(^\text{15}\)

The court paid little attention to the agency role established at the outset of the engagement of Credit Suisse by National Century. Rather, to cabin the “sales” of the securities outside the state of Ohio, the court focused only on the traditional underwriter function of Credit

\(^{14}\) 755 F.Supp.2d at 860.

Although the court correctly described the actual structure of the note offerings, in which the special purpose entities were the issuers of the securities, throughout its analysis the court referred to National Century itself as the issuer. As discussed in this article, that is a significant mischaracterization which fogs the picture of the actual distribution structure and process engineered by National Century, in which Credit Suisse played a central role.

\(^{15}\) Id.
Suisse, whereby Credit Suisse became an actual seller of the notes to non-Ohio purchasers. The manner in which National Century and Credit Suisse structured their transactions, said the court, was "no mere technicality."\textsuperscript{16} In its underwriting role, according to the court, Credit Suisse was not a "middleman" that simply collected money from investors and forwarded it to the seller, and then passed along the securities from the seller to the investors. Rather: "Though Credit Suisse was expected to resell the notes --and had incentive to make a profit by reselling them-- it was not required to resell and in fact bore the risk of loss."\textsuperscript{17} That, of course, is true in any firm commitment underwriting relationship,\textsuperscript{18} but it ignores the reality that neither Credit Suisse in these particular circumstances, nor any firm commitment underwriter generally, is engaged to invest in the securities being distributed, or to engage in any activity other than the distribution of the securities into the hands of investors. Underwriting is a financial \textit{intermediary} function. It has no purpose other than the distribution of an issuer's securities into the hands of investors. The offer and sale of the issuer's securities\textsuperscript{19} encompasses the entire process by which the distribution is completed. Credit Suisse was engaged at the outset to carry out the distribution of securities issued by the special purpose entities --first as outright "agent and financial advisor," and later as underwriter under "Purchase and Agency" agreements.

\textsuperscript{16} Id. at 887.

\textsuperscript{17} Id.

\textsuperscript{18} The role of an underwriter in the distribution of an issuer's securities may be described as either "best efforts" or "firm commitment." In a best efforts underwriting arrangement, the investment banking firm agrees only to use its expertise to sell the issuer's securities, it does not buy the securities from the issuer. A firm commitment underwriting involves the underwriter's agreement to buy the securities from the issuer at a set price, and resell to investors at a higher price, and to accept the risk of loss in failing to do so. See Frank F. Fabozzi & Franco Modigliani, \textit{CAPITAL MARKETS: INSTITUTION AND INSTRUMENTS} 101 (2d ed. 1996). Under whatever underwriting arrangement is in place, the objective is a distribution of an issuer's securities into the hands of investors.

\textsuperscript{19} National Century was not the issuer of the securities in question. The notes were in fact issued by each of the special purpose entities which National Century had put in place for that purpose. As discussed later in this article, the actual issuers being the special purpose entities and not National Century is an important consideration, and contributed significantly to the fundamental flaw in the court's conclusion concerning the proper territorial scope of private remedies for purchasers under Blue Sky laws.
In November, 2002, in the midst of reports and allegations of wrongdoing, National Century filed for Chapter 11 bankruptcy, from which it never emerged. Its demise prompted investors to file numerous civil actions against various participants in National Century's alleged fraud. National Century owners were said to have misappropriated nearly $3 billion. Criminal charges were brought against eleven owners and senior executives, with several ultimately being convicted. In private civil actions, institutional investor purchasers of the promissory notes sued Credit Suisse and other parties on various claims arising under antifraud provisions of the federal securities laws, common law, and the Ohio Blue Sky law. Under the Ohio Blue Sky law, plaintiffs sued Credit Suisse for rescission of their purchases of the securities, alleging that Credit Suisse was a seller of the securities, and also that it had participated with or aided National Century in sales of the securities which violated the Ohio law. Federal Multi-District Litigation Panel proceedings resulted in the cases being lodged in the Southern District of Ohio.

The December 2010 decision to bar Ohio Blue Sky law claims against Credit Suisse was actually the second time over the course of the litigation in which the court considered such claims in relation to out-of-state purchasers. In 2008, the court denied a motion to dismiss claims under the civil remedy provisions of the Ohio Blue Sky law by an out-of-state purchaser against an out-of-state third party based on its alleged participation in the securities offering by National Century. In that chapter of the litigation, the plaintiff purchaser sued a credit rating agency over the high ratings it had assigned to the securities. On a motion to dismiss, the rating agency challenged the application of the Ohio Blue Sky law on the ground that neither it nor the institutional purchaser of the notes was incorporated in or based in Ohio. The court denied the rating agency's motion to dismiss, finding:

The complaint alleges that the notes were issued by an Ohio company, National Century, and this is sufficient for applying the Ohio statute, which regulates a sale or contract of sale of securities in Ohio.\(^{21}\)

Reaching this conclusion in 2008, the court relied on Ohio law articulated in *Federated Mgmt. Co. v. Coopers & Lybrand*,\(^{22}\) in which an Ohio appellate court held that the Ohio Blue Sky law is applicable where the issuer of securities is an Ohio company, even though the lawsuit is between an out-of-state purchaser and an out-of-state underwriter, and the marketing and solicitation of purchasers for the securities did not take place in Ohio.\(^{23}\) In *Federated Management*, the Ohio state court required only that there be significant ties with Ohio insofar as the wrongdoing alleged against the out-of-state underwriter. The Ohio court found a number of activities involving the underwriter leading up to or which were prerequisites to the actual securities offering which were sufficient to make the civil remedy available for out-of-state purchasers.\(^{24}\) Referencing its 2008 decision denying a motion to dismiss the Ohio Blue Sky Law claim by out-of-state purchasers on the basis of *Federated Management*, the *National Century* court in 2010 declared:

The *Federated* court said the focus should be on where the fraud occurs. Thus under *Federated*, the Ohio Act applies to the sale of Ohio-issued securities by an

\(^{21}\) *Id.* at 649.

\(^{22}\) 137 Ohio App. 3d 366 (Ohio Ct. App. 2000).

\(^{23}\) *Id.* at 387.

\(^{24}\) The Court of Appeals described the ties as follows:

This court believes that the ties to Ohio in this case are significant insofar as the wrongdoing alleged against appellee. First, the issuer of the notes, MAW, was an Ohio-based company with its headquarters and principal place of business located in Canal Winchester, Ohio. Therefore, by virtue of its relationship with MAW as MAW’s bank, appellee had significant contacts with MAW in Ohio throughout the period leading up to the Note Offering. Accounting activities regarding MAW’s financial situation (which undoubtedly related to the New Credit Facility and Note Offering) occurred in Ohio. Appellee met with MAW in Ohio regarding MAW’s financial plans and expressed its interest in “playing a role” in MAW’s plans. Appellee outlined to MAW its capabilities in the noncredit area through its affiliate, NW Markets. Appellee hired SCS to conduct an environmental assessment of MAW, which involved visiting Ohio, and that assessment forms the basis of the main claim against appellee. All of these activities led up to and/or were prerequisites to the actual Note Offering. *Id.*
out-of-state seller to an out-of-state buyer if the seller has significant contacts with the issuer’s Ohio-based fraud.  

In National Century 2010, the court referenced its earlier decision, but offered only that for purposes of a motion to dismiss in the earlier case, “sufficient nexus” existed to apply the Ohio Blue Sky Law. An Ohio corporation issued the notes, and the rating agency defendants were alleged to have had many “points of contact” with the National Century fraud. None were identified with reference to application of the Ohio Blue Sky Law. However, in the larger analysis of claims the court noted allegations that the rating agencies had been engaged by National Century, received financial information from National Century in order to analyze credit risk and provide a rating, and that at least one of the agencies received continuing information from National Century suggesting fraudulent activity. In practical terms, these activities were all part of an engagement intended to facilitate the distribution of securities by National Century. And indeed, focusing later on the same Ohio Blue Sky claim against Credit Suisse, its active intermediary role as a placement agent and underwriter engaged by National Century to structure and market the securities placed it directly in what will be discussed later in this article as the “chain of distribution” of the securities.

In National Century 2010, the court did not disagree. To the contrary, reiterating Ohio law as articulated in Federated Management, the court flatly acknowledged that: “[t]he Ohio Act applies to the sale of Ohio-issued securities by an out-of-state seller to an out-of-state buyer if the

25 National Century, 755 F.Supp.2d at 875; see also Federated Management, 137 Ohio App.3d at 387.

26 In assessing the territorial reach of state Blue Sky laws, it is important not to confuse legislative reach with judicial jurisdiction and choice of law. “Contacts” analysis has always been a part of considering the scope of personal jurisdiction of state courts. See International Shoe Co. v. Washington, 326 U.S. 310 (1945). As for choice of law, it is generally recognized that state courts may apply whatever state law is justified by a significant aggregation of contacts, creating state interests, with the parties and the occurrence of the transaction. See Allstate Ins. Co. v. Hague, 449 U.S. 302, 308 (1981). State court choice-of-law decisions do not involve extraterritoriality issues.

27 See 580 F. Supp.2d at 634-36.
seller has significant contacts with the issuer's Ohio-based fraud."28 That said, however, "[e]ven though the Ohio Securities Act would apply to the sales here, a different question is whether the Commerce Clause permits it."29 Applying the Extraterritoriality Principle, which it had not done previously, the court concluded the Blue Sky Law could not be applied to provide a remedy because "commerce" to which the remedy attached, as defined by the court, occurred "wholly outside" of Ohio.

The court did not disagree with the plaintiff purchasers' contentions that the securities were issued by the National Century special purpose entities from Ohio, and that the National Century fraud occurred in Ohio. Nor did the court challenge the "many connections" pointed out by plaintiffs that Credit Suisse had with National Century in Ohio, specifically including the agreements for distribution of the securities which Credit Suisse entered into with National Century. None of this mattered, however, because the "commerce" or "conduct" reached by the Ohio Blue Sky law, said the court, "is the securities transaction and not the fraud." With this conclusion, the court omitted any mention of its outright embrace of Ohio law as articulated in Federated Management that in applying the Ohio Blue Sky Law the focus should be on where the fraud occurs. Plaintiffs in National Century argued that the fraud committed in Ohio should be viewed as in-state conduct regulated by the Ohio Blue Sky Law.30 However, to construct an extraterritoriality bar on application of the civil remedy for out-of-state purchasers victimized by the fraud, the court, in the same opinion, recast the regulatory focus to a "transaction."

As discussed in Part III below, the territorial reach of remedies under Blue Sky laws is not defined in terms of where a transaction occurs. Blue Sky laws address unlawful conduct in

28 Id.

29 755 F.Supp.2d at 875 (Emphasis added).

30 Id. at 877.
the offer and sale of securities in or from a state, wherever an ultimate transaction may take place.\textsuperscript{31} To be sure, where an “offer” or “sale” of securities takes place is a defining limitation on the territorial scope of regulatory authority and civil remedies; however, the “conduct” or “commerce” constituting an offer or sale of securities is the entire process by which securities are created and distributed into the hands of investors. This is the meaning of a distribution of securities, and results in the assessment of acts and conduct as links in the chain of distribution rather than a discrete “transaction.”

III. THE TERRITORIAL REACH OF BLUE SKY LAWS

In \textit{National Century}, the court perceived the only alleged “nexus” with Ohio on which to apply the Ohio Blue Sky Law as being the \textit{issuance} of the securities, and that “[t]he anti-fraud provisions of the Ohio Act speak in terms of offers and sales, not issuances.”\textsuperscript{32} The quoted observation is correct. More than just the antifraud provisions of the Ohio Blue Sky Law, the territorial reach of all Blue Sky Laws, and remedies to purchasers, are defined in terms of offers and sales of securities. In the application of civil rescission remedies, obviously offers and sales are linked to ultimate transactions, for otherwise there would be nothing to rescind or on which

\footnotesize{31} Blue Sky laws based upon any version of the Uniform Securities Act contain an express “Scope” or “Jurisdiction” provision which, as typified by Section 610(a) of the 2002 Uniform Securities Act, provides that various provisions of the Act do not apply to a person that sells or offers to sell a security unless the offer to sell or the sale originates from within the state. 2002 Unif. Sec. Act §610(a), (c); see also Unif. Sec. Act §414. The drafters of the 2002 Uniform Act explained:

\begin{quote}
Section 610(c) provides that an offer which originates in State B and is directed to State A is made in both states. The securities act of State A would apply under Section 610(c)(2). The act of State B would apply also, under Section 610(c)(1). The intent is to prevent a seller in State B from using that state as a base of operations for defrauding persons in other states. Off. Comment 3, 2002 Unif. Sec. Act §610.
\end{quote}

In \textit{National Century}, the court correctly pointed out that the Ohio Blue Sky law, which is not based on the Uniform Act, contains no “scope” provision or language, and thus says little about its territorial scope. 755 F.Supp. 2d at 874. The absence of such a provision in Ohio is inconsequential. The plaintiffs in \textit{National Century} made no contention that offers and sales of securities, and unlawful conduct, forming the basis of their Ohio Blue law claim did not originate from within Ohio.

\footnotesize{32} 755 F.Supp.2d at 880.
to award damages as a rescission equivalent. The transaction, however, is the product of conduct in which the “issuance” of securities is but the starting point in the process of a distribution for which “offers” and “sales” are the foundational elements of liability. The court got it right, but failed to appreciate what speaking in terms of offers and sales of securities means in defining the reach of Blue Sky Laws.

A. “Offers” and “Sales” of Securities under Blue Sky Laws

“Sale” is broadly defined in all state Blue Sky Laws to include every disposition or attempt to dispose of a security or interest in a security for value.⁴³ And ‘sell” means any act by which a sale is made.⁴⁴ An “offer” or “offer to sell,” which is no less significant a trigger for application of Blue Sky Laws, includes “every attempt to offer or dispose of, or solicitation of an offer to purchase a security or interest in a security for value.”⁴⁵ An “offer” of a security, standing alone, has consequences under Blue Sky Laws without regard to whether there is in fact a subsequent sale. Indeed, section 501 of the 2002 Uniform Securities Act, the general antifraud provision, makes it unlawful for a person, “in connection with the offer, sale, or purchase of a security,” to engage in prohibited acts.⁴⁶ Blue Sky antifraud provisions differ in this respect from certain federal securities law provisions. Section 10(b) of the Securities Exchange Act of 1934, ³⁷

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⁴³ See, e.g., O.R.C. § 1707.01(C)(1).
⁴⁴ O.R.C. § 1707.01(C)(2).
⁴⁵ 2002 Unif. Sec. Act §102(26); see also Unif. Sec. Act §401(j)(2).

The Ohio Blue Sky law defines “sale” to include an attempt to sell, or an “offer to sell, directly or indirectly, by agent, circular, pamphlet, advertisement or otherwise.” O. R. C. §1707.01(C)(1).
and SEC Rule 10b-5 adopted under it, for example, address fraud “in connection with the purchase or sale” of a security. “Sale” for purposes of the Exchange Act means a contract to sell or otherwise dispose of a security.

Moreover as Section 414 of the original Uniform Securities Act, which is the basis for a majority of state Blue Sky Laws, makes clear, a person may violate the Act without ever being in the state. Likewise, it is not required that every act necessary to a sale be completed in the state, or that a transaction be completed in the state. The drafters of the Uniform Act explained that

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38 17 C.F.R. §240.10b-5. Taken together, §10(b) and SEC Rule 10b-5, prohibit fraudulent, deceptive and manipulative acts and practices in connection with the purchase or sale of a security. Where there is use of the requisite jurisdictional means, an implied private right of action exists for the assertion of claims by defrauded purchasers or sellers.


But see Section 17 (a) of the Securities Act of 1933, 15 U.S.C. §77q(a), which provides in pertinent part:

It shall be unlawful for any person in the offer or sale of any securities... by use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly--

(1) to employ any device, scheme or artifice to defraud, or
(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. (Emphasis added).

As seen later in this article, the difference between the Exchange Act and Securities Act antifraud provisions undermines an important element of the court’s decision in National Century to impose a transaction test to cabin the availability of a Blue Sky Law civil remedy.

40 Section 414 of the Uniform Securities Act provides in pertinent part:

For the purpose of this section, an offer to sell or buy is made in this state, whether or not either party is then present in this state, when the offer (1) originates from this state, or (2) is directed by the offeror to this state and received at the place to which it is directed....

Unif. Sec. Act (1956) § 414(c). The 2002 Uniform Securities Act, which has been adopted by several states, carries over the same definition of “offer to sell” as in the original Act, see 2002 Unif. Sec. Act § 610(c).

41 Unif. Sec. Act § 414, Official Code Comment (“This section defines and delimits the application of the Act in interstate or international transactions with only some of their elements in the state”).
Section 414 is designed to encompass circumstances in which one state is used as a “base of operations” for defrauding persons in other states.\(^{42}\)

To be sure, courts rightly counsel that activities having no relationship to the offer or sale of securities in a state will not support either the exercise of enforcement authority or the availability of private remedies. There must be some nexus between activities and the state. In *Cors v. Langham*,\(^{43}\) limited partnership investors brought an action alleging violations of the Maryland Securities Act based on a claim that arose entirely in Virginia. No alleged violations took place in Maryland. All of the plaintiffs alleged that they had purchased securities through a Virginia-based representative of the defendant, and they acknowledged that the fraud on which they based their claimed violation of the Maryland Blue Sky Law took place in Virginia. The court concluded that plaintiffs had not stated any cognizable claim under the Maryland law because all acts forming the basis of the claim took place in Virginia.\(^{44}\)

In *Singer v. The Magnavox Co.*,\(^{45}\) the court denied application of the civil remedy provision of the Delaware Securities Act to plaintiffs seeking to rescind the consummation of a corporate merger based on allegedly false or misleading proxy documents relating to the merger. Plaintiffs were residents of Pennsylvania. They were not solicited in Delaware, and it did not appear that the merger agreement at issue was made in Delaware, or that any part of the “sale” to which the Act would apply occurred in Delaware.\(^{46}\) Moreover, the court concluded:

\(^{42}\) *Id.*


\(^{44}\) *Id.* at 1058.


\(^{46}\) *Id.* at 981.
We are not persuaded that because the corporate merger vote was held in Delaware this is a sufficient connection with the alleged fraud to permit plaintiffs to invoke the Act. That is simply too fragile a basis on which to establish subject matter jurisdiction over an alleged fraud in Pennsylvania or over a contract made in New York. And plaintiffs' arguments based on registration of the merger documents in Delaware... and the statutory situs of the Magnavox stock in this State... are equally tenuous and we reject them for the same reason.\(^{47}\)

The focus of Blue Sky Laws on conduct or activity within the state that gives rise to concern for investor protection indicates that territorial scope is, in practical terms, determined on the basis of a course of conduct which, even if directed outside the state, has the realistic potential for impact within the state. *Newsome v. Diamond Oil Producers, Inc.*\(^{48}\) illustrates the point. The court applied the Oklahoma Blue Sky Law to offers and sales made from Oklahoma facilities exclusively to residents of other states:

> Even when Defendants' assertions in regard to the location of offerees or purchasers are taken as true, the Act will apply when any portion of the *selling process* of securities covered by the Act occurs in Oklahoma. In this situation, the Act regulates Oklahoma promoters who sell only to residents of other states.\(^{49}\)

*Newsome* highlights the important notion of a “selling process” --activity designed to bring about sales, without regard to where transactions may occur. The process is the object of

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\(^{47}\)Id., at 982.

*See also McCullough v. Leede Oil & Gas, Inc.*, 617 F. Supp. 384 (W.D. Okla. 1985). The court granted summary judgment dismissing claims under the Oklahoma Securities Act based on offers to sell or sales originating in either Texas or Alabama. The court opined:

A securities transaction comes within the purview of the civil liabilities portion of the Oklahoma Securities Act... under the following two circumstances: (1) when an offer to sell is made in Oklahoma; and (2) when an offer to buy is made and accepted in Oklahoma.... The Plaintiff contends that, because certain documents were sent from the Defendant's branch office in Oklahoma City, the offer to sell can be deemed to have been made in this state. The Court does not agree. After examining the documents exchanged between the parties in the course of negotiations, the Court is satisfied that the documents embodying the offer to sell and the acceptance thereof originated in either Texas or Alabama. Although some correspondence did originate in this state, none of that correspondence amounts to an offer or acceptance of a sale of securities.... *Id.*


\(^{49}\) *Id.*
regulation, not the transaction that ultimately results.\textsuperscript{50} The point was plainly made in \textit{Chrysler Capital Corp. v. Century Power Corp.},\textsuperscript{51} in which the court underscored that a state's Blue Sky law may properly be applied when an issuer has performed actions within the state in connection with a transaction, although the transaction itself occurs out-of-state.\textsuperscript{52} \textit{Chrysler Capital} is particularly significant because the challenge to application of the Blue Sky law was asserted under the Dormant Commerce Clause.

Plaintiffs in \textit{Chrysler Capital} brought an action against several electric utilities seeking damages and injunctive relief for violation of antifraud provisions of the Arizona Blue Sky law, among others. The subject transactions were negotiated and closed entirely outside Arizona, and indeed, the securities were delivered and paid for in another state. However, the court found that the issuer of the securities was an Arizona corporation with its principal place of business in Arizona and, it was alleged, had engaged in more than ministerial acts in Arizona in connection with the transaction. This was held a sufficient basis to conclude that the sale was "from" Arizona.\textsuperscript{53}

As for the Dormant Commerce Clause challenge to application of the Arizona Blue Sky law, the court rejected the challenge, noting, among other things, that no case authority had been presented in which a \textit{remedial} antifraud statute applied extraterritorially was found to burden interstate commerce. The court explained:

\begin{quote}
A myopic focus simply upon where a transaction occurs as establishing the territorial limit of a Blue Sky law is not without some, albeit skeletal, support. In \textit{Allen v. Oakbrook Securities Corp.}, 763 So.2d 1099 (Fla. Ct. App. 1999), the court affirmed dismissal of claims asserted under the Florida Blue Sky law that were based on sales of securities which occurred entirely in other states. Although the securities consisted of stock in a company which was incorporated in Florida, and had its principal place of business there, the court simply embraced a presumption that a law is not intended to apply outside the territorial jurisdiction of the state in which it is enacted, and on that basis concluded that the Florida Blue Sky Law claims were properly dismissed.
\end{quote}

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\textsuperscript{52} \textit{Id.}, at 1193.

\textsuperscript{53} \textit{Id.}, at 1194.
Like any tort recovery statute [an antifraud] provision merely provides a post-hoc remedy for persons aggrieved by allegedly unlawful conduct. Thus, in no sense does it prevent or burden interstate commerce.... If anything, such legislation facilitates commerce far more than it can even be argued to “burden” in any sense... because it provides a measure of assurance that commerce will be honestly transacted.54

Chrysler Capital was decided in the wake of Arizona Corp. Comm’n v. Media Products, Inc.,55 in which the Arizona Court of Appeals determined that securities were sold “from” Arizona, even though: (1) all of the sales activities were conducted by out-of-state broker-dealers in states other than Arizona; (2) the offers to purchase were made and accepted out-of-state; and (3) no sale or offer to sell was made to any Arizona resident. The court found sufficient nexus for application of the Arizona Securities Law because, among other things, although the issuer was a Delaware corporation, its principal place of business and base of operations were in Arizona, and “selling agency” agreements with out-of-state broker-dealers that were material to the offer and sale of securities were made and delivered in Arizona.

In Arizona Media, however, although the court found sufficient basis for applying the Blue Sky Law, it went on to conclude that doing so would impermissibly interfere with interstate commerce.56 Importantly, the case was an enforcement action by the Arizona Corporation

54 Id. at 1195.
56 The court concluded that although a state has an interest in seeing that it is not used as a base from which to conduct illegal activity, there was no basis on which to conclude that Arizona’s reputation would be tarnished by offers and sales made in other states. The court reasoned:

The prospectus and supplement placed prospective purchasers on notice that Media was a Delaware corporation, that the offerings and sales were not approved by the Arizona Corporation Commission, and that the Arizona Corporation Commission might file suit asking for injunctive and other remedies. These statements negate the Commission’s position that if the sale was unfair, blame could be placed on Arizona, tarnishing its reputation. Any out-of-state buyer who familiarized himself with the prospectus and supplement would be advised that it was his own state, not Arizona, that regarded the offer as appropriate. In this case, the state does not have an overriding regulatory policy need. Under the facts of this case the burden, even if it were only incidental, is excessive. Id.
Commission, the state’s securities regulator, seeking to enjoin an offering of stock by the Arizona issuer for failure to comply with the registration provisions of the Arizona Blue Sky law. The Commission action was a direct, preventative, action to stop the sale of unregistered securities occurring outside of the state. The court concluded:

Under the facts of this case, Arizona had no duty to the purchasers whose home states had already determined that the offerings met their own state’s standards and had registered the offerings in those states and with the Securities and Exchange Commission. To hold otherwise would allow the [Corporation] Commission to have an effective veto over offerings and sales approved by the Securities and Exchange Commission and securities officials from other states, even though no purchases were made by Arizona residents. The business reputation of the State of Arizona is not at stake under the facts of this case.57

In Chrysler Capital, the federal court directly responded:

The Arizona anti-fraud statute is not preventative, but remedial in nature. [It] imposes no additional requirements on persons engaged in interstate commerce, nor does it impede any interstate transactions. Rather, like any tort recovery statute, it merely provides a post-hoc remedy for persons aggrieved by allegedly unlawful conduct. Thus, in no sense does it prevent or burden interstate commerce.58

In National Century, no distinction was made between the actual projection of state regulatory authority to prevent interstate transactions and the invocation of a post-transaction antifraud remedy. The court simply saw application of the civil remedy for the benefit of out-of-state purchasers in transactions occurring “wholly outside” Ohio as straightforward regulation of

57 Id.

But see A.S. Goldman & Company, Inc. v. New Jersey Bureau of Securities, 108 F.3d 780 (3d Cir. 1999). In Goldman the court concluded that an administrative enforcement order issued by a state securities regulator preventing the sale of unregistered securities in New Jersey to investors in other states did not violate the Dorman Commerce Clause. Goldman is discussed in Part V(A) of this article, infra.

interstate commerce. The court disregarded facts that National Century, as part of a massive fraud carried out from Ohio, established Ohio special purpose entities to create and issue the securities, engaged an intermediary for the specific purposes of structuring and marketing the securities, and, simply put, set about the entire process by which, with the participation of an intermediary, the securities were distributed from Ohio into the hands of out-of-state investors.

A post-transaction civil remedy under the Ohio Blue Sky Law for out-of-state purchasers of securities which were in fact, by every definition, offered and sold in a distribution engineered and undertaken from Ohio, as part of a fraud carried out in Ohio, is not a projection of state regulation outside of the state. It presents no economic protectionism, erects no barrier to interstate trade, and subjects no one to inconsistent or incompatible regulatory regimes. The decision in National Century to bar the statutory remedy springs from the failure of the court to recognize the focus of Blue Sky Laws on the distribution of securities, which is the entire process whereby securities are created and make their way into the hands of investors. “Offer” and “sale” of securities have specialized meaning in this legal context. Most importantly, no expansion of the territorial reach of Blue Sky Laws results from allowing the invocation of their remedial provisions for the benefit of defrauded purchasers at any point along the chain of distribution.

The court’s misperception of the scope of investor protection under Blue Sky Laws, and its invocation of the Extraterritoriality Principle to deny the Ohio statutory remedy for purchasers in National Century, was largely the product of reliance on the 1982 decision in Edgar v. MITE

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59 As discussed later in this article, the court made an attempt to justify its conclusion that a post-transaction civil remedy amounted to impermissible regulation of commerce by reason of differing culpability standards to which the firm would be subjected under the Blue Sky Laws of other states if they applied to the purchases of National Century securities outside of Ohio. Subjecting a defendant to differing culpability standards between Ohio and any other state would, as reasoned by the court, have an effect on interstate commerce. 755 F.Supp.2d at 885. The supporting analysis is seriously flawed.
In *MITE*, a plurality of Justices of the U.S. Supreme Court struck down an antitakeover law adopted as part of the Illinois Blue Sky Law, finding that it represented an unconstitutional burden on interstate commerce. The case may, rightly or wrongly, be a mainstay in applications of the Extraterritoriality Principle to strike down state laws and regulations, but it was misused by the court in *National Century*, which involved no projection of state regulatory authority to interdict or block interstate commerce. *MITE* is considered in Part IV below in the broader context of the constitutional treatment of Blue Sky Laws, which demonstrates that it offers no support for the Extraterritoriality Principle as applied by the court in *National Century* to deny a statutory remedy to out-of-state purchasers.

IV. BLUE SKY LAWS AND THE EXTRATERRITORIALITY PRINCIPLE

A. The Early Commerce Clause Tests

Early in the Twentieth Century, the validity of state Blue Sky laws under the Commerce Clause was upheld in a trilogy of United States Supreme Court cases commonly referred to as the Blue Sky Cases of 1917.61 With these cases, the Supreme Court cemented the authority of states to regulate trade in securities as an appropriate exercise of state police power, and as imposing no unreasonable burden on interstate commerce. State securities laws considerably predated the federal securities laws, and the exercise of state regulatory authority over “trade” in securities obviously impacted interstate commerce. However, in the 1917 trilogy of cases the Supreme Court succinctly explained that the exercise of that authority was properly within both the police power of states and the confines of the Commerce Clause:

60 457 U.S. 624 (1982).

[W]e think that the statute under review is within the power of the state. It burdens honest business, it is true, but burdens it only that, under its forms, dishonest business may not be done. This manifestly cannot be accomplished by mere declaration; there must be conditions imposed and provision made for their performance.62

Against the backdrop of the Blue Sky Cases of 1917, throughout much of their history, state Blue Sky Laws were viewed as regulating even-handedly, as effectuating legitimate state interests, and as having only incidental effects on interstate commerce relative to the local benefits achieved.63 Blue Sky laws were deemed to be proper “police regulation[s]” that affected interstate commerce only incidentally.64 Extraterritorial reach was never an issue. Indeed, the Supreme Court made clear that securities registration and broker-dealer licensing requirements imposed by Blue Sky Laws applied only to dispositions of securities within a state, and that only persons dealing in securities within the state are subject to licensing requirements.65

The projection of regulatory or enforcement authority under Blue Sky Laws beyond state borders would be addressed much later. As a prelude, however, in Pike v. Bruce Church, Inc.,66

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63 See, e.g., North Star Int'l v. Arizona Corp. Comm., 720 F.2d 578 (9th Cir. 1983).


65 As the Court concluded in Hall regarding the Ohio Blue Sky law:

The provisions of the law, it will be observed, apply to dispositions of securities within the state, and while information of those issued in other states and foreign countries is required to be filed (§ 6373-9), they are only affected by the requirement of a license of one who deals in them within the state. Upon their transportation into the state there is no impediment -- no regulation of them or interference with them after they get there. There is the exaction only that he who disposes of them there shall be licensed to do so, and this only that they may not appear in false character and impose an appearance of a value which they may possess -- and this certainly is only an indirect burden upon them as objects of interstate commerce, if they may be regarded as such. It is a police regulation strictly, not affecting them until there is an attempt to make disposition of them within the state. To give them more immunity than this is to give them more immunity than more tangible articles are given, they having no exemption from regulations the purpose of which is to prevent fraud or deception. Such regulations affect interstate commerce in them only incidentally.

Id. at 558.

the Supreme Court struck down an order issued under the Arizona Fruit and Vegetable Standardization Act which prohibited a company from transporting uncrated cantaloupes from its Arizona ranch to California, for packing and processing, as an unlawful burden upon interstate commerce. The Arizona law required that fruits and vegetables shipped from Arizona meet certain standards of wholesomeness and quality, and that they be packed in standard containers in a particular way. Rather than an objective to protect consumers, there was no issue in the case that the purpose and design of the Arizona law was to protect and enhance the reputation of growers within the state. Although a legitimate state interest, the Supreme Court concluded that the order in question, which forbade packing cantaloupes out of state, imposed a straightjacket on the Arizona company with respect to the allocation of its interstate resources. The consequence of the regulatory scheme was weighed against the state interest which, though legitimate, was found to be minimal at best relative to the interference with interstate commerce.

Pike thus gave birth to a “balancing test,” which holds that even non-discriminatory burdens on interstate commerce may be struck down on a showing that they clearly outweigh the benefits of a state or local practice. The Pike “balancing test” has figured prominently in cases where extraterritorial impact is an issue, as well illustrated in National Century, where the court

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67 The Court counseled:

Although the criteria for determining the validity of state statutes affecting commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates even-handedly to effectuate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

397 U.S. at 142 (Citation omitted).
flatly rejected it in favor of applying the independent Extraterritoriality Principle, with heavy reliance on MITE ⁶⁸ for doing so.

As states adopted laws designed to thwart hostile takeover bids aimed at companies having a significant presence in the state, Commerce Clause challenges were raised. These challenges were largely framed by the 1982 opinion of a plurality of U.S. Supreme Court Justices in MITE, which confronted extraterritorial reach of an antitakeover provision added to the Illinois Blue Sky Law head-on, and set the stage for major legislative and judicial responses. MITE became a prominent feature in Commerce Clause challenges to state regulation generally, and, as noted, played a major role in the district court’s decision in National Century to bar the statutory remedy of rescission for out-of-state purchasers of securities. As will be seen, however, the court in National Century took MITE too far. MITE and its progeny are discussed further below.

B. The MITE Challenge

The historic Blue Sky legal landscape was altered in the 1980s as states adopted various forms of anti-takeover provisions as part of their Blue Sky Laws, which reignited the Commerce Clause debate. In 1982, in a plurality of Justices of the U.S. Supreme Court struck down the Illinois Business Takeover Act, which had been adopted as part of that state’s Blue Sky Law, on

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a finding that it represented an unconstitutional burden on interstate commerce. Typical of emergent anti-takeover laws, the Illinois law imposed several requirements on a hostile takeover bid prior to communicating any offer to shareholders. Requirements included advance notification and submission of materials to the Secretary of State, to be followed by a fairness hearing in which the Secretary of State could determine whether, on fairness grounds, the offer should be permitted to proceed. The Illinois law applied whenever the target of a takeover bid was an Illinois company meeting any two of the following conditions: (1) the corporation has its principal executive offices in Illinois; (2) is incorporated in Illinois; or (3) has at least 10% of its stated capital and paid-in surplus represented in Illinois.

The Illinois antitakeover law was enacted as part of the Blue Sky law. Speaking for the plurality, however, Justice White observed:

The Illinois Act differs substantially from state blue-sky laws in that it directly regulates transitions which take place across state lines, even if wholly outside the State of Illinois. A tender offer for securities of a publicly held corporation is ordinarily communicated by the use of the mails or other means of interstate commerce to shareholders across the country and abroad. Securities are tendered and transactions closed by similar means. Thus, in this case, MITE Corp., the tender offeror, is a Delaware corporation with principal offices in Connecticut. Chicago Rivet is a publicly held Illinois corporation with shareholders scattered around the country, 27% of whom live in Illinois. MITE's offer to Chicago Rivet's shareholders, including those in Illinois, necessarily employed interstate facilities in communicating its offer, which, if accepted, would result in

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69 The Illinois law was also challenged as a violation of the Supremacy Clause, specifically that it conflicted with the federal legislative scheme relating to tender offers set forth in the “Williams Act,” 82 Stat. 454, codified at 15 U.S.C. §§ 78m(d)-(e) and 78n(d)-(f), which added new §§ 13(d), 13(e) and 14(d)-(f) to the Securities Exchange Act of 1934. Enacted in 1968, the Williams Act imposed offeror disclosure and filing requirements with regard to the acquisition of a threshold amount of securities of a target company, and actually making a takeover bid. The Williams Act expressly preserved state authority over any security or person insofar as it does not conflict with the federal law, and thus did not expressly prohibit states from regulating takeovers. Conflict preemption determinations were left to the courts under the traditional inquiry whether the state law stands as an obstacle to the accomplishment and execution of the full purpose and objectives of Congress, see Hines v. Davidowitz, 312 U.S. 52 (1941), or where compliance with both federal and state regulations is impossible, see Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963).

In MITE, three Justices agreed that the Illinois anti-takeover law conflicted with the Williams Act, and would be barred by the Supremacy Clause. The plurality of Justices, however, held the Illinois law unconstitutional under the Commerce Clause, and that was the opinion of the Court.
transactions occurring across state lines. These transactions would themselves be interstate commerce. Yet the interstate transactions not only with Chicago Rivet's stockholders living in Illinois, but also with those living in other states and having no connection with Illinois. Indeed, the Illinois law on its face would apply even if not a single one of Chicago Rivet’s shareholders were a resident of Illinois.  

The plurality Justices concluded that the Illinois law represented a direct restraint on interstate commerce, because it had “a sweeping extraterritorial effect.” The law gave the state power to block an interstate tender offer, and thus interstate transactions, and to exercise authority wholly outside the state by imposing requirements that operated to block transactions based only on the fact that a target company had substantial assets within the state. As explained in the plurality opinion, the Illinois anti-takeover law could be applied to regulate a tender offer which would not affect a single Illinois shareholder. That being the case, “[i]t is therefore apparent that the Illinois statute is a direct restraint on interstate commerce and that it has a sweeping extraterritorial effect.” The Commerce Clause, said the Justices, “preclude[s] the application of a state statute to commerce that takes place wholly outside the State’s borders, whether or not the commerce has effects within the state.” In other words, a statute directly regulating extraterritorial conduct is per se invalid.

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70 457 U.S. at 641-42.

71 Id. at 642.

72 Id. at 641.

73 Id.

74 Id. at 642-43.

75 As will be seen, this conclusion was the lynchpin in National Century. However, an inharmonious post-MITE consideration by the Supreme Court of certain state legislative action in the same arena makes clear that the plurality view in MITE is not nearly so potent in assessing the territorial reach of state regulatory authority as it might otherwise seem to be. Indeed, in the same regulatory arena, in CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987) the Supreme Court, albeit without challenging the result, cautioned that the plurality opinion in MITE did not represent the views of a majority of the Court, and that the Court was not bound by its reasoning. Id. at 81.
MITE focused on the projection of state regulatory authority to prevent interstate transactions, not the availability of a private civil remedy for violations of the Illinois Blue Sky Law. The Illinois anti-takeover law, and others like it in other states, was specifically designed to impose state regulatory authority over hostile tender offers based upon criteria applicable to a target company which established an arguable economic interest of the state. In MITE, the plurality Justices saw the Illinois statute as directly regulating and interdicting interstate commerce.\(^{76}\) The Illinois Secretary of State was empowered to significantly delay, if not outright halt, an interstate tender offer made to nonresident shareholders, and thus control conduct beyond the boundaries of the state.\(^{77}\) In MITE the plurality dispatched the Illinois anti-takeover law based on its nationwide reach, and the authority given to the state regulator to determine whether a tender offer could proceed anywhere.\(^{78}\)

In MITE, the plurality also found the Illinois law an unconstitutional intrusion upon interstate commerce under the test of *Pike v. Bruce Church, Inc.*,\(^{79}\) in which the Supreme Court addressed the extent of burden imposed on commerce by a state statute in relation to the local interests served by the statute. As discussed earlier, *Pike* is regarded as setting a “balancing test.” Under it, a state statute may be upheld if it “regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental... unless the burden imposed on such commerce is clearly excessive in relation to the putative local

\(^{76}\) id. n. 9 (Emphasis added); see also *Shafer v. Farmers Grain Co.*, 268 U.S. 189, 199 (1925) (“[A] state statute which by its necessary operation directly interferes with or burdens [interstate] commerce is a prohibited regulation and invalid, regardless of the purpose with which it was enacted.”).

\(^{77}\) 427 U.S. at 643 (citing *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 775 (1945)).

\(^{78}\) Id., at 643. Among other things, the Court noted that “any attempt to directly assert extraterritorial [power] over persons... would offend sister States and exceed the inherent limits of the State’s power.” Id.

benefits.” Under *Pike*, even when a state statute regulates interstate commerce indirectly, the burden on interstate commerce is to be weighed against the state interest. In *MITE*, the plurality Justices concluded that that Illinois had no legitimate interest in protecting nonresident shareholders against hostile tender offers, and thus, there was nothing to be weighed in the balance to sustain the antitakeover law. For the plurality, Justice White declared:

> While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders. Insofar as the Illinois law burdens out-of-state transactions, there is nothing to be weighed in the balance to sustain the law. We note, furthermore, that the Act completely exempts from coverage a corporation’s acquisition of its own shares.... Thus Chicago Rivet was able to make a competing tender offer for its own stock without complying with the Illinois Act, leaving Chicago Rivet’s shareholders to depend only on the protections afforded to them by federal securities law, protections which Illinois views as inadequate to protect investors in other contexts. This distinction is at variance with Illinois’ asserted legislative purpose, and tends to undermine appellant’s justification for the burdens the statute imposes on interstate commerce.\(^81\)

### C. Second Generation State Antitakeover Laws and the Commerce Clause

The result in *MITE* served as the catalyst for a second generation of state antitakeover laws aimed at regulating the purchase of shares in a corporation which would result in the acquisition of control of the company. These laws, however, were designed only to control voting rights under state corporation laws. In *CTS Corp. v. Dynamics Corp. of America*,\(^82\) the Supreme Court upheld an Indiana law which, although narrower than the Illinois anti-takeover law at issue in *MITE*, operated in a similar manner. The Indiana statute regulated the purchase and sale of stock in corporations chartered in Indiana. Commonly referred to as a “control share acquisition” law, the Indiana law requires that when a potential acquirer seeks to acquire control

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\(^{81}\) 457 U.S. at 644.

of the voting stock in the corporation, approval is required by a majority of pre-existing shareholders, regardless of whether the purchases or sales of stock take place in Indiana.

In operation, the Indiana control share acquisition law regulated potential purchases and sales of stock where the transactions themselves could take place wholly outside the state. Nevertheless, upholding the Indiana law against the Commerce Clause challenge,\(^{83}\) the Supreme Court opined that it would only strike down the statute if it “may adversely affect interstate commerce by subjecting activities to inconsistent regulations” because different states enacted conflicting regulatory schemes.\(^{84}\) The Court saw no such threat raised by the Indiana statute. Moreover, the Court observed that Indiana had a substantial interest in preventing an Indiana corporation from becoming a shield for unfair business practices.\(^{85}\)

The holding in CTS did not contravene the Extraterritoriality Principle, or reject any aspect of MITE, although the CTS Court did make clear that the plurality opinion in MITE did not represent the views of a majority of the Court, and that the Court was not bound by its reasoning.\(^{86}\) There was no reason to reject it, however. In CTS, in simplest terms, the Indiana law regulated internal matters, with external effects the Court found were constitutionally permissible. The Court concluded that it differed in major respects from the Illinois statute involved in MITE, which the CTS Court saw as operating to favor management against offerors,

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\(^{83}\) In CTS, the majority focused heavily on the federal Williams Act preemption question, concluding that the Indiana law actually furthered the a basic purpose of the Williams Act by protecting shareholders from the coercive aspects of some tender offers and furthering the federal policy of investor protection. See 481 U.S. at 83.

\(^{84}\) Id. at 88.

\(^{85}\) Id.

\(^{86}\) 481 U.S. at 81.

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to the detriment of shareholders. The Indiana law, on the other hand, was seen as protecting the independent shareholders against the contending parties.\textsuperscript{87} Moreover, the principal focus of Dormant Commerce Clause scrutiny, said the Court, is on statutes that discriminate against interstate commerce.\textsuperscript{88} The Court found that the Indiana Act was not such a statute: "It has the same effects on tender offers whether or not the offeror is a domiciliary or resident of Indiana," adding: "[I]t visits its effects equally upon both interstate and local business."\textsuperscript{89}

The Court also found that the Indiana statute posed no problem of subjecting activities to inconsistent regulations. So long as each state regulates voting rights only in the corporations it

\textsuperscript{87} Id. at 82.

\textsuperscript{88} Id., at 87.

The Supreme Court has characterized "modern" dormant Commerce Clause law as being driven by concerns about "economic protectionism" --regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors. \textit{Dept. of Rev. of Kentucky v. Davis}, 553 U.S. 328, 337-38, 128 S.Ct. 1801, 170 L.Ed. 2d 685 (2008). The question is whether a challenged law discriminates against interstate commerce. \textit{Id.} at 338. In modern analysis the balancing test articulated in \textit{Pike v. Bruce Church, Inc.}, 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed. 2d 174 (1970), plays an important role. The Court has explained that a discriminatory law is virtually per se invalid, and will survive only if it advances a legitimate local purpose that cannot be adequately served by reasonable non-discriminatory alternatives. Absent discrimination, however, a state law will be assessed using the \textit{Pike} balancing test, such that a law will be upheld unless the burden imposed on interstate commerce is clearly excessive in relation to the putative local benefits. See 553 U.S. at 338-39 (citing authorities).

Modern dormant Commerce Clause law does not supplant extraterritoriality concerns addressed in \textit{MITE}, and which drove the decision in \textit{National Centwy}. However, the Supreme Court underscored the continuing vitality of \textit{Pike} in the calculus. In \textit{National Centwy} the court flatly rejected the call to apply \textit{Pike} and its balancing test where the court was satisfied that the Ohio civil remedy was per se invalid under the Extraterritoriality Principle. As argued in this article, that was a mistake. If the Ohio civil remedy for out-of-state purchasers of securities could be considered "regulation," it should have been judged under the \textit{Pike} balancing test because, as "regulation," the post-transaction remedy has no significant impact on interstate commerce and serves the legitimate state interest of Ohio.

\textsuperscript{89} \textit{CTS}, 481 U.S. at 88, \textit{quoting Lewis v. BT Investment Managers, Inc.}, 447 U.S. 27, 36 (1980). In \textit{Lewis}, an action was brought by an out-of-state bank holding company and its wholly-owned investment management subsidiary seeking declaratory and injunctive relief from Florida statutes which prohibited out-of-state banks and holding companies from owning or controlling a Florida business furnishing investment or advisory services, and barring out-of-state corporations from exercising trust powers and duties in Florida. The holding company and its investment management subsidiary asserted that by restricting the ability of out-of-state bank holding companies to compete in its market, Florida's statutes violated the Commerce Clause by discriminating against them for protectionist purposes. The Supreme Court agreed that the disparate treatment of out-of-state bank holding companies could not be justified as an incidental burden on interstate commerce necessitated by legitimate local concerns. The Florida statutes ran afoul of the general principle that the Commerce Clause prohibits a state from using its regulatory power to protect its own citizens from outside competition. The Court concluded: "There is... no reason to believe that the State's interest in local control, to the extent it legitimately exists, has been significantly or even-handedly advanced by the statutory means that have been employed." 447 U.S. at 44.
has created, said the Court, each corporation will be subject to the law of only one state. The Court added that no principle of corporation law and practice "is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders."\(^{90}\) Moreover, the Indiana law did not create an impermissible risk of inconsistent regulation by different states, and the Court thus embraced *Pike v. Bruce Church, Inc.* to conclude:

On its face, the Indiana Control Share Acquisitions Chapter evenhandedly determines the voting rights of shares of Indiana corporations. The Act does not conflict with the provisions or purposes of the Williams Act. To the limited extent that the Act affects interstate commerce, this is justified by the State's interests in defining the attributes of shares of its corporations and in protecting shareholders. Congress has never questioned the need for state regulation of these matters. Nor do we think such regulation offends the Constitution....\(^{91}\)

Application of the Extraterritoriality Principle was not an issue in *CTS*. Although the Indiana law plainly impacted interstate commerce, it did so under the umbrella of regulating internal state corporation law matters, albeit with some external affects, and did not run afoul of the Commerce Clause given the state's overriding interest in the protection of shareholders. The focus in *CTS* on the legitimate interest of states in protecting the shareholders of corporations chartered by and governed under the laws of the state necessarily conveys a broader message than concern for independent shareholder autonomy and for protection against coercive takeover bids. If the legislative or regulatory authority of states may properly extend to protection of out-of-state shareholders in the independent exercise of voting rights, would that authority not also encompass the application of an express remedy to redress fraud committed on those same shareholders in connection with the offer and sale of securities to them?

\(^{90}\) 481 U.S. at 89.

\(^{91}\) *Id.* at 94.
The broader message in *CTS* was not lost on the court in *National Century* in its consideration of the scope of protection of investors in an Ohio corporation engaged in fraud on a national scale. Indeed, the district court specifically embraced the point when called upon by the investor plaintiffs to apply the *Pike v. Bruce Church, Inc.* balancing test, as had been done by the Supreme Court in *CTS*:

The majority in *CTS* focused on the interests of the state: “[S]tate regulation of corporate governance is regulation of entities whose very existence and attributes are a product of state law.... The Court found the burden imposed on interstate commerce by Indiana’s regulation to be incidental compared to its interest in ‘promoting stable relationships among parties involved in the corporations it charters....’ The Noteholders’ argument [in *National Century*] thus emphasizes Ohio’s interests in regulating fraud committed by its own corporations. *And it would appear that the Noteholders’ case is even the more compelling than the one in *CTS* because the remedial regulation of fraud improves commerce, not burdens it, whereas Indiana’s regulation of control-share acquisitions put some burden on interstate commerce.*

That said, however, the court went on: “The Noteholders would have the court steer away from the extraterritoriality principle in favor of the *Pike* balancing test, but the court cannot do that.” The singular focus on the Extraterritoriality Principle, as the court saw it applied by the plurality in *MITE*, and which the court characterized as “an analysis that has become its own component of Commerce Clause jurisprudence,” precluded any *Pike*-based consideration of the availability of the investor remedy in spite of the court’s open recognition that allowing it would result in no burden on interstate commerce. As embraced by the court in *National Century*, the per se prohibition of state regulation of commerce or conduct taking place outside the state trumps any consideration of legitimate state interest and the extent of any burden on interstate commerce that under *Pike* would otherwise be balanced.

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92 755 F.Supp.2d at 878 (emphasis added).
93 Id.
94 Id.
D. The Two-Tiered Approach to Analyzing State Economic Regulation

Rejecting the Pike balancing test, the court in National Century looked to post-MITE decisions, outside the antitakeover context, in which the Supreme Court reaffirmed the need for separate consideration of state regulatory action under the Extraterritoriality Principle. Post-MITE, the Supreme Court has in fact counseled that there are two categories of state economic regulation, each to be considered differently under the Commerce Clause. In Brown-Forman Distillers Corp. v. New York State Liquor Authority,\textsuperscript{95} while cautioning that there is no clear line separating permissible and impermissible categories of state regulation under the Commerce Clause, the Supreme Court, articulated a two-tiered approach to making the assessment:

This court has adopted what amounts to a two-tiered approach to analyzing state economic regulation under the Commerce Clause. When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry....When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, we have examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local interest.... We have also recognized that there is no clear line separating the category of state regulation that is virtually per se invalid under the Commerce Clause, and the category subject to the Pike v. Bruce Church balancing approach. In either situation the critical consideration is the overall effect of the statute on both local and interstate activity.\textsuperscript{96}

Brown-Forman involved application of an “affirmation” provision in the New York Alcoholic Beverage Control Law. Under it, a distiller licensed to do business in the state may not sell its products to wholesalers within the state except in accordance with a monthly price schedule previously filed with the state, which required the distiller to include with the schedule

\textsuperscript{95} 476 U.S. 573 (1986).

\textsuperscript{96} Id. at 579 (emphasis added).
an affirmation that the prices in the schedule are no higher than the lowest prices the distiller will charge wholesalers anywhere in the United States during the same period. In New York and other states, distillers offered varying promotional allowances to wholesalers based on past purchases and projected future sales. The New York State Liquor Authority commenced license revocation proceedings against Brown-Forman, arguing that such promotional allowances to wholesalers in other states amounted to a lower effective price of products in those other states, which violated the New York price affirmation requirement. Brown-Forman alleged in response that the affirmation provision impermissibly regulated interstate commerce. New York courts held that it did not. On appeal to the U.S. Supreme Court, however, the Court held that the affirmation provision, on its face, violated the Commerce Clause. The Court concluded that a "prospective" statute such as the affirmation provision of the New York law, which required that prices in the state in the current month not be higher than those that will be charged in any other state during the same month, directly regulates out-of-state transactions. The Court explained:

Once a distiller has posted prices in New York, it is not free to change its prices elsewhere in the United States during the relevant month. Forcing a merchant to seek regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce. While New York may regulate the sale of liquor within its borders, and may seek low prices for its residents, it may not "project its legislation into [other states] by regulating the price to be paid" for liquor in those States.97

The same conclusion was reached in *Healy v. The Beer Institute, Inc.*,98 also relied upon by the district court in *National Century*. In *Healy*, the Supreme Court struck down a Connecticut statute requiring shippers of beer to affirm that their posted prices for products sold to Connecticut wholesalers are, as of the moment of posting, no higher than the prices at which those products are sold in the bordering states of Massachusetts, New York and Rhode Island.


Here again, the Court concluded that the statute had the practical effect of controlling commercial activity wholly outside of Connecticut. Speaking for the majority, Justice Blackmun articulated the principles guiding all of the Court’s assessments concerning the extraterritorial effects of state economic regulation:

First, the “Commerce Clause... precludes the application of a state statute to commerce that takes place wholly outside of the State’s borders, whether or not the commerce has effects within the state...,” and specifically a State may not adopt legislation that has the practical effect of establishing a “scale of prices for use in other states....” Second, a statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of the enacting State’s authority and is invalid regardless of whether the statute’s extraterritorial reach was intended by the legislature. The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State.... Third, the practical effect of the statute must be evaluated not only by considering how the challenged statute may interact with the legitimate regulatory regimes of other states and what effect would arise if not one, but many or every State adopted similar legislation. Generally speaking, the Commerce Clause protects against inconsistent legislation arising from the projection of one state’s regulatory regime into the jurisdiction of another State.... And specifically, the Commerce Clause dictates that no State may force an out-of-state merchant to seek regulatory approval in one State before undertaking a transaction in another....

Brown-Forman and Healy instruct that the central question is whether a projection of state legislation or a regulatory scheme outside the state actually controls commerce or conduct, whether as a practical effect or as direct regulation. In both cases, the Supreme Court struck down preventative state regulations that directly controlled product pricing in other states. The blocking impact on interstate activity was unmistakable. In the application of civil remedies for purchasers under Blue Sky Laws there is no blocking impact on any out-of-state activity. For the court to conclude in National Century that application of a post-transaction civil remedy for fraud committed upon out-of-state purchasers of securities operates as state regulation of

99 491 U.S. at 336 (citations omitted).
commercial activity --direct control of commerce-- beyond state boundaries within the prohibitive ambit of Brown-Forman and Healy is thus troubling.

Relying on MITE, Brown-Forman, and Healy for articulation and application of the Extraterritoriality Principle to deny the Ohio statutory remedy, the court in National Century offered no explanation how a post-transaction remedy for out-of-state purchasers of securities equates with the projection of state regulatory authority or has the practical effect of actually regulating interstate commerce, or controlling extraterritorial conduct.100 As will be seen in Part V of this article, the court was simply satisfied that allowing the post-transaction remedy to be applied against Credit Suisse in its role as an alleged aider in a primary violation of the Ohio Blue Sky Law by National Century would result in rescission of sales that took place in other states under whose laws a different standard of culpability for secondary liability would apply, and that as a consequence, there would be an “effect” on interstate commerce.101 Although none of the Supreme Court cases addressing extraterritoriality did so in the context of a post-

100 The court offered the recent Sixth Circuit decision in International Dairy Foods Ass’n v. Boggs, 622 F.3d 628 (6th Cir. 2010), in further support. In Boggs, the court considered an Ohio regulation designed to curb misleading labeling of the composition of dairy products in advertising. Several dairy processors advertised their nonuse of artificial hormones in the product of milk. The regulation at issue was adopted in response to such advertising, and prohibited dairy processors from making claims about the absence of artificial hormones in their milk products, and to require them to include a disclaimer when making such claims about their production processes. Two dairy processor trade associations challenged the Ohio regulation on grounds that dormant Commerce Clause by impermissibly governing extraterritorially, and that the regulation is protectionist.

On appeal from the district court summary judgment for the state, the Sixth Circuit affirmed, upholding the regulation. The court found that the Ohio labeling requirements have no direct effect on the processors’ out-of-state labeling conduct. The court further concluded that the Ohio Rule does not impede or control the flow of milk products across the country --that it creates no serious impediment to the free flow of commerce. Id. at 647. It does not, therefore govern extraterritorially, and that it has no discriminatory purpose. Id., at 648. Boggs simply underscores the essential point in Brown-Forman and Healy that a statute or regulation must actually govern extraterritorially before it will be struck down as per se invalid under the Extraterritoriality Principle.

101 See 755 F.Supp. 2d at 885-86.

As discussed further in Part V(E), infra, a state law may be seen as adversely affecting interstate commerce if it subjects activities to inconsistent regulation. In CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1978), the Supreme Court observed that extraterritorial regulation could be invalided if it is inconsistent with the second state’s regulatory regime, such that one faces incompatible obligations, for which compliance with both is not feasible. Here again, however, the issue is imposition, or projection of an inconsistent regulatory scheme. That is not the case in allowance of a remedy, which imposes no obligations.
transaction remedy, it is safe to say that guided by these cases, to bar availability of a statutory
remedy to out-of-state purchasers of securities, the remedy must amount to the imposition of a
regulatory scheme which directly controls conduct. *MITE, Brown-Forman,* and *Healy* require far
more than an undefined extraterritorial effect.

There is a more fundamental flaw in the court’s application of the Extraterritoriality
Principle in *National Century.* The conduct or commerce seen by the court as being reached by
the Ohio Blue Sky Law and, by extension any Blue Sky Law, is not a securities transaction,
wherever it may occur. Blue Sky Laws address conduct in the offer and sale of securities, terms
having special meaning in defining the scope of state securities regulation. To be sure,
territoriality is and always has been part of the regulatory scope. However, as discussed in Part V
below, given the true focus of Blue Sky Laws, there was no territoriality issue presented in
*National Century* in the first place.

**V. COMMERCE OR CONDUCT WHOLLY OUTSIDE THE STATE?**

**A. The Object of Protection**

In *National Century* the court held that the “commerce” or “conduct” reached by the
Ohio Blue Sky law, and thus necessarily the object of protection, is a securities transaction “and
not the fraud” committed on offerees or purchasers.102 Ohio state courts would disagree. In *In re
Columbus Skyline Securities, Inc.,*103 for example, the Ohio Supreme Court stated:

> The Ohio Securities Act, generally referred to as the Ohio Blue Sky Law, was
> adopted on July 22, 1929 to prevent the fraudulent exploitation of the investing
> public through the sale of securities.... Many of the enacted statutes are remedial
> in nature, and have been drafted broadly to protect the investing public from its
> own imprudence as well as the chicanery of unscrupulous securities dealers... In
> order to further the intended purpose of the Act, its securities anti-fraud
> provisions must be liberally construed.104

102 See 755 F.Supp.2d at 886.

103 74 Ohio St.3d 495 (Ohio 1996).

104 *Id,* at 498.
General antifraud provisions in Blue Sky laws, exemplified by Section 501 of the 2002 Uniform Securities Act, leave no room for doubt as to the scope of intended protection:

**GENERAL FRAUD.** It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly:

(1) to employ a device, scheme, or artifice to defraud;

(2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it is made, not misleading; or

(3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.  

What the court in *National Century* characterized as a “multi-billion dollar fraud on investors” was never an issue. The fraud carried out by National Century through the offer and sale of securities of the Ohio special purpose entities established to create and, through a formal intermediary process, to market them, though hatched and executed from Ohio, was carried out on a national scale. State securities laws, since they first became a part of the American legal landscape early in the Twentieth Century have first and foremost been aimed at protecting the public from fraud.  

Paying heed to *In re Skyline Securities, Inc.*, the court in *National Century* acknowledged the historic mission of the Ohio Blue Sky Law to prevent fraudulent exploitation of the investing public, yet in order to limit the territorial scope of a civil remedy the court incongruously concluded that the conduct reached by the law is not fraud. If fraud, or any unlawful conduct, in the offer and sale of securities carried out in or from a state is the object of

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106 *See Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917) (The term “blue sky law” itself is an expression of the goal of the states to protect the investing public from fraud and insubstantial speculative securities offerings "which have no more basis than so many feet of blue sky").

107 *See 755 F.Supp.2d* at 873 (The purpose of Chapter 1707 of the Ohio Revised Code is to “prevent the fraudulent exploitation of the investing public through the sale of securities”).
investor protection, the place of a resultant “transaction” is meaningless in defining the reach of the Blue Sky Law of the state in which the conduct is committed and the distribution of securities is launched.

National Century engaged in fraud in connection with the distribution of its securities from Ohio. As discussed earlier, the company undertook the process of distribution of its securities to investors by creating Ohio special purpose entities to issue the securities, for which Credit Suisse was first engaged as “placement agent” to structure and market the securities, and later with Credit Suisse performing a traditional underwriter role in placing those securities into the hands of investors. The object in either form of relationship was the creation of securities and their distribution into the hands of investors. In this process, the out-of-state consummation of a transaction was merely the concluding element of the process undertaken in Ohio. One or more in-state elements of this process form the basis for application of the express remedy for purchasers, regardless of where the ultimate transaction takes place. *A.S. Goldman & Company, Inc. v. New Jersey Bureau of Securities,*\(^{108}\) illustrates the point well.

In *Goldmen*, the sole underwriter in an initial public offering of securities brought a declaratory judgment action in response to issuance of a cease and desist order by the New Jersey Bureau of Securities against the offer and sale of unregistered securities. The Bureau’s order, issued under statutory authority in the New Jersey Uniform Securities Act, was aimed at preventing the underwriter, a New Jersey registered securities broker-dealer, from selling securities from New Jersey to investors in other states. The securities offered and sold by the underwriter out of state were not registered in New Jersey, although they were lawfully sold in other states in which regulators had approved the offering. The securities were not offered or

\(^{108}\) 163 F.3d 780 (3d Cir. 1999).
sold to any New Jersey resident. The underwriter, however, maintained its sole office in New Jersey and, as noted, was registered as a broker-dealer in New Jersey.

The underwriter challenged the cease and desist order as a violation of the Dormant Commerce Clause, arguing that the New Jersey securities administrator could not lawfully block the sales of the securities to buyers in other states where the securities were in fact registered, and could lawfully be sold. The district court, applying the *Pike* balancing test, concluded that the New Jersey Blue Sky law imposed an excessive burden on interstate commerce in relation to New Jersey’s local benefits. On appeal by the state, however, the Third Circuit reversed, holding that the Blue Sky law was lawfully applied in furtherance of important New Jersey interests in: (a) preventing fraudulent transactions; (b) preserving the legitimate reputation of securities issuers by preventing New Jersey companies from offering suspect securities to out-of-state buyers; and (c) protecting New Jersey residents from dubious securities that could enter the state in secondary market transactions.\(^{109}\) Most significantly, the Third Circuit concluded that although securities were not sold to any New Jersey residents, they were nevertheless offered within and from New Jersey to out-of-state offerees and purchasers. The Third Circuit adopted the Bureau’s position that:

Section 60 [of the Blue Sky law] simply regulates how brokers located in New Jersey conduct business from their New Jersey offices. In this instance, these were Imatec securities... offered for sale by the underwriter through solicitations of the public from New Jersey. The offer and sale arose in New Jersey. Goldman chose to domicile its highly-regulated business in New Jersey and to conduct that business from within the state.\(^{110}\)

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\(^{109}\) 163 F.3d at 788 ("New Jersey’s regulation of sales by in-state brokers to out-of-state buyers serves the legitimate purpose of preventing fraudulent transactions").

\(^{110}\) *Id.*, at 786.
Looking to jurisprudential history from the Blue Sky Cases of 1917 onward, the Goldmen court counseled that "the constitutionality of state regulations of interstate commerce depends largely on the territorial scope of the transaction that the state law seeks to regulate."\(^{111}\) Goldmen involved a projection of state regulatory authority intended to stop the offer and sale of securities from New Jersey to buyers in other states. Nevertheless, the court rightly recognized that none of the cases established that states are forbidden categorically to regulate transactions that involve interstate commerce, and went on to find no violation of the Commerce Clause because elements of transactions occurred in New Jersey, and New Jersey has an interest in regulating the element of a transaction occurring within its boundaries, namely, the offer of the securities.\(^{112}\) The Third Circuit thus concluded that regulating in-state offers of securities to out-of-state buyers does not violate the Dormant Commerce Clause. Regulation of the in-state portion of an interstate transaction furthered legitimate in-state interests and did not unduly burden interstate commerce.

Although the emphasis on legitimate state interest and no undue burden on interstate commerce suggests application of the Pike v. Bruce Church, Inc. balancing test in reaching this conclusion, the court did not cite or otherwise offer Pik\(e\) as support. It was not necessary,

\(^{111}\) Id. at 786.

\(^{112}\) Id. at 787.

The court reasoned from modern principles of contract law, which take into account that the elements of a transaction may occur in more than one state. As stated by the court:

The...modern approach is to recognize that contracts formed between citizens of different states implicate the regulatory interests of both states. Thus, when an offer is made in one state and accepted in another, we now recognize that elements of the transaction have occurred in each state, and that both states have an interest in regulating the terms and performance of the contract. Id. at 787 (citation omitted).

That said, the court viewed the key to understanding the territorial scope of a contract between Goldmen in New Jersey and prospective buyers in another state. Such a contract, i.e., a transaction does not occur wholly outside New Jersey, but rather elements of it occur in both states, and each state may properly regulate the aspect of the transaction that occurs within its boundaries. Id.
however, as the court saw application of the New Jersey Blue Sky law only as regulating in-state offers of securities to out-of-state purchasers --regulating an in-state element of a transaction rather than projecting regulation or control over out-of-state activities or transactions. In this light, extraterritoriality was a non-issue.\footnote{113}{A strong dissent, however, focused on the outward impact of the state’s exercise of regulatory authority, which had the practical effect of halting sales to out-of-state purchasers, see Id. at 791. The dissenting judge looked to Brown-Forman, and the two-tiered approach to assessing the validity of state economic regulation under the Commerce Clause:

Although I believe a strong case can be made that §60 falls within the first tier of inquiry and therefore could be struck down as a per se violation of the Commerce Clause, I think our inquiry should more appropriately be conducted under the Pike balancing test that guides inquiry under the second tier. Id. at 793.

The dissent observed that without citing Pike the majority had in fact applied it, and went on to conclude that New Jersey’s interest was not sufficient to justify prohibiting solicitations in other states, where the securities could lawfully be sold. Significantly, however, the dissent acknowledged that if the New Jersey Bureau could establish that Goldmen was engaged in fraud, New Jersey would, on application of the Pike balancing test, have a sufficient interest to survive scrutiny under the Commerce Clause. Id. at 794. Goldmen was not a fraud case.}

As illustrated in Goldmen, a “transaction” has multiple conduct elements, each of which may occur in a different state. The exercise of state regulatory authority over the part that occurs in that state will not offend the Commerce Clause, in spite of the ultimate impact on whether a purchase or sale is actually consummated in either state. Blue Sky laws reach unlawful acts or conduct, of which a “transaction” may be the result, but which are not the object of protection. The focal point is the entire process of a distribution.

In National Century, the plaintiff investors also called upon the district court to focus on where the unlawful conduct occurred in determining the scope of the civil remedy. The argument made sense given the court’s 2008 assessment\footnote{114}{See 580 F.Supp.2d 630 (S.D. Ohio 2008).} that the Ohio Blue Sky Law may be applied to provide a remedy for out-of-state purchasers of securities sold by the Ohio issuer, and in which the defendant helped to induce purchases. Moreover, in National Century itself, the court...
acknowledged that, as a matter of Ohio law set out in *Federated Mgmt. Co. v. Coopers & Lybrand* 115 “the focus should be on where the fraud occurs.” 116

The court clearly understood the point. Indeed, the court itself cogently described the investors’ argument:

They contend, without any real rebuttal from Credit Suisse, that Ohio was the center of National Century’s fraud. National Century, the NPF programs and the servicer were incorporated in Ohio. The small group of individuals who formed National Century, served as its corporate principals, and were the primary wrongdoers all resided in Ohio. The NPF entities issued the notes from Ohio, and the NPF reserve account that were plundered were located in Ohio. Further, the Noteholders point out the many connections Credit Suisse had with National Century in Ohio, including entering into purchase agreements for the initial purchase of notes. 117

Nevertheless, the significance of the facts offered in this un-rebutted argument was disregarded, with the court declining to look beyond the simplistic notion of where a transaction is consummated rather than to the actual unlawful conduct giving rise to claims under the Blue Sky law of the state in and from which the distribution of securities. The fundamental error in this is the failure to recognize that securities were offered and sold within and from Ohio. The court failed to consider the unlawful conduct actually involved in the case, as to which the state’s legitimate interest, as discussed below, is beyond challenge. Applying the Extraterritoriality Principle as a bar to a civil remedy for fraud in Ohio’s, and any other Blue Sky law in these circumstances does serious harm to investor protection.

**B. Legitimate State Interest**

As applied by the court in *National Century*, the Extraterritoriality Principle required no consideration of the legitimate interests of Ohio in defining the reach of a remedy for fraud. Yet

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115 No. 03AP-204, 2004 WL 2941159 (Ohio App. 10 Dist Dec. 21, 2004).

116 755 F.Supp.2d at 875.

117 *Id.* at 882 (footnote omitted).
the court was careful to point out with reference to rejection of the principle by the Third Circuit in *A.S. Goldmen* that:

The Third Circuit held that applying New Jersey’s law did not violate the extraterritoriality principle. The securities transactions had the requisite in-state component because the seller offered and sold the securities from New Jersey. Moreover, New Jersey had an interest in maintaining the integrity of legitimate, in state sellers and brokers and preventing the state “from being used as a base of operations for crooks marauding outside the state.”

Although *Goldmen* was not a fraud case, even the dissent made clear that New Jersey’s legitimate interest in protecting against fraudulent business activities through the application of its Blue Sky Law was unquestioned. In *National Century*, where the statutory civil remedy was invoked specifically to address fraud in the offer and sale of securities, the court chose simply to reject the historic antifraud mission of Blue Sky Laws in order to make a “transaction” the object of regulation. As discussed below, this conclusion is flawed.

**C. A “Transaction” Cannot Define the Territorial Scope of Blue Sky Remedies**

The outcome in *National Century* rests on the court’s perception that the offer and sale of securities for purposes of Blue Sky Laws is no different than any commercial sale of goods. The court relied on *Dean Foods Co. v. Brancel* to illustrate “the importance of how commercial transactions are structured” in applications of the Extraterritoriality Principle. In *Dean Foods*, an Illinois milk processor sought to prevent Wisconsin from applying its administrative rules regulating milk processors to purchases of Wisconsin milk that took place out of state. The Illinois processor purchased a substantial amount of milk from Wisconsin dairy farmers, and, along with other processors, paid “volume premiums” to producers supplying it with greater quantities of milk.

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118 *Id.* at 880-81 (citations omitted).


120 187 F.3d 609 (7th Cir. 1999).
A volume premium is a payment over and above the base price for milk, and is calculated based on the amount of milk delivered by the farmer to whom the premium is paid. Because the practice of paying volume premiums encouraged producers to maintain larger herds, it resulted in the loss of several thousand dairy farms over a period of years. In response, the Wisconsin Secretary of the Department of Agriculture, Trade and Consumer Protection promulgated regulations prohibiting the payment of volume premiums. Responding to that regulatory action, Dean Foods instituted a milk purchasing program under which it did not accept the risk of loss until raw milk was accepted at its Illinois plants. Because the “sale” of the milk thus occurred in Illinois, Dean Foods assumed the Wisconsin prohibition against volume premiums was inapplicable, and instituted a declaratory judgment action in federal court against the Wisconsin Secretary, asserting that the Wisconsin volume premium rules violated the dormant Commerce Clause. The district court agreed, and granted injunctive relief, holding that because the transactions took place outside of Wisconsin, the Wisconsin regulations could not be enforced because of the Constitutional ban on extraterritorial legislation.

Applying principles established under the Uniform Commercial Code, as adopted in both Illinois and Wisconsin, the Seventh Circuit affirmed the district court determination that the Wisconsin rules violated the Dormant Commerce Clause. The court concluded there was no contract to purchase milk made in Wisconsin, and rather, that the sales plainly occurred in Illinois where the essential elements of a contract --the formal purchase of goods-- took place. The court opined:

Our view of [the] facts leads us to conclude that the sales indisputably occurred in Illinois, and that no contracts were formed in Wisconsin. No agreement or meeting of the minds, as is required by contract principles, occurred regarding the purchase of any shipment of milk until the product actually arrived in Illinois. Moreover, it was only at that point, when the necessary formalities of contract law had taken place that title, possession, and risk of loss passed.121

121 Id. at 619.
Embracing Dean Foods as support for its conclusion that the territorial reach of the rescission remedy in Ohio Blue Sky law must be limited to the place of an actual transaction, the court in National Century failed to address any distinction between a straightforward extraterritorial prohibition of “commercial” sales of goods, and the operation of state Blue Sky Laws to protect investors in the offer and sale of securities from fraud and other unlawful conduct. Nor did the court consider the significance of a post-transaction civil remedy for unlawful conduct, which neither interdicts nor prevents any commercial activity. Cases such as Dean Foods provide no guidance in these circumstances. Blue Sky Laws do not focus on “transactions.” They address conduct in offers and sales of securities as those terms are specifically defined for purposes of all securities regulation.

The significance of the difference between “offer” and “sale” as applicable under Blue Sky Laws and a “transaction” envisioned by the National Century court was best shown by the court itself, which found the only available guidance in establishing its bright line transactional test to be the 2010 decision of the U.S. Supreme Court in Morrison v. National Australia Bank, Ltd. 122 Morrison held that Section 10(b), and Rule 10b-5, of the Securities Exchange Act of 1934 do not apply extraterritorially. Instead, they apply only to transactions in securities listed on domestic exchanges, and domestic transactions in other securities.123

In Morrison, foreign plaintiffs sued foreign and American defendants for misconduct in connection with securities traded on a foreign exchange. The only question before the Supreme Court was whether the implied private right of action for violations of §10(b) and Rule 10b-5 should be available to foreign purchasers of foreign securities in transnational cases when no transaction occurred in the United States. The foreign plaintiffs in Morrison asserted violations

122 130 S. Ct. 2869 (2010).

123 130 S. Ct. at 2884.
of §10(b) and Rule 10b-5 based on false or misleading statements allegedly contained in annual reports and other public documents disseminated in Australia by the Australian bank issuer of the securities, which touted the success of its U.S. based mortgage servicer subsidiary. The securities were distributed only in Australia, and were traded only on an Australian exchange.

*Morrison* involved no Commerce Clause issue, but the court in *National Century* nevertheless saw it as pointing the way to establishing an in-state transactional test as the basis for determining the territorial limit of Blue Sky law civil remedies for purchasers of securities victimized by fraud. The court was satisfied that the Ohio Blue Sky law focus on the “purchase” and “sale” of a security necessarily made the actual transaction paramount, and that, as with *Morrison* in the transnational setting, a remedy should not be available to purchasers in out-of-state transactions. But *Morrison* provides no guidance in the application of Blue Sky Laws, which are triggered by conduct constituting the offer or sale of securities within a specific jurisdiction regardless of where a transaction may ultimately occur. Even in the federal securities law context, the point is well-illustrated in the wake of *Morrison* by *SEC v. Goldman Sachs & Co.*

In *Goldman Sachs* the court addressed whether allegations of securities fraud in the offer and sale of securities outside the United States could stand after *Morrison*. In its enforcement action, the SEC alleged that defendants violated not only Exchange Act §10(b) and Rule 10b-5, but also §17(a) of the Securities Act of 1933. *Section 17(a) is a general antifraud provision addressing “fraudulent interstate transactions,” which makes it unlawful for any person in the*

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offer or sale of securities to engage in fraudulent acts and practices.\textsuperscript{126} The SEC alleged that Goldman Sachs along with a Goldman Sachs employee who was principally responsible for structuring and marketing certain securities, offered and sold securities to foreign investors while concealing material facts concerning another Goldman Sachs client’s conflicting involvement with Goldman Sachs in the creation of the securities and his own action taking a short position in the securities being sold to the foreign investors. Because the transactions all took place outside the United States, the defendants sought dismissal under \textit{Morrison}.

The court in \textit{Goldman Sachs} accepted the “transactional test” established in \textit{Morrison} as a bar to application of Exchange Act §10(b) and Rule 10b-5 outside the United States, and dismissed those claims. There was no allegation that any purchase of the securities occurred in the United States. At the same time, however, the court left Securities Act §17(a) claims standing because, unlike §10(b) and Rule 10b-5, Securities Act §17(a) applies not only to the “sale” but also to the offer of any securities. Actual sales are not essential for a §17(a) claim.\textsuperscript{127} The court observed:

\begin{quote}
[N]othing in the definition of “offer,” however, indicates that the focus of that term, for purposes of Section 17(a) liability, is on the recipient. To the contrary, the Securities Act defines an “offer” to include every attempt to dispose of,
\end{quote}

\textsuperscript{126}Section 17(a) provides in pertinent part:

\textit{It shall be unlawful for any person in the offer or sale of any securities... by use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly--}

\begin{itemize}
\item (1) to employ any device, scheme or artifice to defraud, or
\item (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
\item (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.
\end{itemize}

\textsuperscript{127} Only §17(a)(3) addresses fraud in relation to a purchaser, thus making a sale an essential element of liability under that subdivision. Sections 17(a)(1) and (2) contain no such reference.
solicitation of an offer to buy, a security or interest in a security for value. This definition leaves no doubt that the focus of “offer,” under the Securities Act, is on the person or entity “attempt[ing] or offer[ing] to dispose of or solicit[ing]... an offer to buy” securities or securities-based swaps.\footnote{Goldman Sachs, 2011 WL at *15. Securities Act §2(a)(3) provides: The term “offer to sell,” “offer for sale,” or “offer” shall include every attempt to offer or dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.}

As in Blue Sky Laws, “offer” is defined in the Securities Act of 1933 to include every attempt or offer to dispose of a security for value.\footnote{Securities Act §2(3), 15 U.S.C. §77(b)(3).} To offer a security is to present another with an investment decision, or to solicit in a manner designed to stimulate interest or consciously set the stage for a decision to be made. In the federal securities law context the Supreme Court has made clear that “offer” and “sell” are expansive terms which encompass the entire selling process.\footnote{United States v. Naftalin, 441 U.S. 768, 773, 99 S.Ct. 2077, 60 L.Ed. 2d 624 (1979).}

Like Section 17(a) of the federal Securities Act, antifraud provisions in state securities laws generally, and specifically the Ohio Blue Sky law at issue in \textit{National Century}, also address both offers and sales of securities. In the application of these provisions, “sale” includes any attempt to dispose of a security, expressly including an offer to sell.\footnote{O.R.C. §1707.01(C) (1).} The full meaning of “sale” contains no territorial limitation, with the clear implication being that the place of an ultimate “transaction” is not the relevant consideration. \textit{Morrison} thus provides no support for the transactional test adopted by the court in \textit{National Century} to deny availability of the Ohio civil remedy to out-of-state purchasers whose “transactions” were simply the final link in a chain of distribution of securities from Ohio.

\textit{D. A Link in the Chain of Distribution}
A distribution is the entire process by which securities are created and distributed into the hands of investors. The chain of distribution obviously begins with the issuer who not only creates the securities, but designs and sets in motion the process by which those securities make their way to investors. In Ohio, National Century created special purpose entities for the specific purpose of engaging in note offerings. In Ohio, Credit Suisse was engaged by National Century for the express purpose of structuring, marketing and selling the securities. A chain of distribution in these circumstances is unmistakable. Market intermediaries such as Credit Suisse are only links in that chain. They are not isolated actors, but are in fact engaged, and are compensated, to be necessary links in the chain. Securities of special purpose entities created in Ohio by National Century as part of a massive fraud, to be distributed through an intermediary process designed in and launched from Ohio by National Century, through an intermediary formally engaged as either a placement agent or underwriter to carry it out, anchors the distribution in Ohio and to the fraud perpetrated in connection with it. Every subsequent act carried out in the designed process, to and including a “transaction” wherever it may occur, is a link in the chain.  

Being a link in the chain of distribution of securities is not dependent on agency status. In National Century, although the agreements entered into by Credit Suisse clearly identified an agency role, the court rejected an argument by plaintiffs that Credit Suisse engaged in the distribution of securities as an agent of National Century and the special purpose entities. A key premise for the argument, which the court also rejected, was that National Century and the special purpose entities were “sellers” of the securities, such that the disposition of the securities

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132 See Ennretex Oil & Gas Co. v. State, 560 S.W.2d 494, 497 (Tex. Ct. App. 1978) (“The Securities Act regulates sellers and sales....It applies if the seller is any link in the chain of the selling process”).
was accomplished directly or indirectly by Credit Suisse as an agent.\textsuperscript{133} It makes no difference. The distribution of securities in which an intermediary was formally enlisted as a link, was undertaken in and from Ohio by National Century and the special purpose entities. Although the special purpose entities were the issuers of the securities, both they and National Century sold the securities when they established the chain of distribution.

The court acknowledged that if National Century and the special purpose entities met the definition of "seller" under the Ohio Blue Sky Law: "[t]his would potentially satisfy the transactional test’s requirement of an in-state element to the securities transaction."\textsuperscript{134} The court, however, rejected the contention that National Century and the special purpose entities were in fact "sellers" of the securities,\textsuperscript{135} challenging plaintiffs’ contrary argument as amounting to an expansion of the definition of a seller:

The difficulty with this argument is that it allows Ohio’s statutory definitions to trump Commerce Clause jurisprudence. Ohio cannot circumvent territorial limitations on its authority to regulate by merely expanding its definition of who is a seller. The transactions by which the Noteholders purchased securities occurred wholly outside of Ohio -- this analysis is controlled by federal Commerce Clause and extraterritoriality jurisprudence. Only once a transaction comes within Ohio’s authority to regulate may it define who is liable for certain proscribed conduct.\textsuperscript{136}

No expansion of any definition was suggested in the case. "Seller" is not a defined term in the Ohio Blue Sky law or any version of the Uniform Securities Act on which other state...

\textsuperscript{133} The definition of "sale" in the Ohio Blue Sky Law, in addition to including any offer, also includes an offer to sell, directly or indirectly, "by agent." O.R.C. § 1707.01(C)(1).

\textsuperscript{134} 755 F.Supp.2d at 886.

\textsuperscript{135} Id.

\textsuperscript{136} Id. at 886.
securities laws are based. “Sale” and “sell,” however, are defined terms in Ohio, and “sale” along with the specific definition of “offer to sell,” are the key defined terms in the Uniform Securities Act which establish the reach of remedies and regulatory authority. The conclusion that National Century and the special purpose entities were not sellers is problematic for several reasons, not the least of which is the court’s immediately subsequent recognition that both National Century and the special purpose entities were sellers for purposes of any claim by Credit Suisse under the Ohio Blue Sky Law. Indeed, looking to the traditional underwriter role of Credit Suisse, the court declared:

[O]hio law does apply to the initial transactions between National Century and Credit Suisse. No one disputes that the Ohio Securities Act would apply to the sale of notes by National Century, NPF VI, and NPF XII to Credit Suisse. And nothing in the court’s ruling hinders the state of Ohio from fully enforcing its own regulations, including those in the Ohio Securities Act, against Ohio corporations.

In the exercise of its traditional underwriter role, the “initial transactions” with Credit Suisse were but links in the chain of distribution. National Century and the special purpose entities it created for that purpose can be no less “sellers” as they established and set in motion the distribution of securities into the hands of investors through an intermediary process. The court did not explain its inharmonious “seller” assessments, or seek to place them into actual definitional context of Blue Sky Laws, which make no territorial distinction in their application. No reconciliation of seller status was necessary, as the only perceived issue before the court was the situs of a transaction. As the court stated: “Only once a transaction comes within Ohio’s

137 See O.R.C. §§ 1707.01(C)(1), (C)(2).


139 755 F.Supp.2d at 886 (Emphasis added).
authority to regulate may it define who is liable for certain proscribed conduct.” Since all transactions in National Century took place outside of Ohio, this determination, said the court, is controlled by federal Commerce Clause and extraterritoriality jurisprudence. Given the court’s 2008 consideration of the scope of the Ohio remedy, which was controlled entirely by state law, this appears to be an overstatement. Nevertheless, extraterritoriality jurisprudence has not re-defined terms that establish the scope of Blue Sky Law remedies, or redirected the focus of Blue Sky Laws away from unlawful conduct in the offer and sale of securities in order to establish a territorial bar to application. Nor can it undermine the determination of territorial availability of civil remedies based, as it should be, on a chain of distribution of securities in which a transaction is simply a part. As presented throughout this article, extraterritoriality jurisprudence has established that the only question is whether a state law directly regulates conduct outside of the state. With that in mind, the court’s assessment of the burden on interstate commerce posed by application of the Ohio Blue Sky remedy to out-of-state purchasers is considered below.

E. Controlling Extraterritorial Commerce or Conduct

As applied by the court in National Century, the Extraterritoriality Principle requires no assessment of impact on interstate commerce by making a civil remedy available to out-of-state purchasers. The fact that a statutory remedy may be triggered by extraterritorial transactions is, under National Century, sufficient to restrain its application. In simplest terms, however, the Extraterritoriality Principle restrains extraterritorial enforcement of state laws and regulations which control commercial activity wholly outside of the state’s borders.

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140 Id.
141 Id.
142 See Healy v. Beer Institute, supra, 491 U.S. at 326 (“The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State....”).
In *National Century*, the court did not undertake to justify its bar on application of the civil remedy under the Ohio Blue Sky Law based on any assessment of such a burden on interstate commerce. Rather, the court opined that the prospect of differing culpability standards among states for imposing secondary liability, and specifically Ohio’s broad standard in comparison to others, would have an undeniable “effect” on interstate commerce. The court premised its conclusion as follows:

Ohio’s imposition of secondary liability... targets the sale transaction. In seeking summary judgment on their § 1707.43 claims, the Noteholders assert that Credit Suisse aided National Century’s primary violations by serving as the initial purchaser, preparing and distributing sales materials, and otherwise acting as the market maker in NPF notes. As the Noteholders stress, they do not need to show that Credit Suisse acted with knowledge of National Century’s fraud or with intent to defraud purchasers. In other words, they merely need to establish that Credit Suisse participated in making the *sale*, not in committing *fraud*.

Ohio’s standard for secondary liability, said the court, belies the notion that interstate commerce would not be burdened by applying the Ohio Blue Sky Law to out-of-state sales. However, the court did not describe any actual burden. That is understandable. Recalling the simple observation of the court in *Chrysler Capital Corp. v. Century Power Corp.*, and applying it here, the civil remedy in the Ohio Blue Sky Law “merely provides a post-hoc remedy for persons aggrieved by allegedly unlawful conduct...[and] in no sense does it prevent or burden interstate commerce.” And indeed, in *National Century* the court itself recognized that rather than burdening interstate commerce, remedial regulation of fraud *improves* it. The only articulated concern, focusing solely on secondary liability, was the potential for imposing

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143 755 F.Supp.2d at 885.
144 *Id.*
146 See 755 F.Supp.2d at 878.
liability on the basis of a lesser culpability standard from those in other Blue Sky Laws, particularly that of the state in which a transaction takes place.

The Ohio statutory remedy for rescission does not on its face prescribe any culpability standard on which liability of either a seller or one who aids or participates with a seller may be found. The court characterized Ohio as different from several other states in this respect. But civil remedies in other Blue Sky Laws for aiding or assisting in sales for the most part do not require proof of knowledge or intent. Rather, they make reasonable care an affirmative defense. In those states with Blue Sky Laws derived from the Uniform Securities Act that is the case.

As a practical matter, for the Ohio rescission remedy to be applied against those who aid or participate with a seller, the burden of proof falls on the purchaser of securities to demonstrate that the party in fact aided or participated with a seller in a sale made in violation of the Blue Sky Law. "Aiding" and "participation" are not defined, but fairly imply an active role and general awareness that one is providing substantial assistance in acts or conduct of a seller. It is true that an aider or participant need not commit the unlawful act, in this case fraud, to be liable with the

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147 But see Williams v. Guarnieri, 2005-Ohio-4044 (Ohio Ct. App. 2005) (Plaintiffs must show that the defendant knowingly sold unregistered securities in order to have rescission, thus injecting a culpability element into a civil liability determination even for primary violators that on the face of the statute would appear absolute).

148 See Unif. Sec. Act §410(b), which provides in pertinent part that every broker-dealer or agent who materially aids in the sale is jointly and severally liable with and to the same extent as the seller:

[u]nless the non-seller who is so liable sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

The Texas Securities Act extends civil liability to "aiders" --any person who, directly or indirectly, with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids a seller, buyer, or issuer of a security who is liable. Tex. Stat § 33.F; see also Sterling Trust Co. v. Aidlerly, 168 S.W. 3d 835 (Tex. 2005) (To impose aiding and abetting liability under the Texas Securities Act a plaintiff must show that the alleged aider "possessed a general awareness this his role was part of an overall activity that is improper").

seller who does. Secondary liability in any setting is derivative. But it is also true that secondary liability is not imposed in the absence of actual involvement in the offer and sale of securities. 149

There are no significantly varying culpability standards for secondary actors from state to state except to the extent that the affirmative defense is expressly available. However, any such differences do not equate with extraterritorial imposition of inconsistent regulatory schemes or legal obligations which could trigger legitimate Commerce Clause concerns. 150 Even in the exercise of regulatory authority, A.S. Goldman v. New Jersey Bureau of Securities has shown that the Dormant Commerce Clause will not prevent the exercise of state regulatory authority directly

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149 In another earlier (2006) consideration of the scope of the Ohio Blue Sky Law rescission remedy in the context of the National Century fraud, the court addressed the point. In that chapter of the litigation, the court addressed a claim by purchasers of the securities offered and sold by National Century and its special purpose entities brought against a bank that had served as indenture trustee for the notes issued by the special purpose entities. The purchasers alleged, among other things, that the bank trustee had aided National Century in the note programs and the scheme to defraud noteholders. The court dismissed the claim, however, stating the following:

[T]he complaints fail to allege how Bank One, as Trustee, aided in the sale of the notes. The statutes [Ohio and New Jersey Blue Sky Laws] do not impose liability on anyone who aided the seller “in any way,” as plaintiffs argue. Rather they impose liability on anyone who aided the seller in any way in making an unlawful sale or contract of sale. The complaints may allege that Bank One aided in the scheme to defraud, but they do not allege that Bank One aided National Century in selling notes. Moreover, the complaints do not allege that Bank One acted as National Century’s agent, advisor, or broker in selling notes. In re National Century Financial Enterprises, Inc. Inv. Lit., 2006 WL 2849784, *10 (S.D. Ohio 2006).

The National Century court itself thus highlighted the active involvement with a seller that is the premise for secondary liability for rescission under the Ohio Blue Sky Law. Particularly meaningful in that assessment is the court’s example of what such an active role might be.

See also In re National Century Financial, Inc. Inv. Lit., 580 F.Supp.2d 630, 649-50 (S.D. Ohio 2008). In this 2008 consideration of the scope of liability for aiding the seller, a rating agency asserted that merely assigning rating to the securities was not enough and that, additionally, there was no allegation of sufficient knowledge or intent on which to premise liability. Denying the rating agency’s motion to dismiss, the court concluded that, at the pleading stage, the complaint adequately alleged that the agency ratings “helped induce” the plaintiff to purchase the securities, thus allowing the claim based on participation or aiding the seller to stand.

150 Inconsistent regulatory regimes can present a Dormant Commerce Clause concern. In CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987), the Supreme Court observed that extraterritorial regulation could be invalidated if it is inconsistent with the second state’s regulatory regime. The Supreme Court did not define “inconsistent” regulation, yet it can fairly be implied that the concern is for imposing incompatible obligations or the impossibility of compliance with multiple regulatory schemes. Any Commerce Clause assessment includes whether a state law at issue “adversely may affect interstate commerce by subjecting activities to inconsistent regulations.” However, civil liability for fraud or other violations of a Blue Sky Law based on conduct within the scope of that law involves no imposition or projection of extraterritorial regulation.
impacting lawful activity in another state, provided some regulated conduct takes place in or from the state exercising such authority.

States do not export purchaser remedies in their Blue Sky Laws. The availability and scope of a civil remedy for any purchaser of securities, whether addressed against a primary or secondary actor, is grounded in conduct directly addressed by and within the intended scope of protection of a Blue Sky Law. In National Century the court concluded that Ohio’s imposition of secondary liability targets a “sales transaction.” As this article has shown, the conclusion is at best half true. Blue Sky Laws target dispositions and every attempt to dispose of securities -- offers and sales, not transactions. A transaction necessarily frames the remedy --either rescission or damages as a rescission equivalent. Liability, however, is a function of an entire process leading to a transaction. That process is “targeted” by Blue Sky Laws, and in National Century

\[151\] In BMW of North America, Inc. v Gore, 517 U.S. 559, 116 S.Ct. 1589, 134 L.Ed.2d. 809 (1996), the Supreme Court, as a matter of the Due Process and dormant Commerce Clauses, restrained the authority of state courts to impose economic sanctions --punitive damages-- on violators of its laws with the intention of changing the violator’s lawful conduct in other states. Id. in Gore, the Court reviewed an award of punitive damages by an Alabama state court which the Supreme Court deemed to be punishment inflicted on lawful out-of-state conduct that was not supported by the state’s interest in protecting its own consumers and its own economy. Plaintiff was the purchaser of a new automobile that had been repainted to repair damage caused in the manufacture or transportation of the automobile. BMW acknowledged at trial that it had adopted a nationwide policy concerning refinishing cars that were damaged in this manner, and that based on the cost of repair relative to the car’s suggested retail price, the car would be sold as new without disclosing to the dealer that repairs had been made. Plaintiff was awarded punitive damages calculated on the basis of the sale of several hundred repaired automobiles nationwide, but only fourteen of which had been sold in Alabama. The U.S. Supreme Court held that lawful conduct outside Alabama could not be considered by an Alabama court in making an award of punitive damages. The Court opined:

Alabama does not have the power... to punish BMW for conduct that was lawful where it occurred and that had no impact on Alabama or its residents. Nor may Alabama impose sanctions on BMW in order to deter conduct that is lawful in other jurisdictions. Id. (footnotes omitted).

The availability of a state’s Blue Sky Law remedy for out-of-state purchasers of securities based in a distribution carried out from that state focuses only on involvement by one who is a link in the chain of that distribution. Civil liability for rescission or damages as a rescission equivalent is not based on lawful conduct in another state, but rather derives entirely from unlawful conduct under the law of the state whose legitimate economic interests are impacted directly, and whose interest in protecting against fraud in the offer and sale of securities is paramount. The concern addressed in Gore is not manifested in any application of a Blue Sky remedy for fraud that is allowed for out-of-state purchasers of securities.

\[152\] 755 F.Supp.2d at 885.
the role of Credit Suisse as placement agent and then underwriter in the distribution of securities was central to the process.

The court's perception of the target of remedial provisions in Blue Sky Laws follows from its perception of the "commerce" or "conduct" reached in this case by the Ohio Blue Sky Law, and by state securities laws generally, being a transaction rather than conduct in violation of the law in the distribution of securities that results in harm to investors in ultimate transactions. As considered further below, these misperceptions, coupled with near complete reliance on Edgar v. MITE Corp., led to a misapplication of the Extraterritoriality Principle to bar a remedy for purchasers.

VI. A MISAPPLICATION OF THE EXTRATERRITORIALITY PRINCIPLE

National Century rests almost entirely on the legal foundation of Edgar v. MITE Corp. The court embraced the plurality Justices' extraterritoriality analysis to extract the central thesis that the Commerce Clause precludes any application of a state statute to commerce that takes place wholly outside of the state's borders. The focus of MITE, said the court, is where "commercial activity" takes place,\(^\text{153}\) which in National Century the court defined solely in terms of a transaction. That being the case, the extraterritorial admonition is absolute, with no further assessment required. Such steadfast reliance on MITE is problematic, however, where the "application" of a state statute means in reality making a post-transaction remedy available, and where the commercial activity is in fact the entire process of a distribution of securities. The court took MITE much too far in the circumstances presented in National Century.

Revisiting MITE, the Illinois statute at issue represented a direct restraint on interstate commerce that the plurality Justices characterized as having a "sweeping extraterritorial

\(^{153}\) Id. at 878.
effect." As addressed throughout this article, the Extraterritoriality Principle as articulated in MITE, and considered by the Supreme Court in subsequent cases, is meaningful in the context of state law interdiction, or direct regulation, of commerce beyond state borders. In Brown-Forman, for example, the Court could not have been any more clear as it struck down the challenged New York statute for no reason other than because it directly regulated conduct outside New York.

Steadfast reliance on MITE only begged the question in National Century. What is regulated extraterritorially by invocation of a post-transaction private remedy by out-of-state purchasers of securities that were in fact offered and sold in a chain of distribution firmly anchored in Ohio? That a remedy may be allowed to out-of-state purchasers simply does not implicate the Extraterritoriality Principle. Neither MITE nor any of the subsequent Supreme Court cases instruct otherwise.

While the Dormant Commerce Clause restrains state power to regulate beyond its borders, regulation was not an issue in National Century. The real issue was no different than had been addressed by the court in 2008 when it denied a motion to dismiss an Ohio Blue Sky Law claim asserted by out-of-state purchasers of securities against a rating agency that played a key role in the creation and distribution of securities. In National Century 2010 the court began from the even more strongly stated position that, as a matter of Ohio law, the Ohio Blue Sky Law applied in the circumstances presented. Unfortunately the court necessarily equated application with regulation in order to invoke the Extraterritoriality Principle and sustain the Dormant Commerce Clause challenge. But the real issue had not changed: Either the post-transaction Ohio remedy could apply for the benefit of out-of-state purchasers, or not. If not, the reason would not lie with the Dormant Commerce Clause, but rather, as illustrated by cases such

154 457 U.S. at 642.

155 755 F.Supp.2d at 873-75.
as *Cors v. Langham*\(^{156}\) and *Singer v. The Magnavox Co.*,\(^{157}\) discussed in Part III of this article, the absence of a nexus between acts and conduct constituting the fraudulent offer and sale of securities in violation of the Ohio Blue Sky Law and the purchases of those allegedly victimized by unlawful conduct who seek to invoke the statutory remedy. In *National Century* the court itself dispatched any notion that the requisite nexus was missing.

The court erected the Extraterritoriality Principle as a bar to availability of the Ohio Blue Sky civil remedy for out-of-state purchasers of securities that were offered and sold within and from Ohio, and in which the defendant intermediary was unquestionably a link in the chain of distribution. The case presented no basis for invoking the principle in the first place. As addressed throughout this article, the availability of a post-transaction civil remedy to out-of-state purchasers to address fraud in the offer and sale of securities does not equate with the extraterritorial projection of regulation by Ohio or any other state. In *National Century* the court did not suggest otherwise, and cited no authority for the contrary proposition. Misapplication of the principle in *National Century* resulted from the court’s misperception of central elements of Blue Sky law generally, and the court’s construction of an object of regulation -- a “transaction”-- which is divorced from any notion of the actual scope of protection and intended reach of Blue Sky Law protections in addressing unlawful conduct, and particularly fraud, in the offer and sale of securities.

The “transactional test” adopted by the court in *National Century* as the basis for invoking the Extraterritoriality Principle is the product of backward logic. A transaction is the end result of a process which is regulated under Blue Sky Laws. It is a resultant event, but says nothing of the acts and conduct which brought it about and which constitute violations on which


liability under Blue Sky Laws is premised. Blue Sky Laws cannot regulate transactions; only the conduct and processes that produce them. A “transaction” is not a violation of a Blue Sky Law. Blue Sky Laws are violated by engaging in unlawful conduct in the offer and sale of securities. If the securities purchased in National Century were offered or sold within or from Ohio, that process --the entire distribution-- is the legitimate object of regulation under the Ohio Blue Sky Law and within the scope of its civil remedies. In National Century, securities were offered and sold within and from Ohio not because their issuance in Ohio by Ohio entities, but rather because of an entire process engineered and set in motion in Ohio to distribute them into the hands of investors--a process in which the engagement and activity of a placement agent or underwriter is a hallmark.

Whether the Extraterritoriality Principle, as perceived and relied upon by the court in National Century, comports with modern dormant Commerce Clause jurisprudence is irrelevant. This article has shown that National Century simply did not present a case for its application at all.

Having misapplied the Extraterritoriality Principle in National Century, should the court have looked instead to the Pike balancing test in assessing the availability of the Ohio remedy for out-of-state purchasers? The court unequivocally acknowledged as a matter of Ohio law that the Ohio rescission remedy would apply but for what has been shown to be a misapplication of the Extraterritoriality Principle. Thus, the two-tiered approach to extraterritoriality articulated by the

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158 The court acknowledged different approaches to the meaning of “extraterritorial control” which have emerged, and which focus on economic protectionism and discrimination against interstate commerce, see 755 F.Supp.2d at 878-79, but was satisfied that its own view, based on MITE, was consistent with recognition that the doctrine remains viable, noting particularly the 2010 decision of the Sixth Circuit in International Dairy Foods Association v. Boggs, 622 F.3d 628 (6th Cr., 2010). Boggs is discussed earlier in the article, as it illustrates along with all cases addressing the matter of extraterritorial control by a state law or regulation, that the critical premise is actual regulation of interstate commerce --a serious impediment to the free flow of commerce. In Boggs, the Sixth Circuit rejected application of the Extraterritoriality Principle. See note 100 and accompany text, supra.
U.S. Supreme Court in Brown-Forman and Healy invites consideration under Pike. In National Century, the court flatly declined to do so. It is certain, however, that given the court’s underlying premise that allowing the Ohio Blue Sky Law remedy to out-of-state purchasers of the securities at issue would have an “effect” on interstate commerce, the Pike balancing test would appropriately be considered.

Although assessment under the Pike balancing test presumes some actual state regulation or projection of regulatory authority which was not present in National Century, the Supreme Court nevertheless considered indirect or incidental effects on interstate commerce generally, and called for weighing the burden imposed on interstate commerce against the legitimate state interest. Under Pike, a statute which has only indirect effects on interstate commerce and regulates even-handedly, the question is simply whether the burden on interstate commerce clearly exceeds the legitimate state interest. Rejecting the plaintiffs’ call for application of Pike in National Century, the court nevertheless answered the central question by observing that the plaintiffs’ case was “compelling” as to the absence of any burden on interstate commerce. Had the court proceeded under Pike, the result was a foregone conclusion.

VII. CONCLUSION

In National Century, the court constructed a barrier to availability of an express private remedy under the Ohio Blue Sky Law to out-of-state purchasers of securities offered and sold within and from Ohio, and against an intermediary that was an essential link in the chain of distribution. The distribution of securities was part of a massive fraud committed on investors through the creation of Ohio special purpose entities as issuers of securities, and the engagement of an investment banking intermediary to carry out their distribution as placement agent and/or

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159 Brown-Forman and Healy, and the two-tiered approach to analyzing state economic regulation, are discussed in Part IV (D), supra

160 755 F.Supp.2d at 878.
underwriter. There are no separate elements of a distribution of securities, only a process that leads from their creation to their placement into the hands of investors.

As with all Blue Sky Laws, Ohio addresses fraud and other unlawful conduct in the offer and sale of securities—terms that have special meaning, and which encompass the entire process by which securities are created and distributed into the hands of investors, wherever those investors may be found. Where an ultimate transaction takes place is meaningless when it is the product of unlawful conduct in the distribution of securities within and from the state providing a remedy to purchasers.

This article has argued that states do not exercise extraterritorial power when a civil remedy for purchasers of securities victimized by unlawful conduct in the offer and sale of those securities is invoked under the Blue Sky Law of the state in and from which the distribution was made. The Extraterritoriality Principle under the Dormant Commerce Clause may rightly restrain the projection of state legislative or regulatory authority to control conduct and commercial activity across state lines. It has not been shown, however, to bar the invocation of a post-transaction remedy for unlawful conduct undertaken in the course of a distribution of securities anchored in the state providing the remedy, and no example of any court doing so other than in *National Century* has been shown. In *National Century*, the court constructed a bright-line “transaction” test to cabin the territorial limit of a purchaser a remedy and support misapplication of the Extraterritorial Principle. Doing so ignored the reality of not only the entire process of a distribution of securities, but most importantly the central focus of Blue Sky Laws on investor protection and the prevention of fraud.