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The Extraterritorial Reach of Section 10(b): A Wolf Hunt Off Wall Street

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THE EXTRATERRITORIAL REACH OF SECTION 10(B): A WOLF HUNT OFF WALL STREET

ABSTRACT

Born to combat the market effects of the Great Depression, the Securities Exchange Act of 1934 protects American investors and maintains American confidence in the U.S. securities market. These objectives are largely accomplished through the imposition of liability from Section 10(b) of the Securities Exchange Act and the SEC's Rule 10b-5. These federal laws impose civil and criminal penalties for domestic insider trading and securities fraud violations. Because Section 10(b) and Rule 10b-5 only apply domestically, when securities violations occur both within the United States and abroad, the reach of federal law becomes questionable, leaving federal courts with a complex issue.

To resolve this issue, the Second Circuit created a Conduct and Effects test that left federal courts with a subpar solution to determine when Section 10(b) may apply extraterritorially. The test developed for over forty years and was widely accepted until the Supreme Court, in Morrison v. National Australia Bank, Ltd.*, brought Section 10(b)'s extraterritorial reach to a screeching halt in 2010. Ushering in a fundamental shift in securities law, Justice Scalia abrogated the Second Circuit's Conduct and Effects test and purported to provide a clear Transactional test that avoided interference with foreign securities regulation. But the Court missed the mark, and instead created two new issues for the circuit courts of appeals. First, the Transactional test created an ambiguity that resulted in a sharply divided split among the First, Second, Third, and Ninth Circuit Courts. Second, the simultaneous enactment of the Dodd-Frank Act prompted a question of whether Congress partially abrogated the Court's decision in* Morrison *and reinstated the Conduct and Effects test.*

In the wake of this circuit split comes uncertainty among the lower courts, threats to stare decisis, plaintiffs avoiding a defendant-friendly Second Circuit by forum shopping, and strains on international comity. To resolve the split, this Comment sets forth a factor-balancing test that determines whether the foreign elements of a transaction overcome the domestic elements to render Section 10(b) inapplicable to the conduct. This Spectrum test provides a flexible, but narrowly tailored, framework that can adapt to a rapidly evolving and

globalizing securities market. It provides courts with a workable and consistent analysis that will facilitate the development of Section 10(b) jurisprudence.

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INTRODUCTION

Federal securities laws protect American investors from securities fraud, insider trading, and other deceptive practices.[1] In the context of a rapidly evolving and globalizing securities market,[2] determining the reach of that protection can be difficult.[3] When a securities transaction occurs, it may occur solely inside the United States, or it may involve parties abroad.[4] But when the transaction occurs both inside and outside the United States, it raises a complex issue for federal courts due to the common law presumption against extraterritoriality. This canon of construction presumes that when Congress legislates, it does so for domestic matters as opposed to foreign matters unless Congress clearly indicates otherwise.[5]

In 2010, the Supreme Court determined that the Securities Exchange Act of 1934 does not overcome the presumption against extraterritoriality, and it does not apply extraterritorially.[6] Consequently, the Court gave a Transactional test to determine when a transaction is domestic in order to impose liability for violations of Section 10(b) of the Securities Exchange Act.[7] The Court did not provide guidance in applying the Transactional test,[8] which naturally gave rise to a split among the First, Second, Third, and Ninth Circuit Courts of Appeals.[9]

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[1] *See Securities Law History*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/securities_law_history (last visited Jan. 2, 2022).

[2] "Globalization has influenced international investing, making it easier than ever before, historically, for market participants to invest in companies, industries, or other financial instruments abroad." Mary Hall, *Globalization and International Investment*, INVESTOPEDIA, https://www.investopedia.com/ask/answers/022615/what-effect-has-globalization-had-international-investments.asp (Aug. 31, 2022). "Market participants can buy stocks, mutual funds, exchange-traded funds (ETFs) or American Depositary Receipts (ADRs) to gain access to the shares of internationally-based companies." *Id.*

[3] *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 260 (2010) ("Commentators have criticized the unpredictable and inconsistent application of § 10(b) to transnational cases." (citations omitted)).

[4] *See* SEC v. Morrone, 997 F.3d 52, 54–55, 58 (1st Cir. 2021) (involving American defendants and private foreign investors).

[5] *See Morrison*, 561 U.S. at 255 (first citing Smith v. United States, 507 U.S. 197, 204, n.5 (1993); and then quoting EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991)).

[6] *Id.* at 265.

[7] *See id.* at 273.

[8] *See* Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012) ("While *Morrison* holds that § 10(b) can be applied to domestic purchases or sales, it provides little guidance as to what constitutes a domestic purchase or sale.").

[9] *See* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 216–17 (2d Cir. 2014) (determining federal securities laws did not apply because "the claims . . . [were] so predominantly foreign as to be impermissibly extraterritorial"); Stoyas v. Toshiba Corp., 896 F.3d 933, 950 (9th Cir. 2018) (rejecting the Second Circuit's approach); *Morrone*, 997 F.3d at 60 (citing *Stoyas*, 896 F.3d at 950) (joining the Ninth Circuit in rejecting the Second Circuit's approach); United States v. Georgiou, 777 F.3d 125, 137 (3d Cir. 2015) ("We now hold that irrevocable liability establishes the location of a securities transaction.").

Congress then added to the chaos by enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act. Because the Dodd-Frank Act was passed nearly simultaneously with the *Morrison v. National Australia Bank Ltd.* decision's release,[10] another ambiguity arose causing the circuit courts to question whether Congress partially abrogated *Morrison* and reinstated the Conduct and Effects test.[11] Several crucial issues arise from the circuit courts' interpretations of *Morrison*, including inconsistent decisions,[12] strains on international comity,[13] threats to stare decisis,[14] and forum shopping.[15]

This Comment addresses the extraterritorial reach of Section 10(b) of the Securities Exchange Act of 1934 as well as the U.S. Securities and Exchange Commission's ("SEC") Rule 10b-5 and provides a new framework for the analysis to resolve these respective issues. In Part I, this Comment discusses the social and economic background[16] that the Securities Exchange Act was legislated against. Part II introduces Section 10(b)'s initial extraterritorial application and the development of the Conduct and Effects test. Part III analyzes the *Morrison* decision and the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Part IV evaluates the circuit courts'

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[10] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (showing "Effective Date" as July 21, 2010); *Morrison*, 561 U.S. at 247 (showing that the Court issued its decision on June 24, 2010).

[11] *See* SEC v. Scoville, 913 F.3d 1204, 1218 (10th Cir. 2019) ("Notwithstanding the placement of the Dodd-Frank amendments in the jurisdictional provisions of the securities acts, . . . it is clear to us that Congress undoubtedly intended that the substantive antifraud provisions [of section 10(b)] should apply extraterritorially when the statutory conduct-and-effects test is satisfied.").

[12] *Compare Parkcentral*, 763 F.3d at 216 ("[W]e think it clear that the claims in this case are so predominantly foreign as to be impermissibly extraterritorial."), *with Stoyas*, 896 F.3d at 949 (citing *Morrison*, 561 U.S. at 273 & 251 n.1) (noting a domestic transaction could almost certainly be established).

[13] *See Parkcentral*, 763 F.3d at 216 (citing *Morrison*, 561 U.S. at 269) ("[T]he application of § 10(b) to the defendants would so obviously implicate the incompatibility of U.S. and foreign laws that Congress could not have intended it *sub silentio*.").

[14] *See Scoville*, 913 F.3d at 1215–19 (declining to follow *Morrison*'s holding that the Securities Exchange Act does not apply extraterritoriality and applying the Conduct and Effects test to the proceeding brought by the SEC). The Supreme Court describes stare decisis as "a foundation stone of the rule of law." Kimble v. Marvel Ent., LLC, 576 U.S. 446, 455 (2015) (quoting Michigan v. Bay Mills Indian Cmty., 572 U.S. 782, 798 (2014)). Stare decisis "promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." *Id.* (quoting Payne v. Tennessee, 501 U.S. 808, 827–28 (1991)).

[15] *See* Jason Halper, Adam Magid & Jonathan Watkins, *Securities Litigation Update: First Circuit Endorses Broad View of Extraterritorial Reach of the Federal Securities Laws, Cementing Split with the Second Circuit on the Meaning of a "Domestic" Transaction*, JDSUPRA (May 26, 2021), https://www.jdsupra.com/legalnews/securities-litigation-update-first-1056649/ ("[I]t is likely that private plaintiffs asserting claims with a foreign nexus will do their best to bypass the Second Circuit and file suit in more hospitable forums, such as the First and Ninth Circuits.").

[16] This background discussion focuses on the Great Crash of 1929 and the Great Depression. *See infra* Part I.

split in the application of the second prong of *Morrison*'s Transactional test. Finally, Part V argues for the implementation of the Spectrum test[17] to resolve the split, and demonstrates its application to existing fact patterns adjudicated by the First and Second Circuits. While the SEC punted on the issue in 2012,[18] the Spectrum test provides a flexible and consistent framework that can adapt to a rapidly evolving and globalizing securities market.

I. A NEW DEAL

Dancing, prohibition, gangsters, and economic prosperity are staples of the American era famously known as the Roaring Twenties.[19] During the Roaring Twenties, social mores evolved and public expectations of women changed.[20] It became socially acceptable for women to dress promiscuously, smoke, drink, and dance vivaciously in public.[21] Throughout this era, dance halls filled and new dance styles proliferated.[22] Contemporaneously, alcohol consumption increased, despite the alcohol prohibition by the 18th Amendment to the U.S. Constitution.[23] Americans were not deterred by the prohibition and resorted to a black market for alcohol.[24] Famous gangsters, like Al Capone, bootlegged

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[17] This Comment introduces the Spectrum test, a novel factor-balancing test that determines whether the foreign elements of a transaction overcome the domestic elements to render Section 10(b) inapplicable to the conduct. *See infra* Part V.

[18] In April 2012,

> Congress directed the Securities and Exchange Commission to carry out a study "to determine the extent to which private rights of action under the antifraud provisions of the Securities and Exchange Act of 1934 . . . should be extended to cover" domestic conduct in connection with foreign transactions or foreign conduct with domestic effects.

Parkcentral, 763 F.3d at 217 n.14 (quoting Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929Y, 124 Stat 1376,1871 (2010)). Illustrating the complexity of these issues, the result of that study did not offer any recommended approach and only gave general options regarding how to proceed. *Id.* (citation omitted).

[19] *See* History.com Editors, *The Roaring Twenties*, HIST., https://www.history.com/topics/roaring-twenties/roaring-twenties-history (Aug. 12, 2022).

[20] *See Roaring Twenties*, OHIO HIST. CENT., https://ohiohistorycentral.org/w/Roaring_Twenties (last visited Dec. 31, 2021).

[21] *See id.*

[22] *See* Salman Mohammed, *Dance in the 1920s*, UNLV PUB. HIST. (Oct. 9, 2016), https://www.unlvpublichistory.com/new-page-1.

[23] Mark Thornton, *Alcohol Prohibition Was a Failure*, CATO INST. (July 17, 1991), https://www.cato.org/policy-analysis/alcohol-prohibition-was-failure. The 18th Amendment prohibited "the manufacture, sale, or transportation of intoxicating liquors within" the United States. U.S. CONST. amend. XVIII, § 1. The 18th Amendment was later repealed by the 21st Amendment to the U.S. Constitution. *See* U.S. CONST. amend. XXI, § 1.

[24] *See* History.com Editors, *The Roaring Twenties*, *supra* note 19.

alcohol through organized crime and were revered as heroes by the public for their defiance against the government.[25]

The American economy flourished.[26] New household products entered the market, the number of Americans that owned automobiles rose, and ordinary people invested in stocks.[27] The stock market rapidly expanded, and stock prices rose to historic levels.[28] Optimistic speculation in the market reigned, and hundreds of millions of shares of stock were financed by bank loans, which were expected to be repaid by the anticipated profits from the stock transactions.[29] Anticipated profits fell short, however, preventing lenders from recovering loan amounts and shattering confidence in the U.S. economy.[30]

In 1929, the United States faced the Great Crash and, soon after, the Great Depression, eviscerating the success of the Roaring Twenties.[31] These historic events led President Franklin Delano Roosevelt to organize the New Deal.[32] The Securities Act of 1933 and the Securities Exchange Act of 1934 arose from the New Deal and are the two most significant U.S. federal securities statutes.[33]

A. Combatting the Great Crash

The Great Crash of 1929 marks the record decline in the American stock market.[34] During this decline, the most severe drop occurred on October 29, 1929, more commonly known as "Black Tuesday."[35] That day, over 16 million shares were sold on the New York Stock Exchange, which caused stock prices to collapse and investors to lose billions of dollars.[36] Although these massive

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[25] *See* Laura Martisiute, *26 Famous Gangsters from the Height of the Public Enemy Era*, ATI, https://allthatsinteresting.com/famous-gangsters-1920s#3 (Jan. 30, 2019).

[26] *See* History.com Editors, *The Roaring Twenties*, *supra* note 19.

[27] *See id.*; *The Roaring 20s*, PBS, https://www.pbs.org/wgbh/americanexperience/features/crash-roaring-20s/ (last visited Dec. 31, 2021); Brian Duignan, *Causes of the Great Depression*, BRITANNICA, https://www.britannica.com/story/causes-of-the-great-depression (last visited Jan. 2, 2022).

[28] *See* Duignan, *supra* note 27.

[29] *See id.*

[30] *See id.*

[31] *See* History.com Editors, *Stock Market Crash of 1929*, HIST., https://www.history.com/topics/great-depression/1929-stock-market-crash (Aug. 12, 2022).

[32] *Great Depression*, HIST., https://www.history.com/topics/great-depression (last visited Jan. 2, 2022).

[33] DAVID G. EPSTEIN, RICHARD D. FREER, MICHAEL J. ROBERTS & GEORGE B. SHEPHERD, BUSINESS STRUCTURES 449 (5th ed. 2019).

[34] *See* History.com Editors, *Stock Market Crash of 1929*, *supra* note 31.

[35] *See id.*

[36] *See id.*

losses were not the sole cause of the Great Depression, the Great Crash was a contributing factor.[37]

The Great Depression of 1929 is the worst economic downturn in the modern history of the world and lasted nearly ten years.[38] A third of banks in America failed, unemployment rates reached almost 25%, housing prices fell 67%, deflation was over 10%, and the stock market lost 90% of its value.[39] Overall, the American economy was devastated.[40]

In response to this economic crisis, the New Deal was created.[41] The New Deal was a series of reforms enacted to combat the effects of the Great Crash and the Great Depression, rebuild the economy, and prevent similar economic crises from occurring in the future.[42] Key areas these programs focused on were the U.S. banking system, agriculture industry, welfare system, public works projects and job creation, and financial reform in the securities market.[43]

The financial reform programs emphasized restoring investor confidence in the U.S. securities market and sought to prevent a future stock market crash like the Great Crash.[44] To prevent another financial catastrophe, the financial reforms addressed the main causes of the Great Crash[45]—the primary cause being abuses in the American stock market that engendered its rapid expansion during the Roaring Twenties.[46] Abuses in the stock market included insider trading, lack of disclosure of relevant company information to investors, and the unrestricted purchase of securities on margin.[47] These abuses were able to proceed because,

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[37] *See id.*

[38] *See* Duignan, *supra* note 27.

[39] *See* Kimberly Amadeo, *9 Principal Effects of the Great Depression*, THE BALANCE, https://www.thebalancemoney.com/effects-of-the-great-depression-4049299 (Mar. 27, 2022); Tom Nicholas & Anna Scherbina, *Real Estate Prices During the Roaring Twenties and the Great Depression*, 41 REAL EST. ECON. 278, 278 (2013).

[40] *See* Amadeo, *supra* note 39.

[41] *The New Deal*, COURSE HERO, https://www.coursehero.com/study-guides/boundless-ushistory/the-new-deal/ (last visited Jan. 2, 2022).

[42] *See id.*

[43] *See id.*

[44] *See* History.com Editors, *SEC: Securities and Exchange Commission*, HIST. (Dec. 6, 2019), https://www.history.com/topics/us-government/securities-and-exchange-commission.

[45] *See, e.g.*, *id.*; *Securities Law History*, *supra* note 1.

[46] *See* History.com Editors, *SEC: Securities and Exchange Commission*, *supra* note 44; *Securities Law History*, *supra* note 1.

[47] *See* History.com Editors, *SEC: Securities and Exchange Commission*, *supra* note 44; *Securities Law History*, *supra* note 1. These abuses also included widespread fraud and unsupported promises of large profits that misled investors. *See* History.com Editors, *SEC: Securities and Exchange Commission*, *supra* note 44; *Securities Law History*, *supra* note 1.

at the time, securities regulation was "virtually nonexistent."[48] Without regulation, these abuses created a "speculative frenzy" that drove the expansion of the market and eventually led to a widespread panic causing investors to liquidate their investments, infamously known as the Great Crash.[49]

For the first time in American history, with the implementation of the New Deal, federal regulation was imposed over the securities market to prevent these abuses and protect investors.[50] Federal securities regulation protects investors by requiring companies that issue securities to disclose "detailed information to investors about themselves" and their securities, and by permitting investors to sue companies that used false or misleading information to sell their securities.[51] These protections are enforced through the Securities Act of 1933 and the Securities Exchange Act of 1934, each of which will be addressed in turn.[52]

B. Securities Act of 1933 and Securities Exchange Act of 1934

The Securities Act of 1933 "governs the issuance of securities" by companies[53] and has two main objectives: (1) ensuring investors receive certain relevant information related to the sale of securities; and (2) prohibiting fraud in the sale of the securities.[54] These objectives are accomplished through the Securities Act's disclosure and registration requirements.[55] Requiring companies to comply with disclosure and registration requirements provides investors with financial transparency to make informed investment decisions

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[48] *See* History.com Editors, *SEC: Securities and Exchange Commission*, *supra* note 44. Most states did have their own securities laws, known as "Blue Sky Laws." *See Securities Law History*, *supra* note 1. The state securities laws are called Blue Sky Laws "because the laws protect against shady promoters who would sell stock by promising the buyer the whole blue sky." EPSTEIN ET AL., *supra* note 33, at 450. However, Blue Sky Laws "were mostly ineffective." History.com Editors, *SEC: Securities and Exchange Commission*, *supra* note 44.

[49] *See Securities Law History*, *supra* note 1.

[50] *See The New Deal*, *supra* note 41 ("For the first time in American history, the government was directly involved in reforming and regulating the economy.").

[51] *See* EPSTEIN ET AL., *supra* note 33, at 449.

[52] *See Securities Law History*, *supra* note 1.

[53] EPSTEIN ET AL., *supra* note 33, at 449.

[54] *The Laws that Govern the Securities Industry*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry (last visited Jan. 2, 2022). A security is "any note, stock, treasury stock, bond, . . . investment contract, . . . any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, . . . or warrant or right to subscribe to or purchase, any of the foregoing." SEC v. W.J. Howey Co., 328 U.S. 293, 297 n.3 (1946) (quoting 15 U.S.C.A. § 77b(a)(1)).

[55] *See The Laws that Govern the Securities Industry*, *supra* note 54. Generally, registration forms require a "description of the company's properties and business[,] a description of the security to be offered for sale," information about company management, and "financial statements certified by independent accountants." *Id.*

and an avenue of recovery if deceived by companies while making those decisions.[56]

The Securities Exchange Act of 1934 governs new securities and resales of securities in the secondary market by requiring companies to continually "provide detailed public reports about their operations"[57] and creating the SEC to ensure its enforcement.[58] The SEC is a federal agency that has the authority to regulate the U.S. securities market by promulgating and enforcing rules pursuant to the Securities Exchange Act.[59] Federal courts possess exclusive jurisdiction over cases arising from violations of the Securities Exchange Act and the rules and regulations promulgated pursuant to it.[60]

In accordance with the purpose of the Securities Exchange Act, the SEC's mission is to protect investors by overseeing the U.S. securities market.[61] Section 10(b) of the Securities Exchange Act is the primary anti-fraud statutory provision and is enforced by the SEC's promulgated Rule 10b-5.[62]

1. Section 10(b) of the Securities Exchange Act of 1934

When determining the application of Section 10(b) to extraterritorial conduct, the focus of the anti-fraud provision is on the purchase and sale of securities in the United States.[63] Accordingly, this Comment focuses on Section 10(b)'s language, "in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered."[64]

Section 10(b) provides:

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[56] *See id.*

[57] EPSTEIN ET AL., *supra* note 33, at 449. The SEC requires companies to file reports, forms, and other information to a searchable, online database called EDGAR. History.com Editors, *SEC: Securities and Exchange Commission*, *supra* note 44.

[58] *See* History.com Editors, *SEC: Securities and Exchange Commission*, *supra* note 44.

[59] *See id.*

[60] 15 U.S.C. § 78aa(a).

[61] *See What We Do*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about/what-we-do (last visited Jan. 2, 2022). In describing its mission, the SEC states on its website that "[f]or more than 85 years since our founding at the height of the Great Depression, we have stayed true to our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation." *Id.*

[62] *See Securities Exchange Act of 1934*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/securities_exchange_act_of_1934 (last visited Jan. 2, 2022).

[63] *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 266–67 (2010).

[64] 15 U.S.C. § 78j(b).

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .
>
> (b) To use or employ, *in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered*, or *any securities-based swap agreement*[,] 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*.[65]

2. Rule 10b-5

In 1948, Rule 10b-5 was promulgated by the SEC under Section 10(b) of the Securities Exchange Act.[66] Rule 10b-5 broadly protects against securities fraud, insider trading, and other deceptive practices.[67] The rule is considered "a bedrock of protection for those who purchase and sell securities. Every securities transaction lives under its protective shade and menacing shadow."[68] Significantly, because Rule 10b-5 was promulgated pursuant to Section 10(b), the extent of its application is limited to the extraterritorial conduct reached by Section 10(b).[69]

Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or the mails or of any facility of any national securities exchange,
>
> (a) To employ any device scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

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[65] *Id.* § 78j (emphasis added).

[66] EPSTEIN ET AL., *supra* note 33, at 455.

[67] *See id.* at 455, 475.

[68] *Id.* at 455 (quoting ALAN R. PALMITER, CORPORATIONS—EXAMPLES AND EXPLANATIONS 413 (6th ed. 2009)).

[69] *See Morrison*, 561 U.S. at 261–62.

in connection with the purchase or sale of any security.[70]

3. Private Actions Versus Public Actions

Rule 10b-5 is among the most litigated federal law provisions and has had more private securities actions brought under it than any other securities law in the last twenty-five years.[71] Although Section 10(b) and Rule 10b-5 do not explicitly provide for private causes of action for violations, private causes of action developed through judicial application and legislative acquiescence, and are well-established in the law.[72]

Public actions by the SEC and the Department of Justice ("DOJ") may also be brought under Section 10(b) and Rule 10b-5.[73] SEC actions under these provisions are civil actions, and can result in monetary remedies, injunctions, and restrictions on participation in the securities industry.[74] Conversely, the DOJ can institute criminal charges for violations of Section 10(b) and Rule 10b-5.[75]

II. SECTION 10(B)'S RALLY ABROAD

Creating a private cause of action under Section 10(b) and Rule 10b-5 was one of the most significant decisions in the history of securities law.[76] The Second Circuit was first to recognize this right,[77] and has since led the development of Section 10(b) jurisprudence.[78] Part of this development included

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[70] 17 C.F.R. § 240.10b-5 (2021).

[71] STUART R. COHN, SECURITIES COUNSELING FOR SMALL & EMERGING COMPANIES § 19:8, Westlaw (database updated Oct. 2021).

[72] *See* Basic Inc. v. Levinson, 485 U.S. 224, 230–31 (1988) (citations omitted).

[73] *See* Brenda Hamilton, *SEC Rule 10b-5*, SEC. LAW. 101, https://www.securitieslawyer101.com/2013/rule-10b-5/ (last visited Jan. 2, 2022).

[74] *See Investor Bulletin: SEC Investigations*, U.S. SEC. & EXCH. COMM'N (Oct. 22, 2014), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_investigations.

[75] *See* Hamilton, *supra* note 73. In *United States v. Georgiou*, Georgiou engaged in a stock fraud scheme that manipulated the markets of four stocks. 777 F.3d 125, 130 (3d Cir. 2015). Consequently, the United States instituted a criminal proceeding for violation of, among other things, Section 10(b) and Rule 10b-5. *See id.* at 132.

[76] Karen Patton Seymour, *Securities and Financial Regulation in the Second Circuit*, 85 FORDHAM L. REV. 225, 229 (2016). Since the enactment of the Securities Act and the Securities Exchange Act as part of the New Deal, "the Second Circuit has been the leading interpreter of U.S. securities laws and arguably the most influential court in the area of securities regulation in the world." *Id.* at 225.

[77] *Id.* at 226 (citation omitted).

[78] *See id.* at 232. No other court has been more influential in securities law than the Second Circuit. *See id.* at 225. At least partially due to its location in the largest securities market in the world, New York City, the Second Circuit has gained unparalleled experience in the area and commands preeminence in securities law. *See id.* at 225–26 (citation omitted). During one period, the court "was responsible for one-third of all securities

creating the standard for determining the extraterritorial reach of Section 10(b).[79] For this analysis, the Second Circuit implemented the Conduct and Effects test.[80] The Conduct test asks "whether 'substantial acts in furtherance of the fraud were committed within the United States[,]'" and the Effects test asks "whether the wrongful conduct had a substantial effect in the United States or upon [U.S.] citizens[.]"[81] Generally, if either of the tests was satisfied, then Section 10(b) could reach the challenged conduct and apply extraterritorially.[82] Although these tests were created separately, they were later combined and applied together to determine whether a federal court possessed subject-matter jurisdiction to adjudicate a case.[83]

A. The Effects Test

During the 1960s, the Second Circuit began its long line of Section 10(b) jurisprudence by developing its Effects test.[84] In 1968, the Second Circuit created the Effects test to determine when challenged conduct would warrant assertion of jurisdiction by federal courts under the Securities Exchange Act of 1934.[85] In *Schoenbaum v. Firstbrook*, an American shareholder of Banff Oil, Ltd., a Canadian corporation that conducted all of its business in Canada, brought a derivative action against Banff Oil's board of directors for damages to Banff Oil resulting from the sale of Banff's treasury stock to another Canadian corporation.[86] Because fraud in Canada giving Banff Oil inadequate consideration for its stocks would lower the bid price for Banff's shares traded

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opinions issued by" the circuit courts, and its decisions comprised up to "70 percent of opinions [published] in securities law casebooks." *Id.* at 225 (citation omitted).

[79] *See id.* at 232 (citation omitted).

[80] *See id.*

[81] *Id.* at 232 n.67 (alteration in original) (citation omitted).

[82] *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 257 (2010) ("The Second Circuit had thus established that application of § 10(b) could be premised upon either some effect on American securities markets or investors *(Schoenbaum)* or significant conduct in the United States *(Leasco)*.").

[83] *See* Itoba Ltd. v. Lep Grp. PLC, 54 F.3d 118, 122 (2d Cir. 1995), *abrogated by Morrison*, 561 U.S. 247; SEC v. Scoville, 913 F.3d 1204, 1216 (10th Cir. 2019) ("The courts of appeals treated application of the conduct-and-effects test to decide when the federal securities acts applied extraterritorially as a matter of subject-matter jurisdiction." (citing *Morrison*, 561 U.S. at 253–54, 257–60)).

[84] *See* Donald C. Langevoort, Schoenbaum *Revisited: Limiting the Scope of Antifraud Protection in an Internationalized Securities Marketplace*, 55 LAW & CONTEMP. PROBS. 241, 241 (1992).

[85] *See* Schoenbaum v. Firstbrook, 405 F.2d 200, 208–09 (2d Cir. 1968) (citations omitted), *abrogated by Morrison*, 561 U.S. 247.

[86] *Id.* at 204–05. "The derivative action is the common law's inventive solution to the problem of actions to protect shareholder interests." Joy v. North, 692 F.2d 880, 887 (2d Cir. 1982). "[A] derivative suit involves two actions brought by an individual shareholder: (i) an action against the corporation for failing to bring a specified suit and (ii) an action on behalf of the corporation for harm to it identical to the one which the corporation failed to bring." *Id.* (citing Ross v. Bernhard, 396 U.S. 531 (1970)).

in America, the court found a "sufficiently serious effect" to warrant assertion of jurisdiction and consider the merits of the American investor's claims against the Canadian corporation's board of directors.[87]

The Second Circuit claimed it had subject-matter jurisdiction because it determined the Securities Exchange Act does have extraterritorial application.[88] The court reasoned that neither the presumption against extraterritoriality nor the "language in Section 30(b) show[ed] 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."[89] According to the court, when the Effects test was satisfied, Section 10(b) could apply extraterritorially.[90]

B. The Conduct Test

Four years later, the Second Circuit developed the Conduct test.[91] In *Leasco v. Data Processing Equipment Corp. v. Maxwell*, an American company suffered damages from securities fraud in connection with securities exchanged in England.[92] The securities were not listed on an American domestic exchange, but some of the challenged conduct occurred in the United States.[93] Section 10(b) applied to the transaction in *Leasco* because misrepresentations inducing the American corporation to purchase the shares were made in the United States and constituted substantial acts in furtherance of the fraud.[94] For the Second Circuit, this was sufficient to trigger Section 10(b) liability even though

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87 *See Schoenbaum*, 405 F.2d at 208–09 (citations omitted).

88 *Id.* at 206.

89 *Id.* In its analysis of subject-matter jurisdiction, the Second Circuit seemed to disregard the presumption against extraterritoriality. *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 256 (2010) (citing *Schoenbaum*, 405 F.2d at 206). Instead of looking for affirmative language to overcome the presumption, it relied on the lack of congressional intent to preclude application of the Securities Exchange Act extraterritorially when its Effects test was met. *See Schoenbaum*, 405 F.2d at 206.

90 *See Schoenbaum*, 405 F.2d at 206 ("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.").

91 *See* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1334–36 (2d Cir. 1972), *abrogated by Morrison*, 561 U.S. 247; *Morrison*, 561 U.S. at 257.

92 *See* 468 F.2d at 1330; *Morrison*, 561 U.S. at 256.

93 *See Leasco*, 468 F.2d at 1334–35; *Morrison*, 561 U.S. at 256–57.

94 *Leasco*, 468 F.2d at 1337.

misrepresentations were also made in England, and the shares were transferred there as well.[95]

The Second Circuit's analysis again disregarded the presumption against extraterritoriality and expanded Section 10(b)'s reach abroad.[96] The Second Circuit replaced the presumption with an inquiry into whether it would be reasonable to apply Section 10(b) to the challenged conduct in question, which essentially looked into congressional intent to determine if Congress would want the courts to use their resources to address a particular case.[97] If either of the Conduct or Effects tests was satisfied, then Congress intended Section 10(b) to cover the challenged conduct.[98] This allowed Section 10(b) to be applied to even "predominantly foreign" transactions.[99] The Second Circuit later combined the Conduct and Effects tests into one test because it believed the combination provided better insight in evaluating whether the federal courts should adjudicate a particular case.[100]

III. A HALT IN EXTRATERRITORIAL REACH

In 2010, the Supreme Court's decision in *Morrison* brought the Second Circuit's Section 10(b) jurisprudence to a screeching halt.[101] This Supreme Court decision, delivered by Justice Scalia, ushered in a "fundamental shift in securities law."[102] After forty years of Section 10(b) extraterritorial applicability jurisprudence,[103] the Supreme Court changed the issue from a question of subject-matter jurisdiction to one of the merits of the claim, and incorporated a new two-step approach to the issue.[104] The two-step analysis eliminated the Conduct and Effects test and replaced it with a bright-line Transactional test that

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95 *See Leasco*, 468 F.2d at 1334–36, 1339; Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 986 (2d Cir. 1975), *abrogated by Morrison*, 561 U.S. 247.

96 *See Morrison*, 561 U.S. at 257 (citing *Bersch*, 519 F.2d at 985).

97 *See id.*

98 *See id.*

99 *See id.* (quoting *Bersch*, 519 F.2d at 985).

100 *See id.* at 258 (citing Itoba Ltd. v. Lep Grp. PLC, 54 F.3d 118, 122 (2d Cir. 1995)).

101 *See* SEC v. Scoville, 913 F.3d 1204, 1217 (10th Cir. 2019) (noting that *Morrison*'s holding was contrary to decades of circuit-level case law). The Second Circuit's Conduct and Effects test "is a much easier standard to meet than the narrower domestic-applicability test articulated in *Morrison*. In a global marketplace, it can almost always be argued that the purchase or sale of securities occurring outside of the U.S. has a foreseeable substantial effect in the U.S." JENNIFER ACHILLES & AARON CHASE, REED SMITH LLP, SEC V. SCOVILLE: THE TENTH CIRCUIT REVIVES EXTRATERRITORIAL APPLICATION OF THE FEDERAL SECURITIES LAWS 4 (2019), https://www.reedsmith.com/en/perspectives/2019/03/sec-v-scoville-the-tenth-circuit-revives-extraterritorial-application.

102 *Scoville*, 913 F.3d at 1218.

103 *See id.* at 1216.

104 *Morrison*, 561 U.S. at 269–70.

determines whether a transaction is domestic.[105] The Court's decision to shift the issue to a question of merit gave rise to an issue with the Dodd-Frank Act,[106] and the Transactional test created ambiguity among the circuits as to whether a domestic transaction was sufficient to trigger Section 10(b) applicability or just a threshold requirement.[107]

A. Morrison v. National Australia Bank, Ltd.

Although the Second Circuit called upon Congress to speak on the issue of Section 10(b)'s extraterritorial application when it adjudicated *Morrison*,[108] the Supreme Court decided to address the case.[109] In *Morrison*, Australian investors purchased shares of National Australia Bank, which were publicly traded on the Australian Stock Exchange Limited.[110] National Australia Bank allegedly committed securities fraud, and, as a result, the Australian investors brought suit in the Southern District of New York.[111] National Australia Bank moved to dismiss the private action for lack of subject-matter jurisdiction and failure to

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[105] *See id.* "The Commonwealth of Australia, the United Kingdom of Great Britain and Northern Ireland, and the Republic of France . . . filed *amicus* briefs in [*Morrison*]." *Id.* at 269. "They all complain[ed] of the interference with foreign securities regulation that application of § 10(b) abroad would produce, and urge[d] the adoption of a clear test that [would] avoid that consequence." *Id.* According to the Court, the Transactional test met that requirement. *Id.* at 269–70.

[106] *See Scoville*, 913 F.3d at 1217–18 (citing *Morrison*, 561 U.S. at 254–55) (noting that *Morrison* "held that the question of the extraterritorial reach of § 10(b) did *not* implicate a court's subject-matter jurisdiction" and that Congress only amended the jurisdictional sections of the Dodd-Frank Act).

[107] *See* Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012) ("While *Morrison* holds that § 10(b) can be applied to domestic purchases or sales, it provides little guidance as to what constitutes a domestic purchase or sale.").

[108] Morrison v. Nat'l Austl. Bank Ltd., 547 F.3d 167, 170 n.4 (2d Cir. 2008), *aff'd*, 561 U.S. 247, 273 (2010).

[109] *Morrison*, 561 U.S. at 253 (granting certiorari).

[110] *Id.* at 251–52. The bank did not have shares listed on a U.S. exchange; however, the bank did have American depositary receipts listed on the New York Stock Exchange. *Id.* at 251. The American depository receipts were derivatives, representing the right to receive a specified number of National Australia Bank's shares listed on the foreign exchange. *See id.* "[American depositary receipts] are negotiable certificates issued by a United States depositary institution, typically banks, and they represent a beneficial interest in, but not legal title of, a specified number of shares of a non-United States company." Stoyas v. Toshiba Corp., 896 F.3d 933, 940 (9th Cir. 2018) (citation omitted). "The depositary institution itself maintains custody over the foreign company's shares. *Id.* "[American depositary receipts] 'allow U.S. investors to invest in non-U.S. companies and give non-U.S. companies easier access to U.S. capital markets.'" *Id.* (quoting SEC. & EXCH. COMM'N, OFF. OF INV'R EDUC. & ADVOC., INVESTOR BULLETIN: AMERICAN DEPOSITORY RECEIPTS 1 (2012)).

[111] *Morrison*, 561 U.S. at 252. National Australia Bank purchased a company headquartered in Florida and included the value of the Florida company's assets on its financial statements. *Id.* at 251. From 1998 to 2001, National Australia Bank's annual reports and other public documents flaunted the Florida company's success. *Id.*

state a claim.[112] The district court granted the motion to dismiss for lack of subject-matter jurisdiction, the Second Circuit affirmed, and the Supreme Court granted certiorari.[113]

The Supreme Court addressed two overarching issues.[114] First, the Supreme Court corrected the lower courts' interpretation of the type of issue raised by the question of Section 10(b)'s extraterritorial reach.[115] Second, the Court addressed whether Section 10(b) applies to actions brought by foreign plaintiffs suing foreign defendants for fraudulent conduct related to securities listed on foreign exchanges.[116]

As to the first issue, the Supreme Court held that the lower courts incorrectly considered the question of Section 10(b)'s extraterritorial reach to be an issue of subject-matter jurisdiction.[117] Justice Scalia, who authored the opinion, reasoned that determining the conduct that Section 10(b) reaches is equivalent to determining the conduct that Section 10(b) prohibits—a merits-based question rather than one of subject-matter jurisdiction.[118] Moreover, the district court already possessed the "power to hear [the] case" because Congress granted exclusive jurisdiction to federal district courts under 15 U.S.C. § 78aa to adjudicate violations arising from the Securities Exchange Act.[119]

Next, the Court addressed the second issue on the merits.[120] The Court began its analysis by raising the presumption against extraterritoriality canon of statutory construction.[121] The presumption against extraterritoriality states that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none."[122] The presumption exists because Congress ordinarily legislates regarding domestic matters instead of foreign matters.[123]

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[112] *Id.* at 253. In July 2001, National Australia Bank reduced the recognized value of its acquired Florida company's assets by $450 million and then, just two months later, wrote down an additional $1.75 billion. *Id.* at 252. National Australia Bank downplayed the first write down and blamed the second on mistaken assumptions and "a failure to anticipate the lowering of prevailing interest rates." *Id.*

[113] *Id.* at 253.

[114] *Id.* at 250–51, 253.

[115] *Id.* at 253.

[116] *Id.* at 250–51.

[117] *Id.* at 253–54.

[118] *Id.* at 254.

[119] *See id.* at 254 & n.3 (quoting Union Pac. R. Co. v. Locomotive Eng'rs, 558 U.S. 67, 81 (2009)). It was unnecessary to remand the case because the label of the dismissal did not affect the lower courts' analyses. *Id.* at 254.

[120] *See id.* at 255.

[121] *Id.*

[122] *Id.*

[123] *Id.* (citing Smith v. United States, 507 U.S. 197, 204 n.5 (1993)).

The Court recognized the lower courts' analyses deviated from this longstanding presumption and that they applied an unreliable test—the Second Circuit's Conduct and Effects test—that attempted to discern whether Congress sought to have Section 10(b) apply in each specific case.[124] Variations of the Conduct and Effects test had been applied in the lower courts for decades, determining the application of the Securities Exchange Act to fraudulent schemes that involved conduct abroad.[125]

The *Morrison* Court criticized the Conduct and Effects test for, among other things, its lack of textual support in the Securities Exchange Act and its inconsistent application.[126] Justice Scalia found that the Conduct and Effects test was based on the flawed premise that, because Congress was silent on the extraterritorial application of Section 10(b), courts were left to determine what Congress envisioned.[127] The Court also pointed out that the Second Circuit admitted that factors that were significant to the application of the test in past cases would not necessarily be dispositive in future cases.[128] Consequently, the Court put an end to the "judicial-speculation" into Congress's intent and provided Congress "a stable background" to legislate against.[129] The Supreme Court abrogated the Conduct and Effects test and revived the presumption against extraterritoriality in the Section 10(b) analysis.[130]

This transition ostensibly streamlined the Conduct and Effects test into a two-step analysis.[131] The two-step analysis first applies the presumption against extraterritoriality to a statute and determines whether there is a clear indication that Congress intended the statute to apply extraterritorially.[132] Then, because the Securities Exchange Act does not rebut the presumption and is limited to

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124 *Id.*

125 *See id.*

126 *Id.* at 258.

127 *See id.* at 260–61.

128 *Id.* at 258–59 (citing IIT v. Cornfeld, 619 F.2d 909, 918 (2d Cir. 1980)).

129 *Id.* at 261.

130 *See id.* at 261, 273 ("Section 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 stock exchange, and the purchase or sale of any other security in the United States.").

131 Under the *Morrison* two-step analysis, a federal statute applies to a case's challenged conduct if the presumption against extraterritoriality has been rebutted or if the challenged conduct only requires domestic application of the statute. *See* SEC v. Scoville, 913 F.3d 1204, 1215 (10th Cir. 2019) (citations omitted).

132 *See Morrison*, 561 U.S. at 265, 267 n.9 ("If § 10(b) did apply abroad, we would not need to determine which transnational frauds it applied to; it would apply to all of them. . . . Thus, although it is true . . . that our threshold conclusion that § 10(b) has no extraterritorial effect does not resolve this case, it is a necessary first step in the analysis.").

domestic application, the second step applies the Court's Transactional test to assess whether the alleged conduct qualifies as domestic under Section 10(b).[133]

As to the first step, the Court determined that the presumption against extraterritoriality applied to Section 10(b) and was not rebutted because the statute lacked a clear indication that it was to apply extraterritorially.[134] In its reasoning, the Court dismissed three arguments that were in favor of Section 10(b)'s application extraterritorially.[135] Each of these arguments failed because the Securities Exchange Act lacks affirmative indication that it is to apply extraterritorially.[136]

With respect to the second step, the Court concluded that Section 10(b) did not apply to the conduct of National Australia Bank.[137] The Court reasoned, "Section 10(b) does not punish deceptive conduct, but only deceptive conduct 'in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered.'"[138] The focus of Section 10(b) is directed to the purchases and sales of securities in the United States rather than where the deception originated.[139]

According to the Court, Congress's focus is limited to domestic transactions.[140] Because the statute seeks to regulate domestic transactions and protect parties to those transactions,[141] "Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with [(1)] the purchase or sale of a security listed on an American stock exchange, and

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133 *See id.* at 266–67. *Morrison* created the Transactional test. *See id.* at 285 (Stevens, J., concurring in the judgment).

134 *See id.* at 265 (majority opinion).

135 *See id.* at 262–64. First, the Court determined that general reference to foreign commerce in the statute's definition of "interstate commerce" was insufficient to defeat the presumption. *Id.* at 262–63. Second, the Securities Exchange Act's reference to the dissemination and quotation abroad of the prices of securities traded in domestic exchanges and markets was insufficient because there was no indication that the "*national* public interest pertains to transactions conducted upon *foreign* exchanges and markets." *Id.* at 263. Third, language in another section of the Exchange Act addressing situations warranting extraterritorial application lent support to the argument against Section 10(b)'s extraterritorial application because it would constitute surplusage for Congress to include that language if the entire Exchange Act already applied extraterritorially. *Id.* at 263–65.

136 *Id.* at 265.

137 *See id.* at 273.

138 *Id.* at 266 (quoting 15 U.S.C. § 78j(b)).

139 *Id.* at 266. The Court reasoned that "[t]he probability of incompatibility with the applicable laws of other countries is so obvious that if Congress intended such foreign application 'it would have addressed the subject of conflicts with foreign laws and procedures.'" *Id.* at 269 (quoting EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 256 (1991)).

140 *See id.* at 266.

141 *Id.* at 266–67.

[(2)] the purchase or sale of any other security in the United States."[142] The case failed both of these prongs because it did not involve securities listed on a domestic exchange, and all aspects of the purchases complained of by the Australian investors occurred outside the United States.[143] Thus, the transactions were not domestic and, accordingly, were out of Section 10(b)'s reach.[144]

In Justice Stevens' concurrence, he argued the Court came to the correct conclusion but employed a flawed analysis.[145] Justice Stevens concluded the Court upended decades of securities law in favor of a bright-line test that rendered Section 10(b) "toothless."[146] With the new Transactional test, defrauders could escape liability for private actions on technicalities by consummating transactions of securities not listed on domestic exchanges overseas.[147] Further, Justice Stevens determined the Court's opinion only applied to private actions brought under Section 10(b) and did not apply to actions brought by the SEC, appearing to anticipate a significant forthcoming issue.[148]

B. Dodd-Frank Wall Street Reform and Consumer Protection Act

Nearly simultaneously with the *Morrison* decision, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act.[149] In the Dodd-Frank Act, Congress granted federal courts *jurisdiction* over public actions brought by the SEC and DOJ for violations of Section 10(b) that satisfy the Conduct and Effects test.[150] The issue that arises from the passage of the Dodd-Frank Act is whether Congress extended Section 10(b)'s reach to apply extraterritorially, despite *Morrison*, and reinstated the Conduct and Effects test for public actions.[151] The answer is unclear because *Morrison* altered the

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142 *Id.* at 273.

143 *Id.* Even though the Florida company's financial models were allegedly manipulated in Florida and the misleading statements were also allegedly made in that state, Section 10(b) did not reach that conduct. *Id*. at 251–52, 273. Additionally, it is worth noting the Court did not comment on the applicability of Section 10(b) to the American investor's complaint regarding the American depositary receipt listed on the New York Stock Exchange since that complaint was dismissed by the District Court for failure to allege damages. *See id.* at 252 n.1.

144 *See id.* at 273.

145 *See id.* at 274 (Stevens, J., concurring in the judgment).

146 *See id.* at 285–86 (quoting Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 175 (2008) (Stevens, J., dissenting)).

147 *See id.* at 285.

148 *See id.* at 284 n.12.

149 *See* SEC v. Scoville, 913 F.3d 1204, 1216–18 (10th Cir. 2019).

150 *See id.* at 1215.

151 *See id.* at 1215, 1218.

question of Section 10(b)'s applicability to one of merit rather than jurisdiction.[152] Thus, arguably, that section of the Dodd-Frank Act had no effect. The Tenth Circuit addressed this question in 2019.[153]

1. The Tenth Circuit—SEC v. Scoville

The Tenth Circuit took a position in favor of extraterritorial application of Section 10(b) for actions brought by the SEC and the DOJ.[154] In 2019, the Tenth Circuit determined the Dodd-Frank Act partially abrogated *Morrison* and granted Section 10(b) extraterritorial application for actions brought by the SEC and the DOJ that satisfy the Conduct and Effects test.[155]

Under the *Morrison* two-step analysis, a federal statute applies to a case's challenged conduct if "the presumption against extraterritoriality has been rebutted" or if the challenged conduct only requires "domestic application of the statute."[156] The Tenth Circuit decided Section 10(b) applied under the first step[157] and determined the presumption against extraterritoriality was rebutted because, by Congress's enactment of the Dodd-Frank Act, there was affirmative and unmistakable congressional intent that Section 10(b) applies extraterritorially when the challenged conduct satisfies the Conduct and Effects test.[158]

The Tenth Circuit determined that the Dodd-Frank Act succeeded in extending Section 10(b)'s reach due to *Morrison*'s deviation from the longstanding precedent of treating its applicability as a subject-matter jurisdiction question and the unfortunate timing of the decision.[159] The court found that *Morrison* was issued too late in the legislative process to reasonably permit Congress to amend a finalized version of a "massive 850-page omnibus bill designed to overhaul large swaths of the United States financial regulations."[160] The court took the position that Congress lacked sufficient

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152 *See Morrison*, 561 U.S. at 254.

153 *See Scoville*, 913 F.3d at 1215 ("Congress has provided that the antifraud provisions apply extraterritorially when significant steps are taken in the United States to further a violation or conduct occurring outside the United States has a foreseeable substantial effect within the United States[.]").

154 *See id.*

155 *See id.*

156 *See id.* (quoting WesternGeco LLC v. ION Geophysical Corp., 138 S. Ct. 2129, 2136 (2018)).

157 *Id.*

158 *Id.* at 1218.

159 *See id.* at 1217–18.

160 *Id.* at 1218.

notice of this "fundamental shift in securities law" to react accordingly, but Congress may have had more notice of this shift than accredited.[161]

2. Congress Failed to Extend Section 10(b)'s Scope for Public Actions

The Dodd-Frank Act grants *jurisdiction* to federal courts for actions or proceedings brought by the SEC or DOJ for violations of Section 10(b) that meet the Conduct and Effects test.[162] Two considerations arise from this language, and the second is important because of the potential conflict with the holdings of *Morrison*.[163] First, the Dodd-Frank Act distinguishes actions brought by the SEC and the DOJ from private actions.[164] Second, the Dodd-Frank Act's grant of jurisdiction creates a question of whether Congress intended to extend the reach of Section 10(b) and, if it did, whether it succeeded.[165] If Congress did succeed, then *Morrison*'s holding would only apply to private actions under Section 10(b) and not public actions.[166]

Regarding the second consideration, the Tenth Circuit's argument that Congress intended to extend the reach of Section 10(b) is compelling, considering the title of the relevant section in the Dodd-Frank Act is "S[trengthening] E[nforcement] B[y] [the] C[ommission]."[167] However, whether Congress succeeded is largely questionable. The Dodd-Frank Act purports to extend federal courts' jurisdiction, but *Morrison* determined that U.S. courts already have jurisdiction over extraterritorial Section 10(b) claims and whether Section 10(b) applied extraterritorially goes to the merits of the claim rather than a question of subject-matter jurisdiction.[168] Thus, arguably, the Dodd-Frank Act technically granted to federal courts what they already possessed and, in effect, was inconsequential.[169]

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161 *Id.* at 1216, 1218 ("In 2006, . . . the Supreme Court addressed the difference between matters that implicate a federal court's subject-matter jurisdiction and matters that go, instead, to proving an element of a claim.").

162 *Id.* at 1215.

163 *See id.* at 1217–18 ("*Morrison*, then, contrary to forty years of circuit-level law, held that the question of the extraterritorial reach of § 10(b) did *not* implicate a court's subject-matter jurisdiction[.] . . . But Congress, in the Dodd-Frank Act, amended only the jurisdictional sections of the securities laws.").

164 *See id.* at 1218.

165 *See id.*

166 *See id.* at 1215.

167 *See id.* at 1218.

168 *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 254 (2010).

169 *See id.* (noting the District Court already had jurisdiction under 15 U.S.C. § 78aa to adjudicate the claim).

This discrepancy arose due to the timing of the Supreme Court's decision in *Morrison* and the enactment of the Dodd-Frank Act.[170] *Morrison* and the Dodd-Frank Act came to different answers for essentially the same question at nearly the same time.[171] *Morrison* deviated from forty years of "circuit-level" precedent and changed the issue of Section 10(b)'s applicability away from a jurisdictional issue.[172] However, against the background of the forty years of precedent, Congress enacted the Dodd-Frank Act and, accordingly, legislated for a broader reach in terms of jurisdiction.[173] The *Morrison* decision was finalized the same day that the Dodd-Frank Act completed joint committee review, and the Dodd-Frank Act was enacted into law less than a month later.[174]

In its discussion of *Morrison*, the Tenth Circuit referenced the Supreme Court's decision in 2006, *Arbaugh v. Y&H Corp.*[175] *Arbaugh* was not a case involving securities laws, but it did "address[] the difference between matters that implicate a federal court's subject-matter jurisdiction" and matters that implicate the merits of a claim.[176] *Arbaugh* held that courts should treat federal statutory limitations "as non-jurisdictional in character" unless Congress ranks the restriction as jurisdictional.[177] The Court relied on Congress's placement of the provision in question in the definitions section of the statute, rather than the jurisdictional provision, to reach its determination that it was facing a merits issue.[178]

Morrison relied on the *Arbaugh* line of cases in reaching its merits holding.[179] Because *Arbaugh* was decided four years prior to the Dodd-Frank Act, the *Arbaugh* line of cases, coupled with the Supreme Court granting certiorari in *Morrison*, should have put Congress on notice of the forthcoming "fundamental shift in securities law."[180] In light of this notice, courts should not rule on this ambiguity in a way that abrogates a Supreme Court decision and erodes stare decisis as a result of Congress failing to take into account a relevant trend in the law and incorrectly addressing an issue. Therefore, while Congress may have intended to extend the scope of Section 10(b) with the Dodd-Frank

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170 *See Scoville*, 913 F.3d at 1217–18.
171 *See id.* at 1216–18.
172 *Id.* at 1217–18.
173 *See id.*
174 *Id.* at 1217.
175 *Id.* at 1216 (citing Arbaugh v. Y&H Corp., 546 U.S. 500, 503 (2006)).
176 *Id.* (citing *Arbaugh*, 546 U.S. at 503).
177 *Id.* (quoting *Arbaugh*, 546 U.S. at 516).
178 *Id.* (citing *Arbaugh*, 546 U.S. at 514–15).
179 *Id.* at 1217.
180 *See id.* at 1216–18.

Act, it cannot be said that its intention was affirmative and unmistakable as the Tenth Circuit argued.

"While the Tenth Circuit's goal of providing clarity to a muddy area of the law is laudable, *Scoville* ultimately leaves as many questions as answers and . . . begs either the Supreme Court or Congress . . . to revisit an important issue of securities law."[181] The Tenth Circuit has taken the first step toward adding another circuit split to the existing one arising from interpreting *Morrison*'s Transactional test.[182] The other circuit courts have not directly faced the Dodd-Frank issue, but the First and Second Circuits have acknowledged the problem as they adjudicated securities cases interpreting the Transactional test.[183]

IV. VOLATILITY IN THE CIRCUITS

Although the Supreme Court in *Morrison* wished to provide clarity to the lower courts with a "clear test,"[184] it missed the mark. The Supreme Court's *Morrison* decision created a crucial ambiguity concerning the Dodd-Frank Act and gave rise to a split among the circuit courts in their interpretations and applications of the second prong of the two-prong Transactional test.

While the First, Second, Third, and Ninth Circuit Courts agree as to what constitutes a domestic transaction under the second prong of *Morrison*'s Transactional test, they differ as to whether it is sufficient to trigger Section 10(b) liability or merely a threshold requirement. For the First, Third, and Ninth Circuits, if the second prong of *Morrison*'s Transactional test is satisfied, then nothing more is required, and Section 10(b) applies to the challenged conduct.[185] Regarding the Second Circuit, even if the second prong of *Morrison*'s Transactional test is satisfied and a domestic transaction exists, Section 10(b)

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181 ACHILLES & CHASE, *supra* note 101, at 2.

182 *See id.* at 4 ("It could be that the Tenth Circuit seized this case as an opportunity to take the first step towards a circuit split . . . .").

183 *See* SEC v. Morrone, 997 F.3d 52, 60 n.7 (1st Cir. 2021) (citing *Scoville* in its note that "*Morrison*'s transactional test only governs conduct occurring before July 22, 2010" in its SEC case); Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 211 n.11 (2d Cir. 2014) ("The import of [the Dodd-Frank] amendment is unclear . . . ."). In *Georgiou*, the Third Circuit's case adopting the Irrevocable Liability test, the court failed to take on the Dodd-Frank issue even though the United States instituted a criminal proceeding against Georgiou. *See* 777 F.3d 125, 132 (3d Cir. 2015) ("Following a three-week trial, a jury found Georgiou guilty of . . . four counts of securities fraud, in violation of Section 10(b) . . . .").

184 *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 269 (2010).

185 *See Morrone*, 997 F.3d at 60 ("We agree . . . that a transaction is domestic . . . if irrevocable liability occurs in the United States. . . . [W]e reject *Parkcentral* as inconsistent with *Morrison*."); *Georgiou*, 777 F.3d at 135–37 (concluding irrevocable liability in the United States can satisfy *Morrison*'s Transactional test); Stoyas v. Toshiba Corp., 896 F.3d 933, 949–50 (9th Cir. 2018) (adopting the irrevocable liability test and rejecting *Parkcentral* as inconsistent with *Morrison*).

still may not apply if there are significant foreign elements surrounding the transaction.[186] This section analyzes that split in authority.

A. The Second Circuit Takes on Morrison

Morrison failed to provide instruction on how to determine what constitutes a domestic transaction. The Second Circuit spearheaded this inquiry and determined that if irrevocable liability occurs within the United States, then there is a domestic transaction under *Morrison*.[187] Later, a difficult fact pattern pressed the boundaries of the Irrevocable Liability test and compelled the Second Circuit to expand the analysis.[188] Due to overwhelming foreign elements, the court concluded a domestic transaction is only a threshold requirement to invoking Section 10(b) liability.[189] This section analyzes the Second Circuit's development of its Irrevocable Liability test and So Predominantly Foreign test.

1. The Irrevocable Liability Test

Fittingly, because the Second Circuit enjoys "preeminence in the field of securities law,"[190] it established the original standard for interpreting the second prong of the Supreme Court's Transactional test.[191] Two years after *Morrison*, the Second Circuit held that to satisfy *Morrison*'s second prong—that a domestic securities transaction exists—"a plaintiff must allege facts suggesting that irrevocable liability was incurred or title was transferred within the United States."[192] Irrevocable liability relies on contract formation and occurs at the point when the parties are bound to carry out the transaction.[193] If irrevocable liability occurred in the United States, then the transaction is considered domestic.[194] Potentially relevant facts for the Irrevocable Liability test include

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[186] *See Parkcentral*, 763 F.3d at 215–16 ("[I]n the case of securities not listed on domestic exchanges, a domestic transaction is necessary but not necessarily sufficient to make § 10(b) applicable. . . . [T]he claims in this case are so predominantly foreign as to be impermissibly extraterritorial.").

[187] *See* Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 68 (2d Cir. 2012).

[188] *See Parkcentral*, 763 F.3d at 216 ("[W]e conclude that, while a domestic transaction or listing is *necessary* to state a claim under § 10(b), a finding that these transactions were domestic would not *suffice* to compel the conclusion that the plaintiffs' invocation of § 10(b) was appropriately domestic.").

[189] *See id.* at 215–16.

[190] Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 260 (2010) (quoting Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 32 (D.C. Cir. 1987)).

[191] *See Ficeto*, 677 F.3d at 62 ("This case requires us to determine whether foreign funds' purchases and sales of securities issued by U.S. companies brokered through a U.S. broker-dealer constitute 'domestic transactions' pursuant to *Morrison* . . . .").

[192] *Id.* at 68.

[193] *Id.*

[194] *Id.*

those "concerning the formation of the contracts, the placement of purchase orders, the passing of title, [and] the exchange of money."[195]

In *Absolute Activist Value Master Fund Ltd. v. Ficeto*, where the Second Circuit developed this doctrine, the court began its analysis by noting that *Morrison* gave little guidance as to under what circumstances the purchase or sale of a security that is not listed on a domestic exchange should be considered a domestic transaction.[196] As a result, the court looked to the text of the Securities Exchange Act for direction in its inquiry.[197] In the Securities Exchange Act's text, the definitions of the terms "purchase," "buy," "sale," and "sell" "suggest that 'purchase' and 'sale' take place when the parties become bound to effectuate the transaction."[198] This point, coupled with *Morrison*'s focus on the purchases and sales of securities, led the court to conclude that the point at which parties become irrevocably bound to carry out the contract can be used to determine the location of a securities purchase or sale.[199] Thus, the

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[195] *Id.* at 70. The court explained its Irrevocable Liability test while dismissing other proposed tests. *See id.* at 69–70. The other tests proposed inquiries into the identity of the parties, the type of security at issue, or whether each individual defendant engaged in conduct within the United States, which the court denied adopting. *Id.* at 69.

[196] *Id.* at 67. In *Ficeto*, nine Cayman Island hedge funds fell victim to a "pump-and-dump" scheme. *Id.* at 62–63. The hedge funds engaged an investment management company to manage its funds, and, allegedly, the investment management company caused the hedge fund to lose over $195 million through a series of fraudulent securities transactions. *Id.* at 62–64. The investment management company, through its power of attorney to invest on the hedge funds' behalf, caused the funds to purchase billions of shares of penny stocks directly from U.S. issuers. *Id.* at 63.

[197] *Id.* at 67. At the time of each of the initial purchases, the officers of the investment management company and the related defendants either already owned "substantial amounts of shares . . . or . . . received shares . . . from the U.S. Penny Stock Companies . . . in exchange for causing the [hedge] Funds to purchase shares from those Companies." *Id.* at 63.

[198] *Id.* at 67. Over the course of three years, the investment fund continued to arrange the financing of these transactions with the penny stock companies to further the scheme. *Id.* at 63. Throughout the arrangement, the investment management company "artificially inflated the prices of [the penny] stocks by trading and re-trading [them] . . . each time trading the stock at a higher price to create the illusion of trading volume." *Id.* At one point, the investment company inflated the price of one of the penny stocks by causing one of the funds to trade its shares at "6000 times [the shares'] valuation just six months earlier." *Id.* at 63–64. Eventually, once the penny stocks hit a specific price, the officers of the investment management company and related defendants caused the hedge funds to purchase their fraudulently obtained shares from them. *Id.* at 64. They reaped a significant profit, and the hedge funds faced a drastic loss from the transactions. *Id.* at 63–64.

[199] *See id.* at 68. The court added that this may not be "the only way to locate a securities transaction" and that the location can also be determined by where title is transferred. *Id.* Interestingly, the court also noted that the SEC brought a proceeding for the same case and successfully argued Section 10(b) applied under the first prong of the Transactional test "because the case involve[d] securities traded on the [domestic] over-the-counter securities market." *Id.* at 66 n.3. However, the court did not offer an opinion on the issue since the question was not before the court. *Id.*

Second Circuit created a bright-line Irrevocable Liability test to interpret *Morrison*'s bright-line Transactional test.[200]

2. The So Predominantly Foreign Test

Soon after *Ficeto*, these bright-line tests faced a case that did not allow for such seamless application.[201] Considering the complexities and developing variations of securities, this was bound to happen.[202] In response, the Second Circuit made nearly a complete turnaround from bright-line rules and implemented a careful textual analysis of *Morrison* to support a more flexible test.[203]

In 2014, the Second Circuit incorporated the So Predominantly Foreign test into the analysis of Section 10(b)'s reach. In *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE*, over thirty international hedge funds employed securities-based swap agreements that referenced the stock of Volkswagen, a German company traded on the Frankfurt Stock Exchange.[204] Porsche, another German company, made public statements, primarily in Germany, that it did not have any intentions to take over Volkswagen.[205] However, over the next two years, Porsche secretly made a series of manipulative and complex securities transactions to acquire nearly enough shares for a controlling interest in Volkswagen.[206] When Porsche's secret plan

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[200] *See id.* at 67. Ultimately, the court concluded that the complaint failed to adequately allege the existence of domestic securities transactions because it did not put forth facts that indicated where the securities transactions occurred. *Id.* at 69–70. However, the court gave leave to amend the complaint because it was originally written before *Morrison* and geared "to satisfy the conduct and effects test" instead of the Transactional test. *Id.* at 71. The court suggested the hedge funds potentially could satisfy the Transactional test because in oral arguments they claimed they possessed transactional documents that showed the transactions occurred in the United States. *See id.*

[201] *See* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 214 (2d Cir. 2014) (questioning whether "a domestic transaction in a security (or a transaction in a domestically listed security)" is a sufficient or only a necessary element to invoke Section 10(b)).

[202] *See id.* at 217 ("In a world of easy and rapid transnational communication and financial innovation, transactions in novel financial instruments—which market participants can freely invent to serve the market's needs of the moment—can come in innumerable forms of which we are unaware and which we cannot possibly foresee.").

[203] *See id.* ("Neither do we see anything in *Morrison* that requires us to adopt a 'bright-line' test of extraterritoriality when deciding every § 10(b) case.").

[204] *See id.* at 201, 207. "A securities-based swap agreement is a private contract between two parties in which they 'agree to exchange cash flows that depend on the price of a reference security, here VW shares.'" *Id.* at 205. "[S]ecurities-based swap agreements do not involve the actual ownership, purchase, or sale of the reference security . . . ." *Id.* at 206. The international hedge funds consummated these transactions essentially as a "bet that [Volkswagen] stock would decline in value." *Id.* at 201.

[205] *Id.* at 201–02.

[206] *Id.* at 202–03.

was revealed, Volkswagen's stock price quickly skyrocketed, giving Porsche huge capital gains and the parties to the swap agreements massive losses.[207] Eventually, it was discovered that Porsche's original public statements regarding its intentions not to acquire Volkswagen were fraudulent, and the American parties to the swap agreements brought suit for violations of Section 10(b) and Rule 10b-5 in the U.S. District Court for the Southern District of New York.[208]

Unlike in *Morrison*, where the most significant facts all pointed in the same direction against classifying the transaction as domestic, *Parkcentral* faced conflicting facts.[209] In *Morrison*, the securities transactions were conducted extraterritorially among foreign parties and involved "misconduct in connection with securities traded on *foreign* exchanges."[210] However, in *Parkcentral*, while the derivative's underlying stock was traded on a foreign exchange and the fraudulent public statements were made in a foreign country, the derivative was privately exchanged in the United States.[211]

To reconcile its case with *Morrison* and *Ficeto*, the court prefaced its analysis by stating the Supreme Court's principles that it does not lay down broad rules to govern all conceivable future questions and makes decisions based on the cases in front of it.[212] *Morrison* and *Ficeto* were cases involving transactions of conventional securities as opposed to derivative securities.[213] This distinction was the underlying premise to the court's ultimate question—whether the existence of a domestic transaction under *Morrison* is sufficient to warrant the applicability of Section 10(b) or only a necessary element in establishing Section 10(b)'s appropriate reach in a case.[214]

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[207] *See id.* at 205. In 2008, Porsche's secret plan was revealed because of the global financial crisis. *See id.* at 204. The global financial crisis put Porsche's financial health in jeopardy and compelled it to make public statements revealing its interest in Volkswagen. *See id.* The parties that bet the stock price would fall lost a total of $38.1 billion. *See id.* at 205.

[208] *See id.* at 201, 203 & n.2.

[209] *See id.* at 221 n.1 (Leval, J., concurring).

[210] *Id.* (quoting Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 250–51 (2010)).

[211] *See id.* at 205, 207 (majority opinion); *id.* at 218 (Leval, J., concurring).

[212] *See id.* at 214 (majority opinion) ("One of the principal 'distinction[s] between courts and legislatures [is that] the former usually act retrospectively, settling disputes between persons, [while] the latter usually act prospectively, setting the general rules for future conduct.'" (quoting Simmons v. Lockhart, 931 F.2d 1226 1230 (8th Cir. 1991))).

[213] *Id.* A conventional security is a normal security like the stock of a company, while a derivative security is a "type of financial contract whose value is dependent on an underlying asset, group of assets, or benchmark." Jason Fernando, *Derivative*, INVESTOPEDIA, https://www.investopedia.com/terms/d/derivative.asp (July 15, 2022).

[214] *See Parkcentral*, 763 F.3d at 214.

Similar to Justice Stevens's concurrence in *Morrison*,[215] the court pointed out that absurd results may occur if a domestic transaction under the Irrevocable Liability test is sufficient to warrant Section 10(b)'s applicability.[216] If a domestic transaction was sufficient, then Section 10(b) could potentially apply to allegedly fraudulent conduct that occurs anywhere, both domestic and abroad.[217] *Parkcentral* is a perfect example. The parties to the securities-based swap agreement had no actual ownership interest in the underlying German stock, but the swap agreement allegedly occurred in the United States—giving rise to a domestic transaction.[218] Porsche's fraudulent conduct would subject it to Section 10(b) liability even though Porsche was not a party to the swap agreement, its fraudulent conduct occurred in Germany, and the underlying German stock was only listed on a foreign exchange.[219] This private exchange between two parties in America—that only referenced the value of the German stock—could still pull Porsche into an American court for Section 10(b) violations.[220]

Thus, the Second Circuit concluded that a domestic transaction is only a necessary element in establishing Section 10(b)'s applicability and not a sufficient condition.[221] To support its conclusion, the court set forth two main arguments from its textual analysis of *Morrison*.[222] First, *Morrison* did not explicitly say that the existence of a domestic transaction or listing was sufficient to make Section 10(b) applicable, and the words chosen by *Morrison* are "consistent with the description of necessary elements rather than sufficient conditions."[223] The Court in *Morrison* held that Section 10(b) applies *only* to domestic transactions, not that Section 10(b) applies to *all* domestic transactions.[224] Second, *Morrison*'s principal concern was to prevent conflict between Section 10(b) and international securities laws in the absence of

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[215] *Cf. Morrison*, 561 U.S. at 285 (Stevens, J., concurring in the judgment) (noting the absurd result that would ensue from applying the Transactional test to his proposed hypothetical).

[216] *See Parkcentral*, 763 F.3d at 214 ("The mere fact that the plaintiffs based their suit on a domestic transaction would make § 10(b) applicable to allegedly fraudulent conduct anywhere in the world.").

[217] *Id.*

[218] *See id.* at 206–07.

[219] *See id.* at 215–16.

[220] *See id.*

[221] *Id.* at 216. The court recognized that *Morrison* established two main rules: (1) Section 10(b) only applies domestically because of the presumption against extraterritoriality; and (2) Section 10(b) does not apply unless the transaction involves a security listed on a domestic exchange or there is a domestic securities transaction. *Id.* at 214–15 (citing Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 265, 267 (2010)).

[222] *See id.* at 215.

[223] *Id.* (citing *Morrison*, 561 U.S. at 267).

[224] *See id.*

congressional intent.[225] Permitting Section 10(b) to apply to a U.S. transaction consisting of wholly foreign activity, and clearly subject to foreign regulation, would create such a conflict and would undermine *Morrison*'s conclusion that Section 10(b) does not have extraterritorial application.[226]

Taking these considerations into account, the court expanded the domestic transaction analysis past the application of the *Ficeto* Irrevocable Liability test.[227] The court decided it need not apply its Irrevocable Liability test to determine if there was a domestic transaction in this case because the necessary element would be outweighed by the other relevant facts anyway.[228] Instead of making a domestic transaction dispositive, the court's new So Predominantly Foreign test used it only as a factor in the analysis.[229]

The So Predominantly Foreign test is a flexible multifactored test that considers the relevant facts of each case in determining whether the conduct was so predominantly foreign that to permit Section 10(b)'s application would violate the presumption against extraterritoriality.[230] The purpose of the So Predominantly Foreign test "is to ensure, in transnational circumstances, that [Section] 10(b) not be given extraterritorial application, while preserving the domestic coverage that Congress intended."[231] Applying the test, the court concluded the relevant actions in this case of first impression were "so predominantly German" that to permit Section 10(b)'s application would violate the presumption against extraterritoriality.[232]

In Judge Leval's concurrence, he expanded on the So Predominantly Foreign test's justification in light of *Morrison*.[233] Judge Leval acknowledged that the language in *Morrison* may be read on its face to require a bright-line rule as opposed to a multi-factor test.[234] He noted that *Morrison* had two main criticisms of the multi-factored Conduct and Effects test that the lower courts used pre-

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225 *See id.*

226 *Id.* at 215–16 ("That is a result *Morrison* plainly did not contemplate and that the Court's reasoning does not, we think, permit.").

227 *See id.* at 216.

228 *See id.*

229 *See id.* at 217 ("We believe courts must carefully make their way with careful attention to the facts of each case and to combinations of facts that have proved determinative in prior cases, so as eventually to develop a reasonable and consistent governing body of law on this elusive question.").

230 *See id.* at 218 (Leval, J., concurring).

231 *See id.* at 219.

232 *Id.* at 216–17 (majority opinion).

233 *See id.* at 220–21 (Leval, J., concurring).

234 *See id.* at 218.

Morrison.[235] The main criticisms were that the test "'disregard[ed]' the presumption against extraterritoriality" and unpredictably applied Section 10(b) in circumstances that conflicted with foreign securities law.[236] However, because these criticisms were mainly focused on the application of the Conduct and Effects test, they should not generally be interpreted as a condemnation of multi-factor tests in this area.[237] Further, Judge Leval added that using a multi-factor test is consistent with modern jurisprudence and an inflexible bright-line rule was insufficient to adapt to a developing securities market.[238]

The Second Circuit reaffirmed its So Predominantly Foreign test in January 2021.[239] The court added that the So Predominantly Foreign test uses Section 10(b)'s "focus on the transaction [of the securities,] rather than the surrounding circumstances, . . . [to] flexibly consider[] whether a claim—in view of the security and the transaction as structured—is still predominantly foreign."[240] The key factors to the analysis are the contacts in connection with the transaction of the securities.[241] With the application of this "gloss on *Morrison*'s rule," a domestic transaction alone is not sufficient to satisfy Section 10(b)'s geographic requirements and only "operates as a threshold requirement."[242]

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235 *Id.* at 218–19.

236 *Id.*

237 *See id.* at 219.

238 *See id.* at 220–21.

239 Cavello Bay Reinsurance Ltd. v. Shubin Stein, 986 F.3d 161, 166–67 (2d Cir. 2021). In the Second Circuit's brief analysis of the irrevocable liability issue, the court recognized that "the transaction arguably took place in the United States" since the agreement was signed in New York. *Id.* at 165. But, on the other hand, the agreement was also signed in Bermuda. *Id.* at 164. The court explained that this demonstrated "the place of transaction is difficult to locate, and impossible to do without making state [contract] law." *Id.* at 165.

240 *Id.* at 166–67.

241 *See id.* at 167. In its analysis, the court classified the facts of the case into three categories. *See id.* In order of importance, the three categories were the following: (1) facts that triggered some U.S. interest or other interest Section 10(b) was meant to protect; (2) "acts evincing contract formation;" and (3) those facts that would have been relevant to the Conduct and Effects test. *See id.* First, the court concluded that providing a domestic forum, in this case, would not enhance confidence in the U.S. securities market or protect U.S. investors. *Id.* The main link to the United States was a provision in the subscription agreement requiring the Bermudan corporation to register the shares with the SEC in the event it wanted to resell the shares. *Id.* Since the Bermudan corporation had not exercised this provision, it did not trigger any U.S. interest. *See id.* Second, the court appeared to disregard the allegations that the parties' communications executing the agreement occurred between New York and Bermuda. *See id.* at 167–68. While these considerations were relevant to where irrevocable liability occurred, they did not resolve the question as to whether the claims were predominantly foreign. *See id.* Third, the court determined that the Bermudian holding company's misstatement that was sent from New York, plan to use the invested funds to invest in U.S. insurance services, and the presence of its CEO, directors, and principal place of business in New York did not matter in the present inquiry. *See id.* at 167 ("The contacts that matter are those that relate to the purchase and sale of securities."). Thus, the court concluded the Bermudian corporation failed to plead a domestic application of Section 10(b). *Id.* at 168.

242 *See id.* at 165–66.

The So Predominantly Foreign test correctly prioritizes *Morrison*'s international comity concerns, but falls back to the principal criticisms that *Morrison* had about the Conduct and Effects test.[243] Like the Conduct and Effects test, the So Predominantly Foreign test lacks dispositive factors that can be applied to future cases.[244] Moreover, when introducing the So Predominantly Foreign test, the Second Circuit conceded it did not "purport to proffer a test that will *reliably* determine when a particular invocation of § 10(b) will be deemed appropriately domestic or impermissibly extraterritorial."[245]

B. The Other Side of the Circuit Split

The other circuit courts strongly oppose the Second Circuit's additional requirement to Section 10(b)'s applicability and claim it is in direct contravention to *Morrison*.[246] But while the First, Third, and Ninth Circuits adopt the Second Circuit's Irrevocable Liability test,[247] their analyses differ in significant respects. The First Circuit rejected the Second Circuit's So Predominantly Foreign test, but used the same language from *Morrison* that the Second Circuit relied on to justify its new test.[248] The Ninth Circuit rejected the So Predominantly Foreign test and implemented its own necessary-sufficiency argument to shift the Second Circuit's international comity concerns to a different part of the Section 10(b) analysis.[249] The Third Circuit failed to address

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[243] *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 258–59 (2010) ("There is no more damning indictment of the 'conduct' and 'effects' tests than the Second Circuit's own declaration that 'the presence or absence of any single factor which was considered significant in other cases . . . is not necessarily dispositive in future cases.'" (quoting IIT v. Cornfeld, 619 F.2d 909, 918 (2d Cir. 1980))). The Supreme Court also agreed with commentators' criticisms of the Conduct and Effects test's "unpredictable and inconsistent application of § 10(b) to transnational cases." *Id.* at 260–61.

[244] *Cf.* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 217 (2d Cir. 2014) ("The conclusion we have reached on these facts cannot, of course, be perfunctorily applied to other cases based on the perceived similarity of a few facts.").

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

[246] *See* Stoyas v. Toshiba Corp., 896 F.3d 933, 950 (9th Cir. 2018); SEC v. Morrone, 997 F.3d 52, 60 (1st Cir. 2021).

[247] *See Morrone*, 997 F.3d at 60 ("We agree with the reasoning of the Second, Third, and Ninth Circuits and hold that a transaction is domestic under *Morrison* if irrevocable liability occurs in the United States."); United States v. Georgiou, 777 F.3d 125, 137 (3d Cir. 2015) ("We now hold that irrevocable liability establishes the location of a securities transaction."); *Stoyas*, 896 F.3d at 949 ("We are persuaded by the Second and Third Circuits' analysis and therefore adopt the irrevocable liability test . . . .").

[248] *Compare Morrone*, 997 F.3d at 60 (quoting *Morrison*'s language of "only transactions in securities" to determine that a domestic transaction is sufficient to apply the federal securities laws), *with Parkcentral*, 763 F.3d at 215 (concluding the "*only* transactions in securities" language is consistent with the description of necessary elements).

[249] *See Stoyas*, 896 F.3d at 950–51 ("*Morrison* delineates the transactions to which the Exchange Act can theoretically apply without being impermissibly extraterritorial, but while applicability is necessary, it is not sufficient to state an Exchange Act claim.").

the Second Circuit's So Predominantly Foreign test altogether.[250] Notably, even the same side of the split lacks uniformity.

1. The Third Circuit—United States v. Georgiou

In 2015, the Third Circuit adopted the Second Circuit's Irrevocable Liability test in *Georgiou*, but failed to address the *Parkcentral* decision, despite the Second Circuit adjudicating *Parkcentral* five months prior.[251] In its case of first impression, the Third Circuit determined whether transactions involving securities "issued by U.S. companies through U.S. market makers acting as intermediaries for foreign entities" satisfy *Morrison*'s second prong.[252]

In *Georgiou*, Georgiou engaged in a stock fraud scheme that manipulated the markets of four U.S. stocks.[253] The stocks were listed only on over-the-counter markets.[254] Throughout the "'pump and dump' scheme," Georgiou used "various alias accounts, nominees, and offshore brokerage accounts" in Canada, the Bahamas, and Turks and Caicos to conceal his ownership of the four stocks and artificially inflate the stocks' prices.[255] To inflate the prices, he traded the shares between the offshore brokerage accounts to create the illusion of an active market for the stocks.[256] Once the prices were inflated, he was "able to sell their shares at inflated prices" to make a profit.[257]

Unfortunately for Georgiou, one of his co-conspirators cooperated with an FBI sting operation.[258] Georgiou was exposed, and the United States instituted

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[250] *See Georgiou*, 777 F.3d at 135–37.

[251] *See Parkcentral*, 763 F.3d at 198, 212; *Georgiou*, 777 F.3d at 125, 135–37.

[252] *Georgiou*, 777 F.3d at 130. A market maker is "an intermediary in a stock exchange who controls buy and sell orders (as by purchase and resale) for a particular stock or group of stocks." *Market Maker*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/market%20maker (last visited Nov. 11, 2021).

[253] *Georgiou*, 777 F.3d at 130.

[254] *See id.* at 134 & n.10.

[255] *Id.* at 130–31, 147.

[256] *Id.* at 130–31.

[257] *See id.* at 131. To solicit investments for one of the stocks, Georgiou sent an email to seven million potential buyers. *Id.* at 147. Georgiou also used the worthless shares as collateral for margin-eligible accounts with several of the offshore brokerage firms. *Id.* at 131. A margin account is "a client's account with a brokerage firm through which the client may buy securities on the firm's credit." *Margin Account*, MERRIAM-WEBSTER, https://www.merriam-webster.com/legal/margin%20account (last visited Nov. 11, 2021). The margin-eligible accounts allowed Georgiou to take out loans from the offshore brokerage firms to purchase other securities, enabling him to make these purchases without the use of his own money. *See Georgiou*, 777 F.3d at 132. Unbeknownst to the offshore brokerage firms, Georgiou in essence used the offshore brokerage firms' own money to manipulate the stocks' prices that were used as collateral, made a profit off the inflated prices, and then never repaid the loans. *See id.* As a result of Georgiou's scheme, one of the offshore brokerage firms lost about $25 million and was liquidated, while another lost about $4 million. *Id.* at 131 n.3, 132.

[258] *Id.* at 131.

a proceeding against Georgiou for violation of, among other things, Section 10(b) and Rule 10b-5.[259] However, Georgiou challenged Section 10(b)'s applicability to his conduct under *Morrison* as impermissibly extraterritorial.[260] The Third Circuit refuted the challenge and concluded Georgiou's conduct fell within the reach of Section 10(b) under the second prong of *Morrison*'s Transactional test.[261]

First, because the stocks were listed only on over-the-counter markets, the Third Circuit determined the four stocks were not listed on a national securities exchange under *Morrison*'s first prong.[262] The court reasoned over-the-counter markets in the United States did not constitute a national securities exchange because the Securities Exchange Act references national securities exchanges and over-the-counter markets separately.[263] The SEC also specifically lists the registered U.S. national securities exchanges on its website and the over-the-counter markets, in this case, were not included in that list.[264] Therefore, the four stocks were not listed on a national securities exchange under *Morrison*'s first prong.[265]

Second, the court established that the location of a transaction determines whether a domestic transaction exists under *Morrison*'s second prong, thus adopting the Second Circuit's Irrevocable Liability test.[266] To determine the location of the transaction, the court concluded that it must look to where the commitment to perform the contemplated agreement took place.[267] In applying the Irrevocable Liability test to the case before it, the court held that "at least one of the fraudulent transactions in each of the [four stocks] was bought and sold

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[259] *Id.* at 130, 133.

[260] *See id.* at 132–33.

[261] *See id.* at 137.

[262] *See id.* at 134–35.

[263] *See id.*

[264] *Id.* at 134. The SEC provides a list of national securities exchanges on its website. *National Securities Exchanges*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/fast-answers/divisionsmarketregmrexchangesshtml.html (last visited Jan. 2, 2022).

[265] *See Georgiou*, 777 F.3d at 135. The Third Circuit distinguished this case from the "foreign cubed action" in *Morrison*. *Id.* A "foreign cubed action" is an action brought by foreign plaintiffs in a U.S. court against a foreign issuer for violations of U.S. securities laws regarding securities transactions that occurred in foreign countries. *Id.* (citing Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 283 n.11 (2010)). In contrast to *Morrison*, this case involved securities transactions of stocks of U.S. companies listed on U.S. over-the-counter markets that were executed by U.S. market makers. *Id.*

[266] *See id.* at 135, 137. The court noted that relevant facts in the analysis include the "formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money." *Id.* at 136 (quoting Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 70 (2d Cir. 2012)).

[267] *See id.*

through U.S.-based market makers."[268] The U.S. market makers bought the stock from Georgiou while in the United States and then sold the stocks to buyers in the United States.[269] The parties to the transactions became irrevocably bound to the transactions in the United States, and thus the securities transactions occurred here.[270] Because the securities transactions occurred in the United States, the transactions were domestic, and Section 10(b) and Rule 10b-5 were applicable to Georgiou's conduct under *Morrison*.[271]

2. The Ninth Circuit—Stoyas v. Toshiba Corp.

Three years later, the Ninth Circuit adopted the Second Circuit's Irrevocable Liability test and rejected its So Predominantly Foreign test.[272] The Ninth Circuit refuted the Second Circuit's position in *Parkcentral* that "a domestic transaction is necessary but not sufficient under *Morrison*" by arguing that it was the location of the transaction that mattered, and not whether a foreign entity was a party to the transaction.[273] According to the court, *Parkcentral* carved out predominantly foreign claims from Section 10(b)'s coverage on the basis of speculation of congressional intent and focused heavily on the foreign location of the deceptive conduct, both bases that *Morrison* explicitly rejected.[274]

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[268] *Id.*

[269] *Id.* at 136.

[270] *See id.* at 136–37.

[271] *Id.*

[272] Stoyas v. Toshiba Corp., 896 F.3d 933, 949–50 (9th Cir. 2018). The court noted that the Irrevocable Liability test "hew[ed] to Section 10(b)'s focus on transactions and *Morrison*'s instruction that purchases and sales constitute transactions." *Id.* at 949. However, the court conceded that application of the Irrevocable Liability test may result in Section 10(b)'s application to extraterritorial conduct. *See id.* at 950.

[273] *Id.* at 949. In its case of first impression, the Ninth Circuit addressed "the question of the nature of [American depositary receipts] and their transactions, and whether [a Japanese corporation's] [American depositary receipts] [were] covered by the [Securities] Exchange Act through either registry on a national exchange, or through domestic sales and purchases." *Id.* at 937. In *Stoyas*, American investors purchased unsponsored American depositary receipts for stock of Toshiba, a publicly traded Japanese corporation. *Id.* at 938, 941. Toshiba's shares were traded on the Tokyo Stock Exchange, and the American depositary receipts were traded on an over-the-counter market listed with the SEC. *Id.* at 937, 939–40. American depositary receipts are unsponsored when their depositary institution files them with the SEC without the formal participation of the underlying shares' company. *See id.* at 941. Additionally, the unsponsored American depositary receipts could be filed without the underlying shares' company's acquiescence. *Id.* Thus, when the unsponsored American depositary receipts are purchased by investors, the transaction would essentially be a two-party contract between the investor and the depositary institution, and not the company of the underlying shares. *Id.* In contrast, sponsored American depositary receipts are sponsored when the depositary institution and the company of the underlying shares jointly file the American depositary receipts with the SEC. *Id.* at 941 n.8. Purchases of sponsored American depositary receipts are essentially three-party contracts. *Id.*

[274] *See id.* at 950. After the American investors purchased the American depositary receipts, investigations directed by the Japanese government revealed that Toshiba deliberately implemented fraudulent accounting practices to inflate Toshiba's profit statements. *Id.* at 937 & n.1. Toshiba later admitted to these fraudulent accounting practices and Toshiba's stock price declined by more than 40%, causing a $7.6 billion loss in market

In its analysis, the Ninth Circuit employed its own necessary-sufficient conditions argument.[275] While "*Morrison* delineates the transactions to which the Exchange Act can theoretically apply without being impermissibly extraterritorial," applicability is only a necessary condition to state a Securities Exchange Act claim.[276] Essentially, Section 10(b)'s capability to reach challenged conduct is not equivalent to satisfying the several requirements for a violation of Section 10(b).[277]

Significantly, the court emphasized Section 10(b)'s "in connection with" element.[278] There must be "a connection between the misrepresentation or omission and the purchase or sale of a security."[279] "[F]or fraud to be 'in connection with the purchase or sale of any security,' it must 'touch' the sale—i.e., it must be done to induce the purchase at issue."[280] "In connection with" should be construed "flexibly to effectuate [the Exchange Act's] remedial purposes" as opposed to technically and restrictively.[281]

The Ninth Circuit's description of the "in connection with" requirement suggests that the concerns the Second Circuit has about excessive foreign elements will be dealt with later, procedurally, when the conduct is evaluated under Section 10(b)'s elements.[282] If the conduct really is so "predominantly

capitalization. *Id.* American investors lost hundreds of millions of dollars and brought a class action against Toshiba for violations of Section 10(b) and Rule 10b-5. *Id.* at 937.

[275] *See id.* at 950–51 ("*Morrison* delineates the transactions to which the Exchange Act can theoretically apply without being impermissibly extraterritorial, but while applicability is necessary, it is not sufficient to state an Exchange Act claim."). In an earlier part of the analysis where the court addressed *Morrison*'s first prong, the Ninth Circuit pointed out that when the *Morrison* court articulated the rule, it repeatedly described the category as "securities listed on *domestic* exchanges" rather than securities listed on national exchanges. *See id.* at 945 (quoting Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 267 (2010)). According to the Ninth Circuit, a national securities exchange is a subset of domestic exchange, and twenty-one national securities exchanges are registered with the SEC. *Id.* The court suggested that *Morrison*'s Transactional test was intended to encompass more than the subset of national securities exchanges and include securities listed on a domestic exchange. *See id.* However, the court refrained from answering that question because it determined that the over-the-counter market that the Toshiba American depositary receipts were traded on did not constitute an "exchange" pursuant to the Securities Exchange Act's definition. *Id.* The over-the-counter market that the American depositary receipts were traded on was "registered with the Securities and Exchange Commission as a 'broker-dealer' alternative trading system." *Id.* at 946 (citations omitted). An alternative trading system is separately regulated by the SEC and is specifically exempt from the Exchange Act's definition of "exchange." *See id.* (citations omitted).

[276] *Id.* at 950–51.

[277] *See id.*

[278] *Id.* at 951 (citing 15 U.S.C. § 78j(b)).

[279] *Id.* (quoting Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 157 (2008)).

[280] *Id.* (citations omitted).

[281] *Id.* (alteration in original) (quoting Chadbourne & Parke LLP v. Troice, 571 U.S. 377, 393 (2014)).

[282] *See id.* at 950–51 (arguing that *Morrison*'s "animating comity concerns" are directly relevant to whether a Securities Exchange Act claim has been sufficiently alleged regarding the "in connection with" requirement).

foreign," then that effectively should preclude Section 10(b)'s "in connection with" requirement from being satisfied.[283] Thus, even if the Irrevocable Liability test grants Section 10(b)'s "theoretical application," the foreign conduct may preclude a sufficient causal link from being established to satisfy the "in connection with" requirement.[284]

3. The First Circuit—SEC v. Morrone

On May 10, 2021, the First Circuit adopted the Irrevocable Liability test and rejected the Second Circuit's So Predominantly Foreign test.[285] The transactions in *Morrone* involved a Delaware corporation with U.S. corporate officers, foreign investors, and its principal place of business in Massachusetts.[286] The Delaware corporation's stock was not registered with the SEC or listed on either a domestic or foreign exchange. [287]

As a response to the anthrax scare after the September 11 terrorist attacks, the Delaware corporation was created to manufacture a machine that was "capable of decontaminating letters of biological pathogens."[288] Unfortunately for investors, the Delaware corporation "never earned a profit and lost at least $2 million each year . . . over a six-year period."[289] During that period, the Delaware corporation only sold about ten of the machines for a total of $430,000, but managed to "raise[] almost $25 million from stock sales to private investors."[290]

The officers of the Delaware corporation first attempted to solicit U.S. investors for the company.[291] However, multiple state investigations curbed the officers' efforts because the securities were not registered with the respective

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283 *See id.*

284 *See id.* ("The court should consider whether the plaintiff has shown some causal connection between the fraud and *the securities transaction in question*."). After applying the Irrevocable Liability test to the facts of the case, the court determined the complaint did not sufficiently allege that irrevocable liability took place in the United States. *See id.* at 949. The court noted, however, that "an amended complaint could almost certainly allege sufficient facts to establish . . . a domestic transaction" because the depositary institutions exchanging the Toshiba American depositary receipts operated in America and, therefore, America likely was where the purchases occurred. *Id.*

285 SEC v. Morrone, 997 F.3d 52, 60 (1st Cir. 2021). In its case of first impression, the First Circuit applied *Morrison* to determine whether a transaction was domestic. *Id.* at 59.

286 *Id.* at 54–55.

287 *Id.* at 55, 59, 61.

288 *Id.* at 55.

289 *Id.*

290 *Id.*

291 *See id.* at 55–56.

states.[292] Consequently, the officers directed their efforts abroad.[293] The corporate officers engaged a foreign brokerage firm that used "boiler room tactics" to solicit investors in Europe.[294] The foreign brokerage firm charged an "exorbitantly high [fee] . . . that no legitimate, professional consulting group would charge."[295] Outside counsel for the Delaware corporation advised the officers not to enter into an agreement with this foreign brokerage firm and, if they did, that the agreement would constitute an "absolutely critical disclosure that would need to be made to any potential investor."[296]

The officers ignored outside counsel and proceeded with the agreement with the foreign brokerage firm.[297] The officers prepared, among other documents, call scripts for soliciting investors and a stock subscription agreement.[298] None of the documents for the potential investors mentioned the foreign brokerage firm's fee.[299] In addition to that fee, the foreign investment funds were further reduced by a large commission fee that the officers of the Delaware corporation paid themselves, leaving the Delaware corporation with less than 25% of the investors' funds.[300] From 2008 to 2010, the officers employed similar schemes until the SEC filed a complaint for multiple violations of the federal securities acts, including Section 10(b) and Rule 10b-5.[301] The officers argued that Section 10(b) and Rule 10b-5 could not reach their conduct because it constituted "foreign transactions involving foreign investors solicited by foreign brokerage firms."[302] The court disagreed and evaluated the case under *Morrison*'s second prong, given that the Delaware corporation's stock was not listed on a domestic exchange.[303]

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[292] *See id.* at 56.

[293] *See id.*

[294] *Id.* at 56, 58. "A boiler room is a scheme in which salespeople apply high-pressure sales tactics to persuade investors to purchase securities, including speculative and fraudulent securities." James Chen, *Boiler Room*, INVESTOPEDIA, https://www.investopedia.com/terms/b/boilerroom.asp (Apr. 18, 2022).

[295] *Morrone*, 997 F.3d at 56 (internal quotations omitted). The foreign brokerage firm received 75% of any investor funds that it raised for the Delaware corporation. *Id.*

[296] *Id.* There was "ample evidence" that the officers knew they had to make disclosures about the foreign brokerage firm's fee and knew about the "boiler-room tactics" but failed to take any corrective action. *Id.* at 62.

[297] *See id.* at 57.

[298] *See id.*

[299] *Id.*

[300] *Id.*

[301] *See id.* at 57–58.

[302] *Id.* at 59.

[303] *Id.* In the First Circuit's analysis, it acknowledged *Morrison*'s determination that "[Section] 10(b)'s focus is on transactions" because its purpose is to regulate securities transactions and "protect 'parties or prospective parties to those transactions.'" *Id.* at 60 (quoting Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 267 (2010)).

The First Circuit adopted the Irrevocable Liability test to determine whether a domestic transaction existed under *Morrison*'s second prong.[304] In applying the Irrevocable Liability test to this case, the court determined that irrevocable liability was incurred in the United States because the stock subscription agreements were executed in Boston and the shares were issued to the investors from Boston.[305] The stock subscription agreements stated that the Delaware corporation had "no obligation" until copies of the executed and delivered subscription agreements were delivered to the purchaser.[306] As a result, the Delaware corporation "became irrevocably liable to deliver the shares in Boston," and, because a domestic transaction existed, Section 10(b) applied to the fraudulent conduct.[307]

Then, like the Ninth Circuit, the First Circuit concluded that a domestic transaction is sufficient to warrant Section 10(b) applicability and rejected *Parkcentral* for its inconsistency with *Morrison*.[308] To support its analysis, the First Circuit cited *Morrison*'s language: "[i]t is in our view *only* transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies."[309] From this language, the First Circuit claimed that the Supreme Court "explicitly said that, if a transaction is domestic, § 10(b) applies."[310] However, the validity of this claim is questionable because the First Circuit failed to address the Second Circuit's principal argument that "only" is an indicator of a necessary condition. [311] Indeed, the First Circuit committed a logical fallacy in its argument since it confused a necessary condition with a sufficient condition.

Despite rejecting the So Predominantly Foreign test, the First Circuit concluded that the claims presented in this case were not "so predominantly

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304 *See id.* The court approved of the other circuits' reasoning that because the point at which parties become irrevocably bound can be used to determine the timing of a securities transaction, it can also be used to determine the locus of a securities transaction. *Id.* at 59–60 ("We agree with the reasoning of the Second, Third, and Ninth Circuits . . . .").

305 *Id.* at 60. "It is undisputed that these subscription agreements were executed . . . in Boston," and that the shares were issued to the investors from Boston. *Id.*

306 *Id.*

307 *See id.*

308 *See id.* ("Like the Ninth Circuit, we reject *Parkcentral* as inconsistent with *Morrison.*").

309 *Id.* (emphasis added) (quoting Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 267 (2010)).

310 *Id.*

311 *Compare id.* (quoting *Morrison*'s language of "only transactions in securities" to determine that a domestic transaction is sufficient to apply the federal securities laws (quoting *Morrison*, 561 U.S. at 267)), *with* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 215 (2d Cir. 2014) ("The ['*only* transactions in securities'] language the Court used was consistent with the description of necessary elements rather than sufficient conditions." (quoting *Morrison*, 561 U.S. at 267)).

foreign as to be impermissibly extraterritorial" and distinguished *Parkcentral*.[312] In applying the So Predominantly Foreign test, the court determined that because the officers and the Delaware corporation were based in the United States, the officers "conducted nearly all of their activities in furtherance of the fraud from the U.S.[,]" and the stock "was not traded on a foreign exchange[,]" there were sufficient U.S. connections to "render[] the fraud domestic."[313] The court argued this case contrasted with *Parkcentral*, which "involved significantly more foreign conduct" and securities in a foreign company listed on a foreign exchange.[314]

In their adoption of the Irrevocable Liability test, the First, Third, and Ninth Circuits stand together on one side of the split, despite the discord in their analyses.[315] On the other side of the split, the Second Circuit deviates, considering a domestic transaction as only a threshold requirement to Section 10(b) applicability, and applying its So Predominantly Foreign test.[316] And, soon, unless the Supreme Court or Congress intervenes, the issue will be presented to the other seven circuit courts, which will further divide the split. Compounding this split, the Tenth Circuit took the first steps toward starting another split arising from the *Morrison* decision. The resolution of these issues requires unanimous implementation of a flexible framework that properly incorporates *Morrison*'s international comity concerns and can adapt to a rapidly developing securities market.

V. IPO OF THE SPECTRUM TEST

This Comment proposes a new framework implementing a Spectrum test for determining Section 10(b) applicability and evaluating domestic transactions under *Morrison*. Currently, the analysis for determining Section 10(b) applicability is as follows.

First, a court implements the *Morrison* two-step analysis to the federal statute.[317] Under the *Morrison* two-step analysis, a court determines (1) whether there is affirmative and unmistakable congressional intent that the federal statute applies extraterritorially to overcome the presumption against extraterritoriality; and (2) if the federal statute does not overcome the presumption against

312 *Morrone*, 997 F.3d at 61 (quoting *Parkcentral*, 763 F.3d at 216).
313 *Id.*
314 *Id.*
315 *Id.* at 60.
316 Cavello Bay Reinsurance Ltd. v. Shubin Stein, 986 F.3d 161, 166–67 (2d Cir. 2021).
317 *See* SEC v. Scoville, 913 F.3d 1204, 1215 (10th Cir. 2019).

extraterritoriality, then the federal statute only applies domestically, and a court must determine whether the challenged conduct is domestic.[318] If the challenged conduct is found to be domestic, then it falls within the federal statute's purview.[319] *Morrison* established that Section 10(b) lacks the congressional intent to overcome the presumption against extraterritoriality and only applies domestically.[320] Thus, Section 10(b) is evaluated under the second step of the two-step analysis.[321]

Second, a court then uses the *Morrison* two-prong Transactional test to determine whether challenged conduct is domestic and invokes Section 10(b) applicability.[322] Under the Transactional test, Section 10(b) only applies to transactions in securities listed on a domestic exchange and purchases and sales in securities made in the United States.[323] Generally, under the first prong, domestic exchanges have been interpreted to include the national securities exchanges listed on the SEC's website.[324] Domestic exchanges may encompass more than the national securities exchanges listed but do not include U.S. over-the-counter markets.[325] Under the second prong, a domestic transaction occurs when the purchaser or seller incurs irrevocable liability from the transaction in the United States.[326]

The third step is where the Second Circuit splits with the First, Third, and Ninth Circuit Courts in the analysis. While the four circuit courts agree that satisfaction of the Transactional test's first prong is sufficient to warrant Section 10(b) applicability,[327] only the First, Third, and Ninth Circuits hold that satisfaction of the second prong is sufficient to trigger Section 10(b) applicability.[328] For these three circuit courts, if the second prong is satisfied,

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318 *See id.*

319 *See id.*

320 *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 265 (2010).

321 *See id.*

322 *See id.* at 266–67.

323 *See id.* at 266.

324 *See* United States v. Georgiou, 777 F.3d 125, 134–35 (3d Cir. 2015); Stoyas v. Toshiba Corp., 896 F.3d 933, 945 & n.13 (9th Cir. 2018).

325 *See Stoyas*, 896 F.3d at 945.

326 *See* Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 68 (2d Cir. 2012).

327 *See* SEC v. Morrone, 997 F.3d 52, 59–60 (1st Cir. 2021); Cavello Bay Reinsurance Ltd. v. Shubin Stein, 986 F.3d 161, 165 (2d Cir. 2021) ("Unless a security is listed on a domestic exchange, a domestic transaction is a necessary element of a § 10(b) claim."); *Georgiou*, 777 F.3d at 134 ("Under the first prong of *Morrison*, Section 10(b) applies to 'the purchase or sale of a security listed on an American stock exchange.'" (quoting *Morrison*, 561 U.S. at 273)); *Stoyas*, 896 F.3d at 945.

328 *See Morrone*, 997 F.3d at 60 ("The existence of a domestic transaction suffices to apply the federal securities laws under *Morrison*."); *Georgiou*, 777 F.3d at 137 ("We now hold that irrevocable liability establishes the location of a securities transaction."); *Stoyas*, 896 F.3d at 949–50.

then Section 10(b) applies to the challenged conduct.[329] The Second Circuit deviates, and treats satisfaction of the second prong as a threshold requirement to Section 10(b)'s applicability.[330] According to the Second Circuit, even if the second prong is satisfied, Section 10(b) still may not apply to the challenged conduct if the challenged conduct is "so predominantly foreign."[331]

A. Spectrum Test Framework

This Comment offers the following framework for the analysis. First, the *Morrison* two-step analysis and conclusion remain unchanged. Section 10(b) does not overcome the presumption against extraterritoriality and does not apply extraterritorially.[332] Second, *Morrison*'s Transactional test remains equally unchanged. Section 10(b) applies to transactions in securities listed on a domestic exchange and to domestic transactions.

Third, differing from the Second Circuit, if either prong of the Transactional test is satisfied, then Section 10(b) applies. *Morrison* determined, in its two-step analysis, that Section 10(b) applies domestically.[333] To determine whether activity is domestic, and Section 10(b) applies, *Morrison* created the Transactional test.[334] Although the Court uses language indicating a necessary condition in its test,[335] the Second Circuit's argument that satisfaction of the Transactional test does not alone warrant that Section 10(b) applicability should be rejected. The Second Circuit's textual argument contradicts *Morrison* and defies common logic.[336] If a transaction involves a security listed on a *domestic* exchange or there is a *domestic* transaction, then it follows that the challenged transaction is *domestic*, since that is the plain label of the activity. Section 10(b) necessarily applies to the domestic transaction because Section 10(b) applies to domestic conduct.

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329 *See Morrone*, 997 F.3d at 60 ("The existence of a domestic transaction suffices to apply the federal securities laws under *Morrison*."); *Georgiou*, 777 F.3d at 137 ("We now hold that irrevocable liability establishes the location of a securities transaction."); *Stoyas*, 896 F.3d at 949–50.

330 *Cavello Bay*, 986 F.3d at 166 (2d Cir. 2021) ("*Morrison*'s 'domestic transaction' rule operates as a threshold requirement, and as such may be underinclusive.").

331 *See id.* at 165–66.

332 *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 265 (2010).

333 *See id.* at 267.

334 *See id.* at 273.

335 *See* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 215 (2d Cir. 2014) (concluding the "*only* transactions in securities" language is consistent with the description of necessary elements).

336 *See* Stoyas v. Toshiba Corp., 896 F.3d 933, 950 (9th Cir. 2018) ("[T]he principal reason that we should not follow the *Parkcentral* decision is because it is contrary to Section 10(b) and *Morrison* itself.").

Indeed, transactions in securities listed on a domestic exchange are sufficient to warrant Section 10(b) liability. For a business to have securities listed on a domestic exchange, there are ample requirements—under the Securities Act, Securities Exchange Act, and regulations promulgated by the SEC—that businesses must comply with and continually follow.[337] If a business is continually complying with these stringent U.S. requirements and benefiting to such a high degree from U.S. investors in the U.S. stock market, no reason suggests that the business should be exempt from complying with Section 10(b) and the SEC's Rule 10b-5. This level of domestic activity surely warrants domestic regulation under Section 10(b), and foreign elements cannot render a transaction in the listed security as extraterritorial. Therefore, a transaction of a security listed on a domestic exchange is sufficient to warrant Section 10(b) applicability.

The Second Circuit's concerns about overbearing foreign elements are not without merit and should be shifted in the analysis.[338] Instead of determining that satisfaction of the second prong of the Transactional test is not sufficient to warrant Section 10(b) applicability, the Second Circuit's concerns should be considered in determining whether a domestic transaction exists under *Morrison*'s second prong.

This is where this Comment's proposal deviates from the circuit courts' conclusions of what constitutes a domestic transaction. *Morrison* failed to give adequate guidance on the inquiry as to what constitutes a domestic transaction and left it for the lower courts to resolve.[339] The circuit courts look to whether irrevocable liability occurred in the United States to determine if a transaction is domestic.[340] These courts recognize that foreign elements are bound to influence the analysis but still rely on this bright-line test to determine if there is a domestic transaction.[341]

The more rational approach is to recognize that the ambiguity derives from what constitutes a domestic transaction. When a transaction has both domestic

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[337] *See* EPSTEIN ET AL., *supra* note 33 ("In general, the [Securities Act of 1933] governs the issuance of securities by the corporation itself. In contrast, the [Securities Exchange Act of 1934] provides information to the markets for new securities and resales by requiring many corporations continually to provide detailed public reports about their operations.").

[338] *See Parkcentral*, 763 F.3d at 216 ("[T]he application of § 10(b) to the defendants would so obviously implicate the incompatibility of U.S. and foreign laws that Congress could not have intended it *sub silentio*.").

[339] *See* Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012).

[340] *E.g.*, *id.* at 68.

[341] *See, e.g.*, *Stoyas*, 896 F.3d at 950 ("[I]t may very well be that the *Morrison* test in some cases will result in the Exchange Act's application to claims of manipulation of share value from afar.").

and foreign elements, the appropriate approach must evaluate how much the domestic elements must outweigh the foreign elements to consider the transaction domestic. This question does not lend itself to a bright-line test. Rather, the inquiry requires a flexible test that can handle the continuing globalization of the securities market and the rapid development of securities.

When determining whether a domestic transaction exists, irrevocable liability that incurred in the United States should be a threshold requirement. Then, if irrevocable liability occurred in the United States but there are significant foreign elements surrounding the transaction, further analysis is required. For this further analysis, this Comment proposes the use of the Spectrum test.

The Spectrum test is a factor balancing test that determines if the foreign elements of a transaction overcome the domestic elements to preclude a domestic transaction, rendering Section 10(b) inapplicable to the conduct. The relevant factors are (1) whether significant steps occurred in the United States that have a direct link to the fraudulent securities transaction; (2) whether the fraudulent conduct will have significant effects on American investors and the U.S. stock market; (3) whether the United States has a strong interest in exercising its judicial resources for the case; (4) the probability that application of Section 10(b) to the case will conflict with other countries' securities laws; and (5) the magnitude of the conflict that Section 10(b) would cause with other countries' securities laws.

This analysis recognizes and accounts for the Supreme Court's concerns in *Morrison*. First, the presumption against extraterritoriality is maintained. Second, the Court's criticism of the Conduct and Effects test's inconsistent application due to a lack of dispositive factors is addressed.[342] *Morrison* disapproved of the Conduct and Effects test, but it criticized the test's application, not the factors themselves. Implementing the Conduct and Effects factors in the analysis permits the Spectrum test to build off the long line of Section 10(b) applicability jurisprudence[343] and provides lower courts with

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[342] *Morrison* criticized the Conduct and Effects test's inconsistent application, lack of textual support, disregard of the presumption of extraterritoriality, and its focus on discovering congressional intent for a particular case. Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 258, 260–61 (2010).

[343] *See generally* Schoenbaum v. Firstbrook, 405 F.2d 200, 208 (2d Cir. 1968) ("[D]istrict court[s] ha[ve] subject matter jurisdiction over [extraterritorial] violations of the Securities Exchange Act . . . when the transactions involve stock registered and listed on a [domestic] exchange, and are detrimental to the interests of American investors."), *abrogated by Morrison*, 561 U.S. 247; Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1337–39 (2d Cir. 1972) (considering where the transactions took place in reaching its conclusion that the Securities Exchange Act reaches transactions involving foreign securities when "substantial

significant direction to continue to develop this area of securities law. The Spectrum test allows the federal courts to progressively set the boundaries of where domestic conduct ends and extraterritorial application begins. Third, the Spectrum test takes into account the Supreme Court's concerns with the international comity of securities laws since these concerns are incorporated into the analysis via factors (4) and (5).[344]

While Section 10(b) only applies domestically, domestic activity in this context must be viewed as a range rather than a clear-cut answer. On one extreme of the spectrum lies a securities transaction of a security listed on the New York Stock Exchange between two U.S. companies. On the extraterritorial end of the spectrum is a foreign cubed action.[345] The Spectrum test allows courts to set the boundaries in that range and determine when a transaction that invoked irrevocable liability in the United States shifts out of the domestic transaction area and into the extraterritorial area of the range.

Thus, the Spectrum test proceeds as follows: First, apply the *Morrison* two-step analysis. Then, after transitioning to the second step, determine whether the security is listed on a domestic exchange. If the security is not listed on a domestic exchange, then establish whether irrevocable liability occurred in the United States. If irrevocable liability did occur in the United States, then determine whether significant foreign elements surround the transaction. If there are significant foreign elements, then apply the Spectrum test. After weighing the factors, a court concludes whether the transaction falls on the domestic side of the spectrum or the extraterritorial side. If the transaction falls on the domestic

misrepresentations were made in the United States"), *abrogated by Morrison*, 561 U.S. 247; Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 992–93 (2d Cir. 1975) (analyzing *Schoenbaum* and *Leasco* in reaching its conclusion of when "the anti-fraud provisions of the federal securities laws" apply), *abrogated by Morrison*, 561 U.S. 247; Itoba Ltd. v. Lep Grp. PLC, 54 F.3d 118, 122 (2d Cir. 1995) (reasoning that combining the tests from *Schoenbaum* and *Leasco* provides "a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court"), *abrogated by Morrison*, 561 U.S. 247; *Morrison*, 561 U.S. at 257 (recounting *Schoenbaum*'s and *Leasco*'s contribution to the Second Circuit's development of Section 10(b) jurisprudence).

344 "International comity is deference to foreign government actors that is not required by international law but is incorporated in domestic law." William S. Dodge, *International Comity in American Law*, 115 COLUM. L. REV. 2071, 2078 (2015) (emphasis omitted). The Supreme Court recognizes that "[l]ike the United States, foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction." *Morrison*, 561 U.S. at 269. It also acknowledges that "the regulation of other countries often differs from ours as to what constitutes fraud, what disclosures must be made, what damages are recoverable, what discovery is available in litigation, what individual actions may be joined in a single suit, what attorney's fees are recoverable, and many other matters." *Id.*

345 A "foreign cubed action" is an action brought by foreign plaintiffs in a U.S. court against a foreign issuer for violations of U.S. securities laws regarding securities transactions that occurred in foreign countries. United States v. Georgiou, 777 F.3d 125, 135 (3d Cir. 2015) (quoting *Morrison*, 561 U.S. at 283 n.11).

side of the spectrum, then it is a domestic transaction, and Section 10(b) applies. However, if the transaction falls on the extraterritorial side, then it is an extraterritorial transaction, and Section 10(b) does not apply.

B. Spectrum Test in Action

Applying the Spectrum test to the facts of *Parkcentral* and *Morrone*—two of the cases discussed in Part IV—demonstrates its operation and capability in allowing courts to set the boundaries of the range identifying whether a transaction should be considered domestic under *Morrison*.[346] A transaction in a security listed on a domestic exchange is on the domestic extreme of the spectrum, and a foreign cubed action marks the extraterritorial extreme. The Part IV cases lie between these two extremes because they involved more domestic conduct than a foreign cubed action but did not involve securities listed on a domestic exchange.[347]

The first step of the new framework, the *Morrison* two-step, can be applied to both *Parkcentral* and *Morrone* because they are disputes about Section 10(b) of the Securities Exchange Act. The Securities Exchange Act does not overcome the presumption against extraterritoriality, so Section 10(b) will only apply domestically, and the cases must be evaluated under *Morrison*'s second step. To evaluate under *Morrison*'s second step, its two-prong Transactional test must be applied. The first prong of the Transactional test—transactions in securities listed on a domestic exchange—can also be resolved for both cases because neither of them involved securities listed on a domestic exchange. Thus, *Parkcentral* and *Morrone* must be evaluated under the Transactional test's second prong to determine whether a domestic transaction exists. The analysis for each case begins with determining whether the irrevocable liability threshold requirement is met and, if so, continues to the Spectrum test. The following application of the Spectrum test begins with the case that lies closer to the extraterritorial extreme of the spectrum and ends with the case that lies toward the domestic extreme of the spectrum.

1. Application to Parkcentral

First, in *Parkcentral*, irrevocable liability occurred in the United States because the United States is where the swap agreements were executed and the

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[346] While the Spectrum test will be applied to the cases retrospectively, the analysis will identify relevant facts that courts can rely on for future application of the test.

[347] *See supra* Part IV.

parties became bound to the contracts.[348] Even though Porsche was not a party to the swap agreements and the underlying Volkswagen stock was listed on a German exchange,[349] this alone does not preclude Section 10(b)'s application because Porsche's fraudulent conduct was arguably in connection with the purchase of the swap agreements—a type of agreement which Section 10(b) explicitly covers.[350]

As the Second Circuit noted, significant foreign elements surrounded this transaction.[351] First, Porsche did not take significant steps in the United States to further the fraudulent securities transactions because its fraudulent public statements were made primarily in Germany and did not directly influence the private transactions.[352] Therefore, this factor weighs against a domestic transaction and is in favor of an extraterritorial transaction. Second, Porsche's public statements did have significant effects on American investors and the U.S. stock market because "parties with short positions in [Volkswagen's stock] . . . lost an estimated total of $38.1 billion."[353] This factor weighs in favor of a domestic transaction and against an extraterritorial transaction. Third, because the primary goals of U.S. securities regulation are to protect investors and protect American confidence in the U.S. securities market,[354] and the investment loss was large, the United States did have some interest in applying Section 10(b) liability to Porsche. However, the U.S. interest was low because the investors in the swap agreements should bear some of the risks that come with purchasing derivative securities deriving their value from a foreign stock that is not listed on a domestic exchange. This factor is neutral, and weighs neither for nor against a domestic or extraterritorial transaction.

Fourth, considering the widespread reputation of Porsche, the publicity surrounding its public statements, and the mass losses incurred by investors, it was very likely that German authorities would investigate the issue, and, in fact, they did.[355] Thus, the probability was high that the application of Section 10(b) would conflict with German securities laws; this factor weighs against a domestic transaction and is in favor of an extraterritorial transaction. Fifth,

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348 *See* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 207 (2d Cir. 2014).

349 *See id.*

350 *See* 15 U.S.C. § 78j ("It shall be unlawful for any person . . . [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 . . . .").

351 *Parkcentral*, 763 F.3d at 207.

352 *See id.*

353 *Id.* at 205.

354 *See supra* Part I.

355 *Parkcentral*, 763 F.3d at 205.

Germany had a strong interest in regulating Porsche because the misconduct occurred in Germany, and the underlying stock in the swap agreement was traded on the Frankfurt Stock Exchange.[356] Germany regulates and implements sanctions regarding stocks traded on its exchange, so the magnitude of the conflict between German securities laws and Section 10(b) would have been great.[357] This factor also weighs against a domestic transaction and is in favor of an extraterritorial transaction. After weighing the factors, the foreign elements of the transaction overcome the domestic elements, rendering it an extraterritorial transaction and precluding Section 10(b)'s applicability.[358]

2. Application to Morrone

Second, in *Morrone*, irrevocable liability occurred in the United States because the subscription agreements for the Delaware corporation stock were executed in Boston and the shares were issued to the investors from Boston.[359] Although the threshold irrevocable liability requirement is met, significant foreign elements surround the transaction because the U.S. defendants used a foreign broker to push the shares on foreign investors generally located in the United Kingdom[360] and Europe.[361]

First, the American defendants in *Morrone* took significant steps in the United States that had a direct link to the fraudulent transactions because they: (a) executed the transactions in the United States; (b) issued the shares from the United States; (c) employed a foreign broker and prepared call scripts for the boiler room tactics while in the United States; and (d) used the investors' funds in connection with the transaction to pay themselves imprudent fees as part of

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356 *See id.* at 207.

357 "The Hessian Stock Exchange Supervisory Authority is responsible for market and legal supervision of the Frankfurt Stock Exchange." *Exchange Supervisory Authority of the State Hesse*, BÖRSE FRANKFURT, https://www.boerse-frankfurt.de/en/know-how/about/organisation-der-boerse/hessische-boersenaufsicht (last visited Jan. 2, 2022). "To ensure proper exchange trading, the Exchange Supervisory Authority cooperates closely with the exchange trading supervisory authorities and the Federal Financial Supervisory Authority (BaFin)." *Id.* "[T]he Exchange Supervisory Authority may impose sanctions against market participants." *Id.*

358 Notably, the Second Circuit also rendered Section 10(b) inapplicable when it adjudicated the case. *See Parkcentral*, 763 F.3d at 216 ("[W]e think it clear that the claims in this case are so predominantly foreign as to be impermissibly extraterritorial.").

359 *See* SEC v. Morrone, 997 F.3d 52, 60 (1st Cir. 2021).

360 *See* Complaint at 17, SEC v. Morrone, No. 1:12CV11669 (D. Mass. 2019). "The Financial Conduct Authority (FCA) regulates the financial services industry in the UK. Its role includes protecting consumers, keeping the industry stable, and promoting healthy competition between financial service providers." *Financial Conduct Authority*, GOV.UK, https://www.gov.uk/government/organisations/financial-conduct-authority (last visited Jan. 2, 2022).

361 *See Morrone*, 997 F.3d at 56.

the scheme while in the United States.[362] Therefore, this factor weighs in favor of a domestic transaction and against an extraterritorial transaction.

Second, the transactions did not have significant effects on either American investors or the U.S. stock market because the scheme targeted foreign investors in the United Kingdom[363] and Europe.[364] As a result, this factor weighs against a domestic transaction and is in favor of an extraterritorial transaction. Third, although the transactions did not directly affect U.S. investors, the United States still had a strong interest in exercising its judicial resources over this case because significant fraudulent conduct occurred in the United States,[365] which negatively affects American confidence in the U.S. securities market. Additionally, before the American defendants looked abroad to raise funds, they first tried to execute the scheme domestically but were prevented by various U.S. state authorities.[366] This demonstrates that the United States already had a strong interest in the case and maintained an interest to see the case through to resolution. This factor weighs in favor of a domestic exchange and against an extraterritorial transaction.

Fourth, it was not likely that foreign authorities would investigate the issue because the American defendants implemented aggressive boiler room tactics to raise millions of dollars from private-foreign investors over a two-year period without interruption despite the American defendants receiving "numerous complaints" about their tactics.[367] Indeed, the foreign authorities had ample opportunity to investigate but failed to do so. Moreover, by targeting private investors with a non-publicly traded stock, the American defendants likely kept the transactions discrete, concealing the transactions from foreign authorities.[368] Thus, the probability of a conflict with other countries' securities laws was low; this factor weighs in favor of a domestic transaction and against an extraterritorial transaction.

Fifth, European countries did have an interest in regulating these transactions insofar as protecting their investors from fraudulent conduct that occurred abroad. However, the interest was weak because it was not a stock traded on a foreign exchange or widely traded in the foreign countries.[369] Thus, the

362 *Id.* at 57, 60.
363 *See* Complaint, *supra* note 360.
364 *See Morrone*, 997 F.3d at 56.
365 *See id.* at 57, 60.
366 *See id.* at 55–56.
367 *See id.* at 56–58.
368 *See id.* at 56 (employing call centers to target investors in Europe).
369 *See id.* at 57–58, 61.

magnitude of any conflict that Section 10(b) liability would cause with other countries' securities laws is low. This factor weighs in favor of a domestic transaction. After weighing the factors, the domestic elements of the transaction overcome the foreign elements, rendering it a domestic transaction and permitting Section 10(b) applicability.[370]

As demonstrated, the Spectrum test takes into account the totality of the circumstances while maintaining focus on the transaction. The examples above produce the same outcomes that the circuit courts reached[371] using similar facts but with a more structured analysis that can be consistently applied. This consistent analysis can resolve the circuit split and prevent further exacerbation by the rest of the circuit courts when the issue is presented to them in the near future. This issue in securities law has plagued the federal courts for decades, only to worsen with the adjudication of *Morrison* and enactment of the Dodd-Frank Act. It is time to mend the split.

CONCLUSION

Morrison left open what constitutes a domestic transaction. Alone, the Irrevocable Liability test is too narrow to properly encompass the elusive distinction between domestic and foreign conduct—particularly in the context of an extensive list of regulated securities that allocate many different interests among parties. As for the So Predominantly Foreign test, the Second Circuit identifies compelling concerns but uses clever wordplay to address them in a manner that contradicts *Morrison*.[372]

As demonstrated, the Spectrum test provides a solution to these deficiencies with a framework that adheres to stare decisis—upholding confidence and tradition in the judicial system. Importantly, the test does so while providing a workable analysis that will resolve confusion in the lower courts and facilitate the development of Section 10(b) jurisprudence. A rapidly developing securities market demands a flexible test that can continually adapt to it and resolve international conflicts that accompany a globalizing securities market.

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[370] Notably, the First Circuit also rendered Section 10(b) applicable when it adjudicated the case. *See id.* at 61.

[371] *See* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 216 (2d Cir. 2014) ("[W]e think it clear that the claims in this case are so predominantly foreign as to be impermissibly extraterritorial."); *Morrone*, 997 F.3d at 61.

[372] *See* Stoyas v. Toshiba Corp., 896 F.3d 933, 950 (9th Cir. 2018) ("[T]he principal reason that we should not follow the *Parkcentral* decision is because it is contrary to Section 10(b) and *Morrison* itself.").

This Comment petitions Congress to step in once again and resolve these issues. In Section 10(b) extraterritorial cases, there is inconsistency among the circuit courts in applying *Morrison*'s second prong of its Transactional test, and potentially another circuit split arising from the Dodd-Frank issue. Congressional action implementing this Spectrum test to both public and private actions will end the circuit splits, preserve judicial resources, uphold stare decisis, prevent plaintiffs from turning away from a defendant-friendly Second Circuit,[373] and protect international comity.

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[373] The circuit split incentivizes private plaintiffs in these cases to forum shop. Mason v. Cont'l Grp., Inc., 474 U.S. 1087, 1087–88 (1986) (White, J., dissenting) (noting that, because circuit differences in rules "may have the troubling effect of encouraging forum shopping by plaintiffs[,]" the "conflict among the Circuits . . . can hardly be passed over as an unimportant one unworthy of this Court's attention"). Plaintiffs will avoid a defendant-friendly Second Circuit and turn toward the First and the Ninth Circuits. *See* Halper et al., *supra* note 15 ("[I]t is likely that private plaintiffs asserting claims with a foreign nexus will do their best to bypass the Second Circuit and file suit in more hospitable forums, such as the First and Ninth Circuits."). These latter circuits are more plaintiff-friendly because the plaintiffs only need to allege that the transaction occurred in the United States, as opposed to the Second Circuit, where the court will consider additional foreign elements that may give defendants greater support in their arguments even if the transaction occurred in the United States. *See id.* The outcomes of these cases in the Second Circuit will be more difficult for plaintiffs to predict and will present an additional barrier for plaintiffs to pass in order to succeed in their cases. *See id.*

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