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Like Moths to a Flame - International Securities Litigation after Morrison: Correcting the Supreme Court's Transactional Test

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Like Moths to a Flame? International Securities Litigation After *Morrison*: Correcting the Supreme Court’s “Transactional Test”

MARCO VENTORUZZO*

Because of the broad jurisdiction American courts have asserted in cases arising under the Securities Exchange Act of 1934, they have been called a Shangri-la for “foreign-cubed” class actions with little connection to the United States. Over the past forty years, the standards used by American courts to determine their jurisdiction in international securities disputes have evolved, culminating in the U.S. Supreme Court’s Morrison decision of 2010. The new transactional test promulgated in Morrison replaced all of its predecessor tests, from a test measuring whether the conduct in question took place in the United States to a test measuring whether the effects of the conduct were felt in the United States, to a combined conduct-effects test. This new transactional test is unsatisfactory, however, because depending on how it is interpreted, it is either too narrow to protect American investors as Congress intended in Section 10(b) of the Securities Exchange Act, or too broad to resolve the ambiguities that plagued the conduct-effects test. This Article proposes a new effects test that will resolve ambiguities, protect American investors, and refrain from asserting American judicial jurisdiction overseas contrary to principles of international comity. Though the effects test would not grant private parties a cause of action against violators operating in the United States but who exclusively defraud those overseas, Congress has already granted authority to federal agencies to pursue such bad actors. The effects test is also in accordance with principles of other important jurisdictions, such as the European Union, and could serve as a basis for an international agreement on jurisdiction in international securities cases.

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INTRODUCTION

Since the late 1960s, U.S. federal courts have grappled with the extraterritorial reach of American securities laws. In particular, courts have struggled with Section 10(b) of the Securities Exchange Act of 1934 [the “Exchange Act”].¹ The application of this rule to class actions with an international dimension has proved to be complex and uncertain. Courts have developed the “conduct-effects test,”² a two-pronged test — or, as

1. Rule 10b-5 prohibits the use of any act or omission to defraud or deceive in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (2011).

2. *See Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 122–24 (2d Cir. 1995). For a further discussion of the history behind the two tests and the eventual combination of the two tests in *Itoba*, see Dennis R. Dumas, *United States Antifraud Jurisdiction over Transnational Securities Transactions: Merger of the Conduct*

more aptly suggested by one court, “approach”³ — to determine subject-matter jurisdiction and the scope of Section 10(b) in international disputes. Under this approach, U.S. courts have adjudicative jurisdiction when either substantial conduct relevant to the violation has been carried on in the United States, when the alleged fraud has caused some damage in the United States to American plaintiffs, or both.⁴ These standards for determining when a U.S. court has adjudicative jurisdiction have not been uniformly defined and require a fact-intensive, case-by-case analysis.⁵

The conduct-effects approach raised concerns in two distinct but interrelated aspects. First, the absence of bright-line rules led to inconsistent, if not glaringly contradictory, results. Second, critics claim the conduct-effects approach excessively expanded the scope of the securities laws to cover transactions that the United States had little interest in regulating.⁶ This overreaching assertion of jurisdiction could be considered a form of legal imperialism that set the United States on a collision course with the legitimate interests of other sovereign nations and undesirably distracted the limited resources of the American legal system from more proper purposes. Critics aimed their concerns in particular at “foreign-cubed”⁷ securities class actions: collective lawsuits, often attorney-driven rather than client-centered, in which foreign investors sued foreign defendants in the United States for misrepresentations connected to transactions occurring abroad.⁸ Adoption of the conduct-effects approach thus led the federal judicial system to move toward becoming, in the words

and Effects Tests, 16 U. PA. J. INT’L BUS. L. 721, 723–31 (1995).

3. In *Kautbar SDB BHD v. Sternberg*, 149 F.3d 659, 665 (7th Cir. 1998), the Seventh Circuit noted that the term “approach” is more accurate because “test” is too inflexible to characterize the present state of the case law.

4. *See, e.g.*, *Itoba Ltd.*, 54 F.3d at 123–24. *See also* *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1336–37 (2d Cir. 1972) (discussing the “conduct test”); *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206–09 (1968) (announcing the “effects test”), *rev’d on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc).

5. *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2878–80 (2010).

6. Regarding the broadness of the effects test, see W. Barton Patterson, Note, *Defining the Reach of the Securities Exchange Act: Extraterritorial Application of the Antifraud Provisions*, 74 *FORDHAM L. REV.* 213, 226 (2005) (“A problem with the effects test is that it broadens with every technological advance that makes United States investors and markets more accessible to the world. This is especially true as the extent and scope of the effects test have never been adequately defined.”).

7. Stuart M. Grant & Diane Zilka, *The Role of Foreign Investors in Federal Securities Class Actions*, in *CORPORATE LAW AND PRACTICE HANDBOOK SERIES* (Number B-1442) 91, 96 (Practicing Law Institute ed., 2004) (using the term “foreign-cubed”).

8. Hannah L. Buxbaum, *Multinational Class Actions under Federal Securities Law: Managing Jurisdictional Conflict*, 46 *COLUM. J. TRANSNAT’L L.* 14, 26 (2007) (“Critics were particularly concerned that plaintiffs’ attorneys, rather than plaintiffs themselves, were managing class actions, with the frequent result that case outcomes enriched the attorneys rather than providing meaningful compensation to the plaintiff class.”).

of Justice Scalia, the “Shangri-la of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets.”⁹

Indeed, Justice Rehnquist famously defined Rule 10b-5 as a “legislative acorn” from which a “judicial oak” developed.¹⁰ In the view of its critics, the conduct-effects test was an overgrown branch of that tree, one that trespassed on the jurisdiction of other nations.¹¹

In August 2010, the Supreme Court picked up the shears in *Morrison v. National Australia Bank Ltd.* — its first case on foreign-cubed securities class actions. The *Morrison* decision disposed of forty years of case law and substituted for the conduct-effects test what Justice Stevens, in a concurring opinion, defined as a new “transactional test.”¹² This revolutionary approach limited the application of Section 10(b) of the 1934 Act to only parties using manipulative or deceptive devices in connection with “the purchase or sale of a security *listed on an American stock exchange*, and the purchase or sale of any other security *in the United States.*”¹³

This Article argues that both the previous conduct-effects test and the new transactional test are incorrect and proposes that a third solution, based solely on the effects of the transaction, should be adopted. While the conduct-effects test can be blamed for its fuzziness and potentially excessive reach, the rigid solution now provided by the Supreme Court is not without its own flaws.

To begin, the textual foundation of the transactional test, supposedly derived from the text of the Exchange Act, is at least as fragile as the foundation of the conduct-effects test. Questions can also be raised concerning the alleged bright-line nature of the transactional test. The most serious concern with the transactional test, however, is that the Supreme Court’s approach is too narrow, undermining the investor protection goals of the securities laws. As this Article will illustrate, *Morrison* can deprive American investors who buy securities from an American issuer of the protections of the securities laws merely because the transaction occurs abroad. It would take more than a little text-twisting to accept that this is what Congress intended in enacting the securities

9. *Morrison*, 130 S. Ct. at 2886.

10. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975).

11. Concerning the extraterritorial application of U.S. securities laws, see, e.g., Kun Young Chang, *Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject-Matter Jurisdiction*, 9 FORDHAM J. CORP. & FIN. L. 89, 100–01 (2003) (“[T]he extraterritorial application of U.S. securities laws may give rise to a breach of international comity as well as cause frequent conflicts with the sovereignty of other countries.”) (internal citations omitted); Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 914 (1998) (“[T]o the extent the United States seeks to regulate investment activity abroad, it cannot help but interfere with the regulatory systems of other countries.”).

12. *Morrison*, 130 S. Ct. at 2888.

13. *Id.* (emphasis added).

laws. This Article is not alone in this criticism: The concurring opinion in *Morrison* also expresses similar concerns about the majority's position.¹⁴

Yet, contrary to what that concurring opinion seems to suggest, this Article will not argue that the conduct-effects test should have been preserved. Instead, the Article advocates a simple solution: The extraterritorial reach of Section 10(b) should be based *exclusively* on a revised version of the conduct-effects test that ignores, in the case of private actions, conduct in the United States that has no consequences in this country.¹⁵

This Article will demonstrate that a revised approach to the conduct-effects test fits squarely within the thrust of the Exchange Act. Furthermore, when combined with an intelligent application of other procedural and substantive rules, this revised approach would avoid the overreach caused by the application of the conduct-effects test to foreign-cubed class actions by limiting the application of Section 10(b) and Rule 10b-5 to violations that cause harm in the United States. At the same time, the effect-only test that this Article advocates would not completely eliminate all judicial discretion, because a modicum of flexibility should be preserved. International disputes often defy bright-line rules and depend heavily on the factual circumstances of a particular case. As will be demonstrated below, a redefined "effect test" would also be in line with general principles of international law and comity, as well as with existing international agreements on jurisdiction to which the United States is not a party.

The Article proceeds as follows: Part I analyzes the status quo ante of the *Morrison* decision. It begins with a brief explanation of the "fatal attraction" of foreign plaintiffs to American courts in securities cases and addresses why Rule 10b-5 claims have raised extremely delicate extraterritorial application problems. It then outlines the statutory and regulatory provisions that create the interpretative conundrum concerning subject-matter jurisdiction in cases with international elements. Next, Part I provides an overview of the development of the conduct and the effects

14. *Id.* at 2895 (Stevens, J., concurring) ("Imagine, for example, an American investor who buys shares in a company listed only on an overseas exchange. That company has a major American subsidiary with executives based in New York City; and it was in New York City that the executives masterminded and implemented a massive deception which artificially inflated the stock price — and which will, upon its disclosure, cause the price to plummet. Or, imagine that those same executives go knocking on doors in Manhattan and convince an unsophisticated retiree, on the basis of material misrepresentations, to invest her life savings in the company's doomed securities. Both of these investors would, under the Court's new test, be barred from seeking relief under § 10(b)."); *see also* *Stoneridge Inv. Partners v. Scientific Atlanta*, 552 U.S. 148, 175 (2008) (Stevens, J., dissenting) (arguing that the Court should not "render the private cause of action under § 10(b) toothless").

15. My proposal is consistent with what appeared to be the original approach envisioned by the Second Circuit in its 1968 landmark decision, *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), *rev'd on rehearing on other grounds*, 405 F.2d 215 (2d Cir. 1968).

tests. It also posits whether the dangers of the conduct-effects test have been greatly exaggerated. Finally, Part I points out several rules applicable to collective litigation that already limit the risks of expending resources on foreign disputes.

Part II concentrates on the *Morrison* decision. After a brief description of the case and the reasoning of the Supreme Court, this Part advances the criticisms of *Morrison's* holding. It discusses the textual arguments that buttressed the Court's conclusion and calls into question the consistency of *Morrison* with other areas of the law. More importantly, this Part shows that the transactional test adopted by the majority is profoundly ambiguous and might cause uncertainties in its application. Furthermore, if the transactional test is interpreted narrowly enough to avoid uncertainties, it will undermine the integrity of American securities markets.

Part III looks at future developments. It first discusses legislative developments that followed the *Morrison* decision, particularly the Dodd-Frank Act of 2010, which might affect the regulation of international class actions. Part III also spells out this Article's proposal to adopt a revised effect test, illustrates the benefits of such an adoption, and expounds on the need to conclude an international agreement on jurisdiction in transnational securities litigation.

I. THE STATUS QUO ANTE: FROM WHENCE WE CAME

A. *The "Fatal Attraction" of Foreign Investors (and Their Lawyers) for American Courts in Cases of Fraud*

Securities class actions with an international dimension based on Section 10(b) of the Exchange Act and Rule 10b-5 raise the issues of subject-matter jurisdiction and extraterritorial application of the securities laws of the United States. Of course, there are other private causes of action, express or implied, in the securities laws that are invoked by foreign plaintiffs and are thus relevant to the issue of subject-matter jurisdiction in transnational litigation. Prominent examples include causes of action under Sections 11 and 12 of the Exchange Act, which concern the violation of the registration requirements in a securities offering,¹⁶ and the implied cause of action for false or misleading statements in connection with the solicitation of a proxy (Rule 14a-9).¹⁷ In these cases, however, because there is generally extensive contact with the United States, the question of extraterritorial application does not come under scrutiny.¹⁸

16. The bibliography on these provisions is endless. For a concise but thorough overview, see generally THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* 271 (2009).

17. For an overview, see generally *id.* at 354-59.

18. A registration statement would not be necessary if the securities were not offered in the

The broad reach of Rule 10b-5's "anti-fraud" provision encompasses virtually any misstatement or fraudulent device employed in connection with the purchase or sale of any security and is theoretically applicable to transactions with limited contacts with the United States.¹⁹ Additionally, the private cause of action available under Section 10(b) and Rule 10b-5 is implied. As with most creatures of judicial implication, this private cause of action lacks the sharp boundaries that a legislature can draw. Therefore, the question of its extraterritorial reach was left open.²⁰ For these reasons, the issue of subject-matter jurisdiction in foreign-cubed class actions, on which this Article focuses, developed primarily in the context of suits based on Rule 10b-5.²¹

But what makes American courts so attractive to foreign plaintiffs (or their attorneys)?²² Both substantive and procedural reasons contribute to this draw.²³ Most features of the American legal landscape that make it desirable to foreign litigants are well known and do not require extensive discussion. First, the American class-action mechanism is uniquely fit for disputes in which there are a multitude of investors with small individual claims whose combined amount represents a substantial sum.²⁴ While several other legal systems have recently introduced new types of collective

United States, and proxy solicitation rules only apply to corporations registered pursuant to the 1934 Act. See Stephen J. Choi, *The Unfounded Fear of Regulation S: Empirical Evidence on Offshore Securities Offerings*, 50 DUKE L.J. 663, 665 n.2 (2000).

19. 17 C.F.R. § 240.10b-5 (2011).

20. See *id.*

21. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2878–80 (2010).

22. "As moth is drawn to the light, so is a litigant drawn to the United States. If he can only get his case into their courts, he stands to win a fortune. At no cost to himself, and at no risk of having to pay anything to the other side. The lawyers there will conduct the case 'on spec' as we say, or on a 'contingency fee' as they say. The lawyers will charge the litigant nothing for their services but instead they will take 40 percent of the damages, if they win the case in court, or out of court on settlement." J. Stanton Hill, Note, *Towards Global Convenience, Fairness, and Judicial Economy: An Argument in Support of Conditional Forum Non Conveniens Dismissals Before Determining Jurisdiction in United States Federal District Courts*, 41 VAND. J. TRANSNAT'L L. 1177, 1179 n.1 (2008), (quoting *Smith Kline & French Lab. Ltd. v. Block*, (1983) 1 W.L.R. 730, 733 (Eng.)).

23. *Id.* at 1179 n.2. A precise distinction between the former and the latter is not always easy. Clearly, some "substantive" elements have "procedural" relevance. Consider, for example, the need to plead the reliance requirement in order to state a claim and survive a motion to dismiss under Fed. R. Civ. P. 12(b)(6). Reliance is required as an element of a Section 10(b) cause of action because it "provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." *Basic, Inc. v. Levinson*, 485 U.S. 224, 243 (1988).

24. See, e.g., David A. Skeel, Jr., *Can Majority Voting Provisions Do It All?*, 52 EMORY L.J. 417, 423 (2003) (mentioning that "most other countries do not have procedural devices that are even remotely similar to the U.S. class action"); Gerhard Walter, *Mass Tort Litigation in Germany and Switzerland*, 11 DUKE J. COMP. & INT'L L. 369, 372 (2001) ("[C]lass actions do not exist in Germany, Switzerland, and most other countries of the civil law system."). But cf. Michael P. Murtagh, *The Rule 23(b)(3) Superiority Requirement and Transnational Class Actions: Excluding Foreign Class Members in Favor of European Remedies*, 34 HASTINGS INT'L & COMP. L. REV. 1, 36–39 (2011) (exploring the mechanisms in Europe for mass claims, including the Dutch Collective Settlement Act).

remedies,²⁵ these new procedural tools have yet to be well tested and present significant differences from the American system — differences that might undermine their suitability in the securities litigation context. For example, the American opt-out system provides that individual investors who do not want to be bound by the outcome of the class action have to explicitly opt out after proper notice.²⁶ Conversely, foreign legislatures have generally adopted an opt-in system, in which only the plaintiffs that actively join the collective litigation are bound by the decision or settlement.²⁷ This difference in approach affects the dimension of the putative class, which is much larger when small claimants must take action to opt out, and reduces the value of the lawsuit in opt-in jurisdictions.²⁸

Contingency fee arrangements, easily available in the United States for business litigation, provide further fuel for this type of class action litigation.²⁹ Compensation for adequate legal representation for a multitude of investors who individually suffered relatively small losses must correlate with the collective value of these claims.³⁰ Additionally, the absence of a “loser pays” rule in the United States further encourages litigation.³¹

The discovery mechanism is another feature mostly unique to American civil procedure. While “fishing expeditions” might raise concerns, the

25. See generally Murtagh, *supra* note 24, at 36–39.

26. See FED. R. CIV. P. 23(c)(3).

27. A brief but complete comparative overview of class actions and collective remedies systems around the world is offered by Sara Corradi et al., *L'Azione Collettiva Risarcitoria: Profili Comparatistici*, 1 ANALISI GIURIDICA DELL'ECONOMIA 285, 299 (2008), who point out how the opt-out mechanism has been adopted in the United States and considered in France, but has been rejected in favor of an opt-in approach in the United Kingdom, Germany, Sweden, the Netherlands, Spain, and Italy. This important difference is also noted by Professor Miller in his work comparing U.S. and Italian class-action mechanisms. Geoffrey P. Miller, *Punti Cardine in Tema di «Class Action» negli Stati Uniti e in Italia*, 1 ANALISI GIURIDICA DELL'ECONOMIA 211, 224 (2008).

28. See, e.g., Corradi et al., *supra* note 27 (showing differences among countries).

29. Marc Galanter, *Anyone Can Fall Down a Manhole: The Contingency Fee and its Discontents*, 47 DEPAUL L. REV. 457, 474 (1998).

30. See generally Peter Karsten, *Enabling the Poor to Have Their Day in Court: The Sanctioning of Contingency Fee Contracts, A History to 1940*, 47 DEPAUL L. REV. 231 (1998) (offering a historical perspective on contingency fees). For a broader discussion of contingency fees, see Galanter, *supra* note 29; Adam Shajnfeld, *A Critical Survey of the Law, Ethics and Economics of Attorney Contingent Fee Arrangements*, 54 N.Y.L. SCH. L. REV. 773 (2009–2010). For a discussion of contingency fees in class actions and securities litigation, see Brian T. Fitzpatrick, *Do Class Action Lawyers Make Too Little?*, 158 U. PA. L. REV. 2043 (2010). See also, e.g., *Ressler v. Jacobson*, 149 F.R.D. 651, 653 (D. Fla. 1992), (holding that a reasonable compensation for attorneys with respect to a settlement in a securities case would be approximately thirty percent of the gross settlement fund as fees); Shelley Thompson, *The Globalization of Securities Markets: Effects on Investor Protection*, 41 INT'L LAW. 1121, 1131 n.68 (2007) (reporting that contingency fees sought in securities litigation cases typically range between five percent and thirty-five percent).

31. ROBERT D. COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 408–10 (3d ed. 2000) (evaluating the claim that the “loser pays all” approach causes less litigation than the American rule requiring each party to pay his own litigation expenses).

American discovery process provides a unique opportunity to create parity of information between plaintiff and defendant, especially in situations in which, as happens with securities litigation, defendants enjoy an informational advantage over plaintiffs.³²

Beyond these general features of U.S.-style litigation, specific elements of a Rule 10b-5 claim also contribute to lure investor-plaintiffs to America. All modern legal systems prohibit fraud in connection with securities transactions, but systems' regulatory strategies and concrete provisions vary significantly. For example, European systems are required by Article 6 of Directive 2003/71 to provide for specific statutory causes of actions for misstatements and omissions in a prospectus used in a public offering of securities.³³ These provisions, which might be considered the European equivalents of Sections 11 and 12 of the Exchange Act, apply only to registered public offerings. Different member states have implemented this vague European rule in radically different ways, with the consequence that standards of legal protection tend to vary significantly across European Union (EU) countries.³⁴ Furthermore, in several civil law systems within the EU, investors outside the public offer scenario are left to the protection of general tort principles or to the doctrine of precontractual

32. The striking difference between U.S.-style discovery processes and the absence of similar mechanisms in other legal cultures is vividly illustrated by the fact that compliance with discovery orders abroad can violate local laws. See Laurent Martinet & Ozan Akyurek, *The Perils of Taking Discovery to France*, PRAC. LITIGATOR, Sept. 2009, at 39, 40. For a discussion of discovery mechanisms specific to the securities litigation context after the 1995 Private Securities Litigation Reform Act, see MICHAEL A. PERINO, SECURITIES LITIGATION AFTER THE REFORM ACT § 4 (2000); Tracy Bishop Holton, *Stating Causes of Action for Securities Fraud Under the Private Securities Litigation Reform Act of 1995*, 26 CAUSES OF ACTION 2d 109 § 8 (2004); Jason M. Rosenthal, *Staying Discovery in Federal Securities Lawsuits*, PRAC. LITIGATOR, Nov. 2002, at 7.

33. In the relevant part, paragraphs 1 and 2 of Article 6 of Directive 2003/71 provide that:

1. Member States shall ensure that responsibility for the information given in a prospectus attaches at least to the issuer or its administrative, management or supervisory bodies, the offeror, the person asking for the admission to trading on a regulated market or the guarantor, as the case may be. The persons responsible shall be clearly identified in the prospectus by their names and functions or, in the case of legal persons, their names and registered offices, as well as declarations by them that, to the best of their knowledge, the information contained in the prospectus is in accordance with the facts and that the prospectus makes no omission likely to affect its import.

2. Member States shall ensure that their laws, regulation and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus.

Council Directive 2003/71, 2003 O.J. (L 345) 6 (EC). These provisions leave extreme latitude to single Member States, and as a consequence, no really harmonized or uniform regulation of civil liabilities for false or misleading prospectuses exists in Europe. It should also be noted that, when compared with corresponding U.S. provisions, the above-mentioned rule is significantly lax and clearly less protective of investors. For example, in contrast to section 11 of the Securities Act, there is no strict liability for the issuer provided under European law. *Id.*

34. For an analysis of the major approaches to the issue of prospectus liability in Europe, see MARCO VENTORUZZO, LA RESPONSABILITÀ DA PROSPETTO NEGLI STATI UNITI D'AMERICA TRA REGOLE DEL MERCATO E MERCATO DELLE REGOLE, 207ff (2003).

liability for the diffusion of false, misleading, or incomplete information.³⁵ From the point of view of defrauded investors in the EU, these remedies generally have less bite than Rule 10b-5. This is especially true because, while the reliance element in a Rule 10b-5 action can be presumptively satisfied in the United States under *Basic, Inc. v. Levinson*,³⁶ many foreign systems have explicitly rejected the “fraud-on-the-market” theory that buttresses that presumption.³⁷

Yet another attractive feature of Rule 10b-5 when compared with similar remedies available abroad is the measure of damages. Rule 10b-5 does not regulate the amount of damages available to defrauded investors.³⁸ Damages are not confined to the “out-of-pocket” measure and can include the disgorgement of defendants’ profits, which is not allowed in many foreign systems.³⁹ Not only does this increase the availability of damages to injured parties, but the mere possibility of these damages also raises the settlement value of a lawsuit brought in the United States.⁴⁰

Of course, the rules existing in different jurisdictions reflect legitimate policy choices and do not necessarily imply a lower level of investor protection. The regulatory approach of Continental states relies more on ex ante administrative action rather than on ex post private litigation — a strategy that can be as effective as the American approach.⁴¹ Assessing

35. *Id.*

36. 485 U.S. 224, 247 (1988). As I will discuss, the question of whether the reliance presumption also applies to investors that acquire securities on foreign markets is far from settled, but the mere possibility of enjoying this inversion of the burden of proof can attract potential plaintiffs.

37. Recent scholarship has also considered the “fraud-on-the-global-market” theory. See Hannah L. Buxbaum, *Transnational Regulatory Litigation*, 46 VA. J. INT’L L. 251, 262 (2006) (explaining the “fraud on the global market” argument: “[E]ven if [plaintiffs] did not rely directly on the fraudulent SEC filings . . . , the statements in those filings would necessarily have affected the price of shares in the foreign markets.”); Julie B. Rubenstein, Note, *Fraud on the Global Market: U.S. Courts Don’t Buy It; Subject-Matter Jurisdiction in F-Cubed Securities Class Actions*, 95 CORNELL L. REV. 627, 648–54 (2010). However, this approach has been rejected by courts considering the argument in the context of international securities litigation. See, e.g., *In re AstraZeneca Sec. Litig.*, 559 F.Supp.2d 453, 465–66 (S.D.N.Y. 2008).

38. See generally Elizabeth Chamblee Burch, *Reassessing Damages in Securities Fraud Class Actions*, 66 MD. L. REV. 348 (2007) (arguing for a limitation on the amount of damages recoverable to out-of-pocket losses).

39. *Id.*

40. See Robert B. Thompson, *Simplicity and Certainty in the Measure of Recovery Under Rule 10b-5*, 51 BUS. LAW. 1177, 1081–85 (1996).

41. This point is clearly stated in the brief for the Republic of France as amicus curiae in *Morrison*: “France has its own reticulated regime of securities regulation and enforcement that rests on legal traditions and policy judgments that are of fundamental importance to France, are shared with many countries, and differ in important respects from those of the United States. Among the differences are a greater role for government as opposed to private regulation and enforcement, as reflected in the reliance on public actions (*l’action publique*) rather than private class actions, and a concern with the procedural fairness of certain forms of class action that purport to bind persons who have taken no affirmative step to participate in the collective lawsuit (the opt-out class action).” Brief for the Republic of France as Amicus Curiae in Support of Respondents at *1–2, *Morrison v. Nat’l Austl.*

these differences, however, is beyond the scope of this Article, which focuses solely on underlining some of the procedural and substantive reasons for the development in the United States of foreign-cubed securities class actions based on Rule 10b-5. Interestingly enough, as this Article discusses more analytically below, the very features of the American system that attract foreign plaintiffs to the United States might be — and often are — the grounds for dismissing their claims or for excluding them from the putative class.⁴² The more profound and significant the differences between the home jurisdiction and the United States, the more a foreign plaintiff might find it attractive to sue in the United States. These profound differences also reduce the deference that the U.S. decision or settlement might receive abroad, thus negatively affecting the likelihood of its enforcement and the scope of claim preclusion. This possibility, in turn, affects the “superiority” requirement of a class action that includes foreign plaintiffs, leading American judges to exclude foreign claimants from the class altogether.⁴³

B. A Statutory Conundrum: The Extraterritorial Reach of Section 10(b) of the Exchange Act

A starting point for analyzing transnational securities litigation is to understand that the subject-matter jurisdiction of federal courts and the substantive coverage of Section 10(b) (and Rule 10b-5) are interrelated, if not perfectly overlapping. The Exchange Act’s jurisdictional provision makes this explicit. Section 27 of the Act provides in relevant part that U.S. courts “shall have exclusive jurisdiction of violations” of the Act and the rules and regulations promulgated pursuant to its authority.⁴⁴ It follows that, if conduct violates Section 10(b), federal courts have exclusive adjudicative jurisdiction. Thus, for most practical purposes, the substantive scope of the antifraud provision and the question of subject-matter jurisdiction merge together. In the last forty years, federal courts confronted with securities disputes with an international dimension have first considered whether they held subject-matter jurisdiction.⁴⁵ To answer this question, these courts have examined the substantive scope of Rule 10b-5.⁴⁶

Bank Ltd., 130 S. Ct. 2869 (2010) (No. 08-1191).

42. See *infra* Part I.D.

43. See, e.g., *In re Vivendi Universal, S.A. Sec. Litig.*, 242 F.R.D. 76 (S.D.N.Y. 2007).

44. 15 U.S.C. § 78aa (2006).

45. This conclusion is generally true any time federal jurisdiction is predicated on a federal question. When the facts at issue are not regulated by federal law and fall outside the substantive scope of the statute whose coverage is invoked, there is no subject-matter jurisdiction based on a federal question. Of course, the inverse is not necessarily true: There might be subject-matter jurisdiction, even where the specific facts at issue might not be covered by federal law.

46. Federal courts have subject-matter jurisdiction in foreign-cubed class actions, but plaintiffs

The Exchange Act is, however, laconic in its international reach, and the scarcity of explicit indications has spurred controversy. Three basic arguments based on the text of the Exchange Act have been used to contend for or against its extraterritorial application. It should be noted that none of these positions, which come down to arguments either for or against the application of Rule 10b-5 to actions characterized by significant foreign elements, has been held to be decisive.

First, the Exchange Act applies to “interstate commerce.”⁴⁷ This expression has traditionally been interpreted as including commerce with foreign states. By including foreign states within the definition of interstate commerce, it is possible to include foreign transactions within the scope of the Exchange Act.

Second, Congress’s silence on the extraterritorial application of Rule 10b-5 has been interpreted as an indication of the intention to either include or exclude fraud with foreign elements.⁴⁸ The opposite meanings attributed to this silence depend on different understandings of the legislative history of the Exchange Act and Congress’s awareness of the international dimension of financial markets or its anticipation of more recent international developments.⁴⁹

Finally, Section 30(b) of the Exchange Act has been used by “reductionists” and “expansionists” to arrive at diametrically opposed conclusions as to the extraterritorial applicability of Rule 10b-5. This Section provides that the Exchange Act “shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of

have no claim if the securities were not listed on an American exchange or if the transactions did not occur in the United States. The Supreme Court held that these cases have to be dismissed under Fed. R. Civ. P. 12(b)(6) — failure to state a claim — and *not* Rule 12(b)(1) — lack of subject-matter jurisdiction. *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2873, 2876–77 (2010). I will come back to this distinction later, but, as we will see, while it might have important procedural consequences, it does not affect the substance of our analysis at this stage.

47. See 15 U.S.C. § 78j(b) (2006) (“It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of *interstate commerce* or of the mails, or of any facility of any national securities exchange . . . (b) [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”) (emphasis added).

48. See, e.g., John D. Kelly, *Let There Be Fraud (Abroad): A Proposal for A New U.S. Jurisprudence with Regard to the Extraterritorial Application of the Anti-Fraud Provisions of the 1933 and 1934 Securities Acts*, 28 LAW & POL’Y INT’L BUS. 477, 491 (1997) (arguing that Congress’s silence implies a refusal to apply securities laws to transactions occurring outside the United States). *But see* Margaret V. Sachs, *The International Reach of Rule 10b-5: The Myth of Congressional Silence*, 28 COLUM. J. TRANSNAT’L L. 677, 681 (1990) (suggesting that the issue of the extraterritorial reach of the antifraud provisions was left by the legislature to the courts).

49. See Sachs, *supra* note 48, at 681.

such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.”⁵⁰ Some courts and commentators read this Rule as implying a general extraterritorial application of the statute,⁵¹ while others read it as confirming that the scope of the Rule excludes certain foreign transactions, with exceptions arising where they are prohibited by the SEC.⁵² Because it does not offer a clear definition of jurisdiction, Section 30(b) seems to say that the Act applies both to activities within its jurisdiction and to activities that the SEC deems it necessary to curtail in order to avoid evasion of the Act.

Reductionists have often supplemented their interpretations of the Act with a reference, which was also invoked by the Supreme Court, to the existence and scope of a general presumption against the extraterritorial application of federal law.⁵³ In truth, the Supreme Court has alternatively embraced and rejected this presumption quite liberally throughout the last decades.⁵⁴ Moreover, even assuming the validity of such a presumption, the question of its scope remains a significant one, and the legislative history of the Exchange Act may allow rebuttal of the presumption.

The bottom line of this Subsection is thus twofold. First, subject-matter jurisdiction of federal courts in international securities class actions based on Rule 10b-5 is a matter intertwined, if not identical, to the question of the substantive scope of the Rule. Second, the text of the Exchange Act is ambiguous with respect to its extraterritorial reach.

50. 15 U.S.C. § 78dd(b) (2006).

51. *See, e.g.,* Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc) (“We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities. In our view, neither the usual presumption against extraterritorial application of legislation nor the specific language of Section 30(b) show Congressional intent to preclude application of the Exchange Act to transactions regarding stocks traded in the United States which are effected outside the United States, when extraterritorial application of the Act is necessary to protect American investors.”); Symposium, *Oversight by the U.S. Securities and Exchange Commission of U.S. Securities Markets and Issues of Internationalization and Extraterritorial Jurisdiction*, 29 INT’L LAW. 731, 737 (1995).

52. *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2882–83 (2010); Merritt B. Fox, *The Political Economy of Statutory Reach: U.S. Disclosure Rules in a Globalizing Market for Securities*, 97 MICH. L. REV. 696, 715 n.46 (1998) (“And while the legislative history dealing specifically with that phrase is sparse and uninformative, § 30(b) of the Exchange Act sheds some light on Congress’s desire to keep the extraterritorial reach of the Exchange Act’s regulation of the securities business to a minimum.”).

53. *Morrison*, 130 S. Ct. at 2877.

54. *See* James E. Ward, Comment, “Is That Your Final Answer?” *The Patchwork Jurisprudence Surrounding the Presumption Against Extraterritoriality*, 70 U. CIN. L. REV. 715, 717 (2002) (casting doubts on the strength of the presumption that legislation, in the absence of an express option, should not be applied to international disputes); William S. Dodge, *Understanding the Presumption Against Extraterritoriality*, 16 BERKELEY J. INT’L L. 85, 124 (1998) (“Congress’s focus on domestic conditions does not mean that its legislation should be applied only to conduct that occurs within the United States. Rather it should be applied only to conduct that affects those conditions, regardless of where that conduct occurs.”).

C. *The Conduct-Effects Test: From Cradle to Coffin?*

The conduct-effects test had been developed and applied in a long series of precedents. For the purpose of illustrating the development of the test, it is sufficient to focus on some leading cases. This Article will simply offer a summary of the judicial trend before *Morrison*.

In 1968, the U.S. Court of Appeals for the Second Circuit was confronted with *Schoenbaum v. Firstbrook*,⁵⁵ a case involving a derivative action brought by an American shareholder against the directors of Banff, a Canadian corporation whose shares were listed both in Canada and in the United States.⁵⁶ The plaintiff claimed that the directors sold Banff treasury stock to its controlling corporation (also a Canadian entity) at a suboptimal price that did not take into account undisclosed information on the mining activities of Banff. If this information had been taken into account, or disclosed, it would have had a positive impact on the price of the shares.⁵⁷ The complaint argued that the transaction was deceptive and in violation of Section 10(b), but the court dismissed the case for failure to state a claim. The court held that there is no Section 10(b) deception when independent directors, in possession of inside information, decide to sell shares of a corporation, even if the consideration is grossly inadequate (the conduct might, however, constitute a breach of the directors' fiduciary duties).⁵⁸

The relevant point of *Schoenbaum*, for purposes of this discussion, is that the court affirmed that it held subject-matter jurisdiction.⁵⁹ The litigation involved American investors, plaintiffs suing derivatively on behalf of a foreign corporation, for a transaction (the sale of treasury stock) occurring outside the United States and between foreign parties. Notwithstanding the limited contacts with the United States, jurisdiction was retained based on the "effects" of the transaction in the United States.⁶⁰ The court based this effects analysis on the theory that alleged damages to Banff could have indirectly affected the price of its shares listed in the United States.⁶¹ This decision introduced the effect test into transnational securities litigation, but the notion of "effects" was far from clearly defined.

The conduct test was introduced four years later in the equally famous decision in *Leasco Data Processing Equipment Corp. v. Maxwell*.⁶² In *Leasco*, the

55. 405 F.2d 200 (2d Cir. 1968), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc).

56. *Id.* at 204.

57. *Id.* at 205.

58. *Id.* at 204.

59. *Id.*

60. *Id.* at 208–09. *See also supra* note 51.

61. *Id.* ("A fraud upon a corporation which has the effect of depriving it of fair compensation for the issuance of its stock would necessarily have the effect of reducing the equity of the corporation's shareholders and this reduction in equity would be reflected in lower prices bid for the shares.")

62. 468 F.2d 1326 (2d Cir. 1972).

wholly-owned subsidiary, incorporated in the Netherlands Antilles, of an American corporation was allegedly induced by a British citizen through fraudulent statements to buy the shares of a British corporation listed on the London Stock Exchange.⁶³ While the securities transaction occurred in the United Kingdom, a significant part of the deceptive conduct occurred in the United States.⁶⁴ The defendants met several times in New York with officers and board members of the plaintiff corporation, and false and misleading documents were sent to the United States.⁶⁵

The court focused on the fact that extensive fraudulent acts were performed in the United States and concluded that the federal courts had jurisdiction based on that conduct.⁶⁶ Chief Judge Friendly, however, writing the opinion of the court, carefully noted that limited conduct in the United States might not be enough to establish adjudicative jurisdiction.⁶⁷ In particular, he distinguished the situation in *Leasco* from a hypothetical case in which two foreigners meet in the United States and, during this meeting, one deceives the other, causing her to purchase shares abroad.⁶⁸ Chief Judge Friendly observed that in this second scenario, U.S. courts would not have jurisdiction.⁶⁹ The decision seemed to suggest that damage to an American investor is an essential element to consider before establishing jurisdiction. Interestingly enough, this case arguably could have found subject-matter jurisdiction under the effect test because the alleged violation of Section 10(b) also caused effects in the United States. One of the victims of the damage caused by the fraud was an American investor, Leasco, who was the single shareholder of Leasco N.V., the foreign subsidiary that purchased the shares.⁷⁰ The court, in applying a “conduct test” rather than an “effects test,” most likely considered these effects to be too indirect and speculative to serve as grounds for subject-matter jurisdiction.

Subsequent decisions have moved away from the *Leasco* approach of simply concentrating on whether any conduct had taken place in the United States. *Bersch v. Drexel*,⁷¹ decided by the Second Circuit in 1975, was a meaningful step in that direction. Dealing with a complex offering of securities that involved significant foreign elements, the court spelled out two bases for the application of the U.S. securities laws. Section 10(b) would apply: (a) to sales to American citizens in the United States,

63. *Id.* at 1330.

64. *Id.* at 1330–33.

65. *Id.* at 1332.

66. *Id.* at 1334, 1339.

67. *Id.* at 1337.

68. *Id.* at 1338.

69. *Id.*

70. *Id.*

71. 519 F.2d 974 (2d Cir. 2010).

independent of the occurrence of acts in the United States; and (b) to sales to American citizens abroad, if significant acts that contributed to the loss occurred in the United States.⁷² The court added that federal law would not apply to sales to foreigners outside the United States if acts in this country did not cause the loss.⁷³ In its totality, then, this decision is interpreted as extending federal jurisdiction only to situations in which there was relevant conduct that occurred in the United States.

Since *Bersch*, the conduct test has taken a variety of forms. The circuits have taken diverging roads with respect to “the degree to which the American-based conduct must be related causally to the fraud and the resultant harm to justify the application of American securities law.”⁷⁴ A 1998 decision by the Seventh Circuit, *Kauthar v. Sternberg*,⁷⁵ effectively summarizes the major differences. The District of Columbia Circuit took the narrowest approach, arguing that, in order to establish jurisdiction, domestic conduct must be present in all the elements of the cause of action.⁷⁶ The Third, Eighth, and Ninth Circuits adopted a broader test, asserting jurisdiction more aggressively. In these circuits, some conduct occurring in the United States in furtherance of a fraudulent scheme was sufficient to establish jurisdiction.⁷⁷ The Second Circuit struck the middle ground between these two extremes, requiring “substantial” acts in furtherance of the fraud to be committed in the United States.⁷⁸ Moreover, even within these general distinctions, additional inconsistencies could be found. In particular, the Second Circuit’s standard of “substantial” acts in furtherance of the fraud eluded a clear-cut definition.⁷⁹

To further complicate the matter, an additional decision in the mid-1990s commingled the effects and conduct tests, holding that, in determining federal jurisdiction, the tests did not need to be satisfied separately and distinctly, but could be combined. In *Itoba v. Lep Group*,⁸⁰ the Second Circuit observed that there are no separate minimum degrees of “effects” or “conduct” that needed to be met to affirm jurisdiction; effects and conduct could be seen as communicating vessels, in which conduct and effects mingle to reach the required minimum contact with

72. *Id.* at 993.

73. *Id.*

74. *Kauthar SBN BHD v. Sternberg*, 149 F.3d 659, 665–66 (7th Cir. 1998).

75. *Id.* (discussing the differences among the circuits).

76. *Zoelsch v. Anderson*, 824 F.2d 27, 31 (D.C. Cir. 1987).

77. *See, e.g., Grunenthal GmbH v. Hotz*, 712 F.2d 421, 425 (9th Cir. 1983); *Cont’l Grain (Austl.) Pty. Ltd. v. Pac. Oilseeds, Inc.*, 592 F.2d 409, 420 (8th Cir. 1979); *SEC v. Kasser*, 548 F.2d 109, 114 (3d Cir. 1977).

78. *Psimenos v. E.F. Hutton*, 722 F.2d 1041, 1045 (2d Cir. 1983).

79. *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2879 (2010) (noting the difficulty in applying the resulting “conduct test”).

80. 54 F.3d 118 (2d Cir. 1995).

the United States.⁸¹ This approach opened the door for a broad expansion of the reach of the securities laws. Even if *Itoba* was later distinguished by a significant number of subsequent cases and thus had a limited impact,⁸² it still contributed to confounding the notion of subject-matter jurisdiction.

As if the existing jurisprudence were not already complicated enough, a third approach was embraced by the Restatement (Third) of Foreign Relations Law of the United States of 1987.⁸³ Two provisions of the Restatement are relevant: Sections 416(1) and 416(2). While Section 416(1) spells out criteria fairly similar to the ones considered by the conduct and effect tests, Section 416(2) contains a reference to a reasonableness standard, based on the notion of comity, as a ground for retaining jurisdiction.⁸⁴ Pre-*Morrison* case law was far from clear, and some decisions seemed to stretch the coverage of the securities laws to disputes in which the United States had little interest. Under the effects test, the concept of what amounted to effects that would trigger jurisdiction in the United States was elusive — whether a potential effect on the price of securities issued by an American entity or listed on an American exchange was sufficient, for example, was not always clear. The sliding scales for extraterritorial application later derived in the conduct test did little to resolve the subject-matter jurisdiction question; inconsistencies among the different circuits (and, occasionally, within a single circuit) due to the unique, fact-intensive nature of securities fraud inquiries.⁸⁵ Combining the two tests, as *Itoba* did, only amplified the uncertainties that accompanied each test. Finally, the balancing test adopted by the Restatement, which has received limited judicial application, also presented relevant uncertainties.

81. *Id.* at 122.

82. For cases distinguishing *Itoba*, see, for example, *In re Parmalat Sec. Litig.*, 497 F. Supp. 2d 526, 531 (S.D.N.Y. 2007); *Blechner v. Daimler-Benz AG*, 410 F. Supp. 2d 366, 373 (D. Del. 2006); *Burke v. China Aviation Oil (Sing.) Corp.*, 421 F. Supp. 2d 649, 653 (S.D.N.Y. 2005); *In re Alstom SA*, 406 F. Supp. 2d 346, 370 (S.D.N.Y. 2005); *Euro Trade & Forfaiting, Inc. v. Vowell*, No. 00 CV 8431, 2002 WL 500672, at *9 (S.D.N.Y. Mar. 29, 2002); *In re Cable & Wireless, PLC*, 321 F. Supp. 2d 749, 764 (E.D. Va. 2004); *In re Baan Co. Sec. Litig.*, 103 F. Supp. 2d 1, 10 (D.D.C. 2000); *McNamara v. Bre-X Minerals Ltd.*, 32 F. Supp. 2d 920, 923 (E.D. Tex. 1999).

83. For a description of this approach, see D.C. Langevoort, *Schoenbaum Revisited: Limiting the Scope of Antifraud Protection in an Internationalized Securities Marketplace*, 55 LAW & CONTEMP. PROBS. 241, 248 (1992); Corrado Malberti, *Le <International Securities Litigations> Nel Diritto Degli Stati Uniti D'America*, 28 BANCA IMPRESA SOCIETÀ 125, 144 (2009).

84. Restatement (Third) of Foreign Relations Law § 416 (1987).

85. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2878–80 (2010).

D. *Is the “Dangerous Extraterritoriality” of U.S. Securities Laws Really So Dangerous?*⁸⁶

The Supreme Court explicitly abrogated almost all the cases mentioned above, and several others, in 2010 with the *Morrison* decision.⁸⁷ This abrogation raises two issues. The first question is whether, notwithstanding the undeniable problems accompanying the conduct-effects test, the existing doctrines really posed a significant threat in terms of excessive extension of American jurisprudence that was in conflict with the sovereignty of other jurisdictions. The second question is whether there actually was a strain on American courts that were called on to resolve primarily foreign disputes. A negative answer to both questions would not be, in itself, a strong argument in favor of the conduct-effects test. The answers are relevant not only to put the alleged problems in perspective, but also to assess the superiority of the new “transactional test” envisioned by *Morrison* in comparison with the conduct-effects test and the alternative solution suggested in this Article.

Empirical evidence is a good place to start in assessing the claim that the conduct-effects test, as it existed prior to *Morrison*, resulted in the excessive and onerous exercise of American jurisdiction in securities cases with international elements. A recent study shows that from 2005 to 2009, the number of securities class action lawsuits filed against a foreign corporation (including but not limited to foreign-cubed actions) amounted to between 11.2% and 17.1% of the total number of securities class actions filed.⁸⁸ The proportion of actions against foreign defendants tended to increase slightly more in the years in which the overall number of securities class actions was higher. In 2008, for example, there were 210 federal class actions involving securities litigation and 17.1% of these actions were brought against foreign defendants. By contrast, in 2006 and 2009, when 110 and 155 class actions were filed respectively, the percentage of cases involving a foreign defendant was 12.7% and 12.9%, respectively.⁸⁹

It is difficult to draw any particular conclusion from this scant empirical evidence. Two observations seem fair. First, the relative stability of the number of federal lawsuits involving foreign defendants, in proportion to the total number of securities class actions brought annually, suggests that there has not been—at least in the five years considered—a

86. See generally Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT'L L. & BUS. 207 (1996) (suggesting that extraterritorial application of U.S. securities laws should be limited to protect investors).

87. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2877–81 (2010).

88. PRICEWATERHOUSECOOPERS, 2009 SECURITIES LITIGATION STUDY 6, 35, available at <http://tinyurl.com/yaznmhs> (listing the number of total U.S. federal securities class action lawsuits and the total number of those lawsuits that were filed against foreign companies).

89. *Id.*

disproportionate increase in foreign-based litigation. Instead, the number of actions brought against foreign corporations appears to be more of a function of variables common to securities class actions generally, such as market trends, rather than the consequence of an excessive opening of federal courts to foreign plaintiffs through an irresponsible use of the conduct-effects test.

Second, in absolute terms, it does not seem that, even under the conduct-effects test, the scarce resources of the federal judiciary were particularly burdened by securities cases with no connection to the United States. Between 2005 and 2009, the average annual number of federal securities class actions with a foreign defendant was twenty-three.⁹⁰ On average, this corresponds to approximately 14% of all securities class actions.⁹¹ However, even in actions with a foreign defendant, most involved at least some plaintiffs who were American investors. Of the remaining cases that involved no American plaintiff, only a small number of these cases could be considered pure foreign-cubed class actions.⁹² Of course, it may be argued that, while the available data do not suggest an alarming situation, it might be that these latter cases were particularly complex and thus put a heavy burden on the caseload of federal courts.

In addition to the two observations derived from available empirical evidence, theoretically not every case that satisfies the jurisdictional requirement under the conduct-effects test would result in a prolonged expenditure of judicial resources on predominantly foreign disputes. To assert subject-matter jurisdiction does not automatically transform our judicial system into a Shangri-La for foreign plaintiffs and the plaintiffs' bar. Securities class actions based on Rule 10b-5 face several additional hurdles that a foreign plaintiff must overcome. Courts can thus apply intelligent and well-advised judicial discretion in using these rules in order to curb frivolous litigation and prevent the misuse (or abuse) of American courts by foreign plaintiffs and their attorneys. Three of the most relevant and powerful devices that can be used, and that have been used to this effect, are class certification, pleading standards (particularly with respect to the reliance requirement), and the *forum non conveniens* doctrine.

1. *Class Certification*

Subject-matter jurisdiction is not the only obstacle that the foreign plaintiff must overcome to bring a securities lawsuit in a U.S. court.

90. *Id.*

91. From 2005 to 2009, a total of 807 federal securities class action lawsuits were filed with 116 of those suits involving a foreign defendant. *Id.*

92. *Id.* at 44 (noting the few significant F-cubed cases).

Another crucial question is class certification.⁹³ Pursuant to Fed. R. Civ. P. 23(a), a class must meet the following requirements to be certified: the class must be numerous enough so that a joinder of all parties would not be an adequate instrument for the collective litigation, there must be factual and legal elements common to the each member of the class, the class representative must have a “typical” claim based on the conduct and legal arguments applicable to the rest of the class, and the class representative must “adequately” represent the class.⁹⁴ It is not necessary, in this Article, to analyze each element set forth by Rule 23(a). Rather, it is sufficient to say that the heterogeneity that often characterizes the positions of the putative members of an international class might clash with the above-mentioned requirements.

More relevant to this Article are the requirements for class certification established by Rule 23(b), particularly Rule 23(b)(3), the so-called “superiority” requirement. The superiority requirement is a flexible standard that requires the court to examine whether a class action is the most appropriate judicial instrument for dispute resolution, especially in the case of foreign plaintiffs.⁹⁵ It is a powerful device against the proliferation of transnational class actions, especially if there are significant differences between the substantive laws of the United States and those of the other legal systems involved.⁹⁶ In other words, the lower the likelihood of the recognition or enforcement of an American judgment or settlement abroad, the higher the likelihood that a U.S. court will not expand the class to include the foreign plaintiffs.

To determine whether the superiority requirement is satisfied, courts must engage in a case-by-case analysis of the possible effects of the litigation in other systems, relying heavily on expert testimony. If the inquiry suggests that the American decision may not be recognized as final in other jurisdictions, and that some investors might get a second bite at the same apple by suing again in a foreign jurisdiction, these investors are likely to be kept out of the class.⁹⁷ More specifically, courts have devised a

93. See Brian P. Murray & Maurice Pessa, *The Accident of Efficiency: Foreign Exchanges, American Depository Receipts, and Space Arbitrage*, 51 BUFFALO L. REV. 383, 388–89 (2003) (discussing the issue of class certification in the context of the fraud on the market presumption); see also Erez Reuveni, *Extraterritoriality as Standing: A Standing Theory of the Extraterritorial Application of the Securities Laws*, 43 U.C. DAVIS L. REV. 1071, 1073 (2010) (mentioning how the nature of global financial markets raises class certification concerns).

94. FED. R. CIV. P. 23(a).

95. FED. R. CIV. P. 23(b)(3).

96. Recent scholarship has advocated adopting such an approach in light of the growing number of jurisdictions that have mechanisms for resolving these mass claims, particularly in Europe. See Murtagh, *supra* note 24, at 36–43 (detailing the mechanisms in Europe and arguing that European plaintiffs, in particular, should be excluded from such class actions in the United States).

97. FED. R. CIV. P. 23(b)(3) (delineating particular factors for courts to consider). See generally Murtagh, *supra* note 24, at 16–43 (providing a host of concerns to consider if foreign plaintiffs were

“near certainty” test under which foreign investors are not included in the class if there is a significant likelihood that they might also sue in a foreign jurisdiction that would not recognize the outcome of an American-style class action.⁹⁸ *In re Vivendi Universal*⁹⁹ is a good example of application of the superiority requirement. In this case, German and Austrian investors were not included in the class action, while Dutch and French investors were allowed to proceed with litigation in the American forum.¹⁰⁰

2. Reliance and the “Fraud on the Global Market” Theory

American investors suing under Rule 10b-5 generally do not need to prove reliance on the alleged misstatements of the defendants in order to have a cause of action, because the Supreme Court decision in *Basic* allows for a presumption of reliance.¹⁰¹ The basis for this presumption is the assumption that markets are efficient and therefore reflect all publicly available information.¹⁰² Because a defendant’s misstatement alters the integrity of the market price of its securities by fraudulently affecting available public information, securities transactions based on reliance on market prices are functionally equivalent to transactions relying directly on fraudulent statements. For example, a misstatement could lead to an artificial inflation of the price of a security, which would in turn damage investors who paid more than the proper market value or price of the security because they believed that the price they paid reflected the real value of the security.¹⁰³

This presumption, known as the “fraud-on-the-market” doctrine,¹⁰⁴ is rebuttable by the defendant, but represents formidable protection of

included in American class action lawsuits in federal court).

98. See *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 996 (“[W]hile an American court need not abstain from entering judgment simply because of a possibility that a foreign court may not recognize or enforce it, the case stands differently when this is a *near certainty*.”) (emphasis added).

99. 381 F. Supp. 2d 158 (S.D.N.Y. 2003).

100. *In re Vivendi Universal, S.A. Sec. Litig.*, 242 F.R.D. 76, 109 (S.D.N.Y. 2007).

101. *Basic Inc. v. Levinson*, 485 U.S. 224, 245 (1988) (“The presumption of reliance employed in this case is consistent with, and, by facilitating Rule 10b-5 litigation, supports, the congressional policy embodied in the 1934 Act.”).

102. *Id.* at 246–47.

103. See Merritt B. Fox, *Causation in Fraud-on-the-Market Actions*, in PERSPECTIVES ON CORPORATE GOVERNANCE 235, 237 (F. Scott Kieff & Troy A. Paredes eds., 2010). See also Merritt B. Fox, *Regulation FD and Foreign Issuers: Globalization’s Strains and Opportunities*, 41 VA. J. INT’L L. 653, 687–88 (2001) (“The underlying logic of the fraud on the market doctrine is that the purchasers have been made unfairly worse off by the false statement and thus deserve compensation.”).

104. The Third Circuit provides a clear explanation of this doctrine. See *Peil v. Speiser*, 806 F.2d 1154, 1160–61 (3d Cir. 1986) (“The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendants’ fraud and the plaintiffs’ purchase

investors in the litigation setting. Actual proof of reliance, which might require a single plaintiff to offer evidence that she actually read or heard the misleading statements and invested on that basis, can be extremely difficult, particularly in anonymous markets. Additionally, the presumption is not only important from a substantive point of view, but is also often regarded as an essential element in enabling the establishment of a class action. If each member of the class were required to demonstrate actual reliance, it is likely that the class would not be certified, or that only a small number of investors could compose the class, thus making collective litigation untenable. The presumption that all investors included in the putative class relied on the integrity of the market price is essential for the creation of the class.¹⁰⁵

An interesting and delicate question posited by transnational securities litigation is whether the fraud-on-the-market theory can also apply to the purchase or sale of securities in foreign markets. In other words, do investors who purchase securities on a foreign exchange need to provide positive proof of reliance on the defendants' misstatements, or can they also rely on the presumption available to American investors?

The answer that federal courts have systematically given to this question is that the fraud-on-the-market theory does *not* apply to transactions in foreign markets.¹⁰⁶ Even when an issuer has the same class of securities listed both abroad and in the United States, and a link can be established between the prices of the securities on the different markets, courts have refused to extend the rationale of *Basic* to foreign-cubed class actions and, more generally, to transactions occurring abroad.¹⁰⁷ With the fraud-on-the-market theory unavailable to them, the inability of foreign plaintiffs to prove reliance on the misstatements might lead to the dismissal of the case for both lack of subject-matter jurisdiction and failure to state a claim, since reliance is one of the elements of a Rule 10b-5 action. This judicial position, sometimes described as the refusal of the "fraud-on-the-global-market" theory, thus contributes to reducing the risk of overburdening American courts with disputes in which the United States has little interest.

One of the leading and most recent decisions of the Southern District of New York deals with the fraud-on-the-global-market theory. *In re AstraZeneca Securities Litigation* offers an illustration of how the refusal to recognize this theory can be the basis for denying subject-matter

of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.").

105. See Merritt B. Fox, *Causation in Fraud-on-the-Market Actions*, in PERSPECTIVES ON CORPORATE GOVERNANCE 235, 237 (F. Scott Kieff & Troy A. Paredes eds., 2010).

106. On this basis, courts have also denied subject matter jurisdiction. See *In re AstraZeneca Sec. Litig.*, 559 F. Supp. 2d 453, 466 (S.D.N.Y. 2008); *In re The Baan Co. Sec. Litig.*, 103 F. Supp. 2d 1, 25 (D.D.C. 2000). A convincing defense of the "fraud-on-the-global-market" argument is offered by Julie B. Rubenstein. See *supra* note 37, at 651–54.

107. Rubenstein, *supra* note 37, at 648–51.

jurisdiction.¹⁰⁸ In *AstraZeneca*, the defendant was a British corporation with shares listed on the NYSE, London Stock Exchange, and Stockholm Exchange.¹⁰⁹ The defendant had allegedly disseminated false information concerning the safety of one of its products, an anticoagulant medicine.¹¹⁰ To establish jurisdiction under the conduct prong of the conduct-effects test, the foreign plaintiffs who acquired stock abroad had to demonstrate that conduct beyond mere preparation for the commission of fraud had occurred in the United States and that this conduct directly caused the plaintiffs' losses that resulted from their reliance on the misstatements. The foreign plaintiffs tried to satisfy this second condition by invoking the application of the fraud-on-the-market theory to purchases in foreign exchanges, but the court rejected this argument.¹¹¹

Interestingly enough, the district court did not refute the validity of the fraud-on-the-global-market theory in general. The court argued that the theory might hold true, but still dismissed the case for lack of jurisdiction, observing that allowing the foreign plaintiffs to plead reliance in this way would improperly and excessively broaden the reach of U.S. securities laws.¹¹²

Although the *AstraZeneca* court declined to assess the fraud-on-the-global-market theory, the availability of this argument to foreign plaintiffs remains controversial.¹¹³ For example, whereas the U.S. District Court for the Southern District of New York seems at least willing to consider the validity of the theory, one of the amicus curiae briefs submitted to the Supreme Court in *Morrison* by students of the Yale Law School Capital Markets and Financial Instruments Clinic strongly argued that the foreign investors' claim in that case should have been dismissed under Fed. R. Civ. P. 12(b)(6) because the presumption of reliance on market prices is not available to foreign investors.¹¹⁴ The presumption, the amici argued, is inapplicable in light of existing empirical evidence on the nature of the interrelated behavior of securities markets in different jurisdictions.¹¹⁵ In taking this position, the amici claimed that differences in market price reactions of the same security listed on different exchanges generally undermine the efficiency hypothesis on which the fraud-on-the-market

108. *In re AstraZeneca Sec. Litig.*, 559 F. Supp. 2d at 466.

109. *Id.* at 464.

110. *Id.* at 457.

111. *Id.* at 465–66.

112. *Id.* at 466.

113. See Rubenstein, *supra* note 37, at 648–54.

114. Brief of Amici Curiae, Professors and Students of the Yale Law School Capital Markets and Financial Instruments Clinic, in Support of Respondents at 3, *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869 (2010) (No. 08-1191).

115. *Id.* at 16 (noting that ADR prices take longer than a day to “fully integrate shocks to the prices of foreign underlying shares”).

theory is based.¹¹⁶ Proponents of the fraud-on-the-global market theory, meanwhile, argue that the amici's position here is based on a misconception of the fraud-on-the-market theory.¹¹⁷

Whether this theory is generally accepted is not crucial to the current discussion. The key point is that federal courts have adopted a rigorous standard for establishing the element of reliance in foreign-cubed Rule 10b-5 lawsuits. As a result, foreigners who transacted on a foreign exchange must demonstrate *actual* reliance on a fraudulent or misstated fact; they do not benefit from the presumed reliance standard, predicated on the fraud-on-the-market theory, to which U.S. plaintiffs may look. The consequence of this is that the claims of foreign investors can often immediately be dismissed for lack of subject-matter jurisdiction or failure to state a claim. Moreover, even if foreign investors survive these motions, they might be left out of the class on class certification grounds, such as for failure to meet the commonality requirement.

3. *Forum Non Conveniens*

Notwithstanding the ancient echoes of its Latin name, the doctrine of *forum non conveniens* is relatively new. The doctrine was born in English and Scottish courts in the nineteenth century and was largely developed in admiralty cases.¹¹⁸ At its core, the doctrine states that, independent from the issue of jurisdiction, a court can dismiss a case if it appears that an alternative forum is more convenient to all parties involved.¹¹⁹

116. *Id.* at 16–17.

117. Proponents of the fraud-on-the-global-market theory argue that the fraud-on-the-market theory should be extended to a global context because the latter doctrine does not necessarily require information efficiency in financial markets. According to *Basic*, it is sufficient that market prices reflect incorrect information to invoke the presumption of reliance; it is *not* necessary for the market reaction to be immediate or even particularly quick. As long as the integrity of market prices is tainted by untrue or misleading information, investors do not need to demonstrate that they relied *directly* on the information to establish their cause of action. Clearly enough, then, the *Basic* test is satisfied even if the effect of the false information on the market is delayed one day after the information becomes public, as long as investors bought or sold securities based on altered prices. For example, investors buying on the Tokyo stock exchange can state a claim under *Basic*, even though misleading information disclosed in the United States will only be reflected in Tokyo shares' prices after a time lag. Moreover, even if this interpretation of *Basic* is rejected, empirical evidence used by opponents of the fraud-on-the-global-market theory as to the information efficiency in U.S. markets as compared to other foreign exchanges on which the same securities are listed is scant and not particularly convincing. *Id.* at 15–17. In fact, assuming that there is an inherently superior information efficiency only in U.S. markets runs counter to the fact that information travels quite rapidly between globally connected financial markets. *See also* Rubenstein, *supra* note 37, at 651–54.

118. Hill, *supra* note 22, at 1182–83 & n.23.

119. *Sinochem Intern. Co. Ltd. v. Malaysia Intern. Shipping Corp.*, 549 U.S. 422, 425, 429 (2007); Paxton Blair, *The Doctrine of Forum Non Conveniens in Anglo-American Law*, 29 COLUM. L. REV. 1, 1 (1929).

In the United States, the doctrine was described in a seminal 1929 article by Paxton Blair¹²⁰ and reached the Supreme Court for the first time in 1947 in the leading case of *Gulf Oil Corp. v. Gilbert*.¹²¹ In that decision, the Court established a balancing test, based on public and private interest factors, that a court should consider in order to dismiss a case on the grounds of *forum non conveniens*.¹²²

Forum non conveniens analysis remained important in transnational litigation and reached the Supreme Court again in 1981 in *Piper Aircraft Co. v. Reyno*,¹²³ which fairly settled the general parameters of the doctrine in cases involving foreign parties. *Reyno* found that, if there is a foreign forum that could adjudicate the dispute, a U.S. court can dismiss a case following a cost-benefit analysis of litigation in the United States compared to the foreign forum.¹²⁴

The most recent Supreme Court decision concerning *forum non conveniens* further established the parameters of this doctrine by affirming that dismissal for *forum non conveniens* can be decided independently of the existence of subject-matter jurisdiction.¹²⁵ This is particularly relevant in the context of foreign-cubed securities cases asserted under Section 10(b) and Rule 10b-5. Consider, for example, a typical foreign-cubed action based on Rule 10b-5, in which Italian investors buy shares of a Swiss corporation on the London Stock Exchange. Even if part of the allegedly illegal conduct occurred in the United States and, in theory, subject-matter

120. Blair, *supra* note 119, at 21. On the topic of *forum non conveniens*, see generally David W. Feder, *The Forum Non Conveniens Dismissal in the Absence of Subject-Matter Jurisdiction*, 74 *FORDHAM L. REV.* 3147 (2006); Walter W. Heiser, *Forum Non Conveniens and Choice of Law: The Impact of Applying Foreign Law in Transnational Tort Actions*, 51 *WAYNE L. REV.* 1161 (2005); Finity E. Jernigan, *Forum Non Conveniens: Whose Convenience and Justice?*, 86 *TEX. L. REV.* 1079 (2008).

121. 330 U.S. 501 (1947). The case involved a Virginia citizen, Gilbert, who brought an action in a federal district court in New York City against a Pennsylvania corporation, qualified to do business in both Virginia and New York, to recover damages for destruction of the plaintiff's public warehouse and its contents in Virginia by a fire resulting from the defendant's negligence. *Id.* at 502–03. The Court ruled that, although the Court had jurisdiction and the venue was correct, all events in litigation had taken place in Virginia, most of the witnesses resided there, and both state and federal courts in Virginia were available to the plaintiff and were able to obtain jurisdiction of the defendant. *Id.* at 511–12. The Court dismissed the suit based on the doctrine of *forum non conveniens*. *Id.* at 512.

122. *Id.* at 508 (“Important considerations are the relative ease of access to sources of proof; availability of compulsory process for attendance of unwilling, and the cost of obtaining attendance of willing, witnesses; possibility of view of premises, if view would be appropriate to the action; and all other practical problems that make trial of a case easy, expeditious and inexpensive.”).

123. 454 U.S. 235 (1981) (dismissing the case in favor of Scottish jurisdiction because the victims were Scottish).

124. *Id.* at 255–61 (finding the district court's analysis of the factors to be reasonable and thus, did not warrant reversal by the Court of Appeals).

125. *Sinochem Int'l Co. Ltd. v. Malaysia Int'l Shipping Corp.*, 549 U.S. 422, 432 (2007) (“A district court therefore may dispose of an action by a *forum non conveniens* dismissal, bypassing questions of subject-matter and personal jurisdiction, when considerations of convenience, fairness, and judicial economy so warrant.”).

jurisdiction could be established under the conduct-effects test, it is more likely than not that the case would be dismissed on *forum non conveniens* grounds.¹²⁶

The analysis courts undertake in *forum non conveniens* considerations is quite cursory.¹²⁷ It is generally sufficient for the party requesting dismissal to demonstrate that the issue can be litigated in an alternative, foreign forum. Disputes as to the effect of applicable substantive laws and to the likelihood that the plaintiff will obtain a remedy in the alternative forum are usually not relevant.¹²⁸ Moreover, the Supreme Court shows great deference to district courts' discretion in deciding whether to dismiss a case on the basis of *forum non conveniens*. This approach has raised criticism,¹²⁹ but this Article does not take a position in this debate. Rather, this Article aims to demonstrate that the *forum non conveniens* doctrine represents yet another powerful and flexible tool that federal courts can use to avoid adjudicating foreign-cubed securities class actions that present little connection to the United States.

Foreign plaintiffs can always attempt to engage in forum shopping in the United States. In order to prevent the federal judiciary from becoming the Shangri-La of aggressive litigants and their attorneys, American courts must have judicial resources to combat and curb abusive behaviors in cases that present limited connections to this country without undermining their own adjudicative jurisdiction in securities disputes. Class certification requirements, the actual reliance element in Rule 10b-5 actions, and the *forum non conveniens* doctrine are such resources that have successfully limited the availability of U.S. courts to foreign investors. With these additional protections at hand, the use of the conduct-effects test may not be as dangerous as its opponents claim.

II. MORRISON V. NATIONAL AUSTRALIA BANK

In Part I, this Article examined some of the existing legal hurdles that reduced the risk of proliferation of foreign-cubed securities litigation in the United States. Class certification, pleading standards for reliance, and the *forum non conveniens* doctrine represent serious barriers for foreign investors who intend to access the American judicial system. A reasonable and

126. See, e.g., *Pfizer v. Abdullahi*, 562 F.3d 163, 189–90 (2d Cir. 2009) (suggesting that *forum non conveniens* was an alternative ground to dismissing the case for failure to state a claim).

127. See generally Jernigan, *supra* note 120 (arguing that the level of deference accorded in *forum non conveniens* issues is too lax). *Contra* *Pfizer v. Abdullahi*, 562 F.3d 163, 189–90 (2d Cir. 2009).

128. For example, in *Piper Aircraft*, the Court considered and rejected the argument that dismissing the case would subject the plaintiff to a forum where the law was less favorable to the plaintiff because such a decision was “inconsistent with the purpose of the *forum non conveniens* doctrine.” 454 U.S. at 247–52.

129. See generally Jernigan, *supra* note 120 (discussing criticism).

intelligent use of these rules can resolve most, if not all, of the criticisms raised by those who argue against the application of U.S. securities laws to claims with foreign elements. One advantage of relying on these rules to dismiss cases where U.S. interests are minimal is their lack of hindrance of the scope of U.S. courts' adjudicative jurisdiction in other situations.

The Supreme Court took a different view in *Morrison* and abandoned the traditional conduct-effects test in determining subject-matter jurisdiction. Instead, the Court ruled in favor of a much narrower (and, as will be argued, equally uncertain) "transactional" test. The following will take a closer look at the *Morrison* decision and argue that the bases for the Supreme Court's holding are contestable.

A. *The Decision*

National Australia Bank (NAB) is one of the largest Australian financial institutions.¹³⁰ The bank's common stock (ordinary shares) is listed on the stock exchanges of Australia, Japan, New Zealand, and London. American Depository Receipts (ADRs) representing NAB's common stock are listed on the NYSE.¹³¹ In 1998, NAB acquired HomeSide Lending, a mortgage service provider based in Florida.¹³² In 2001, NAB announced significant write-downs affecting the value of HomeSide Lending, arguably due to improper accounting practices of the controlled company, which resulted in a material drop in the price of the shares and ADRs of NAB.¹³³ Litigation ensued wherein three plaintiffs sought to represent a class of non-American purchasers of NAB's shares, while one plaintiff, *Morrison*, sought to represent American investors who bought ADRs. These parties brought suit in the U.S. District Court for the Southern District of New York, alleging a violation of Rule 10b-5.¹³⁴

Applying the conduct-effects test, the district court held that the foreign plaintiffs lacked subject-matter jurisdiction and dismissed the case under Fed. R. Civ. P. 12(b)(1).¹³⁵ The court also dismissed the claim of the domestic plaintiffs under Rule 12(b)(6) for failure to state a claim upon which relief can be granted by not having alleged damages caused by the fraud.¹³⁶ Only the foreign plaintiffs chose to appeal.

130. Scott Murdoch, *Big Four Australian Banks have joined the Global Elite*, THE AUSTRALIAN (Jan. 26, 2009, 12:00 AM), <http://tinyurl.com/7a9woa4>.

131. *In re Nat'l Austl. Bank Sec. Litig.*, No. 03-CV-6537, 2006 WL 3844465, at *1 (S.D.N.Y. Oct. 25, 2006).

132. *Id.* at *1.

133. *Id.* at *2.

134. *Id.*

135. *Id.* at *4-5.

136. *Id.* at *9.

The Second Circuit Court of Appeals affirmed the dismissal after a lengthy discussion of the conduct-effects test.¹³⁷ The court focused on the conduct of the defendants and held that the allegedly fraudulent activities showed stronger and more relevant contacts with Australia.¹³⁸ Digging into the particular facts of the case is beside the point and beyond the scope of this Article. What is worth mentioning is that the court's consideration of "declining jurisdiction over all 'foreign-cubed' securities fraud actions would conflict with the goal of preventing the export of fraud from America."¹³⁹ The court concluded that the conduct test properly balances the goal of preventing the export of fraud with the conflicting goal of limiting the use of American courts to disputes in which a significant American interest is at stake.¹⁴⁰ It wisely observed that in this area, "rigid bright-line rules . . . cannot anticipate all the circumstances in which the ingenuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction."¹⁴¹

The Supreme Court granted certiorari and used the opportunity to close the book on over forty years of case law. Procedurally, the Court framed the question of the admissibility of foreign-cubed class actions not as a jurisdictional issue, but as a merits question. The Court stated that the district court had jurisdiction to hear the case under 15 U.S.C. § 78aa and that the question at issue in the case revolved around the substantive reach of Section 10(b).¹⁴² Consequently, the Court held that the question of jurisdiction concerning the foreign plaintiffs should be addressed as a motion to dismiss for failure to state a claim under Rule 12(b)(6) and not for lack of subject-matter jurisdiction under Rule 12(b)(1).¹⁴³ As the Court recognized, this characterization of the question at hand does not alter the analysis and the practical result of the Court's decision.¹⁴⁴ This Article concentrates on the Court's interpretation of the substantive scope of Rule 10b-5.

B. The Presumption Against Extraterritoriality

Justice Scalia, writing for the majority, buttressed the rejection of the conduct-effects test by pointing to the so-called "presumption against extraterritoriality."¹⁴⁵ According to this principle, federal statutes are

137. *Morrison v. Nat'l Austl. Bank Ltd.*, 547 F.3d 167, 177 (2d Cir. 2008).

138. *Id.* at 176.

139. *Id.* at 175.

140. *Id.*

141. *Id.*

142. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2873 (2010).

143. *Id.* at 2873, 2876–77.

144. *Id.* at 2877.

145. *Id.* at 2882–83.

intended to apply only within U.S. territory, unless this presumed inward-looking attitude of the legislature can be rebutted by contrary evidence.¹⁴⁶ The problem with this principle is that it is more a myth than a reality in American law. Even a cursory review of decisions suggests that its foundations are shaky. The scope and very existence of a similar presumption oscillated within the jurisprudence of the Supreme Court itself and has received extensive scholarly critique.¹⁴⁷ In the last century, the judicial pendulum of the Supreme Court swung several times in different directions. From *American Banana v. United Fruit Co.*¹⁴⁸ to *Hartford Fire Insurance Co. v. California*,¹⁴⁹ the Court moved between accepting the presumption and holding the presumption inapplicable. Looking further to the analysis of lower courts' decisions, the confusion seems to increase.¹⁵⁰ As one author has described, "Supreme Court and lower court cases reveal that there is no coherent canon of construction being applied to ambiguous statutes. Instead, the presumption [against extraterritoriality] requires courts to piece together scant evidence of congressional intent and gap-filling in a manner consistent only with the outdated bases for the presumption."¹⁵¹

With this premise, the presumption against extraterritoriality is a rather weak basis for limiting the scope of Section 10(b) of the Exchange Act. Moreover, a fairly large number of decisions that embraced the presumption against extraterritoriality agree that the presumption could be overcome by the presence of *effects* of relevant conduct in the United States. Examples of this line of thought are found, for example, in *United*

146. *Id.* at 2877–78.

147. Without clear evidence of congressional intent, the presumption is to bar the application of U.S. federal statutes abroad. However, this presumption has no force when a statute, on its face, relates to foreign affairs. A presumption in favor of extraterritoriality in those cases allows the judiciary to avoid assumptions and misinterpretations regarding congressional intent. The presumption against extraterritoriality, as currently applied, on the other hand, does not afford the judiciary the same benefit when adjudicating extraterritorial disputes. See generally William S. Dodge, *Extraterritoriality and Conflict-of-Law Theory: An Argument for Judicial Unilateralism*, 39 HARV. INT'L. L.J. 101 (1998) (suggesting a change in approach in the application of laws extraterritorially); Ward, *supra* note 54 (discussing the presumption against extraterritoriality by lower U.S. courts).

148. 213 U.S. 347, 356–57 (1909) (“[T]he general and almost universal rule is that the character of an act as lawful or unlawful must be determined wholly by the law of the country where the act is done. . . . For another jurisdiction, if it should happen to lay hold of the actor, to treat him according to its own notions rather than those of the place where he did the acts, not only would be unjust, but would be an interference with the authority of another sovereign, contrary to the comity of nations, which the other state concerned justly might resent. . . . The foregoing considerations would lead, in case of doubt, to a construction of any statute as intended to be confined in its operation and effect to the territorial limits over which the lawmaker has general and legitimate power.”).

149. 509 U.S. 764, 795–96 (1993) (“Although the proposition was perhaps not always free from doubt, it is well established by now that the Sherman Act applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States.”).

150. See Ward, *supra* note 54, at 729.

151. *Id.* at 750.

*States v. Alcoa*¹⁵² *Sale v. Haitian Centers Council, Inc.*,¹⁵³ and *Hartford Fire*.¹⁵⁴ Regarding the Exchange Act, Judge Bork, in another seminal case, *Zoelsch v. Arthur Anderson & Co.*,¹⁵⁵ similarly noted that “Congress was concerned with extraterritorial transactions *only* if they were part of a plan to harm American investors or markets.”¹⁵⁶

Thus, even assuming the validity of the presumption against extraterritoriality, at least one version of this doctrine is compatible with the effects test originally envisioned by the Second Circuit in transnational securities litigation cases. The conclusion that Section 10(b) should apply to securities transactions that display effects in the United States aligns with the central thesis of this Article.

C. Textual Doubts

In the debate over the extraterritorial reach of Section 10(b) of the Exchange Act, Section 30(b) of the Act is often cited both in support and in denial of the applicability of the antifraud provision to foreign transactions. In relevant part, Section 30(b) provides that the Exchange Act and any rule or regulation thereunder “shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States,” unless he does so in violation of SEC rules designed to prevent “evasion” of the Act.¹⁵⁷

The Supreme Court offers its own reading of Section 30(b) in *Morrison*, arguing that Section 30(b) confirms the limitation of Section 10(b) to domestic transactions.¹⁵⁸ In reality, this Article argues that the first part of Section 30(b) is, at best, neutral with respect to the issue of jurisdiction. The text simply explains that the Exchange Act applies when it applies. Conduct proscribed by Section 10(b) and Rule 10b-5 is, by definition, covered by the Exchange Act and within the jurisdiction of the United States. The fact that the Rule also contains an “anti-elusion” provision does not seem sufficient to argue that the entire Act does not apply extraterritorially.

152. 148 F.2d 416, 444 (2d Cir. 1945) (“[W]e shall assume that the Act does not cover agreements, even though intended to affect imports or exports, unless its performance is shown actually to have had some effect upon them.”).

153. 509 U.S. 155, 177 (1993) (indicating that a court will consider all available evidence before applying the presumption against extraterritorial application of a U.S. law).

154. See *Hartford Fire*, 509 U.S. at 795–96 (emphasizing that the Sherman Act applies to “foreign conduct that was meant to produce and did in fact produce some *substantial effect* in the United States”) (emphasis added).

155. 824 F.2d 27 (D.C. Cir. 1987).

156. *Id.* at 32 (emphasis added). See also Dodge, *supra* note 54, at 108–09 (“In short, Judge Bork read the presumption as meaning that acts of Congress apply not to conduct that occurs in the United States but to conduct that *causes effects* in the United States.”) (emphasis added).

157. 15 U.S.C. § 78dd(b) (2006).

158. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2882–83 (2010).

In response to this interpretation, Justice Scalia, in his opinion in *Morrison*, raises a rhetorical question: “[I]f the whole Act applied abroad, why would the Commission’s enabling regulation be limited to those preventing ‘evasion’ of the Act, rather than all those preventing ‘violation?’”¹⁵⁹ This question, however, confounds two different issues. To illustrate, imagine a simple fictitious statute that provides for three rules: (a) Section 1, which states that murder is prohibited and punished; (b) Section 2, which requires administrative permission in order to possess and use a firearm; and (c) Section 3, which provides that the statute applies only to those who shoot a firearm within the jurisdiction of the United States, or who do so in violation of the regulations issued to prevent evasion of the statute by a special agency responsible for regulating firearm possession and use. If, standing on the Mexican side of the border, Mr. X shoots and kills Ms. Y in the United States, the conduct of Mr. X represents a violation of the statute. Mr. X could also shoot from Mexico to a straw target located in the United States and be in violation of the statute. Section 3 of this hypothetical statute grants to the firearms agency the authority to regulate this conduct as an evasion of Section 2, without necessarily implying that Section 1 only applies to killers that shoot from within the United States.

Applying this hypothetical to Section 30(b), the antievasion clause in Section 30(b) could be considered a rule designed to “close the system” and be interpreted as applicable to *some* provisions of the Exchange Act that *normally* would not apply to conduct abroad. If, as this Article advocates, Section 10(b) *only* applies to transactions that have an effect in the United States, Section 30(b) would give to the commission the power to regulate conduct abroad *before* that conduct causes any effect in the United States. Yet, Section 30(b) does not provide a solid ground to anchor any final conclusion as to the scope of application of Section 10(b).

Furthermore, Section 30(a) of the Exchange Act explicitly prohibits certain conduct of brokers and dealers on foreign exchanges if the issuer is a U.S. entity. The Court argues that the explicit mentioning of extraterritorial application in Section 30(a) confirms that the rest of the statute applies only domestically.¹⁶⁰ This argument is also not persuasive. Referring back to the hypothetical statute regulating murder and firearm possession and use, the equivalent of Section 30(a) would be an additional section that states that, if you are shooting *from* the United States *into* Mexico without the agency’s permission, then you are violating the law. It clarifies a possible doubt and defines more clearly the scope of application of the rule, but it does not mean that killing a person in the United States

159. *Id.* at 2882.

160. *Id.* at 2883.

while shooting from Mexico (in violation of the hypothetical Section 1 of the statute) is legal.

Accordingly, for the reasons above, the textual arguments advanced in *Morrison* based on the Exchange Act are not conclusive for the purpose of excluding the application of Section 10(b) to conduct occurring outside the United States that causes adverse consequences in this country.

D. *Consistency with Subject-Matter Jurisdiction in Antitrust Cases*

The question concerning the extraterritorial application of securities laws presents some similarities with the issue of the extraterritorial reach of antitrust legislation. Notwithstanding the obvious and profound differences between these two substantive areas, in both situations conduct in violation of American law can have — and often has — international effects. The conduct and the damages that either type of case might cause can occur either in the United States or abroad. Securities fraud, as well as anticompetitive actions, can adversely affect separate but connected markets. From this perspective, Hannah Buxbaum and other scholars have examined transnational litigation in antitrust and securities laws in parallel.¹⁶¹

Contrary to the situation with securities regulation, Congress has provided a clearer rule for international antitrust disputes. The Foreign Trade Antitrust Improvements Act of 1982 states that U.S. courts have jurisdiction over foreign conduct (a) where there is a “direct, substantial and reasonably foreseeable effect” on markets in the United States and (b) where the effect represents a cause of action under the Sherman Act.¹⁶² It follows that American parties who suffered harm due to the domestic effects of anticompetitive foreign conduct can always sue in the United States. Foreign parties, on the other hand, have a cause of action only if they can demonstrate that the harm suffered was the consequence of the effects in the United States — and *not* abroad — of the illegal behavior.¹⁶³

In transnational antitrust litigation, statutory provisions and case law thus adopt an “effects” test that stresses the consequences in the United States of worldwide conduct. While this is certainly not a *per se* argument against the *Morrison* transactional test, it is worth considering whether it is sensible to have two radically different approaches to the extraterritorial

161. See, e.g., Buxbaum, *supra* note 37, at 273–78 (considering the application of jurisdictional law to transnational antitrust and securities litigation). See also Erica Siegmund, Note, *Extraterritoriality and the Unique Analogy Between Multinational Antitrust and Securities Fraud Claims*, 51 VA. J. INT'L L. 1047 (2011) (using judicial treatment of the F-cubed securities fraud cases to draw an analogy with transnational antitrust litigation).

162. 15 U.S.C. § 6(a) (2006).

163. *F. Hoffman-La Roche, Ltd. v. Empagran S.A.*, 542 U.S. 155, 158–59 (2004).

reach of the Sherman Act and of the Exchange Act. In both areas, the existence of global, integrated markets suggests that adverse consequences of foreign conduct can and should be sufficient to establish subject-matter jurisdiction. If conduct proscribed by the laws of country X causes adverse effects in that country, X's courts should have adjudicative subject-matter jurisdiction, regardless of where the conduct occurred. This alternative approach, in alignment with well-established principles of international law, would partially reconcile the discrepancies created by *Morrison* between the extraterritorial application of antitrust law and securities regulation.

E. Between a Rock and a Hard Place: The Dangerous Uncertainties of the "U.S. Exchange-Transaction" Test Versus Its Collateral Effects

In disposing of the conduct-effects test, the Supreme Court criticized not only the excessive reach that the test allowed to American securities laws, but also the unpredictable and inconsistent results it has created.¹⁶⁴ The problem is that the cure offered (the new transactional test) is not much better than the disease (the traditional conduct-effects test). More precisely, depending on how the transactional test is interpreted, it can either present ambiguities that are no less significant than the ones embedded in the conduct-effects test or it can lead to an unacceptable reduction of the protections offered by the securities laws to U.S. investors.

To understand this statement, consider the following analytical reading of the transactional test as stated in Justice Scalia's opinion: "[S]ection 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American exchange, and the purchase or sale of any securities in the United States."¹⁶⁵

The first question that this language raises is whether a transaction involving American Depositary Receipts (ADRs) or American Depositary Shares (ADSs), financial instruments listed in the United States that represent foreign securities of a foreign issuer, would trigger Section 10(b).¹⁶⁶ This question can be answered in the affirmative, considering that both ADRs and ADSs ought to be deemed securities according to the *Howey* test.¹⁶⁷

164. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2880–81 (2010).

165. *Id.* at 2888.

166. On ADRs and ADSs, see, for example, Stephen J. Choi & Linda J. Silberman, *Transnational Litigation and Global Securities Class-Action Lawsuits*, 2009 WIS. L. REV. 465, 469–70, 476 (2009); Kenneth B. Davis, Jr., *The SEC and Foreign Companies: A Balance of Competing Interests*, 71 U. PITT. L. REV. 457, 469 (2010); Marco Pagano et al., *The Geography of Equity Listing: Why Do Companies List Abroad?*, 57 J. FIN. 2651, 2660 (2002).

167. The *Howey* test asks "whether the scheme involves an investment of money in a common

More important, and more central to this Article's discussion, is the meaning of "purchase or sale . . . in the United States." Despite its appeals to the need for a bright-line rule, the Supreme Court does not seem to clearly and unequivocally define this expression. When does a purchase or sale occur in the United States? A narrow reading suggests that the contractual obligation to buy or sell securities must have arisen in the United States. In other words, the contract must be *executed* in the United States for Section 10(b) to apply. If, however, this is the correct interpretation of the transactional test, it is difficult not to agree with the concurring opinion in *Morrison*, signed by Justices Stevens and Ginsburg, that states that the new rule would leave some American investors out in the cold.¹⁶⁸

For example, consider the following hypothetical. A, an elderly American citizen and resident of New York City, is convinced by B, an unscrupulous U.S. financier, to buy securities of a closely-held corporation incorporated and doing business in California. All of their discussions, tainted by extensive misrepresentations by B, occur in New York City. The investor, however, is flown over to Nice, on the French Riviera, for the closing of the deal and the signing of the contract. In this example, applying a narrow reading of the transactional test, investor A could not invoke the protections offered by the antifraud provisions of the 1934 Act. This outcome cannot be considered in line with the goal of the statute.¹⁶⁹

The only logical alternative then would be to read something more into the second prong of the transactional test. If, however, the expression "purchase or sale of any securities in the United States" can be expanded to include situations like the one described in the above hypothetical, we are back at square one by giving relevance to the conduct of the defendant,

enterprise with profits to come solely from the efforts of others." SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946). The Court notes that this test "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Id.* at 299.

168. *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2895 (2010) (Stevens, J., concurring).

169. *See id.* Apart from hypothetical situations, *Morrison* has already had concrete consequences in the real world that can hardly be considered to be in the spirit of the Exchange Act. At the end of September 2010, the Southern District Court of New York applied the transactional test from *Morrison* in *In re Societe Generale Securities Litigation*, No. 08-CV-2495, 2010 WL 3910286 (S.D.N.Y. Sept. 29, 2010). Judge Berman, deciding the controversy, not only held that Section 10(b) did not apply to investors who purchased securities on a French stock exchange, but also that purchases of ADRs negotiated over-the-counter in the United States were not covered by the antifraud provision. *Id.* at *6. In addition, parties have also begun to argue that under *Morrison*, it is the location of the transaction that matters, and thus, even American investors may not bring claims based on their purchases of a foreign issuer's shares on a foreign exchange. *See, e.g.*, UBS Defendants' Memorandum of Law in Support of Their Motion to Dismiss All Claims Based on Purchases of UBS Shares Outside the United States at 15-17, *In re UBS AG Securities Litig.*, No. 07-CV-11225, 2010 WL 3521486 (S.D.N.Y. Aug. 31, 2010).

or to the effects of the transaction, in order to define the scope of application of Section 10(b).

This outcome further adds to the reasons the *Morrison* decision is not satisfactory and should not be considered persuasive. The transactional test leaves us between a literal interpretation, which would lead to absurd consequences, and a more flexible reading, which would reintroduce at least some of the uncertainties of the conduct-effects test.

III. WHAT NEXT?

A. *Congress Strikes Back. Maybe.*

The day after the *Morrison* decision, a House-Senate Conference Committee passed the Wall Street Reform and Consumer Protection Act, better known as the Dodd-Frank Act.¹⁷⁰ President Obama signed the Act into law less than a month later.¹⁷¹ The question of subject-matter jurisdiction and the extraterritorial reach of the securities laws was both on the legislative agenda and in the final version of the bill. Two provisions in the Act regulate this issue.

The first provision is Section 929P(b), which explicitly gives federal courts jurisdiction over actions brought by the SEC or the Department of Justice (DOJ) if conduct within the United States “constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors,” or if conduct occurring outside the United States “has a foreseeable substantial effect within the United States.”¹⁷² With respect to actions brought by the SEC or the United States, Congress has therefore immediately reestablished the conduct-effects test that the Supreme Court rejected in *Morrison*.

This amendment to the securities laws, however, is not necessarily incompatible with *Morrison*. It is not surprising that enforcement agencies and government branches are granted broader reach and stronger legal instruments to seek damages than are private parties. From a strict textualist point of view, Section 929P(b) of the Dodd-Frank Act could be considered to confirm indirectly that, *with the exception* of SEC and DOJ actions, Section 10(b) of the Exchange Act does not apply to foreign-

170. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

171. Stephen R. Smerek & Jason C. Hamilton, *The Extraterritorial Reach of U.S. Securities Law After the Morrison Decision and the Dodd-Frank Act*, 16 WORLD SEC. L. REP. 23 (2010), available at <http://www.bnai.com/MorrisonDoddFrank/default.aspx>.

172. Dodd-Frank Wall Street Reform and Consumer Protection Act, § 929P(b), 124 Stat. at 1864.

cubed transactions, even when there are effects or conduct in the United States.

This is not the only possible reading. If read with a greater emphasis on policy concerns, Section 929P(b) seems aimed at containing the possible consequences of *Morrison*. In addition, the fact that Congress expressly opted for extraterritorial application of the Exchange Act in some cases might be interpreted as another chink in the not-so-impenetrable armor of the presumption against extraterritoriality. Through Section 929(b), Congress has demonstrated that the conduct-effects test is not necessarily a misconceived and ill-advised judicial creation, but rather a possible — and indeed, useful — ground for jurisdiction.

The second relevant provision of the Dodd-Frank Act is Section 929(y), but the consequences of this Section are still tenuous. Section 929(y) requires the SEC to conduct a study and solicit public comments on the topic of the application of Section 10(b) of the Exchange Act to instances where conduct in the United States constitutes a significant step in the violation of the Act or where conduct occurring outside this country has a substantial and foreseeable effect within the country.¹⁷³ At the very least, this provision demonstrates the skepticism and dissatisfaction of Congress with the transactional test adopted by the Supreme Court. It is possible, depending on the conclusion of the study, that further statutory or secondary regulation will dispose of the transactional test even for private litigation and reintroduce a different, clearer version of the old conduct-effects test. This Article relies on this possibility to argue for the introduction of a revised “effects test,” discussed hereinafter.

B. *A New Solution from Old Precedents: The Revised Effect Test*

Before formally introducing this Article’s proposal, it is helpful to summarize the discussion. Part I overviewed the development of the conduct-effects test, observing how the application of this judge-made standard has sometimes led to conflicting and uncertain results. From there, Part I sought to explain how courts mitigate the alleged dangers of an overbroad extraterritorial application of Section 10(b). Importantly, Part I explained that there are different legal devices that have been, and can continue to be, used to keep the excessive proliferation of foreign-cubed litigation at bay. Examples include the rules concerning class certification, the requirement for proof of actual reliance, and the availability of the doctrine of *forum non conveniens*. Part II then analyzed the transactional test introduced by *Morrison* and discussed its flaws: the test’s weak basis (in terms of the Court’s tenuous use of statutory interpretation and the presumption against extraterritorial application of statutes rationale), its

173. *Id.* § 929Y, 124 Stat. at 1871.

inconsistency with the standards applied in the antitrust field, and — most importantly — its narrowness and lack of predictable applicability in future cases. Section III.A discussed the skepticism with which Congress received the *Morrison* decision.

The stage is now set for a simple alternative proposal that has been implicit in much of this Article. Specifically, an “effects-only” test should be adopted. Put in other words, in order to establish subject-matter jurisdiction and the existence of a private cause of action under Section 10(b), private plaintiffs should be required to plead that the illegal conduct — a criterion borrowed from antitrust litigation — created direct, substantial, and reasonably foreseeable effects in the United States. SEC- and DOJ-initiated actions could, meanwhile, be based on conduct in the United States as now sanctioned by the Dodd-Frank Act.

Viewing this problem from a different perspective, this Article argues that the “conduct test” was the primary cause of uncertainties and excessive reach in the extraterritorial application of the securities laws.

To illustrate how the effects-only test would work, consider some examples. First, as raised by Justice Stevens in his concurring opinion in *Morrison*, there is the case of an American investor induced to invest in a U.S. corporation by other Americans, but whose transaction occurred abroad.¹⁷⁴ Under the effects-only test, the American investor could invoke the protection of the securities laws because the damages (that is, the effect) of the illegal conduct occurred in the United States.¹⁷⁵ On the other hand, a pure foreign-cubed action could be sustained by a foreign plaintiff against a foreign defendant in a U.S. court only when the illegal conduct also produced consequences in the United States. This outcome would likely be automatic if the securities affected by the fraud were listed (directly or through ADRs) in the United States. The “effects” condition could also be met if the securities were negotiated in the United States without being listed, such as in an over-the-counter transaction or in transactions where other holders of those securities were American citizens or residents.¹⁷⁶

174. *Morrison*, 130 S. Ct. at 2895 (Stevens, J., concurring).

175. For example, under the *Morrison* test, the American investor plaintiff in *Schoenbaum v. Firstbrook*, 405 F.2d 200, 204 (2d Cir. 1968), *rev'd on rehearing on other grounds*, 405 F.2d 215 (2d Cir. 1968), would be barred from seeking relief under Section 10(b).

176. It should be noted that this is broader than the antitrust decision in *F. Hoffmann-La Roche Ltd. v. Empagran*, 542 U.S. 155 (2004). That holding merely stipulated that, when foreign anticompetitive conduct plays a significant role and foreign injury is independent of domestic effects, Congress hoped America’s antitrust laws would interact with those of other nations. *Id.* at 169. *Empagran* justified this interpretation of congressional intent by noting that Congress would not have tried to impose America’s antitrust policies in the international marketplace for such ideas if it had thought that such policies would not have been accepted. *Id.*

Under the effects-only test, the situation left out of coverage under Section 10(b) is the one in which the only contact with the United States is conduct in this country that exclusively produces effects abroad. In this case, a private (foreign) plaintiff could not use the American judiciary system to recover the damages suffered. Of course, this approach would not preclude jurisdiction in all cases because the SEC or the DOJ could exercise its discretion in deciding, pursuant to the Dodd-Frank Act, whether to bring suit against these perpetrators. It seems reasonable that the evaluation of this interest is left to the government given the likelihood of legal recourse in the country where the effects occurred and the inconvenience of having American courts deal with such matters. The SEC or DOJ could handle the exceptions to this general rule.

Needless to say, recognizing adjudicative jurisdiction and the existence of a possible cause of action on the basis of effects in the United States does not necessarily mean that foreign plaintiffs would be fully entitled to their day in court. U.S. judges could still decide to not certify the class for failure to meet the superiority requirement, to require actual proof of reliance by not accepting the fraud-on-the-global-market theory, or to dismiss on the basis of *forum non conveniens*.

C. *The Effect Test and International Law: A Comparative View*

A further advantage of the proposed effects-only test is that the test would be in line with principles of international law and might facilitate an international agreement on jurisdiction in securities cases. To understand this concept, one must first establish the premise that Section 10(b) and Rule 10b-5 of the Exchange Act have their antecedents in the common law tort of fraud.¹⁷⁷ This Article contends that these rules codify, obviously with some significant differences, a particular tort. Thus, in the language of civil law countries, Section 10(b) and Rule 10b-5 can be considered “noncontractual obligations.”

One of the most important and broadest international regulations of jurisdiction for noncontractual obligations is contained in Regulation No. 44/2001 of the European Union.¹⁷⁸ Pursuant to this Regulation, a plaintiff can sue the defendant, in a claim based on a noncontractual obligation, either where the defendant’s domicile is located or, according to Article 5, number 3, where the damaging effect occurred or could have occurred.¹⁷⁹ The European Court of Justice (ECJ) has actually interpreted this

177. Under the common law of torts, fraud is intentional misrepresentation, deceit, or concealment of a material fact with the intention of depriving a person of property or legal rights, or otherwise causing injury. This definition has been adopted by statute in several states. *See, e.g.*, ALA. CODE § 6-11-20 (2006); CAL. CIV. CODE § 3294(c)(3) (2006).

178. Council Regulation 44/2001, 2001 O.J. (L 12).

179. *Id.* art. 5(3).

Regulation in a broader way, allowing the plaintiff to sue in the jurisdiction where the prohibited conduct took place as well.¹⁸⁰ In other words, adjudicative jurisdiction can be established on the basis of an effects test and, at least according to the ECJ case law, on the basis of conduct.

The effects test proposed in this Article would be consistent with this approach. Conforming to an established principle of international jurisdiction might promote a much-needed international agreement on jurisdiction in the field of securities litigation, which currently suffers from the uncertainty of which nation's laws will be applied when fraud or other improprieties are alleged and the plaintiffs and defendants are not all of the same nationality. This is thanks in considerable part to the continued confusion under *Morrison*.¹⁸¹

CONCLUSION

Prominent jurists and other observers have long recognized the flaws in the conduct-effects test and its preexisting constituent parts as traditionally applied. Unfortunately, when the U.S. Supreme Court took the salutary step of addressing these flaws in *Morrison*, it left the situation as confused as it had been prior to its decision in *Morrison*. Not only will further litigation be required to determine the scope of the decision, the two most likely interpretations are inadequate. If the decision is interpreted narrowly, the purpose of, not to mention the practical need for, U.S. securities laws will be frustrated as American investors lose essential protections. If, instead, the decision is interpreted broadly, the same ambiguities that afflicted previous tests will afflict *Morrison's* new transactional test.

Jurisdiction in international securities regulation is far from just an American problem — it is a problem spread across continents. This Article's straightforward effects-only test would not only simplify jurisdictional questions for American courts and those who consider accessing them, but its consonance with well-established jurisprudence in other influential jurisdictions could promote an international accord resolving, once and for all, the conflicts in international securities law jurisdiction.

180. See, e.g., Case C-18/02, *Danmarks Rederiforening v. LO Landsorganisation i Sverige*, 2004 E.C.R. I-1; Case 21/76, *Handelskwekerij G.J. Bier BV v. Mines de Potasse*, 1976 E.C.R. 1735.

181. See Smerek & Hamilton, *supra* note 171 ("Because the extraterritorial jurisdiction provisions of the Dodd-Frank Act are limited to actions by the SEC or the United States, the 'transactional test' set forth by the Supreme Court in *Morrison* clearly remains in effect for private actions brought under the Securities Exchange Act. The transactional test most certainly provides a sharper picture regarding the application of U.S. securities laws. However, even from the facts set forth in *Morrison*, it is clear that the fuzzy edges of this bright-line rule will be drawn into focus only through further litigation.").

Instead of looking at where conduct took place regardless of where that conduct had its effects, or at some combination of the locations of conduct and effects, a pure effects test will limit American courts' jurisdiction to those cases in which the United States has a substantial interest. The already-granted authority possessed by federal agencies to pursue violators whose conduct takes place domestically but which has exclusively foreign effects will ensure that the United States does not become a haven for those defrauding international investors.