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Paradise Lost: § 10(b) after Morrison v National Australia Bank

Elizabeth Cosenza
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Elizabeth Cosenza*

Abstract

§ 10(b) of the Securities Exchange Act of 1934—the key anti-fraud provision of the US securities laws—has been in force for three-quarters of a century. However, its application to transnational, or cross-border, transactions had been unsettled for decades often leading different courts to conflicting results. The Supreme Court attempted to remedy this problem earlier this year when it decided the landmark case of *Morrison v National Australia Bank, Ltd.* In that case, the Court addressed the extraterritorial reach of § 10(b) for the first time and issued a bright-line transactional test that limited the application of § 10(b) to purchases or sales made in the US or involving securities listed on a domestic exchange.

This Article analyzes the Supreme Court’s bright-line test and proposes a different standard for the extraterritorial application of § 10(b). Under the standard proposed by this Article, a transnational securities fraud violates § 10(b) when the fraud involves significant conduct in the United States that is material to the fraud’s success and that fraud directly caused the plaintiff’s injury. As explained below, this standard strikes the proper balance between advancing § 10(b)’s remedial objectives and conserving the scarce resources of US courts and law enforcement authorities for regulation of securities fraud that has a substantial connection to the US.

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I. INTRODUCTION

The Deepwater Horizon oil spill in the Gulf of Mexico has shed light on a problem that has riddled US securities lawyers and the courts for decades. BP PLC is a foreign company. Its shareholders—the majority of whom reside abroad—purchased most of BP's shares on the London Stock Exchange. At the time of the disaster, BP shares were trading at nearly $60, but they have lost nearly half their value since the catastrophic spill. BP's shareholders are outraged and are seeking redress against the company and its executives for the losses they have sustained. Citing BP's history of safety lapses, cost-cutting measures, and workplace disasters, BP's foreign shareholders have filed a securities class action lawsuit in the US based on claims that the company misled investors prior to the spill. However, there is a fundamental question surrounding BP's shareholders' suit: do the US securities laws even permit securities fraud claims that are brought against foreign issuers on behalf of foreign investors that purchased securities on foreign exchanges?

"Foreign-cubed" litigation, the name of these types of securities fraud claims, is the latest legal nemesis of lawyers for companies ranging from BP to Toyota (especially after Toyota's massive safety recalls). The increasing globalization of capital markets has caused these so-called "foreign-cubed," or "f-cubed," actions to gain even greater prominence as there is now even greater potential for transnational, or cross-border, securities fraud. Thus, over the past decade, foreign investors—like BP's shareholders—have increasingly initiated securities fraud class actions against foreign companies in US courts.

* Assistant Professor of Law and Ethics, Fordham University Gabelli School of Business. B.A., 1998, Fordham University; J.D., 2001, Harvard Law School. I would like to thank my husband for inspiring this article with his prior legal scholarship on this topic. I also wish to express my gratitude for the able assistance of Jim Shields and Wayne Bush; the invaluable advice offered by Mark A. Conrad and Kenneth R. Davis; and the generous support of the Fordham University Gabelli School of Business.

1 See, for example, Complaint against Paul Anderson, BP America Inc, BP, PLC, Antony Burgmans, Cynthia Carroll, William Castell, Erroll B. Davis, Jr, Anthony Hayward, Andy Inglis, H. Lamar McKay, Carl-Henric Svanberg with Jury Demand, Ludlow v BP, PLC, No 10-CV-00818 (WD La filed May 21, 2010).


3 See Buxbaum, 46 Colum J Transnatl L at 17 (cited in note 2).
Although § 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act” or the “1934 Act”)—the key anti-fraud provision of the US securities laws—has been in force for three-quarters of a century, whether, or to what extent, it applies to transnational, or cross-border, transactions has perplexed the lower courts for many decades. Of particular note, there has been a three-way circuit court split over the proper application of § 10(b) to foreign-cubed lawsuits. Even more significantly, the Supreme Court had never considered the extraterritorial reach of § 10(b) until June 2010 when it decided the landmark case of Morrison v National Australia Bank, Ltd. The increased volatility experienced by investors in both the domestic and international securities markets finally forced the Court to address the confounding question of which law to apply in the increasingly internationalized setting of securities fraud claims.

Section II of this Article sets forth the provisions of § 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. To determine whether, or to what extent, the US anti-fraud laws apply extraterritorially, Section II examines the language and legislative intent of § 10(b) and Rule 10b-5. Section connection with this examination, Section II also discusses two longstanding canons of statutory construction—the presumption against extraterritoriality and the Charming Betsy rule.

Section III begins with a discussion of the doctrinal history of the “conduct” and “effects” tests. Developed by the Second Circuit four decades ago, these tests state that § 10(b) can be applied extraterritorially where either: (1) the wrongful conduct occurred in the US, or (2) the wrongful conduct had a substantial effect in the US, or upon US citizens. Section III then examines the application of the conduct and effects tests in four recent securities class actions—In re Vivendi Universal SA Securities Litigation, Cornwell v Credit Suisse

4 See Morrison v National Australia Bank, Ltd, 130 S Ct 2869, 2880 (2010) (“Commentators have criticized the unpredictable and inconsistent application of § 10(b) to transnational cases.”)
5 Compare Zoelsch v Arthur Anderson & Co, 824 F2d 27, 29–30 (DC Cir 1987) (“[J]urisdiction will lie in American courts where the domestic conduct comprises all the elements of a defendant's conduct necessary to establish a violation of Section 10(b) and Rule 10b-5.”), with SEC v Kasser, 548 F2d 109 (3d Cir 1977) (holding that conduct comes within the scope of the Exchange Act if “at least some activity designed to further a fraudulent scheme occurs within this country”), and Robinson v TCI/US W Communications, Inc, 117 F3d 900, 906–07 (5th Cir 1997) (holding that the conduct test requires that the domestic conduct in question be: (1) “more than merely preparatory” to the fraud; and (2) a direct cause of the loss in question).
6 Morrison, 130 S Ct at 2869.
9 In re Vivendi Universal SA Sec Litig, 634 F Supp 2d 352 (SDNY 2009).
Group,10 Copeland v Fortis,11 and In re European Aeronautic Defence & Space Company Securities Litigation.12

Section IV discusses the material differences between the US class action system and other class action regimes, particularly those of the EU. Against the backdrop of these differences, Section IV analyzes the increasingly pitched policy debate surrounding the extraterritorial application of § 10(b). Drawing on the paradigm of the US securities class action model, this Section frames the debate around the question of whether extending the reach of § 10(b)'s private right of action to foreign-cubed securities class actions undermines other nations' investor protection regimes and compromises the attractiveness of the US for foreign investment.

Section V discusses the factual and procedural background of the historic National Australia Bank case as well as the Supreme Court's decision. Not only does this case mark the first time the Supreme Court ruled on the transnational reach of § 10(b), but the factual background of the National Australia Bank case also provides a somewhat eerie preview of the subprime mortgage collapse of the US economy. Sweeping away four decades of lower court jurisprudence, the Supreme Court issued a bright-line transactional test. The new transactional test signaled a major paradigm shift by limiting the application of § 10(b) to purchases or sales made in the US or involving securities listed on a domestic exchange.13

Against the backdrop of National Australia Bank, Section VI explores the complexities of foreign-cubed securities class actions in the larger context of the statutory, jurisprudential, and policy framework of securities fraud liability under § 10(b). In view of this integrated framework, Section VI rejects the Supreme Court's bright-line test as overly myopic. It instead proposes a standard for the extraterritorial application of § 10(b) that accomplishes the seemingly competing goals of limiting frivolous litigation and preserving investors' ability to recover on meritorious claims. The proposed standard maintains fidelity to principles of interjurisdictional efficiency and judicial restraint while prescribing a workable framework for the extraterritorial application of § 10(b) in limited circumstances that warrant the application of US laws.

10 Cornwell v Credit Suisse Group, 689 F Supp 2d 629 (SDNY 2010).
11 Copeland v Fortis, 685 F Supp 2d 498 (SDNY 2010).
12 In re European Aeronautic Defence & Space Co Sec Litig, 703 F Supp 2d 348 (SDNY 2010) ("EADS Litig").
13 Morrison, 130 S Ct at 2885.
II. THE STATUTORY AND LEGISLATIVE FRAMEWORK OF § 10(b)

A. Statutory Language

§ 10(b) of the Exchange Act and Rule 10b-5—the primary SEC regulation promulgated thereunder—prohibit fraud in connection with the sale or purchase of a security.14 Specifically, § 10(b) makes it illegal “[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”15 Rule 10b-5 states, in relevant part, that:

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,

(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 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,

in connection with the purchase or sale of any security.16

To state a claim for relief under § 10(b)/Rule 10b-5, a plaintiff must prove that the defendant knowingly made a material misrepresentation on which the plaintiff relied and that the misrepresentation proximately caused the plaintiff’s economic loss.17 Despite the broad proscriptions against fraud, manipulation and

14 See Ernst & Ernst v Hochfelder, 425 US 185, 212-14 (1976). See also Central Bank of Denver, NA v First Interstate Bank of Denver, NA, 511 US 164, 173 (1994). If Section 10(b) does not give rise to liability, a fortiori, Rule 10b-5 does not either. See Jeanne L. Schroeder, ENEMY AND OUTSIDER TRADING: THE CASE OF MARTHA STEWART, 26 Cardozo L Rev 2023, 2046 (2005) (“Although the language of Rule 10b-5 is broader than that of § 10(b), under the basic principles of administrative rulemaking, the rule should not be read more expansively than the statute under which it is promulgated.”).

15 15 USC § 78j(b) (2000).

16 17 CFR § 240.10b-5.

17 The making of an untrue statement or the failure to disclose information (an omission) is actionable only if the untrue statement (or omission) is material. The standard for materiality is whether “there is a substantial likelihood that a reasonable shareholder would consider [a fact or omission] important” when making an investment decision. TSC Indus, Inc v Northway, Inc, 426 US 438, 449 (1976) (defining materiality in the context of proxy statements and Rule 14a-9). To establish the requisite reliance, plaintiffs must prove that “defendants’ conduct caused [them] to engage in the transaction in question.” Newton v Merrill Lynch, Pierce, Fenner & Smith, Inc, 259 F3d 154, 174 (3d Cir 2001) (internal citations and quotations omitted). See Basic, Inc v Levinson, 485 US
deception, § 10(b) does not grant an express private right of action to defrauded investors. To effectuate the remedial purposes of the federal securities laws, however, courts have for many years recognized an implied right of action under § 10(b).

B. The Presumption Against Extraterritoriality

Whether § 10(b)’s proscription against fraud should be interpreted to grant a private right of action to foreign investors who purchased securities of a foreign issuer on a foreign exchange implicates two distinct canons of statutory construction. The first is the presumption against extraterritoriality. This presumption reflects a well-established precept of American law “that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.”

As mandated by the presumption against extraterritoriality, courts must determine whether the statutory language unequivocally expresses congressional intent “to extend its coverage beyond places over which the United States has sovereignty or has some measure of legislative control.” If there is some ambiguity, the statute should be limited,

224, 243 (1987). Furthermore, plaintiffs must sustain the burden of showing loss causation. Consistent with the Supreme Court’s decision in Dura Pharmaceuticals v Broudo, 544 US 336 (2005), plaintiffs must prove that any losses resulted from the fraud itself and not other market forces such as investor expectations, market conditions, or developments within the company. See id, 544 US at 343:

Given the tangle of factors affecting price, the most logic alone permits us to say is that the higher purchase price will sometimes play a role in bringing about a future loss. It may prove to be a necessary condition of any such loss, and in that sense one might say that the inflated purchase price suggests that the misrepresentation (using language the Ninth Circuit used) “touches upon” a later economic loss. But, even if that is so, it is insufficient. To “touch upon” a loss is not to cause a loss, and it is the latter that the law requires.

Lastly, plaintiffs must establish that the defendant made the untrue statement (or omission) with scienter, or with the “intent to deceive, manipulate, or defraud.” Ernst & Ernst, 425 US at 216 (Blackmun dissenting). The federal appellate courts have ruled that severe recklessness is sufficient to establish the necessary state of mind. See id at 194 n 12.

18 Ernst & Ernst, 425 US at 196.
19 See id; In re Parmalat Sec Litig, 376 F Supp 2d 472, 494 (SDNY 2005) (noting that the implied private right of action under Rule 10b-5 has been recognized in the lower courts since 1946 and was acknowledged by the Supreme Court in 1971).
20 EEOC v Arabian Am Oil Co, 499 US 244, 248 (1991) (“Aramco”), quoting Foley Bros, Inc v Filardo, 336 US 281, 284-85 (1949). To refute this presumption, the party asserting extraterritorial application must identify specific statutory language that reflects Congress’ unequivocal intent to extend the statute’s reach beyond the territorial limits of the United States. Id at 251–52. In other words, that party must cite actual statutory “words which definitely disclose an intention to give [the law] extraterritorial effect.” Aramco, 499 US at 251, quoting NY Cent RR Co v Chisholm, 268 US 29, 31 (1925).
both in its operation and effect, to impact only the geographic boundaries of the US.\(^2\)

The presumption against extraterritoriality is grounded in a number of public policy considerations.\(^2\) Foremost among them is that Congress legislates primarily to address domestic—not foreign—concerns.\(^2\) Further, to comply with longstanding principles of comity, Congress usually refuses to impose US laws on primarily foreign conduct.\(^2\) Such comity-based concerns are rooted in the notion that the application of US laws to foreign conduct or events could usurp the ability of another nation to regulate conduct that occurs within its geographic borders.\(^2\) The presumption thus "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord."\(^2\) Moreover, the presumption reflects the judiciary's deference to congressional power in the area of foreign affairs. Unlike Congress, the judiciary cannot adjust or revise US laws.\(^2\) As a result, whether or to what extent a statute has "extraterritorial thrust" should remain "in Congress' court," without the courts seeking to "forecast[] Congress' likely disposition" of a statute's extraterritorial scope from ambiguous text.\(^2\) Therefore, the

\(^2\) See Chisholm, 268 US at 31–32; Aramco, 499 US at 248 (cited in note 20) ("[U]nless there is 'the affirmative intention of the Congress clearly expressed,' a federal statute cannot be applied extraterritorially."), (citation omitted). Merely possible, or even plausible, interpretations of the statutory language that are suggestive of the statute's transnational application do not suffice to overcome the presumption. See Aramco, 499 US at 253 (cited in note 20). See also Microsoft Corp v AT&T Corp, 550 US 437, 442 (2007) ("[p]lausible" reading rejected). If the statute's language is ambiguous, or if it leaves any doubt regarding its transnational scope, then the law must be interpreted to apply only within the territorial boundaries of the US. See Smith v United States, 507 US 197, 203–04 (1993). The corollary to the presumption against extraterritoriality is an equally fundamental presumption that, without a clear statement to the contrary, Congress intends to legislate for conduct within the territory of the US. As noted by Justice Holmes—and before him, by the courts of England—"[a]ll legislation is prima facie territorial." American Banana Co v United Fruit Co, 213 US 347, 356 (1909), quoting Ex parte Blain, LR 12 Ch Div 522, 528 (1879). Congress's authority to legislate all conduct within the nation's territory, regardless of the interest that any foreign nation might also have in such conduct, has been beyond dispute. See Schooner Exch v McFaddon, 11 US (7 Cranch) 116, 136 (1812) ("The jurisdiction of the nation within its own territory is necessarily exclusive and absolute. It is susceptible of no limitation not imposed by itself."); Restatement (Third) of Foreign Relations Law of the United States § 402, cmt c (2009) ("The territorial principle is by far the most common basis for the exercise of jurisdiction to prescribe, and it has generally been free from controversy.").

\(^2\) Smith, 507 US at 204 n 5.

\(^2\) Id. See also Foley Bros, 336 US at 285.


\(^2\) Chisholm, 268 US at 31–32.

\(^2\) Aramco, 499 US at 248.

\(^2\) Id at 259.

presumption against extraterritoriality requires courts to determine if Congress has indicated in the statutory text that the law at issue should be given extraterritorial application.  

C. The Charming Betsy Rule

Another canon of construction is the Charming Betsy rule—a canon that may apply even when the presumption against extraterritoriality does not. Derived from a nineteenth century case, this rule provides that a law of Congress should never be construed to conflict with the laws of other nations if any other possible interpretation of the statutory language remains. In Charming Betsy, the Supreme Court considered whether a US law that prohibited trading with enemy aliens could be construed to support the seizure of a Danish ship. Although the vessel was seized outside the US, it had once been registered as American, and the individual who purchased the ship was born in the US (though he was, at the time of the ship’s seizure, a Danish subject and had registered the ship as Danish). Chief Justice Marshall held that the US statute did not support the seizure of the ship because it would have violated international rules of salvage and prize and also potentially conflicted with the laws of Denmark.

Like the presumption against extraterritoriality, the Charming Betsy rule requires that Congress express its intention to apply the statute abroad. If any interpretation of the statute avoids conflict with the laws of other nations, then that interpretation must prevail. Furthermore, if the statute is unclear, the ambiguity must be resolved in a way that avoids unreasonable encroachment on the sovereign authority of other nations. The rationale for the Charming Betsy

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30 Id at 442.
31 Murray v Schooner Charming Betsy, 6 US (2 Cranch) 64, 118 (1804). See Hartford Fire Insur Co v California, 509 US 764, 814–15 (1993) (Scalia dissenting) (noting that “[h]is canon is ‘wholly independent’ of the presumption against extraterritoriality,” and it applies even “if the presumption against extraterritoriality has been overcome or is otherwise inapplicable”) (citation omitted).
32 Charming Betsy, 6 US at 68–69. The conduct at issue in Charming Betsy had nothing to do with the United States, was subject to a well-developed regime of maritime law, and the potential interference with the sovereignty of the seized ship’s nation (Denmark) was patent. See id.
34 Charming Betsy, 6 US at 118.
35 F. Hoffmann-LaRoche Ltd v Empagran SA, 542 US 155, 164, 174 (2004) (stating that even a “more natural reading of the statutory language” must be disregarded to avoid such interference, so long as the text is not so conclusive that “we must accept that reading”). Specifically, “the law of nations, or customary international law,” includes choice-of-law principles that place “limitations on a nation’s exercise of its jurisdiction” and thus requires courts, in the absence of a clear and
rule is that significant policy determinations that affect the relationship between the US and other nations should be made by the legislature alone.36

D. Interpretation of the Language of § 10(b): Two Schools of Thought

Both the presumption against extraterritoriality and the Charming Betsy rule require courts to identify specific language in § 10(b) that clearly expresses an affirmative intention of Congress to apply the provision extraterritorially.37 In the absence of such language, both canons mandate that § 10(b) be construed not to apply extraterritorially. Since § 10(b)’s enactment over three-quarters of a century ago, there have been two widely divergent schools of thought on how to interpret the language of § 10(b).

1. The anti-extraterritorialist view: the statute has no extraterritorial reach.

On one end of the spectrum, there are those who argue that the text of § 10(b) is silent, or at best ambiguous, regarding the question of its extraterritorial application (hereinafter, the “anti-extraterritorialists”).38 Given the absence of any explicit textual command, the anti-extraterritorialists contend that courts must presume that Congress did not intend for § 10(b) to apply contrary congressional statement, to assume that statutes incorporate international choice-of-law principles. See Hartford Fire, 509 US at 815, 817 (cited in note 31) (Scalia dissenting), quoting Romero v Intl Terminal Operating Co, 358 US 354, 382 (1959). This “practice of using international law to limit the extraterritorial reach of statutes is firmly established in our jurisprudence[.]” Romero, 358 US at 818 (Scalia dissenting). And it “help[s] ensure that ‘the potentially conflicting laws of different nations’ will ‘work together in harmony,’ a matter of increasing importance in an ever more interdependent world.” Sosa v Alvarez-Machain, 542 US 692, 761 (2004) (Breyer concurring in part and in the judgment), quoting Empagran, 542 US at 164.

36 McCulloch, 372 US at 22, quoting Benz, 353 US at 147. The presumption that Congress, when it legislated, intended to embrace international choice-of-law principles raises the question of what those principles were when Congress enacted the Exchange Act in 1934. See Lawrizen v Larsen, 345 US 571, 577 (1953). The answer to this question is lex loci deliei. Sosa, 542 US at 705 (cited in note 35), citing Restatement (First) of Conflict of Laws § 379 (1934). The common-law roots of the securities fraud action under Section 10(b) are found in common-law tort actions for deceit and misrepresentation. See Dura Pharm, 544 US at 341, 343-44.

37 See, for example, Aramco, 499 US at 248 (cited in note 20).

38 See David Michaels, Note, Subject Matter Jurisdiction Over Transnational Securities Fraud: A Suggested Roadmap to the New Standard of Reasonableness, 71 Cornell L Rev 919, 930–31 (1986) (“Congress was silent regarding the extraterritorial application of much of the Securities Exchange Act of 1934, including its general antifraud provision, section 10(b). The Securities Exchange Commission was similarly silent regarding rule 10b-5, the general antifraud rule promulgated under section 10(b).”). See also Itoha Ltd v Lep Group PLC, 54 F3d 118, 121 (2d Cir 1995) (“It is well recognized that the Securities Exchange Act is silent as to its extraterritorial application.”).
Although § 10(b) refers to “interstate commerce,” which has been defined in the Exchange Act as commerce “between any foreign country and any State,” they maintain that this is merely boilerplate language that can be found in any number of congressional acts. It does not suffice to overcome the presumption against extraterritoriality or to negate the application of the Charming Betsy principle.

To further buttress the conclusion that § 10(b) does not apply to transnational conduct, the anti-extraterritorialists point to two other statutory provisions in the Exchange Act that in their view have unambiguous transnational applications. First, § 30(b) of the Exchange Act provides that it “shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.” According to the anti-extraterritorialists, § 30(b) restricts the Exchange Act to the transaction of business within the US but creates an explicit, potential extraterritorial application of the statute as promulgated by the SEC. Because § 10(b) contains no such carve-out, it does not apply extraterritorially. In addition, § 30(a) explicitly addresses transactions on foreign exchanges. § 30(a) authorizes the SEC to adopt rules and regulations covering transactions in securities of US issuers that are “effect[ed]” by “any broker or dealer” on an exchange not within or subject to the jurisdiction of the US, and makes it unlawful for brokers and dealers to violate those rules. According to the anti-extraterritorialists, § 30(a) demonstrates that Congress, unlike in § 10(b), made a clear statement of intent to regulate transactions on foreign exchanges by broker-dealers.

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39 See Michael J. Calhoun, Tension on the High Seas of Transnational Securities Fraud: Broadening the Scope of United States Jurisdiction, 30 Loyola U Chi L J 679, 687 (1999) (“If, however, Congress is silent with regard to whether jurisdiction extends beyond the borders of the United States, there is a presumption against extraterritoriality.”).
40 15 USC § 78c(a)(17).
41 See Aramco, 499 US at 250-51.
42 15 USC § 78dd(b).
44 Zoelch v Arthur Andersen & Co, 824 F2d 27, 30 (DC Cir 1987) (commenting that the Exchange Act provides “no specific indications of when American federal courts have jurisdiction over securities law claims arising from extraterritorial transactions”).
45 15 USC § 78dd(a).
2. The extraterritorialist view: the statute has extraterritorial application.

On the other end of the spectrum, there are those who argue that the language of § 10(b) unambiguously indicates that the statute has (at least some) extraterritorial reach (hereinafter, the "extraterritorialists"). The extraterritorialists offer three justifications for their interpretation of the statute. First, § 10(b) prohibits "any person" from employing, even indirectly, "any means or instrumentality of interstate commerce" in contravention of rules against manipulative and deceptive devices set forth by the SEC. The Exchange Act in turn defines "interstate commerce" to include "trade, commerce, and transportation, or communication . . . between any foreign country and any State." By the express terms of the statute, therefore, a person violates the Exchange Act if she uses any means or instrumentality of interstate commerce—a term which, by definition, has extraterritorial meaning—to perpetrate a fraud. Second, when Congress explained the statute's remedial purposes, it noted that securities sales and purchases are impacted by data and trading activities that cross national borders. The Exchange Act's preamble

(stating that the Supreme Court has "made no pretense that it was Congress' design to provide the remedy afforded"). Created under an "ancien regime" of law where federal judges invented unexpressed rights of action in order to better effectuate what they divined Congress's intent to be, the Section 10(b) private right of action is, in reality, vestigial. See Alexander v Sandoval, 532 US 275, 287 (2001) (emphasis and citation omitted).

47 See Buxbaum, 46 Colum J Transnat'l L at 21 (cited in note 2) ("However, the presumption against extraterritoriality can be overcome by a finding that Congress intended the legislation in question to reach foreign conduct or transactions. In securities cases, courts have frequently held that the strength of the legislative interest in protecting US investors and markets is sufficient to justify the regulation of foreign conduct that causes effects within the United States.").

48 15 USC § 78j(b).

49 15 USC 78c(a)(17). By the express terms of the statute, a federal violation occurs whenever a fraud is committed in connection with the purchase or sale of any security under one of three conditions. The Exchange Act is violated if a person uses any means or instrumentality of interstate commerce or uses the US mails or uses any facility of any national securities exchange to perpetrate a securities fraud. Under ordinary rules of statutory construction, the disjunctive "or" means that any one of the three conditions is a basis for jurisdiction. See Duncan v Walker, 533 US 167, 174 (2001) (stating that when interpreting statutory language, it is the court's duty to give meaning, if possible, to every clause or word of the statute). Any of the three conditions enumerated in the statute therefore is a predicate condition for actionable securities fraud.

"Interstate commerce" refers to the phone or wire systems in the US. See 15 USC § 78c ("The term 'interstate commerce' means trade, commerce, transportation, or communication among the several States, or between any foreign country and any State . . . . The term also includes intrastate use of (A) any facility of a national securities exchange or of a telephone or other interstate means of communication . . . .").

50 15 USC § 78b(2) (observing that prices of transactions on US securities markets are "disseminated and quoted" and "constitute a basis for determining" securities prices in "foreign countries").
states that the Act “provide[s] for the regulation of securities exchanges . . . operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges . . .”—indicating that the Act was intended to reach more than conduct affecting only Americans or US-based securities exchanges.\(^{52}\) Lastly, the extraterritorialists argue that § 30 of the Exchange Act should be interpreted to support the transnational application of § 10(b). As set forth above, § 30(b) exempts from regulation foreign brokers, dealers, and banks conducting transactions abroad unless the Commission determines that regulating them is necessary to prevent evasion of the Act.\(^{53}\) Contrary to the anti-extraterritorialist interpretation of § 30(b), this exemption would make little sense if the Act did not apply in the first instance to securities transactions that occur abroad.\(^{54}\) Moreover, the inference that the anti-extraterritorialists draw from § 30(a) is likewise incorrect. Rather, both provisions demonstrate that Congress appreciated the extraterritorial implications of the Act, and while Congress restricted the Act’s extraterritorial scope in § 30, it failed to make a similar restriction in § 10(b). The natural inference is that Congress specifically intended not to impose such limits on § 10(b).\(^{55}\)

Consistent with this latter view, the lower courts have uniformly agreed that § 10(b) applies to transnational, or cross-border, securities frauds. The extent of § 10(b)’s extraterritorial reach, however, was the subject of ongoing judicial debate until the \textit{Morrison} decision.\(^{56}\) This led to “considerable

\(^{52}\) Pub L No 73-291, 48 Stat 881 (1934) (emphasis added). Those opposing the extraterritorial application of Section 10(b) maintain that all this means is that securities exchanges and over-the-counter markets in the US were operating in interstate and foreign commerce and that Congress intended to regulate them.


\(^{54}\) According to opponents of Section 10(b)’s extraterritorial application, by specifically articulating a limited area of extraterritorial application in Section 30, Congress intended that the Act would otherwise apply only domestically. “When Congress provides exceptions in a statute, it does not follow that courts have authority to create others. The proper inference . . . is that Congress considered the issue of [creating other exceptions]—here extraterritorial application—“and, in the end, limited the statute to the [exceptions] set forth.” \textit{United States v Johnson}, 529 US 53, 58 (2000).

\(^{55}\) \textit{Zoesch}, 824 F2d at 31–32; \textit{Bersch v Drexel Firestone, Inc}, 519 F2d 974, 984 n 20 (2d Cir 1975).

\(^{56}\) See \textit{Kauthar SDN BHD v Sternberg}, 149 F3d 659, 664–65 (7th Cir 1998), cert denied, 525 US 1114 (1999); \textit{Alfadda v Fenn}, 935 F2d 475, 478 (2d Cir 1991), cert denied, 502 US 1005 (1991); \textit{Kasser}, 548 F2d at 112–14, cert denied, 431 US 938 (1977). Concluding that Congress did not intend “to allow the United States” to become “a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners,” a consideration which has become known as the “Barbary Coast” rationale, the courts of appeals fashioned an “effects” test and a “conduct” test, see Section II, to determine the extent of Section 10(b)’s transnational reach. See
fragmentation and complexity” in the case law and to a three-way circuit split regarding the proper application of § 10(b) to fraudulent events that are not neatly confined within territorial boundaries.57

III. THE CREATION AND DEVELOPMENT OF THE “CONDUCT” AND “EFFECTS” TESTS

A. The Second Circuit’s Conduct and Effects Tests

The US Court of Appeals for the Second Circuit was the first court to address the transnational application of the US securities laws. For the better part of four decades, the Second Circuit has “consistently looked at two factors” to determine whether it has jurisdiction over securities fraud claims asserted by foreign investors: “(1) whether the wrongful conduct occurred in the United States; and (2) whether the wrongful conduct had substantial effect in the United States or upon United States citizens.”59 These factors are known, respectively, as the “conduct test” and the “effects test.”60

In securities class actions, claims brought by domestic shareholders who purchased shares of foreign corporations on foreign exchanges (known as “foreign-squared” or “f-squared” cases) have historically satisfied the effects test.
The mere fact that the putative class members are domestic has traditionally been all that is required to demonstrate a substantial effect upon US citizens. However, jurisdiction over the claims of foreign shareholders who purchased shares of foreign corporations on a foreign stock exchange (“foreign-cubed” or “f-cubed cases”) generally hinged on the extent of defendants’ conduct within the US. In considering what quantum of US conduct is necessary to warrant the application of the US securities laws to non-US transactions, the Second Circuit highlighted two policy considerations. On the one hand, the court understood that if § 10(b) was restricted to not apply extraterritorially, issuers potentially would be encouraged to use the US as a base of operations to export securities fraud to foreign investors. On the other hand, as noted by the Second Circuit, “the securities laws are not to apply in every instance where something has happened in the United States.” In light of these competing policy considerations, the Second Circuit found that the conduct test is met when: “(1) the defendant’s activities in the United States were more than ‘merely preparatory’ to a securities fraud conducted elsewhere and (2) the activities or culpable failures to act within the United States ‘directly caused’ the claimed losses.” In essence, foreign investors are required to demonstrate that substantial acts in furtherance of the fraud were committed within the US. As the Second Circuit described it, there must be predominant domestic conduct that “comprise[d] the heart of the alleged fraud.”

Consider Danielle Kantor, The Limits Of Federal Jurisdiction And The F-Cubed Case: Adjudicating Transnational Securities Disputes In Federal Courts, 65 NYU Ann Surv Am L 839, 878 (2010) (“Instead of a foreign class, foreign defendant, and foreign exchange, the f-squared action would feature a foreign class, foreign defendant, and, most likely, a domestic exchange.”).

This consideration is known as the “Barbary Coast” rationale because denying jurisdiction in these circumstances “may embolden those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations . . . [and] allow the United States to become a ‘Barbary Coast,’ as it were, harboring international securities ‘pirates.’” SEC v Kasser, 548 F2d 109, 116 (3d Cir 1977).

In a particularly noteworthy decision, Judge Denise L. Cote applied the Second Circuit’s conduct test in a foreign-cubed securities fraud action to exclude foreign investors from the class certified in In re SCOR Holding (Switzerland) AG Litigation, 537 F Supp 2d 556 (SDNY 2008). Plaintiffs there alleged that Converium, a Swiss reinsurer, misrepresented its financial information by failing to disclose loss reserve deficiencies, particularly, at CRNA, Converium’s North American subsidiary. Plaintiffs cited numerous instances of US-based conduct, including the participation of CRNA executives in the alleged fraud, board meetings at which financial information reporting was discussed, and alleged false statements included in SEC filings and made on calls with Wall Street analysts. The court, however, found that the vast bulk of the fraudulent statements were issued abroad and that the fraudulent scheme was allegedly “masterminded” by foreign decision-makers.

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61 Consider Danielle Kantor, The Limits Of Federal Jurisdiction And The F-Cubed Case: Adjudicating Transnational Securities Disputes In Federal Courts, 65 NYU Ann Surv Am L 839, 878 (2010) (“Instead of a foreign class, foreign defendant, and foreign exchange, the f-squared action would feature a foreign class, foreign defendant, and, most likely, a domestic exchange.”).
62 See Robinson, 117 F3d at 906.
63 This consideration is known as the “Barbary Coast” rationale because denying jurisdiction in these circumstances “may embolden those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations . . . [and] allow the United States to become a ‘Barbary Coast,’ as it were, harboring international securities ‘pirates.’” SEC v Kasser, 548 F2d 109, 116 (3d Cir 1977).
64 IT, 519 F2d at 1018 (emphasis added).
65 Berger, 322 F3d at 193 (citations omitted) (emphasis added).
66 See Morrison v National Australia Bank, Ltd, 547 F3d 167, 175 (2d Cir 2008) (“Morrison 2d Cir”). In a particularly noteworthy decision, Judge Denise L. Cote applied the Second Circuit’s conduct test in a foreign-cubed securities fraud action to exclude foreign investors from the class certified in In re SCOR Holding (Switzerland) AG Litigation, 537 F Supp 2d 556 (SDNY 2008). Plaintiffs there alleged that Converium, a Swiss reinsurer, misrepresented its financial information by failing to disclose loss reserve deficiencies, particularly, at CRNA, Converium’s North American subsidiary. Plaintiffs cited numerous instances of US-based conduct, including the participation of CRNA executives in the alleged fraud, board meetings at which financial information reporting was discussed, and alleged false statements included in SEC filings and made on calls with Wall Street analysts. The court, however, found that the vast bulk of the fraudulent statements were issued abroad and that the fraudulent scheme was allegedly “masterminded” by foreign decision-makers.
Like the Second Circuit, the Fifth and Seventh Circuits adopted a similar interpretation of the conduct test—requiring that the domestic conduct be predominant and sufficiently central to the claim of fraud.\textsuperscript{67} Other courts, however, have adopted varying interpretations of the Second Circuit's conduct test. For instance, the US Court of Appeals for the DC Circuit has implemented the most restrictive interpretation of the conduct test, mandating "that the domestic conduct at issue must itself constitute a securities violation."\textsuperscript{68} On the opposite end of the spectrum, the Third, Eighth, and Ninth Circuits have followed a much less restrictive approach, "requiring only that at least some activity designed to further a fraudulent scheme occur in the United States."\textsuperscript{69}

B. Recent Case Law Applying the “Conduct” and “Effects” Tests

Recently, there have been significant developments in three foreign-cubed cases as well as one foreign-squared case. As illustrated by the analysis and divergent holdings of those cases, the complexities presented by transnational securities class actions lead to differing outcomes based on the court's interpretation of the conduct and effects tests. The following sections provide an overview of the important issues raised by the Vivendi, Credit Suisse, Fortis and EADS securities class actions and the implications of the courts’ differing approaches in those cases.

\textsuperscript{67} SCOR Holding, 537 F Supp 2d at 564-68. The court thus held that foreign investors had not satisfied their burden of establishing either sufficient US conduct or losses resulting from such US conduct and excluded foreign investors who purchased shares on a foreign exchange from the certified class. Id.

\textsuperscript{68} See Robinson, 117 F3d at 906-07 (holding that the conduct test requires that the domestic conduct in question be: (1) more than merely preparatory to the fraud; and (2) a direct cause of the loss in question); Kautbar, 149 F3d at 667 ("[Its approach] represents the same midground as that identified by the Second and Fifth Circuits. . . . [W]e would do serious violence to the policies of these statutes if we did not recognize our country’s manifest interest in ensuring that the United States is not used as a ‘base of operations’ from which to ‘defraud foreign securities purchasers or sellers.’").

\textsuperscript{69} See Kasser, 548 F2d at 109 (holding that conduct comes within the scope of the Exchange Act if “at least some activity designed to further a fraudulent scheme occurs within this country”); Continental Grain (Austl) Pty Ltd v Pacific Oilseeds, Inc, 592 F2d 409, 421 (8th Cir 1979) (holding that the Exchange Act provisions were applicable when the domestic conduct “was in furtherance of a fraudulent scheme and was significant with respect to its accomplishment”). See also Grunenthal GmbH v Hotz, 712 F2d 421, 425 (9th Cir 1983).

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1. In re Vivendi Securities Litigation.

In Vivendi, plaintiffs alleged that Vivendi, former CEO (Jean Marie Messier), and former CFO (Guillaume Hannezo) misled the public about the company’s cash flow problems relating to their promotion of a three-way merger between Vivendi, Seagram’s entertainment businesses, and Canal Plus S.A. in December 2000. Plaintiffs complained that Vivendi hid the severity of its liquidity problems—particularly its total debt that resulted from the three-way merger and Vivendi’s prior transactions. After the Board of Directors of Vivendi terminated Messier in early July 2002, a series of securities class actions were initiated against Vivendi, Messier, and Hannezo in the US.

 Defendants in Vivendi argued that the court did not have subject matter jurisdiction over the claims asserted by foreign investors who acquired their shares of Vivendi, a foreign corporation, on various foreign stock exchanges. The district court, however, disagreed. Applying the conduct test, the court found that “the fraud alleged in the [complaint] was perpetrated, in important part, in the United States.” In support of its findings, the court commented that a significant number of the alleged misleading statements were made by the company, Messier, and Hannezo to investors and analysts in New York. Accordingly, the Vivendi court concluded that the allegations demonstrated that the fraudulent conduct was sufficiently centralized in the US to merit the court’s exercise of jurisdiction.

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70 In re Vivendi Universal S.A. Sec Litig., 634 F Supp 2d 352, 354–55 (SDNY 2009). Vivendi is a global conglomerate comprised primarily of two major divisions: Media and Communications and Environmental Services. In re Vivendi Universal, S.A. Sec Litig., 242 FRD 76, 81 (SDNY 2007) ("Vivendi Class Certification"). In June 1996, Vivendi began an acquisition spree, with Messier and Hannezo at the helm. This growth strategy resulted in the accumulation of a sizeable debt. After Vivendi acquired Seagram for $36 billion and Canal Plus for $12 billion, Vivendi purchased substantial equity positions in a host of other companies, including Houghton Mifflin Co, Studio Canal, and USA Network Entertainment, using Vivendi stock or by borrowing against future earnings. Vivendi Universal, 634 F Supp 2d at 354. Pursuant to this growth strategy, plaintiffs alleged that it was crucial for defendants to continue to report favorable financial results in order to keep Vivendi’s stock price high and to maintain its favorable credit ratings and access to additional debt financing. Id at 354–55.

71 Vivendi Universal, 634 F Supp at 355.

72 Vivendi Class Certification, 242 FRD at 80.

73 Id at 79.

74 Id at 81.

75 Id at 81–82.

76 Vivendi Class Certification, 242 FRD at 80. After holding that it had subject matter jurisdiction over the foreign investors' claims, the court subsequently addressed whether the foreign investors' claims should be adjudicated as a class action. In doing so, the court had to determine whether different foreign jurisdictions would give preclusive effect to a judgment by a US court in a class action. Id. Over strong objection from defendants, the district court concluded that the courts of
2. Credit Suisse securities class action.

In Credit Suisse, investors brought securities fraud claims against, among others, the company, based on allegations that Credit Suisse, a Swiss corporation, failed to record losses relating to the declining value of its mortgage-related assets, including collateralized debt obligations (CDOs). The complaint also alleged that weaknesses in Credit Suisse's risk management and internal controls for mortgage-related products were deliberately ignored. Two different sets of plaintiffs were designated in the complaint. One set represented both domestic and foreign investors who purchased American Depository Receipts (ADRs) of Credit Suisse on the New York Stock Exchange (the NYSE). Foreign-cubed plaintiffs—foreign investors who purchased shares of Credit Suisse on the Swiss Stock Exchange—comprised the other set.

As in Vivendi, the court employed the conduct test to the facts alleged in the Credit Suisse complaint. The court noted that foreign plaintiffs' jurisdictional argument relied primarily on the location of Credit Suisse's investment banking segment in New York (as well as certain of the company's investment banking

France, England, and the Netherlands would likely enforce a US judgment and included investors from those countries in the Vivendi class action. See Id at 102 (finding subject matter jurisdiction over the claims of French investors), 102-03 (finding subject matter jurisdiction over the claims of English investors), 105 (finding subject matter jurisdiction over the claims of Dutch investors). The court, however, excluded investors from Germany and Austria because it was not sufficiently certain that German and Austrian courts would respect such a US judgment. Id at 105. The Vivendi case was the first foreign-cubed action to go to trial. See Andrew Longstreth, Extremely Rare F-Cubed Securities Class Action Trial to Start Against Vivendi, The American Lawyer (Oct 7, 2009), online at http://www.law.com/jsp/law/international/LawArticleIntl.jsp?id=1202434341256 (visited Oct 30, 2010) (calling the Vivendi f-cubed trial “once-in-a-lifetime”). After hearing the evidence for three months, the jury was charged with evaluating fifty-seven allegedly false public disclosures made by the defendants from October 2000 to June 2002. See Court Finds Vivendi Liable For Misleading Investors, NY Times B3 (Jan 30, 2010). The jurors concluded that each disclosure contained a material misstatement or omission and that Vivendi, but not Messier and Hannezo, had acted "recklessly" in issuing those disclosures to the public.

Cornwell, 689 F Supp 2d at 632. The fraud at the heart of plaintiffs' claim fell into five categories of alleged misstatements and omissions regarding: (1) Credit Suisse's valuation system (including intentional misvaluation by a group of rogue employees in London); (2) its unauthorized placement of assets backed by high-risk loans in client accounts (including criminally prosecuted conduct of two traders in New York); (3) its risk management practices; (4) its sub-prime exposure (including exposure caused by inadequate hedging practices); and (5) its financial state constituting violations of generally accepted accounting principles ("GAAP"). Id. In sum, plaintiffs alleged that defendants repeatedly misrepresented the magnitude of the serious issues confronting Credit Suisse.

Id at 638.

Id.

Cornwell, 689 F Supp 2d at 633.
and risk management officers). The location of such US-based management, according to the court, was not enough to satisfy the conduct test. The critical issue was that most of the alleged misrepresentations and omissions constituting the heart of the fraud originated from Switzerland, not the US. On that basis, claims asserted on behalf of foreign-cubed investors (unlike those in *Vivendi*) were dismissed from the action.

As to the domestic and foreign purchasers of ADRs on the NYSE, the court concluded that only the domestic purchasers could proceed with their claims in the US. Noting that approximately seventy-five million shares of Credit Suisse securities (approximately 11.4 percent of its outstanding shares) were held by US institutional investors, the court concluded that the “effects” of the fraud were substantial enough to warrant the application of the US securities laws for claims brought by domestic ADR purchasers. Because the geographic source of the fraud was still predominately foreign, the court found no ground upon which to exercise jurisdiction over the claims brought by foreign plaintiffs under the conduct test.

3. *Fortis* securities class action.

The allegations underlying the *Fortis* securities class action were like those in *Credit Suisse*. In *Fortis*, investors claimed that information about Fortis’s CDOs and its other risky subprime mortgage-backed securities was concealed from investors or otherwise misrepresented. Plaintiffs also alleged that defendants had misled investors about how Fortis’s decision to acquire ABN AMRO Holding NV (ABN AMRO) had compromised the company’s finances. After the governments of Belgium, the Netherlands, and Luxembourg “bailed out” Fortis, investors brought a securities class action in the US against Fortis and certain of its senior officers.

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82 Id at 634.
83 Id at 633 (finding that “the heart of this alleged fraud comprised statements made in Switzerland and that [the court] lacked subject matter jurisdiction over claims by these foreign plaintiffs because sufficient fraudulent conduct had not occurred in the United States”).
84 *Cornwell*, 689 F Supp 2d at 634.
85 Id.
86 Id at 634-35.
87 Id at 634.
88 *Copeland*, 685 F Supp 2d at 500.
89 Id.
90 Id. Fortis is an international provider of banking and insurance services. Id. Fortis has two parent companies: Fortis SA NV, incorporated in Belgium, and Fortis N.V., incorporated in the Netherlands. *Copeland*, 685 F Supp 2d at 500. During the class period, it was purported to be “among the 15 largest financial institutions in Europe.” Id. Fortis securities were traded on the
On February 18, 2010 (a week after the issuance of the ruling in *Credit Suisse*), the SDNY court again utilized the conduct and effects tests. First, based on the alleged conduct, the court found that the fraud was “masterminded” in Brussels, not in the US. Supporting that conclusion, the court noted that “[a]lthough all of the CDO valuation activity was performed by employees in New York City, the complaint allege[d] that all decisions on how to value the CDOs and how the company would report the values to the public were made in Brussels.” According to the court, plaintiffs alleged that the New York office provided “complete” information to Fortis’s headquarters in Brussels, “but the executives in Brussels deliberately disregarded that information in favor of minimizing the company’s sub-prime exposure.” Furthermore, the court rejected plaintiffs’ argument that subject matter jurisdiction could be premised on Fortis’s filings with the SEC relating to the terms of its acquisition of ABN AMRO securities. The court commented that “the act of filing documents with the SEC is insufficient standing alone to confer jurisdiction in an action for damages.”

Moving on to the effects test, the court concluded that the complaint failed to adequately allege substantial “effects” in the US. Although there was “no doubt that some Fortis investors are US residents, and that Fortis’s alleged fraud had some effect upon US investors and the US securities market,” the court could not determine that the effects were “substantial” based on the allegations in the complaint.

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91 Copeland, 685 F Supp 2d at 503.
92 Id at 505.
93 Id.
94 Id (citation omitted).
95 Id at 506 (emphasis omitted).
96 Copeland, 685 F Supp 2d at 506. In support of its holding, the court relied on the complaint’s lack of detail regarding the number or percentage of US resident investors, where US investors may have purchased their securities, or any relationship that foreign purchasers had to the United States such that US investors were actually affected by the harm that the foreign purchasers suffered. Id at 506. The court, accordingly, dismissed the entire complaint for lack of subject matter jurisdiction. Id at 507.
4. *In re European Aeronautic Defence & Space Company Securities Litigation (EADS litig).*

In *EADS litig*, an American pension fund brought an action in US federal court (on behalf of US purchasers of EADS securities). 97 The action alleged that EADS, a European aerospace company, and several of its high-ranking officers, misled investors about delays in the production of the Airbus A380 super-jumbo aircraft in several disclosures originating from Europe. However, once the company revealed the extent of the aircraft’s production delays, its stock price dropped. 98 According to plaintiffs, the conduct test was satisfied: (1) EADS employees had several meetings with media and analysts in New York, and (2) American analysts participated in conference calls regarding EADS’s earnings. 99 The court ruled, however, that the conduct test had not been met. According to the court, the events relied on by plaintiffs—in the context of the material misrepresentations and omissions made in Europe—were merely incidental to the alleged fraud. 100 Although EADS personnel met with investors in New York, the personnel only repeated public statements made originally in Europe that had already been appreciated by the markets. The court commented:

This was a European fraud. EADS is headquartered in Europe. Its shares trade only on European exchanges. It is subject to regulation by the European Union and its member states. Its investor disclosures were prepared and disseminated in Europe. The A380 production difficulties transpired in Europe. [The Plaintiff] purchased EADS shares on a European exchange. The gravamen of the Complaint is that EADS’s fraudulent disclosures in Europe inflated its share price on European exchanges, causing [the Plaintiff’s losses]. The only thing American about this case is [the Plaintiff]. 101

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97 Defendant EADS is a public limited liability company organized under Dutch law, headquartered in the Netherlands, with facilities throughout Europe. *EADS litig.*, 703 F Supp 2d at 351. EADS has a US holding company for North America with an office in Arlington, Virginia. Id. EADS shares are listed on the Eurolist of Euronext Paris SA (the Paris stock exchange), the *Amtlicher Markt* of the Frankfurter Wertpapierbose (the Frankfurt stock exchange), and the Madrid, Bilbao, Barcelona, and Valencia Stock Exchanges (the Spanish stock exchanges). Id. EADS shares are also listed on European electronic exchanges including Virtix Europe, Chi-X Europe, and Euro Composite, among others. Id at 352. While EADS shares are not traded on any securities market in the United States, three depositary banks—Bank of New York, Citibank, and Deutsche Bank—have issued unsponsored ADRs in EADS shares. Id.

98 Id at 354.

99 *EADS litig.*, 703 F Supp 2d at 356.

100 Id at 357.

101 Id.
Focusing on the effects test, the court held that limiting the class of investors to US residents is not enough to satisfy the effects test. Although claims brought by domestic shareholders who purchase shares of foreign corporations on foreign exchanges (known as “foreign-squared” or “f-squared” cases) have, as noted above, usually satisfied the effects test, the court in *EADS litig* ruled differently. It held that absent allegations tying the effects of the fraud directly to the US, the US securities laws do not cover predominantly foreign fraud. Here, the court found that all of the alleged misstatements and omissions occurred abroad, with the impact of those misstatements or omissions—the inflation of EADS’s share price followed by its decline when the company made a corrective disclosure—felt predominately on foreign exchanges. Such allegations by themselves, lacking any nexus to American securities markets, were not sufficient to satisfy the effects test. Without allegations showing a “substantial” effect on those purchasers, even if some class members acquired shares as ADRs, the court concluded that the effects test had not been met.

C. Limits on § 10(b)’s Transnational Application Are Not Jurisdictional

Interestingly, every court to have addressed the transnational application of § 10(b), including the district courts in the *Vivendi, Credit Suisse, Fortis,* and *EADS litig* class actions (as well as the Second Circuit in *National Australia Bank* discussed in Section V), has cast the issue as a jurisdictional question. Framing the issue in jurisdictional terms, however, has misdirected much of the debate on the extraterritorial application of § 10(b). In fact, the limits on § 10(b)’s transnational reach do not relate to the subject matter jurisdiction of the federal courts.

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102 Id at 357–59.
103 *EADS litig*, 703 F Supp 2d at 358.
104 Id at 359.
105 Id. “[Plaintiffs] attempt[ed] to vault over the lack of connection to domestic securities markets by highlighting the number of EADS shares owned by Americans.” Id at 358. “Plaintiff[s] [sought] to buttress [their] allegations by noting that there are at least seventy-three US investors who hold approximately 7 percent of EADS’s total outstanding shares valued at ‘hundreds of millions of dollars.’” *EADS litig*, 703 F Supp 2d at 358.
106 Id at 359.
107 See, for example, Brief for the United States of America as Amicus Curiae Supporting Respondents, *Morrison v National Australia Bank, Ltd*, No 08-1191, *9 (filed Feb 26, 2010) (“US Amicus Brief”) (“The connection between an alleged securities fraud and the United States does not affect the federal courts’ subject-matter jurisdiction. Rather, that connection bears on whether Section 10(b) applies to the securities fraud at issue and whether a particular private plaintiff can invoke Section 10(b)’s implied private right of action.”).
courts. Instead, those limitations raise two significant non-jurisdictional questions: (1) whether the conduct at issue is subject to § 10(b)’s substantive prohibition against securities fraud, and (2) whether § 10(b)’s implied private right of action can be invoked by particular investors.

1. Arbaugh v Ye’H Corp.

In 2006, the Supreme Court decided a Title VII case that seemingly had nothing to do with the extraterritorial reach of the US securities laws. In Arbaugh v Ye’H Corp, the plaintiff filed a sexual harassment claim under Title VII of the Civil Rights Act of 1964 against her employer. After losing at trial, the employer moved to dismiss the case for lack of subject matter jurisdiction. Because the employer had fewer than fifteen employees, it argued that Title VII could not apply to the conduct at issue in light of Title VII’s fifteen person numerosity requirement.

The Court held that the numerosity threshold of Title VII is a constraint on “a plaintiff’s claim for relief, not a jurisdictional issue.” Conceding that its prior decisions had not provided sufficient guidance on the dichotomy between jurisdiction and element-of-the-claim for relief, the Court established a bright-line rule to determine whether Title VII’s fifteen-employee numerosity requirement was jurisdictional. The Court stated that “a threshold limitation on a statute’s scope shall count as jurisdictional” only when “the Legislature clearly

108 See id at *9–10 (“The determination whether the defendant’s conduct is governed by the law on which the plaintiff bases his claim for relief is generally a merits-related decision about whether the plaintiff has ‘state[d] a claim upon which relief can be granted, [Fed R Civ P 12(b)(6)], rather than a determination about whether the federal courts have ‘subject-matter jurisdiction,’ [Fed R Civ P 12(b)(1)].”).
109 See id at *11. See also Steel Co v Citizens for a Better Environment, 523 US 83, 89 (1998); Bell v Hood, 327 US 678, 682 (1946).
111 Id at 510.
112 Id at 507–08.
113 Id at 508. The subject matter jurisdiction issue can be raised at any time, even after trial. See Arbaugh, 546 US at 506. Furthermore, a court must consider potential jurisdictional defects on its own initiative even if they have not been identified by the parties. Id. In contrast, an objection that a complaint fails to state a valid claim for relief is forfeited if not raised by the opposing party before trial on the merits. Id at 507. Recognizing that limits on the transnational application of Section 10(b) are non-jurisdictional therefore avoids “unfairness and waste of judicial resources.” Id at 515 (brackets, quotation marks, and citation omitted).
114 Arbaugh, 546 US at 510.
115 Id at 516 (“But when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character. Applying that readily administrable bright line to this case, we hold that the threshold number of employees for application of Title VII is an element of a plaintiff’s claim for relief, not a jurisdictional issue.”).
states” that it has that character. In contrast, “when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as non-jurisdictional.” The Court further explained that the text of Title VII governing its federal jurisdiction does not contain an employee-numerosity requirement. Instead, that limitation appears “in a separate provision that ‘does not speak in jurisdictional terms or refer in any way to the jurisdiction of the district courts.’” In other words, the fifteen-employee requirement involves the merits-related question of whether a particular employer is covered by Title VII’s prohibitions.

2. Arbaugh applied to § 10(b).

The Supreme Court’s decision in Arbaugh has required courts to reconsider their reflexive reliance on principles of subject matter jurisdiction when analyzing the securities laws’ extraterritorial reach. Under the Arbaugh bright-line test, constraints on the extraterritorial application of § 10(b) are not jurisdictional. Pursuant to 28 USC § 1331, federal courts have broad subject matter jurisdiction over “all civil actions arising under the Constitution, laws, or treaties of the United States.” The Exchange Act does not restrict § 1331’s grant of jurisdiction to federal courts. Indeed, the Exchange Act expressly provides that federal subject matter jurisdiction over claims arising under the Act is “exclusive” and extends to “all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder.” Thus, there are no provisions of the Exchange Act limiting a federal court’s subject matter jurisdiction over a § 10(b) claim on the basis of whether the alleged violation took place in the US. If a particular suit is appropriate to enforce a “liability or duty” created by the Exchange Act (or rules promulgated thereunder), Sections 1331 and 78aa grant the federal courts with jurisdiction to resolve the claim.

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116 Id at 515.
117 Id at 516.
119 Id.
120 28 USC § 1331.
121 15 USC § 78aa (emphasis added).
122 Classifying the limits on Section 10(b)’s transnational application as non-jurisdictional also accords with the Supreme Court’s treatment of restrictions on the extraterritorial reach of other statutes. The Court has held, for example, that limits on the extraterritorial application of the Jones Act, 46 USC § 30104, affect only whether particular plaintiffs have stated a “cause of action” and do not call into question the jurisdiction of the federal courts. Romero v Int'l Terminal Oper Co, 358 US 354, 393–94 (1959); Lauritzen v Larsen, 345 US 571, 574–75 (1953).
D. § 10(b)’s Substantive Prohibition Versus § 10(b)’s Private Right of Action

Correctly describing the limitations on § 10(b)’s extraterritorial application as non-jurisdictional affords courts the ability to distinguish between the limits of § 10(b)’s substantive prohibition and other limitations that constrain only the statute’s implied private right of action.123 Because the SEC’s enforcement activities are not limited by some of the constraints that apply only to private suits, this is an important distinction. For example, while private plaintiffs must prove reliance and loss causation as elements of their claims, the SEC is not required to show that any investor actually relied on an allegedly false public disclosure or that the false statement caused investors financial harm.124 The statutory provisions governing SEC enforcement actions provide that “[w]henever it shall appear to the Commission that any person has violated any provision of [the Exchange Act], . . . the Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, upon a proper showing, a civil penalty to be paid by the person who committed such violation.”125 Thus, the SEC has broad authority to pursue enforcement actions whenever a securities fraud is sufficiently connected to the US to bring it within § 10(b)’s substantive prohibition.

Moreover, in the same way that it had made a monetary amount-in-controversy an element of subject matter jurisdiction under 28 USC § 1331 prior to 1980, Congress could have made the geography of the fraudulent conduct a jurisdictional element of a § 10(b) claim. However, neither the Exchange Act’s jurisdictional provision, 15 USC § 78aa (authorizing jurisdiction over suits “to enforce” the Act), nor 28 USC § 1331, provides any specific threshold for US-based conduct similar to the monetary floor provision that was previously part of § 1331. According to the statute’s express terms, jurisdiction is premised on whether the fraudulent conduct employed some form of interstate commerce, the US mails, or any facility of any national securities exchange. In other words, the plain language of the statute covers the manner in which the fraudulent conduct is implemented, not where the sale of the securities at issue occurred.

123 See Central Bank of Denver, 511 US at 172 (cited in note 14) (explaining that “the scope of conduct prohibited by § 10(b)” and “the elements of the 10b-5 private liability scheme” present distinct questions).
124 See SEC v Blain, 760 F2d 706, 711 (6th Cir 1985).
125 15 USC § 78u(d)(3)(A). The SEC has similarly broad and unqualified authority to bring an action for injunctive relief “[w]henever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of [the Act].” 15 USC § 78u(d)(1).
Importantly, the distinction between subject matter jurisdiction and the ingredient of the claim is among the reasons the Supreme Court granted certiorari in the National Australia Bank case. Advancing many of the same arguments set forth in Arbaugh, the Supreme Court clarified that the locus of the fraudulent conduct in a § 10(b) case has no bearing on the court’s jurisdiction to hear the case but instead relates to the substantive merits of the claim. This distinction is critical and bears directly on the question of which standard is appropriate for the extraterritorial application of § 10(b). Before turning to the Supreme Court's decision, the following Section considers some of the policy concerns surrounding the application of § 10(b) to cross-border, or transnational, conduct.

IV. POLICY CONSIDERATIONS

A. Material Differences Between the US Class Action System and the Class Action Systems of Other Nations

The current US private securities class action regime derives from a number of decisions that attempt to strike the appropriate balance among several factors including protecting investors, deterring fraud, and avoiding opportunistic and vexatious strike litigation. It should come as no surprise that the substantive and procedural rules of the US are significantly different from those of foreign countries in the area of securities law.

126 Morrison, 130 S Ct at 2877.
127 See Buxbaum, 46 Colum J Transnatl L at 61–64 (cited in note 2). While some jurisdictions do not permit individuals to bring collective securities fraud claims at all, those nations that have adopted some form of class action regime generally have requirements that are distinct from those under FRCP 23 and that reflect different policy choices than those embodied by the US class action system. See Brief of Amici Curiae the Securities Industry and Financial Markets Association, the Association for Financial Markets in Europe, the Chamber of Commerce of the United States of America, the United States Council for International Business, the Association Française des Entreprises Privées, and GC100 In Support of Respondents, Morrison v National Australia Bank, Ltd, No 08-1191, 8 (2d Cir filed Feb 26, 2010) (“Financial Markets Brief”) (“In France, for example, securities fraud claims may only be brought on a collective basis by associations that represent investors who opt-in to the litigation. See French C Mon & Fin Arts L452-1, L452-2 (2010), online at http://195.83.177.9/code/liste.php?lang=uk&cc=25&c=899 (visited Oct 30, 2010).” Likewise, “Argentinean federal law allows collective actions only by associations, and only in the context of environmental, civil rights, and consumer goods litigation.” See Global Legal Group, The International Comparative Legal Guide to Class & Group Actions 2010, 19 (2009) (“C&G 2010”). “The Netherlands permits use of its class action mechanism where a group of plaintiffs has negotiated a settlement on the question of liability or damages that it wishes to submit for court approval; alternatively, associations representing the interests of injured parties may seek a judicial declaration of a defendant’s liability—collective litigation of damages is prohibited.” See Dutch Civil Code (Burgerlijk Wetboek) Arts 3:305a, 3:305b (2008). “Germany recently adopted a ‘representative action’ statute for securities lawsuits that allows courts to consolidate cases that
For example, unlike many countries, the US permits the use of the fraud-on-the-market theory to establish reliance—a required element of a § 10(b) violation—in securities class action lawsuits. The fraud-on-the-market doctrine provides that a defendant’s fraud will be reflected in the price of a security and that any plaintiff is presumed to have relied on that fraud when purchasing the security, regardless of whether the plaintiff actually relied on any particular misrepresentation. The theory is premised on the existence of an efficient market—one in which any information (including false or materially misleading information) that is publicly disclosed and widely disseminated is incorporated into a security’s trading price. The purpose of the fraud-on-the-market theory is to ease the evidentiary burden on plaintiffs in class action lawsuits. Rather than requiring each individual plaintiff in the class to prove reliance, the courts will presume that the entire market relied on the informational integrity (or lack thereof) reflected in the security’s trading price. The US’s acceptance of presumed reliance (vis-à-vis the fraud-on-the-market theory) is in marked contrast with most European countries’ requirement that investors prove actual reliance on a particular misrepresentation.


129 The “fraud-on-the-market” doctrine is based on the theory that “in an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business [and that] misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements.” Id.

130 Id at 241–42, 245.

131 See, for example, Buxbaum, 46 Colum J Transnatl L at 61 (cited in note 2) (“[T]he United States is unusual in recognizing presumed reliance based on the fraud on the market theory, rather than requiring investors to prove actual reliance on misleading information.”); Michael Duffy, ‘Fraud on the Market’: Judicial Approaches to Causation and Loss from Securities Nondisclosures in the United States, Canada and Australia, 29 Melb U L Rev 621, 640, 655 (2005) (Australia).
In addition, the US is generally recognized to be more lenient than most European countries when it comes to the procedural mechanisms of its class action system.\(^{132}\) Underscoring the divergence of procedural mechanisms between the US and the European class action systems are the US’s: (1) “opt-out” procedures, (2) use of contingency fees, and (3) “pay your own way” rule. First, pursuant to Federal Rule of Civil Procedure 23(b)(2), investors who purchased securities during the time period when the fraud is alleged to have occurred will automatically be included in the putative class unless they affirmatively request exclusion from the class by a specified date.\(^{132}\) Second, the US permits the use of contingency fees.\(^{134}\) Contingency fees typically become payable to the attorney if the lawsuit is successful or is favorably settled out of court and are tied to a percentage of plaintiffs’ ultimate recovery.\(^{135}\) Europeans

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\(^{132}\) See, for example, Financial Markets Brief at *17–18 (cited in note 127) (“In addition to having different substantive standards for establishing securities fraud, nations also use vastly different procedural mechanisms to govern the assertion of collective private securities claims. Some foreign nations have legislated with the express intent of diverging from the US model for securities class action litigation and the policy choices it embodies. Indeed, some jurisdictions do not allow individuals to bring collective securities fraud claims.”).


\(^{134}\) One of the primary criticisms of contingency fee arrangements, particularly in the context of securities class actions, is the perceived windfall for attorneys who arguably receive more than their hourly rate for winning a case. Such fees are often seen as creating a conflict of interest because attorneys may choose to settle for less than is in the client’s interest to avoid perceived risks or to favor entrepreneurial incentives. However, a common justification for permitting contingency fee arrangements is to provide greater access to justice for those who could not otherwise afford the often high costs of litigation by providing incentives for attorneys to represent such clients.

refer to this payment arrangement between the plaintiff and the attorney as the "no-win-no-pay" rule. Finally, in contrast to the "loser pays" rule of Europe, the US requires each party to pay its own legal fees ("pay your own way" rule). This means that the losing party is typically not responsible for the fees and costs the other party incurs.

Highlighting the different policy determinations reached overseas, most European nations reject the opt-out model, contingency fee arrangements, and "pay your own way" rule of the US class action system. The primary concern among European nations is that these procedural mechanisms promote conflicts of interest for attorneys litigating such cases, and therefore represent a "toxic cocktail" [that] should not be introduced in Europe." For instance, several European countries have argued that "opt-out" procedures give plaintiffs' attorneys a relatively cheap method to enlist class members and enhance their fee award if they obtain a successful outcome. Adding to the so-called "toxic cocktail," contingency fees seemingly incentivize attorneys to pursue weak claims or pursue new theories of financial recovery, which in combination with the absence of a "loser pays" rule—a rule which imposes some discipline on the decision of whether, and how many resources will be expended, to pursue a claim—eliminates an important limit on the filing of frivolous or unsupported cases. In the view of many European countries, these features of the US class action system comprise a triumvirate of lenient procedural mechanisms that has turned the US into a global securities litigation tourism mill—a "Shangri-La," so to speak, for securities fraud lawsuits by foreign investors.


See, for example, Financial Markets Brief at *22 (cited in note 127) ("In other nations' views, contingency fees incentivize 'lawyers to take the risk of pursuing claims or to push for new theories of recovery,' while the absence of a 'loser pays' rule—a rule which imposes discipline on the decision of whether, and how aggressively, to pursue claims—removes an impediment to filing weak or problematic cases.") (citation omitted).


See, for example, Financial Markets Brief at *22 (cited in note 127).

B. Recent Supreme Court Jurisprudence Reflects Policy Concerns over Expanded § 10(b) Right of Action

The reluctance to adopt these procedural mechanisms in Europe is further supported by recent attempts to limit misuse of the class action device in the US. Given the potential for abuse, the Supreme Court has recently reinforced the need to construe narrowly the implied private right of action under § 10(b). For example, in *Tellabs, Inc v Makor Issues & Rights, Ltd*, the Supreme Court interpreted the heightened pleading standards of the Private Securities Litigation Reform Act of 1995 (the PSLRA) to require § 10(b) plaintiffs to set forth factually well-pleaded cases, particularly with respect to allegations of scienter, before being permitted to proceed with their lawsuits.¹⁴¹ Plaintiffs in that case filed a class action lawsuit against Tellabs, a manufacturer of specialized equipment for fiber optic networks, alleging securities fraud violations in connection with purported intentional misrepresentations the company and its chief executive officer made about various networking devices as well as the company’s overall financial health.¹⁴² Evaluating the plaintiffs’ claim of intentional misrepresentations, the *Tellabs* Court considered what it means to create a “strong inference” of scienter within the meaning of § 21(D)(b)(2) of the PSLRA. The Court held that “an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.”¹⁴³ The Court cautioned that,

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¹⁴² In *Tellabs*, shareholders of Tellabs, Inc. filed a class action lawsuit against Tellabs and its chief executive officer, Notebaert, alleging securities fraud in violation of Section 10(b). See id at 316. Plaintiffs claimed that, during the class period extending from December 2000 until June 2001, Notebaert: (1) made statements indicating that demand for Tellabs’ flagship networking device, the TITAN 5500, was growing, when, in fact, demand for the product was declining; (2) made statements indicating that Tellabs’ next-generation networking device, the TITAN 6500, was available for delivery, and that demand for that product was growing, when in fact the product was not ready for delivery and demand was waning; (3) falsely represented Tellabs’ financial results for the fourth quarter of 2000, and in connection with those results, condoned the practice of “channel stuffing,” under which Tellabs flooded its customers with unwanted products; and (4) overstated revenue projections, while knowing that demand for the TITAN 5500 was weak and that production of the TITAN 6500 was behind schedule. *Tellabs*, 551 US at 315-16 (cited in note 141). On June 19, 2001, Tellabs disclosed that demand for the TITAN 5500 had dropped significantly and simultaneously lowered its revenue projections for the second quarter of 2001. See id at 316. The following day, the price of Tellabs’ stock plunged to a low of $15.87 after having reached a high of $67 during the class period. Id at 315.

¹⁴³ See *Tellabs*, 551 US at 322–23. The Court set forth a three-step process for evaluating motions to dismiss Section 10(b) claims for failure to adequately plead scienter. First, a court must, as with any motion to dismiss for failure to plead a claim upon which relief can be granted, accept all allegations in the complaint as true. See id at 322. Second, a court must consider the complaint in its entirety. See id at 322–23. The inquiry is “whether all of the facts alleged, taken collectively,
“if not adequately contained, [private securities class actions] can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law.”

Furthermore, in Stoneridge Investment Partners v Scientific-Atlanta, Inc, the Supreme Court rejected scheme liability (the successor to aiding and abetting liability) as a cognizable theory of recovery under § 10(b). Plaintiffs in Stoneridge—shareholders who purchased Charter Communications, Inc. ("Charter," or the "Company") stock—argued that Charter, one of the nation’s largest cable television providers, had engaged in a “pervasive and continuous fraudulent scheme intended to artificially boost the Company’s reported financial results” by, among other things, entering into sham transactions with two equipment vendors that improperly inflated Charter’s reported operating revenues and cash flow. At issue in the case was whether imposing liability on the vendors could be reconciled doctrinally with the Court’s rejection of aiding and abetting liability in a prior case. Hewing closely to the Supreme Court’s prior decision in Central Bank, the Eighth Circuit held that the allegations against the vendors were merely claims of aiding and abetting disguised as “scheme liability.” The court argued that to impose liability on a business that entered into an arm’s-length transaction with an entity that then used the transaction to publish false and materially misleading statements to its investors would give rise to a strong inference of scienter,” not whether any individual allegation, scrutinized in isolation, meets that standard. See id (“The inquiry, as several Courts of Appeals have recognized, is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.”). And finally, in determining whether the pleaded facts give rise to a “strong inference” of scienter, a court must take into account plausible opposing inferences. See Tellabs, 551 US at 323. Congress did not merely require plaintiffs to allege facts from which an inference of scienter rationally could be drawn. See id (“Congress required plaintiffs to plead with particularity facts that give rise to a ‘strong’—i.e., a powerful or cogent— inference.”).

144 Id at 313.
145 See In re Charter Communs, Inc, See Litig, 443 F3d 987, 989–90 (8th Cir 2006), cert granted sub nom; Stoneridge, 552 US 148 (2008). Plaintiffs claimed that the vendors with whom Charter had firm contracts to purchase set-top boxes at a set price agreed to receive an additional $20 per set-top box from Charter in exchange for returning those additional payments to Charter in the form of advertising revenues. See Charter, 443 F3d at 989. In addition, plaintiffs maintained that the vendors entered into these sham transactions knowing that the transactions were contrived to inflate Charter’s operating cash flows in order to meet the revenue and operating cash flow expectations of Wall Street analysts. See id at 990.

146 See Central Bank, 511 US at 177. In an effort to eschew Central Bank’s holding, plaintiffs framed the vendors’ conduct instead as participation in a “scheme to defraud.” See id at 992.

147 See id. (“[A]ny defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b-5.”).
potentially introduce far-reaching duties and uncertainties for those engaged in
day-to-day business dealings. The Stoneridge Court further warned that private
securities class actions have the potential to “allow plaintiffs with weak claims
[against secondary actor defendants such as the vendors] to extort settlements
from innocent companies.” Although neither Tellabs nor Stoneridge directly
addressed the desirability of the US class action system’s procedural
mechanisms, both Tellabs’ stringent interpretation of the PSLRA’s pleading
standards and Stoneridge’s rejection of scheme liability reflected a larger public
policy concern that an expansive regime of securities fraud liability under § 10(b)
could encourage opportunistic litigation, particularly in cases where there is an
insufficient nexus between the facts of the fraud and the alleged wrongdoer.

Notwithstanding the Supreme Court’s recent imposition of limits on §
10(b), securities fraud litigation continues to be viewed as creating costs and
uncertainties that reduce the attractiveness of US markets from the perspective
of foreign issuers who raise capital in the US.” The cost of possibly losing
access to some foreign capital in the US is all the more significant in the wake of
the recent global economic crisis. The persistent concerns surrounding the

148 See id at 992–93. The Supreme Court’s decision in Stoneridge is significant to the extent it
attempted to draw back on the potentially broad reach of Section 10(b) liability that, in this
particular case, would have extended to remote secondary actors (the vendors) who had not
themselves violated any express prohibition of Section 10(b) but who merely had a relationship
with the primary wrongdoer (Charter Communications). See Stoneridge, 552 US at 158. Instead, in
Section 104 of the PSLRA, Congress authorized only the SEC to prosecute aiders and abettors.
See id. In the Court’s view, imposing “scheme” liability on the vendors would thus be
inconsistent with the will of Congress. See id at 165.

149 Professor Daniel Fischel has defined secondary actor liability as “judicially implied civil liability
which has been imposed on defendants who have not themselves been held to have violated the
express prohibition of the securities statute at issue, but who have some relationship with the
primary wrongdoer.” Daniel R. Fischel, Secondary Liability Under Section 10(b) of the Securities Act

150 Stoneridge, 552 US at 163. Once a securities class action lawsuit makes it past the motion-to-dismiss
stage, “the mere existence of an unresolved lawsuit has settlement value to the plaintiff . . .
because of the threat of extensive discovery and disruption of normal business activities which
may accompany a lawsuit which is groundless in any event, but cannot be proved so before trial.”

151 See, for example, Financial Markets Brief at *8 (cited in note 127) (“The dramatically increased
globalization and interdependence of financial markets has greatly heightened the need to impose
appropriate limits on the extraterritorial application of domestic securities laws. Application of
domestic law where a private securities claim has only a remote connection to the United States
threatens to undermine the attractiveness of the United States for foreign investment, and the
competitiveness and effective operation of US markets.”).

152 See id at *8–9:
The absence of a clear standard leaves open the risk for non-US entities that engaging in investment
activity in the United States—be it direct investment, such as acquiring a US subsidiary, or raising
capital in US markets—will give rise to liability for claims under an expansive Section 10(b)
attractiveness and competitiveness of the US capital markets, exacerbated in part by the recent volatility and turbulence in the global financial markets, has heightened the need to delineate the precise transnational scope, if any, of the US securities laws.

On June 24, 2010, the Supreme Court ruled for the first time on the extraterritorial reach of § 10(b). In a unanimous decision sending shivers down the spines of foreign investors (including plaintiffs in the BP securities class action lawsuit), the Supreme Court wiped away four decades of lower court jurisprudence and categorically rejected the Second Circuit’s longstanding conduct and effects tests. In doing so, the decision reflects a major paradigm shift in the way courts are expected to evaluate foreign-cubed securities class actions. The following Part sets forth the factual background of National Australia Bank as well as the Supreme Court’s landmark decision in that case.

V. MORRISON v NATIONAL AUSTRALIA BANK LITIGATION

A. Factual Background of the Case

National Australia Bank Limited (NAB) is established under the laws of Australia and is one of Australia’s largest financial institutions. In 1999, NAB was the third-largest company in Australia by stock-market capitalization and conducted business in fifteen countries. NAB’s common shares traded principally on the Australian Stock Exchange (ASX) (now the Australian Securities Exchange), the country’s primary exchange, since 1974. Those shares also were traded on the London, Tokyo, and New Zealand stock exchanges, but not on any US-based stock exchange. And, only 1.1 percent of NAB’s shares—in the form of ADRs—were traded on the NYSE.

Australian laws and rules governed NAB’s financial disclosures. For instance, NAB filed its annual and semiannual disclosures with the ASX as well as the Australian Securities and Investment Commission (ASIC)—the Australian equivalent of the SEC in the US. NAB also filed additional disclosures as required by the ASX. NAB was obligated to conform its financial disclosures to “Generally Accepted Accounting Principles applicable in Australia.” Given the issuances of its ADRs in the US, NAB also was required to file disclosures with the SEC. Generally, NAB’s disclosures to the SEC duplicated its Australian disclosures.

155 Id.
156 Id.
157 In re Natl Austl Bank, 2006 WL 3844465 at *4 (“[T]he aggregate value of the ADRs represented a mere 1.1% of NAB’s nearly one-and-a-half billion ordinary shares, any effect on the United States market from the alleged fraud pales in comparison to the effect on the foreign markets.”). ADRs are investment vehicles for investors to register and earn dividends on non-US stock without direct access to the overseas market itself. US-based depository banks hold the overseas securities in custody in the country of origin “and convert all dividends and other payments into US dollars for receipt holders.” W. Bailey, G. Andrew Karolyi, and C. Salva, The Economic Consequences of Increased Disclosure: Evidence from International Cross-Listings, 81 J Fin Econ 175, 180 n 8 (2006).
158 See Brief for Respondents in Morrison at *9 (cited in note 154).
159 See id.
160 See id.
161 See id.
163 Since NAB’s ADRs were Level 3 ADRs under SEC regulations, NAB was required to file with the SEC Forms 6 and 20, which are analogous to Forms 10-Q and 10-K filed with the SEC by US
In late 2003, investors in NAB filed a putative class action. That action was filed on behalf of non-US shareholders of NAB who purchased its stock on foreign exchanges between April 1, 1999, and September 3, 2001 and alleged violations of the US federal securities laws—principally § 10(b). According to plaintiffs, NAB issued fraudulent public disclosures regarding HomeSide Lending, Inc, a company it had acquired in 1998 that was based in Jacksonville, Florida. HomeSide was, at the times relevant to the allegations in the complaint, a subsidiary of NAB, and was one of the many businesses that NAB owned and operated around the world. The core business of HomeSide was processing homeowners’ payments on mortgage loans in exchange for fees. Future fees that HomeSide would receive for its services were called “mortgage servicing rights” (MSRs). The MSRs were treated as an asset on the company’s balance sheet and had a present economic value.

Plaintiffs alleged that between April 1, 1999 and September 3, 2001, NAB, HomeSide, and HomeSide’s three principal executive officers violated Generally Accepted Accounting Principles by intentionally overvaluing HomeSide’s mortgage portfolio. Plaintiffs claimed that improper mortgage prepayment speeds were intentionally selected by defendants to meet overinflated earnings targets. This overvaluation was further exacerbated because interest rates were declining, leading customers to refinance and pay off their mortgages being serviced by HomeSide. Thus, HomeSide’s only real asset, its MSRs, was, in
essence, evaporating. Based on the allegations in plaintiffs’ complaint, the misleading information concerning HomeSide’s overvalued mortgage-related assets, including specifically its MSRs, was then sent to NAB’s headquarters in Australia, incorporated into the company’s public disclosures that were issued out of Australia, and provided to its shareholders.

The focus of plaintiffs’ claims was that the fraudulent scheme originated in Florida, where HomeSide’s offices were located, and that NAB participated in the scheme through its interactions with its US subsidiary. Plaintiffs alleged that each misleading public disclosure made by NAB concerning HomeSide’s financial performance and operations was copied from the false financial information emanating from Florida that was concocted by HomeSide. In addition, plaintiffs noted that NAB maintained an office in New York City. At that office, NAB engaged in complicated hedging transactions in order to limit its outstanding mortgage interest rate exposure. According to plaintiffs, the use of the hedging strategy required US traders to have an intimate understanding of the mortgage portfolio size and income stream from the expected mortgage payments. Plaintiffs maintained that the hedging activity in New York exacerbated the damage of the fraud in Florida, and, in fact, the hedging losses totaled $1.88 billion in 1999 and 2000.

Due partially to these hedging losses, NAB announced a write-down of HomeSide’s overall value of $450 million in July 2001, which NAB attributed to a breakdown in the risk management system of HomeSide. Two months later, on September 3, 2001, NAB announced a significantly larger second write-down of over three billion Australian dollars. The Australian press described the

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173 See id. Due to a series of interest rate cuts, 2001 ended up being a very bad year for MSRs. By year’s end, interest rates had reached forty-year lows. See id at *15.

174 See Morrison 2d Cir, 547 F3d at 169.

175 See id at 171–72.

176 See id.

177 See Brief for Petitioners, Morrison v National Australia Bank, No 08-1191, *9 (US filed Jan 19, 2010).

178 See id.

179 See id.

180 See id.

181 See Morrison 2d Cir, 547 F3d at 169. “This write-down led NAB to hire a consultant to complete a detailed review of the estimated market sale value for HomeSide.” Brief for Respondents in Morrison at *15 (cited in note 154). During this review, NAB claimed that it discovered that HomeSide had been using mistaken interest rate inputs in its MSR valuation model, and that other assumptions in the model had to be revised in light of turbulent market conditions. See id at *15.

182 See Morrison 2d Cir, 547 F3d at 170.
write-downs as the "biggest investment disaster in Australian corporate history." Immediately after the September 3, 2001 announcement, NAB's ordinary shares dropped from AU$33.20 to AU$28.90 (or 13 percent) on the ASX.

B. The District Court's Decision

Viewing the allegations in the complaint as a whole, the district court dismissed plaintiffs' claims. The court held that it lacked subject matter jurisdiction over plaintiffs' claims because the alleged fraud had an insufficient connection to the US. The court stated that "HomeSide's alleged conduct... amounts to, at most, a link in the chain of an alleged overall securities fraud scheme that culminated abroad." The court also observed that HomeSide's alleged fraudulent conduct "would be immaterial to [plaintiffs'] Rule 10b-5 claim but-for (i) the allegedly knowing incorporation of HomeSide's false information; (ii) in public filings and statements made abroad; (iii) to investors abroad; (iv) who detrimentally relied on the information in purchasing securities abroad." In sum, the court concluded that, "[o]n balance, it is the foreign acts—not any domestic ones—that 'directly caused' the alleged harm here."

C. The Second Circuit's Decision

The US Court of Appeals for the Second Circuit affirmed the district court's subject matter jurisdiction ruling. In determining whether subject matter jurisdiction exists over an alleged transnational securities fraud, the Second Circuit noted that traditionally it has considered whether the alleged wrongful conduct had significant effects in the US and whether sufficient wrongful conduct occurred in the US to merit the application of § 10(b). The

183 See Brief for Respondents in Morrison at *15–16 (cited in note 154).
185 See id at *9.
186 See id at *8 (“While the instant case presents a close call, the Court is ultimately left with the impression that the Lead Foreign Plaintiffs have not met their burden of demonstrating that Congress intended to extend the reach of its laws to the predominantly foreign securities transactions at issue here.”).
187 Id.
189 Id.
190 See Morrison 2d Cir, 547 F3d at 177.
191 See id at 171 (“As our case law makes clear, we believe that it is consistent with the statutory scheme to infer that Congress would have wanted to redress harms perpetrated abroad which have a substantial impact on investors or markets within the United States.”) (citation omitted).
court found that the NAB case raised only the latter question because plaintiffs did not seek to base their suit on effects in the US.\textsuperscript{192}

The court went on to explain that allegations of domestic conduct in furtherance of a transnational securities fraud are usually sufficient to establish subject matter jurisdiction “only if the defendants’ conduct in the United States was more than merely preparatory to the fraud, and particular acts or culpable failures to act within the United States directly caused” the plaintiffs’ losses.\textsuperscript{193} The court described the key analytical question as “what conduct comprises the heart of the alleged fraud.”\textsuperscript{194} Admitting that “what is central or at the heart of a fraudulent scheme versus what is ‘merely preparatory’ or ancillary can be an involved undertaking,” the court noted that its “conduct test” was the best standard to apply in these situations.\textsuperscript{195} The court further commented that it was “leery of rigid bright-line rules because [it] cannot anticipate all the circumstances in which the ingenuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction.”\textsuperscript{196}

Applying the “conduct test” to the underlying facts, the court concluded that the US activities simply did not comprise the “heart” of the alleged NAB fraud. The court made three main findings in support of its determination that subject matter jurisdiction was lacking under the “conduct test.”

First, the actions of NAB in Australia were “significantly more central to the fraud and more directly responsible for the harm to investors than the manipulation of the numbers in Florida.”\textsuperscript{197} The court observed that “NAB, not

\textsuperscript{192} See id at 176 (“Appellants press their appeal solely on behalf of foreign plaintiffs who purchased on foreign exchanges and do not pursue the ‘effects’ test. They do not contend that what Appellants allegedly did had any meaningful effect on America’s investors or its capital markets.”).

\textsuperscript{193} Id at 172.

\textsuperscript{194} See \textit{Morrison 2d Cir}, 547 F3d at 174 (cited in note 66):

However, the potential conflict between our anti-fraud laws and those of foreign nations does not require the jettisoning of our conduct and effects tests for ‘foreign-cubed’ securities fraud actions and their replacement with the bright-line ban advocated by Appellees. The problem of conflict between our laws and those of a foreign government is much less of a concern when the issue is the enforcement of the anti-fraud sections of the securities laws than with such provisions as those requiring registration of persons or securities. The reason is that while registration requirements may widely vary, anti-fraud enforcement objectives are broadly similar as governments and other regulators are generally in agreement that fraud should be discouraged.

\textsuperscript{195} Id. The Second Circuit also rejected (without express acknowledgment) the SEC’s proposed test. The SEC’s standard would have extended Section 10(b) “to transnational frauds that result exclusively or principally in overseas losses if the conduct in the United States is material to the fraud’s success and forms a substantial component of the fraudulent scheme.” See Brief of the Securities and Exchange Commission as Amicus Curiae, in Response to the Court’s Request, \textit{Morrison 2d Cir}, No 07-0583-cv, *27 (US filed Sept 18, 2008).

\textsuperscript{196} \textit{Morrison 2d Cir}, 547 F3d at 174.

\textsuperscript{197} Id at 176.
HomeSide, is the publicly traded company and its executives—assisted by lawyers, accountants, and bankers—take primary responsibility for the corporation’s public filings, for its relations with investors, and for its statements to the outside world” and “[w]hen a statement or public filing fails to meet these standards, the responsibility, as a practical matter, lies in Australia, not Florida.”

Second, there was a “striking absence” of any claim that the alleged fraud impacted either investors in the US or US capital markets. Plaintiffs failed to explain that what allegedly happened “had any meaningful effect on America’s investors or its capital markets.”

Third, there was a “lengthy chain of causation between the American contribution to the misstatements and the harm to investors.” The court noted that the complaint did not allege “that HomeSide sent any falsified numbers directly to investors.” Rather, as the court described, “while HomeSide may have been the original source of the problematic numbers, those numbers had to pass through a number of checkpoints manned by NAB’s Australian personnel before reaching investors.”

According to the Second Circuit, these findings “add[ed] up to a determination” that subject matter jurisdiction was lacking in NAB. Although the Court refused to issue a ruling barring all foreign-cubed securities class actions, the Court explicitly stated that it is “an American court, not the world’s court,” and that it “cannot and should not expend [its] resources resolving cases that do not affect Americans or involve fraud emanating from America.”

D. The Supreme Court’s Decision

In its decision, the Supreme Court first addressed the fundamental question of whether the Second Circuit’s ruling that the extraterritorial application of § 10(b) raised a question of subject matter jurisdiction was
According to the Court, the Second Circuit was wrong in how it handled this issue. Advancing many of the same arguments set forth in Arbaugh, the Court concluded that the extraterritorial application of a US statute, including § 10(b), goes to the “merits” of a plaintiff’s claim for relief—whether the statute “prohibits” the conduct about which plaintiffs complain—not to subject matter jurisdiction. By making this critical distinction, the Supreme Court’s decision corrected the lower courts’ erroneous reliance on principles of subject matter jurisdiction when considering a statute’s extraterritorial reach.

Next, the Court concluded that the Exchange Act is silent as to the extraterritorial application of § 10(b). In light of this interpretation of the statutory language, the Court held that the presumption against extraterritoriality—a fundamental canon of statutory interpretation—should apply. As noted by the Court, “[w]hen a statute gives no clear indication of an extraterritorial application, it has none.” Viewing the presumption in this context, the Court stated that § 10(b) should be given “the effect its language suggests, however modest that may be.” The Court noted that the traditional conduct and effects tests lacked a textual basis and that the judiciary improperly extended the statute to perceived “admirable purposes.” Moreover, the traditional conduct and effects tests, including the “proliferation of vaguely related variations,” according to the Court, stemmed from the failure to adhere to the presumption against extraterritoriality. As such, “the results of judicial-speculation-made-law—divining what Congress would have wanted if it had thought of the situation before the court—demonstrate the wisdom of the presumption against extraterritoriality.”

The Court then addressed investors’ argument that § 10(b) should apply in NAB because the deceptive conduct took place in Florida. Rejecting that argument, the Court retorted that, “[t]he presumption against extraterritorial application would be a craven watchdog indeed if it retreated to its kennel...
whenever some domestic activity is involved in the case.”

The Court found that the “focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States.”

Moreover, § 10(b) does not punish all deceptive conduct, “but only deceptive conduct 'in connection with the purchase or sale of any security registered on a national exchange or any security not so registered.”

Considering the statute’s text and the presumption against extraterritoriality, the Court adopted a bright-line “transactional test.” Pursuant to that test, § 10(b) reaches the use of a manipulative or deceptive device or contrivance only when “the purchase or sale is made in the United States, or involves a security listed on a domestic exchange.” Applying the transactional test to the facts in NAB, the Court affirmed dismissal of the case for failure to state a claim. The Court found that the NAB shares at issue traded exclusively on foreign exchanges, and none of the relevant purchases or sales occurred in the US. Moreover, the “adoption of [this] clear test” eliminated concerns that the application of the conduct and effects tests “infringe[s] upon” the sovereign authority of other nations to regulate securities transactions within their geographic boundaries.

Lastly, the Court refuted the argument put forth by investors and the US government that some formulation of the traditional conduct test was needed to “prevent[] the US from becoming a ‘Barbary Coast’ for malefactors perpetrating frauds in foreign markets.” The Court commented that “there is no reason to believe that the United States has become the Barbary Coast for those perpetrating frauds on foreign securities markets,” however, “one should also be repulsed by [the] adverse consequences” of the conduct test—specifically, that the US “has become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets.”

215 Id at 2884 (emphasis omitted).
216 Id (emphasis added).
217 Id (emphasis added).
218 *Morrison*, 130 S Ct at 2886.
219 Id.
220 Id at 2888.
221 Id at 2884–85.
222 *Morrison*, 130 S Ct at 2886. The concern is that extending the reach of § 10(b) to foreign-cubed cases is not only imperialistic to the extent it supplants or interferes with other countries’ securities regulation, but it also turns the US into a global litigation mill where securities litigation tourism will become prevalent.
223 Id at 2886.
224 Id.
1. Justifications for the Supreme Court's bright-line test.

The Supreme Court's articulation of a bright-line transactional test in *National Australia Bank* came after a number of foreign governments urged the adoption of such a test in various amicus briefs to the Court. These foreign governments offered three principal justifications for adopting a bright-line rule. First, they argued that such a rule would eliminate the unpredictability and uncertainty surrounding the application of the conduct and effects tests. Because these tests turn on fact-specific distinctions about the quantity and qualitative type of conduct and effects that warrant the imposition of US laws, the application of these tests in any given circumstance is inherently unpredictable. As a result, the lack of a clear standard makes the prospect of liability under an expansive § 10(b) implied right of action and a lenient class action procedural regime uncertain for non-US entities that engage in investment activity in the US. The potential exposure to US securities

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225 See id at 2885 (noting that “[t]he Commonwealth of Australia, the United Kingdom of Great Britain and Northern Ireland, and the Republic of France have filed *amicus* briefs in this case. So have (separately or jointly) such international and foreign organizations as the International Chamber of Commerce, the Swiss Bankers Association, the Federation of German Industries, the French Business Confederation, the Institute of International Bankers, the European Banking Federation, the Australian Bankers' Association, and the Association Francaise des Entreprises Prives”).

226 See *Morrison*, 130 S Ct at 2886 (“They all complain of the interference with foreign securities regulation that application of § 10(b) abroad would produce, and urge the adoption of a clear test that will avoid that consequence.”). The risks of listing on a US exchange for foreign issuers are highlighted by *Itoba Ltd v LEP Group, PLC*, 54 F3d 118, 122–23 (2d Cir 1995). There, the Court of Appeals found that a foreign issuer's filing of a Form 20-F in the US for its ADRs traded on a US exchange was sufficient under the conduct test to permit foreign investors (who had not bought ADRs or read the Form 20-F) to pursue a Section 10(b) claim based on purchases of the company’s ordinary shares on a foreign exchange. *Itoba*, 54 F3d at 122. See, for example, *In re RoyalAhold NV Sec & ERISA Litig*, 351 F Supp 2d 334, 362 (D Md 2004) (citing *Itoba* and relying in part on a foreign company's SEC filings to permit § 10(b) claims of non-US investors who purchased company's stock on foreign exchanges). If an issuance of ADRs—typically a small fraction of a company's total equity—subjects a foreign issuer to a US securities class action relating to trading of its foreign-issued securities by foreign investors in a foreign market (or even raises the specter of such risk), foreign issuers will be discouraged from listing in the United States in the first instance. See John C. Coffee, Jr, *Corporate Securities: Securities Policeman To the World? The Cost of Global Class Actions*, NY L J 5 (Sept 18, 2008) (noting that “the issuer may face a multi-billion dollar class action that can threaten its insolvency”).

227 See *Morrison*, 130 S Ct at 2779 (“As they developed, these tests were not easy to administer. The conduct test was held to apply differently depending on whether the harmed investors were Americans or foreigners: When the alleged damages consisted of losses to American investors abroad, it was enough that acts 'of material importance' performed in the United States 'significantly contributed' to that result; whereas those acts must have ‘directly caused’ the result when losses to foreigners abroad were at issue.”) (citation omitted).

228 See id at 2880:
litigation—enhanced by the *ad hoc* analyses employed by courts under the conduct and effects tests—undermines the predictability necessary to foster foreign investment in the US and preserve US preeminence in the capital markets arena.\(^{229}\) In contrast, the predictability and clarity of a bright-line rule would facilitate the free flow of investment and capital into the US and eliminate the risk of deterring foreign companies from acquiring US subsidiaries or raising capital in the US for fear of becoming subject to the US securities laws (even if their securities are not traded in the US).\(^{230}\)

Second, proponents of the Supreme Court's bright-line rule contend that it would avoid burdening the US courts with primarily foreign disputes.\(^{231}\) The argument for judicial economy is motivated not only by a desire to conserve US law enforcement and judicial resources for conduct that presents substantial domestic concerns but also by a desire to limit the risk of reciprocal retaliatory

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While applying the same fundamental methodology of balancing interests and arriving at what seemed the best policy, they produced a proliferation of vaguely related variations on the 'conduct' and 'effects' tests. As described in a leading Seventh Circuit opinion: “Although the circuits . . . seem to agree that there are some transnational situations to which the antifraud provisions of the securities laws are applicable, agreement appears to end at that point.”

(citation omitted).

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\(^{231}\) See *Morrison*, 130 S Ct at 2885:

Like the United States, foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction. And 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.
action that may be taken by foreign jurisdictions. Particularly, in this global age, where tools such as the Internet make it possible to establish a connection, however tenuous, between any conduct and any country, the absence of strict limits on the application of US laws to foreign transactions may make it more likely that US companies will face legal repercussions in foreign countries for any de minimis contact with those countries.

Third, as highlighted by the Supreme Court, supporters of the bright-line rule assert that it would result in jurisprudence that respects the sovereignty of foreign nations by allowing them to establish liability rules best suited to their own markets. Because most other countries have implemented class action systems that deliberately reflect different policy choices than those embodied by the US class action system, the imposition of US substantive and procedural law could be perceived as an act of legal imperialism that subverts longstanding principles of comity and jurisdictional independence.

VI. PROPOSED STANDARD

Notwithstanding legitimate criticisms surrounding the application of the Second Circuit’s conduct and effects tests, the Supreme Court’s bright-line transactional test also raises significant concerns. Although it provides certainty, which, admittedly, is a significant benefit to the conduct of business transactions, the ease of application of such a rule is no excuse for ignoring the fundamental remedial purposes of the federal securities laws. Moreover, the Supreme Court’s standard creates an uncompromising, rigid rule that is neither supported by the statutory language nor necessary in light of the broader public policy interests cited by its own proponents.

The correct standard for the transnational application of § 10(b) is the one proposed by then-Solicitor General Elena Kagan in the Government’s amicus brief to the Supreme Court. Under that standard, a transnational securities fraud violates § 10(b) when the fraud involves significant conduct in the US that

232 See id at 2874 (“The 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. Like the United States, foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction.”) (citation omitted).

233 See id at 2885–86.

234 F. Hoffmann-LaRoche Ltd v Empagran SA, 542 US 155, 169 (2004). See also Morrison, 130 S Ct at 2885–86.

235 See Morrison, 130 S Ct at 2895 (Stevens dissenting) (“And while the clarity and simplicity of the Court’s test may have some salutary consequences, like all bright-line rules it also has drawbacks.”).

236 See generally US Amicus Brief (cited in note 107).
is material to the fraud’s success and that fraud directly caused the plaintiff’s injury.\(^{237}\) This standard strikes the proper balance between advancing § 10(b)’s remedial objectives and conserving the scarce resources of US courts and law enforcement authorities for regulation of securities fraud that has a substantial connection to the US. The Solicitor General’s standard is also consistent with the presumption against extraterritoriality and the *Charming Betsy* rule, and fits in neatly with the larger mosaic of recent Supreme Court securities fraud jurisprudence.

**A. Second Circuit Standard Versus the Solicitor General’s Standard**

Unlike the Second Circuit’s view that a securities fraud must involve predominantly domestic conduct in order to fall within § 10(b)’s coverage, the Government’s standard finds that a transnational securities fraud violates § 10(b) if significant conduct material to the fraud’s success occurs in the US.\(^{238}\) While the domestic conduct need not be predominant, or, as the Second Circuit described it, comprise the “heart” of the alleged fraud, it must be instrumental in achieving the fraud. As the Solicitor General noted in the Government’s amicus submission, frauds often “involve multiple components, participants and events centered in several countries.”\(^{239}\) Thus, cases are increasingly likely to arise in which no single country can meaningfully be described as the “heart” of the fraud.\(^{240}\) If all countries adopted the Second Circuit’s “heart of the fraud” approach, the perpetrators of many transnational frauds could not be held accountable in any jurisdiction. The Solicitor General’s standard addresses that practical problem while still being stringent enough to filter out securities-related conduct that is not sufficiently connected to the US.\(^{241}\)

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\(^{237}\) See id at *13, *25; *Morrison*, 130 S Ct at 2895 (Stevens dissenting) (“The Court instead elects to upend a significant area of securities law based on a plausible, but hardly decisive, construction of the statutory text. In so doing, it pays short shrift to the United States’ interest in remedying frauds that transpire on American soil or harm American citizens, as well as to the accumulated wisdom and experience of the lower courts.”).

\(^{238}\) See US Amicus Brief at *13 (cited in note 107).

\(^{239}\) See id at *19.

\(^{240}\) See *In re Alstom S.A. Sec Litig.*, 406 F Supp 2d 346, 372 (SDNY 2005).

\(^{241}\) See US Amicus Brief at *11 (cited in note 107).
B. The Statutory Language Supports § 10(b)’s Extraterritorial Application

Most importantly, the Solicitor General’s standard adheres to the language of § 10(b). Despite arguments that the reference to “interstate commerce” in § 10(b) has no extraterritorial meaning, this interpretation of the statutory language is neither consistent with customary rules of statutory construction nor supported by the Exchange Act’s own definition of “interstate commerce.” To state that the reference to “interstate commerce” is merely boilerplate language found in any number of congressional acts suggests that Congress used superfluous language in the statutory text for no reason. This is not in accord with the fundamental rule of statutory interpretation: that each word or phrase must be given its natural meaning. In addition, the Exchange Act defines “interstate commerce” as “trade, commerce, and transportation, or communication . . . between any foreign country and any State.” By its express terms, then, the statute covers any deceptive or manipulative conduct that employs any means or instrumentality of interstate commerce. In other words, conduct that has a transnational, or cross-border, component falls within § 10(b)’s prohibition.

As set forth in Section II.D.1, other provisions of the Exchange Act also support the conclusion that § 10(b) has extraterritorial application. By way of example, the exclusion from the Act’s coverage in § 30(b) (for foreign broker-dealers) would be superfluous if Congress did not intend for the Act to apply to securities transactions that occur abroad. § 30(b), if anything, is persuasive authority to support the view that Congress was fully aware of the extraterritorial breadth of the Act, and while Congress specifically carved out the statute’s extraterritorial application in § 30(b), it clearly did not do so in § 10(b). Therefore, the absence of such an exemption in § 10(b) indicates that Congress intended for the statute to have (at least some) extraterritorial reach.

242 See Morrison, 130 S Ct at 2881–83.
243 See Duncan v Walker, 533 US 167, 174 (2001) (stating that when interpreting statutory language, it is the court’s duty to give meaning, if possible, to every clause or word of the statute).
244 15 USC 78c(a)(17) (emphasis added).
245 See discussion of relevant provisions of statutory text in Section I.D.2; see also Morrison, 130 S Ct at 2892 n 9 (Stevens dissenting) (“Other provisions of the Exchange Act make clear that Congress contemplated some amount of transnational application. . . . The Court finds these textual references insufficient to overcome the presumption against extraterritoriality, but as explained in the main text, that finding rests upon the Court’s misapplication of the presumption.”).
246 See 15 USC § 78dd(b).
247 See id.
C. Policy Concerns Support § 10(b)’s Extraterritorial Application

The Solicitor General’s standard is also consistent with the broader policy interests of increasing foreign investment in the US, promoting judicial economy, and advancing long-established principles of comity. First, the Solicitor General’s standard would increase foreign investment in the US by offering protection to foreign investors in limited circumstances that warrant the application of the US securities laws, while shielding foreign companies from opportunistic or vexatious litigation. On the other hand, contrary to the arguments set forth by proponents of the Supreme Court’s bright-line rule, the exclusion of foreign transactions from § 10(b)’s coverage might lead foreign investors not to invest in companies with US-based operations or US subsidiaries because of the absence of protections afforded to them by the US securities laws. This could result in a decrease of foreign investment capital flowing into the US.

Second, the Solicitor General’s standard promotes judicial economy. By limiting § 10(b)’s coverage to frauds involving significant and material conduct in the US that directly caused the plaintiff’s injury, the standard ensures that the statute is not overly expansive in its reach and would not apply to situations where the domestic conduct is insignificant or the effect on the US is insubstantial. In that respect, the Solicitor General’s standard properly preserves American judicial and law-enforcement resources for conduct that presents legitimate domestic concerns. Admittedly, like the Second Circuit’s standard, the Solicitor General’s standard turns on fact-oriented distinctions about what constitutes significant and material conduct, which theoretically heightens the potential for lawyer-driven, class action litigation. However, the Solicitor General’s standard is much less burdensome in its application because,

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250 See US Amicus Brief at *17 (cited in note 107).

251 Id at *16, *18 (noting that the standard “preserves American judicial and law-enforcement resources for conduct that is a legitimate domestic concern”).
unlike the Second Circuit’s standard, courts are not required to make qualitative judgments as to where the “heart” of the alleged fraud took place.252

Third, the Solicitor General’s standard advances the well-established principles of comity.253 Given the deliberate policy choices made by other countries in the implementation of their own class action systems, one particularly salient concern is that extending the reach of § 10(b)’s implied private right of action to foreign transactions may undermine those countries’ own investor protection regimes.254 Although most countries agree that fraud should be discouraged, the limited extent that certain foreign countries seek to impose liability for securities-related fraud could lead to conflict vis-à-vis the US. As compared to other nations, US law affords investors (and their attorneys) procedures and remedies that are simply not available abroad.255 Despite these legitimate comity-based concerns, the adoption of a rigid, bright-line rule (such as the one articulated by the Supreme Court) is not the appropriate solution. Instead, there are other, more flexible ways to address concerns relating to comity.

252 Id at *19 (“If all countries interpreted their securities laws in accordance with the ‘heart of the fraud’ approach, the perpetrators of many transnational frauds could not be held accountable in any jurisdiction.”).

253 Id at *26 (“[A]pplication of the substantive federal antifraud provisions to transnational securities frauds usually will not interfere with comity among different nations because there is broad international consensus about the need for securities regulation.”).

254 See US Amicus Brief at *26 (cited in note 107). But see Buxbaum, 46 Colum J Transnatl L 14, 62 (2007) (cited in note 2) (“[T]he extraterritorial application of US law in the area of securities regulation has simply not generated the same level of difficulty and hostility as extraterritorial regulation in other areas”). See also ITT, An Intl Inv Trust v Cornfeld, 619 F2d 909, 921 (2d Cir 1980) (observing that “[t]he primary interest of [a foreign state] is in the righting of a wrong done to an entity created by it. If our anti-fraud laws are stricter than [a foreign state’s], that country will surely not be offended by their application”). This conclusion is supported by the Restatement, which concludes that, when the law of American securities fraud is applied, “the likelihood of conflict with regulation by other states is slight.” Restatement (Third) of Foreign Relations Law at § 416 (cited in note 22). Summarizing its findings, the Restatement states that:

[In contrast to regulation under the antitrust laws which not infrequently involved prohibition of conduct which another state favored or required, United States securities regulation (other than transnational discovery efforts) has not resulted in state-to-state conflict....] No instance is known in which a transaction challenged under United States law—such as misrepresentation or insider trading—was asserted to be mandated or encouraged by the law of a foreign state.

Id at § 416 (citations omitted).

255 See Brief of the International Chamber of Commerce, the Swiss Bankers Association, Economiesuisse, the Federation of German Industries, and The French Business Confederation as Amici Curiae in Support of Respondents, Morrison v National Australia Bank, Ltd, No 08-1191, *24 (US filed Feb 26, 2010) (noting, for example, that “US lawsuits also conflict with many Swiss policy judgments in the civil arena”).
The application of the *forum non conveniens* doctrine, for example, better addresses the problems associated with interjurisdictional conflict for securities fraud regulation. Forum non conveniens is a common law doctrine that “finds its roots in the inherent power of the courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.” Pursuant to *forum non conveniens*, a US court has the discretion to refuse to hear a case if the court concludes that it would be more appropriate for the dispute to be resolved in a foreign forum. US courts usually undertake a three-pronged analysis in determining whether the doctrine should be applied to a particular dispute: (1) whether a foreign forum has a substantial interest in having the subject matter tried locally, (2) whether the plaintiff's choice of forum should be given any deference, and (3) the balance of private and public policy factors implicated by the choice of forum. Rather than setting undue limitations on § 10(b)'s substantive coverage through the enactment of a bright-line exclusionary rule, *forum non conveniens* gives courts wide latitude not to hear cases with a tenuous connection to the US.

Lastly, the Solicitor General's standard advances arguably the most important purpose of § 10(b)—protecting US investors against fraud. As noted by the Solicitor General in her brief to the Supreme Court, “if the United States interprets its securities laws to prohibit fraudulent domestic conduct that injures overseas investors, other countries are more likely to offer comparable

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256 See Reply Brief, *Morrison v National Australia Bank, Ltd*, No 08-1191, *14–15 (US filed Mar 19, 2010) (“If the plaintiff's choice of forum is not supported by a 'bona fide connection with the United States,' dismissal will ensue. Thus, if the plaintiff is a foreign securities purchaser ... *forum non conveniens* may dictate dismissal of an action brought in the U.S.: '[W]hen the plaintiff's choice is not its home forum, ... the presumption in the plaintiff's favor 'applies with less force for the assumption that the chosen forum is appropriate is in such cases “less reasonable.”’”) (citation omitted).


258 See *Sinochem Intl Co v Malaysia Intl Shipping Corp*, 549 US 422, 436 (2007) (“[A] district court has discretion to respond at once to a defendant's *forum non conveniens* plea, and need not take up first any other threshold objection. In particular, a court need not resolve whether it has authority to adjudicate the cause (subject-matter jurisdiction) or personal jurisdiction over the defendant if it determines that, in any event, a foreign tribunal is plainly the more suitable arbiter of the merits of the case.”).

259 See *Gulf Oil Corp v Gilbert*, 330 US 501, 508 (1947) (federal courts have discretion to decline to hear cases within their jurisdiction, based on a number of public and private interest factors). In *Piper Aircraft Co v Reyno*, the Supreme Court explained that *forum non conveniens* should prevent US courts from turning into a magnet for foreign plaintiffs by providing courts with the discretion not to hear cases with a tenuous connection to the US. See 454 US 235, 249 (1981), quoting *Williams v Green Bay & W.R. Co*, 326 US 549, 557 (1946) (noting that the *forum non conveniens* doctrine is “not ... a rigid rule to govern discretion,” but rather lets “each case turn[] on its facts”).
protection to American investors. In contrast, if fraudsters operating in the US can target foreign victims, other countries might be reluctant to act against their residents that seek to transport securities fraud to the US—which is particularly troublesome given that those wrongdoers may be outside the jurisdiction of the US courts. The Solicitor General's standard thus provides a possible indirect benefit if other countries actually offer reciprocal protections to US investors.

D. Barbary Coast or Shangri-La?

Much of the policy debate surrounding the extraterritorial application of § 10(b) has focused on two hyperbolic metaphors. Opponents of the Supreme Court’s bright-line rule argue that the exclusion of foreign transactions from § 10(b)’s coverage risks turning the US into a “Barbary Coast” of sorts—a territory that securities fraudsters can use to export their fraud to foreign markets. Without the threat of liability under § 10(b), some US-based frauds could victimize foreigners with impunity. As a result, both foreign and domestic investors might lose the high amount of confidence that they place in the integrity of the US securities market. On the other hand, if wrongdoers must face the prospect of legal claims being brought by all the parties they harm, including foreign investors, they may be deterred from engaging in such wrongful conduct in the US. Dismissing this argument as overblown, Justice Scalia, writing for a unanimous Court in National Australia Bank, emphasized that the greater concern is that the US, with its unpredictable conduct and effects tests and procedurally lenient class action mechanisms, has turned into a “Shangri-La” for plaintiff class action lawyers.

Although both camps made facially strong arguments, they undoubtedly took some artistic license in describing the US class action environment that

260 See US Amicus Brief at *17 (cited in note 107).
261 See JIT v Vencap, Ltd, 519 F2d 1001, 1017 (2d Cir 1975); SEC v Kasser, 548 F2d 109, 114, 116 (3d Cir 1977) (stating that a bright-line rule risks harboring international securities “pirates” who use the US “as a base for manufacturing fraudulent security devices for export”).
262 See Grunenthal, 712 F2d at 425 (cited in note 69); Brief of Amici Curiae The Australian Shareholders’ Association and the Australian Council of Super Investors in Support of Petitioners, Morrison v National Australia Bank Ltd, No 09-1191, *11-12 (US filed Jan 26, 2010) (arguing that without the protection of the US legal system, perpetrators of securities fraud within the United States are able to export the consequences of their wrongdoing with little or no risk of being held accountable).
263 See Kasser, 548 F2d at 116 (“[T]o deny such jurisdiction may embolden those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations. [Denying jurisdiction] would, in effect, create a haven for such defrauders and manipulators.”).
264 Morrison, 130 S Ct at 2886 (cited in note 4).
would result from the application of their opponent’s standard. The Solicitor General’s standard, however, offers a workable middle-ground approach for the transnational application of § 10(b). By requiring that the domestic component of the fraud be significant and material to the fraud’s success, the Solicitor General’s standard imposes strict limits on the transnational reach of § 10(b) without overly restricting foreign investors’ access to the US courts.

E. The Application of the Presumption Against Extraterritoriality to the Solicitor General’s Standard

The Solicitor General’s standard is also consistent with the presumption against extraterritoriality. Underlying the presumption against extraterritoriality is the notion that a US statute should not be applied to foreign conduct. However, if the statute applies to significant and material conduct taking place within the US—as would be the case under the Solicitor General’s standard for § 10(b)—the presumption would not be implicated. In fact, applying § 10(b) to such fraudulent activity is not “extraterritorial” because it involves, in essence, regulation of domestic conduct. Moreover, although § 10(b) must be narrowly construed because of the principle “that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States,” that interpretive rule does not apply when the statute itself indicates that it has extraterritorial reach. Furthermore, the presumption against extraterritoriality is consistent with the Solicitor General’s approach in that it supports the view that § 10(b) should not apply when a securities fraud

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265 See Joseph Story, *Commentaries on the Conflict of Laws* §§ 18–19 at 21–22 (Little Brown 1865) (“The first and most general maxim or proposition is . . . that every nation possesses an exclusive sovereignty and jurisdiction within its own territory . . . the sovereign may in like manner make laws for foreigners, who even pass through his territories . . . for the preservation of order within his dominion.”).

266 See US Amicus Brief at *22 (cited in note 107) (“[W]hen a securities fraud is executed in part through domestic conduct, the presumption against extraterritoriality does not identify the type or amount of domestic conduct necessary to bring the fraud within the reach of Section 10(b).”). In *Pasquantino v United States*, 544 US 349 (2005), the Court held that the presumption against extraterritoriality was not implicated by application of the federal wire-fraud prohibition to a scheme to use domestic interstate communications to defraud Canada of tax revenue.

267 See *Pasquantino*, 544 US at 371 (finding that application of the statute did not give the law “extraterritorial effect,” because the government was punishing the “domestic element of [the defendants’] conduct”).

268 *Aramco*, 499 US at 248 (citation omitted). See US Amicus Brief at *23 (cited in note 107) (“The rationales underlying the presumption against extraterritoriality also support the conclusion that it is not implicated by application of Section 10(b) to frauds involving significant and material conduct within the United States.”)
with no effects in the US is masterminded and executed entirely outside the US.\textsuperscript{269}

F. The Application of \textit{Charming Betsy} to the Solicitor General’s Standard

Likewise, the Solicitor General’s standard does not run afool of the \textit{Charming Betsy} principle. The Restatement (Third) of the Foreign Relations Law of the United States (Foreign Relations Law Restatement) further buttresses this conclusion. It states that the US may prescribe laws governing “conduct occurring predominantly in the United States that is related to a transaction in securities, even if the transaction takes place outside the United States.”\textsuperscript{270}

There are other provisions in the Foreign Relations Law Restatement indicating that the US may establish laws concerning conduct related to global securities fraud even when the prohibited conduct does not take place predominantly in the US. For instance, § 402(1)(a) provides that a nation may pass laws relating to conduct that takes place “in substantial part” within its territorial boundaries unless such laws would be “unreasonable.”\textsuperscript{271} § 403 then sets forth a list of various factors for the reasonableness inquiry, including, among others: (1) the link between the regulated activity and the regulating country, (2) the nature of the activity, (3) the degree of international agreement on the need for regulation, (4) the importance of regulation to the international economic system, and (5) the possibility of conflict with regulation by another country.\textsuperscript{272} These factors indicate that the US’s regulation of transnational securities frauds is indeed reasonable, and in accordance with the Restatement on Foreign Relations Law, when conduct significant and material to the fraud occurs within the US.

G. Limits Placed on § 10(b)’s Extraterritorial Reach by the Implied Private Right of Action

Although § 10(b)’s substantive provision encompasses transnational securities frauds that involve significant conduct in the US that is material to the fraud’s success, a private plaintiff cannot obtain relief simply by demonstrating that a violation has occurred. § 10(b)’s implied private right of action also imposes additional limits on the transnational application of § 10(b).\textsuperscript{273}

\textsuperscript{269} \textit{Aramco}, 499 US at 248 (citation omitted).
\textsuperscript{270} Restatement (Third) of the Foreign Relations Law at § 416(1)(d) (cited in note 22).
\textsuperscript{271} Id at §§ 402(1)(a), 403(1).
\textsuperscript{272} Id at § 403(2).
\textsuperscript{273} See \textit{Stoneridge}, 552 US at 157 (cited in note 46).
that the text of § 10(b) does not expressly create a private right of action, courts have had the primary responsibility for establishing those limitations using the available evidence concerning how Congress would have restricted an express private right of action.\textsuperscript{274} Applying this same analysis, the Supreme Court held in \textit{Dura Pharmaceuticals v Broudo} that to recover under § 10(b), a private plaintiff must prove that he relied on the defendant’s misrepresentations and that defendant’s fraud was the proximate cause of his losses.\textsuperscript{275} In that case, a class action complaint alleged that Dura Pharmaceuticals had made misrepresentations about the FDA’s imminent approval of its new asthmatic spray device, leading plaintiffs to purchase the company’s stock at artificially inflated prices.\textsuperscript{276} The Supreme Court found that misrepresentations by themselves do not establish the necessary causal connection to an economic loss suffered by investors.\textsuperscript{277} The Court then explained that even if the artificially inflated purchase price suggested that the misrepresentation “touche[d] upon” a later economic loss, to “touch upon” a loss is not the same as to \textit{cause} a loss.\textsuperscript{278} In applying \textit{Dura’s} rule of loss causation to cases involving transnational frauds, courts must also require private plaintiffs to establish that their losses resulted directly from the component of the fraud that occurred in the US.\textsuperscript{279} This requirement is in accordance with the Solicitor General’s standard and further limits the availability of US-based remedies to situations where the domestic conduct is closely tied to the plaintiff’s claim for relief.

H. The Solicitor General’s Standard is Consistent with Recent Supreme Court Jurisprudence

Like \textit{Dura}, the Supreme Court’s decisions in \textit{Tellabs} and \textit{Stoneridge} reflect a period of retrenchment in securities fraud jurisprudence that has introduced a narrower view of the private right of action under § 10(b). One of the main reasons proponents of the Supreme Court’s bright-line test support its application is concern over the initiation of frivolous litigation, particularly when the standard of liability is fact-oriented and susceptible to manipulation.\textsuperscript{280} The Solicitor General’s standard is indeed fact-intensive. However, it is stringent enough to eliminate meritless litigation and, at the same time, is consistent with

\begin{itemize}
\item \textsuperscript{274} See \textit{Central Bank of Denver}, 511 US at 173.
\item \textsuperscript{275} \textit{Dura Pharmaceuticals v Broudo}, 544 US 336, 347 (2005) (“\textit{Dura Pharm}”).
\item \textsuperscript{276} Id.
\item \textsuperscript{277} Id.
\item \textsuperscript{278} Id.
\item \textsuperscript{279} \textit{Dura Pharm}, 544 US at 347. See also US Amicus Brief at *26 (cited in note 107).
\item \textsuperscript{280} See \textit{Morrison}, 130 S Ct at 2779 (“As they developed, these tests were not easy to administer.”).
\end{itemize}
the language of the statute and its underlying remedial goals. To the extent that concerns surrounding the application of the Solicitor General’s standard persist, those concerns should be mitigated by the substantive limits on § 10(b) liability already imposed by the PSLRA’s stringent pleading requirements as interpreted by the Supreme Court in Tellabs, Stoneridge’s rejection of “scheme liability,” and Dura’s rule of loss causation. Together with these limits, the Solicitor General’s standard would form part of a balanced doctrine of § 10(b) liability that is neither excessively lax for plaintiffs nor unduly stringent for defendants.

I. Application of the Solicitor General’s Standard to National Australia Bank

Lastly, the application of the Solicitor General’s standard to the facts of National Australia Bank warrants dismissal of plaintiffs’ securities fraud claims in that case. The complaint alleged that NAB issued false information to the public in Australia that was generated by HomeSide and its officers in the US with the expectation that it would be incorporated into NAB’s financial statements. Based on these allegations, the conduct in the US was not merely preparatory but was integral to the fraud. Accordingly, the fraud seemingly had a sufficient connection to the US. But that does not end the inquiry under the Solicitor General’s standard. It is clear that the component of the alleged fraud that occurred in the US did not directly cause plaintiffs’ alleged injury. As the Second Circuit accurately noted, “while HomeSide may have been the original source of the problematic numbers, those numbers had to pass through a number of checkpoints manned by NAB’s Australian personnel before reaching investors.” Critically, NAB personnel were not acting under the direction and control of HomeSide when they allegedly incorporated the false numbers into NAB’s financial reports and other public statements. Instead, they were exercising independent judgment as officers of HomeSide’s parent corporation. Plaintiffs’ allegations only established a “lengthy chain of causation between what HomeSide did and the harm to investors,” and that chain included a number of significant events that occurred outside the US.

281 See Morrison 2d Cir, 547 F3d at 171–72.
282 Id at 176–77.
283 Id.
284 Id.
285 Morrison 2d Cir, 547 F3d at 176. See also US Amicus Brief at *31 (cited in note 107) (“In allegedly incorporating the false numbers into NAB’s financial reports and other public statements, NAB personnel were not acting under the direction and control of HomeSide, but rather were exercising independent judgment as officers of HomeSide’s parent corporation.”).
286 Morrison 2d Cir, 547 F3d at 176.
The remoteness of the link between the actions in Florida and plaintiffs' injuries precludes investors from stating a viable claim under § 10(b) upon which relief can be granted.

VII. CONCLUSION

After the Supreme Court's landmark decision in National Australia Bank, what becomes of the shareholder class actions against BP and other similar class action lawsuits? The answer to this question is that unless Congress enacts legislation that overrules the Supreme Court's bright-line transactional test and implements the Solicitor General's standard, foreign investors will be precluded from bringing suit in US courts. Foreign companies will, in turn, become nearly impervious to § 10(b) liability even if a significant component of the fraud that was material to the fraud's success and directly caused investors' injuries took place in the US.

Notwithstanding certain limitations, the Solicitor General's standard sets forth a more sophisticated and nuanced approach to liability than the Supreme Court's formalistic, one-size-fits-all approach. In addition, unlike the Second Circuit's "heart of the fraud" approach, the Solicitor General's approach accommodates the complexities of the modern securities fraud. Whether the alleged BP fraud would satisfy the Solicitor General's standard is unknown. What is known, however, is that foreign investors will not even get their day in court. If the US was ever a so-called Shangri-La for plaintiff class action lawyers, the doors to paradise have now been slammed shut.

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287 On October 15, 2009, Representative Paul E. Kanjorski of Pennsylvania introduced the Investor Protection Act of 2009. The proposed legislation was then referred to the House Committee on Financial Services and approved by the Committee on November 4. Section 215 of that legislation (which responds to the questions raised in the aftermath of the In re National Australia Bank decision) would have expanded the jurisdiction of federal district courts in the US over violations of the antifraud provisions of the Securities Exchange Act of 1934, the Securities Act of 1933, and the Investment Advisers Act of 1940 to transnational fraud. Jurisdiction would be satisfied if there is either: (i) "conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors," or (ii) "conduct occurring outside the United States that has a foreseeable substantial effect within the United States." Congress elected not to include this provision in the Investment Advisers Act of 1940 in the recently enacted financial reform legislation (the Dodd-Frank Wall Street Reform and Consumer Protection Act). Instead, Congress only amended the Securities Exchange Act of 1934 and the Securities Act of 1933. Congress asked the SEC to prepare a study within eighteen months of enactment of the financial reform bill on the implications of authorizing an explicit legislative private right of action based on the conduct-and-effects test. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub L No 111-203, 124 Stat 1376, § 929P(b) (2010), to be codified at 12 USC § 5301 et seq.