

2011

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Nidhi M. Geevarghese

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Recommended Citation

Nidhi M. Geevarghese, *A Shocking Loss of Investor Protection: The Implications of Morrison v. National Australia Bank*, 6 Brook. J. Corp. Fin. & Com. L. (2011).

Available at: <http://brooklynworks.brooklaw.edu/bjcfcl/vol6/iss1/9>

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A SHOCKING LOSS OF INVESTOR PROTECTION: THE IMPLICATIONS OF *MORRISON V. NATIONAL AUSTRALIA BANK*

INTRODUCTION

Since the enactment of federal securities laws in the 1930s, securities markets around the world have become more interconnected than anyone could have imagined at that time.¹ The antifraud provisions of the U.S. securities laws are silent as to their extraterritorial application, however, and as international securities transactions became commonplace, courts were forced to address the question of whether these provisions applied to transactions involving foreign parties or foreign-traded stock.² For decades, in dealing with this issue, the courts sought to balance the protection of investors and markets with respect for the sovereignty of other nations. Recently, the Supreme Court, for the first time, addressed the issue of the extraterritoriality of U.S. antifraud provisions in *Morrison v. National Australia Bank*.³ In this landmark case, the Court overturned nearly forty years of precedent⁴ and stripped the protection of American antifraud laws from Americans investing abroad. As a result, if such investors suffer losses due to securities fraud, they now have no choice but to seek redress under the laws and procedures of foreign jurisdictions.

This note will examine some of the securities class action laws and procedures of other countries and discuss whether, as a result of *Morrison*, American investors transacting abroad are left without sufficient protection against foreign securities fraud. Part I of this note provides background as to how the courts dealt with the question of the extraterritorial application of U.S. securities laws prior to *Morrison*. Part II presents the facts and procedural history of *Morrison*. Additionally, it sets out the new test articulated by the Supreme Court, and its implications, including forcing Americans investing abroad to seek redress for securities fraud in foreign jurisdictions. Part III examines some of the securities class action procedures found in other countries and how they provide insufficient

1. See Daniel S. Kahn, *The Collapsing Jurisdictional Boundaries of the Antifraud Provisions of the U.S. Securities Laws: The Supreme Court and Congress Ready to Redress Forty Years of Ambiguity*, 6 N.Y.U. J. L. & BUS. 365, 369–70 (2010) (“[T]he Congress that enacted the securities laws could not have anticipated the future globalization of the American economy. . . . The web of international connections in the securities market was then not nearly as extensive or complex as it has become.”).

2. See generally 15 U.S.C. § 78j(b) (2006); 17 C.F.R. § 240.10b-5 (2010). See also Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 COLUM. J. TRANSNAT’L L. 14, 18–19 (2007) (“[T]he anti-fraud provisions of the federal securities laws do not speak directly to the scope of their application in the international context.”).

3. *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869 (2010).

4. See *id.* at 2888 (Stevens, J., concurring) (stating that the Court should have adhered to “the general approach that has been the law in the Second Circuit, and most of the rest of the country, for nearly four decades”).

protection for American investors. Finally, in Part IV, I argue that Congress should, in furtherance of the goals of U.S. securities laws, legislate to mitigate the effects of *Morrison*, and I offer a legislative proposal to better protect American investors and deter foreign securities fraud.

I. JURISDICTION OVER FOREIGN TRANSACTIONS PRE- *MORRISON*

Over the past forty years, U.S. courts struggled to determine whether the antifraud provisions of U.S. securities laws applied to securities transactions involving foreign issuers or foreign-traded stock.⁵ This is due to the fact that the prevailing antifraud measure regulating secondary markets, § 10(b) of the Securities and Exchange Act of 1934 (the Exchange Act), is silent as to the extraterritorial application of the law.⁶ As a result, courts were forced to create and apply their own tests, which focused on “whether Congress would have wished the precious resources of the United States courts and law enforcement agencies to be devoted” to a securities fraud claim with extraterritorial elements.⁷ Prior to the Supreme Court’s ruling in *Morrison*, the lower federal courts framed the issue as one of subject matter jurisdiction: U.S. courts could potentially have subject matter jurisdiction over claims with extraterritorial elements if the claim was based on conduct taking place in the United States, or on effects felt within the United States.⁸

A. THE CONDUCT TEST

Under what was aptly named the “conduct” test, U.S. courts exercised jurisdiction over extraterritorial securities fraud actions if enough fraudulent

5. See Stephen J. Choi & Linda J. Silberman, *Transnational Litigation and Global Securities Class-Action Lawsuits*, 2009 WIS. L. REV. 465, 467 (2009) (“[M]uch uncertainty surrounds the consideration of extraterritorial issues within securities class-action lawsuits. The individual doctrines applied within the courts—such as the conduct and effects tests—are often ambiguous and difficult to predict.”).

6. Section 10(b) of the Exchange Act reads:

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 . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). It follows that, since Rule 10b-5 was promulgated under § 10(b), they have the same scope. See *United States v. O’Hagan*, 521 U.S. 642, 651 (1997) (“Liability under Rule 10b-5 . . . does not extend beyond conduct encompassed by § 10(b)’s prohibition.”).

7. *Eur. & Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 125 (2d Cir. 1998) (internal citations omitted).

8. Buxbaum, *supra* note 2, at 18–20.

conduct occurred within the United States.⁹ Under the standard applied by the Second Circuit,¹⁰ to assert jurisdiction, the domestic conduct must have “directly caused” the loss to plaintiffs and must have been more than “merely preparatory” to the fraud that occurred abroad.¹¹ An additional consideration was whether exercising jurisdiction over a particular extraterritorial dispute would discourage fraudulent actors from using the United States to defraud investors.¹² Courts reasoned that expanding the reach of U.S. securities laws and actively policing global markets would deter international securities fraud and encourage other countries to implement and enforce their own securities fraud laws in cross-border transactions.¹³

B. THE EFFECTS TEST

The “effects” test, which has been applied both alone and in conjunction with the “conduct” test,¹⁴ was first articulated in *Schoenbaum v. Firstbrook*.¹⁵ The test focused on whether the fraudulent activity that occurred overseas had a substantial effect on U.S. markets or citizens.¹⁶ The

9. *See Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 986–87 (2d Cir. 1975).

10. The Second Circuit’s standard:

[E]stablished that application of § 10(b) could be premised upon either some effect on American securities markets or investors (*Schoenbaum*) or significant conduct in the United States (*Leasco*). It later formalized these two applications into (1) an “effects test,” “whether the wrongful conduct had a substantial effect in the United States or upon United States citizens,” and (2) a “conduct test,” “whether the wrongful conduct occurred in the United States.”

Morrison v. Nat’l Austl. Bank Ltd., 130 S. Ct. 2869, 2879 (2010).

11. *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir. 1991) (“[A] federal court has subject matter jurisdiction if the defendant’s 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 losses to foreign investors abroad.”).

12. *See Banque Paribas London*, 147 F.3d at 125 (reasoning that “Congress would not want the United States to become a base for fraudulent activity harming foreign investors”). *See also SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir. 1977) (stating that, from a policy perspective, jurisdiction should be asserted because Congress did not “intend[] to allow the United States to become a ‘Barbary Coast,’ . . . harboring international securities ‘pirates’”).

13. *See Kun Young Chang, Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject-Matter Jurisdiction*, 9 *FORDHAM J. CORP. & FIN. L.* 89, 99–100 (2003). *See also Kasser*, 548 F.2d at 116 (“By finding jurisdiction here, we may encourage other nations to take appropriate steps against parties who seek to perpetrate fraud in the United States.”).

14. The Second Circuit generally applies both the “conduct” and the “effects” tests together. *See Itoba Ltd. v. Lep Grp. PLC*, 54 F.3d 118, 122 (2d Cir. 1995) (“[A]n admixture or combination of the two [tests] often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court.”).

15. *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968).

16. *See id.* at 206 (“We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of

policy behind this approach was one of American self-interest: American investors should be protected even if the fraud affecting them occurred abroad.¹⁷ Yet, claims of reducing investor confidence or of a general detrimental effect on the U.S. economy were later held to be insufficient to establish jurisdiction.¹⁸ Plaintiffs were required to show that a specific U.S. interest was adversely affected by the foreign conduct.¹⁹

C. THE END OF THE LINE FOR THE CONDUCT AND EFFECTS TESTS

While the “conduct” and “effects” tests were originally articulated in decisions by the Second Circuit, other circuit courts adopted different standards as to the nature and amount of domestic activity required in order to find subject matter jurisdiction over a foreign transaction.²⁰ As a result, several commentators criticized these tests as ambiguous,²¹ inconsistent,²² and unpredictable,²³ and called for clearer, stricter standards in determining

improper foreign transactions in American securities.”). *See also* *Morrison v. Nat’l Austl. Bank Ltd.*, 547 F.3d 167, 171 (2d Cir. 2008).

17. *See Schoebaum*, 405 F.2d at 208 (stating that subject matter jurisdiction should be exercised over transactions that take place outside the United States, which “are detrimental to the interests of American investors”).

18. *See Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 989 (2d Cir. 1975) (holding that jurisdiction did not exist where there was only “an adverse effect on this country’s general economic interests or on American security prices”). *See also* *Buxbaum*, *supra* note 2, at 22 (stating that plaintiffs “must show detrimental effect on specific interests within the United States,” as courts “have consistently rejected arguments that U.S. securities law reaches foreign conduct simply because that conduct affects general confidence in the U.S. securities markets”).

19. *Bersch*, 519 F.2d at 989.

20. *Buxbaum*, *supra* note 2, at 25 (“Over the years, the different circuits have developed competing standards for evaluating the kind or quantity of local conduct that is necessary to create jurisdiction over predominantly foreign transactions.”). The Fifth and Seventh Circuits adopted approaches similar to that of the Second Circuit. *See Robinson v. TCI/US W. Cable Commc’ns Inc.*, 117 F.3d 900, 906–07 (5th Cir. 1997); *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 667 (7th Cir. 1998). The D.C. Circuit took a stricter interpretation and required that the domestic conduct itself be an independent violation of U.S. securities laws. *See Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27, 30–33 (D.C. Cir. 1987). On the other hand, the Third, Eighth, and Ninth Circuits adopted a broad approach, which required that the domestic conduct be in furtherance of the alleged fraud. *See SEC v. Kasser*, 548 F.2d 109, 114 (3d Cir. 1977); *Continental Grain (Austl.) Pty. v. Pacific Oilseeds, Inc.* 592 F.2d 409, 420 (8th Cir. 1979); *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 424–25 (9th Cir. 1983).

21. *See Choi & Silberman*, *supra* note 5, at 467 (“[M]uch uncertainty surrounds the consideration of extraterritorial issues within securities class-action lawsuits. The individual doctrines applied within the courts—such as the conduct and effects tests—are often ambiguous and difficult to predict.”).

22. *See Chang*, *supra* note 13, at 96 (“[C]ourts do not apply the conduct test with the same degree of uniformity.”); Michael J. Kaufman, *Supreme Court’s Test in Morrison for Extraterritorial Application of Rule 10b-5 to Foreign Cubed Cases*, in 26 SEC. LITIG.: DAMAGES § 10:2.50 (2011) (“[F]ederal circuits that confronted the question [of whether there is subject matter jurisdiction under the conducts test] came up with a number of different approaches.”).

23. *See* Robert L. Hickok & Daniel J. Boland, *Do Antifraud Provisions of U.S. Securities Laws Apply to Foreign Actions?*, THE LEGAL INTELLIGENCER (Dec. 22, 2009), <http://www.law.com/jsp/pa/PubArticlePA.jsp?id=1202437129880&slreturn=1> (“There is a split among the circuit courts regarding the proper interpretation of the conduct test, potentially resulting in different outcomes

whether there was jurisdiction over extraterritorial securities claims.²⁴ Recently, however, the Supreme Court surprised many²⁵ with its decision in *Morrison* by rejecting and replacing the “conduct” and “effects” tests.²⁶

II. *MORRISON V. NATIONAL AUSTRALIA BANK*

National Australia Bank (NAB), located and incorporated in Australia, has “ordinary shares,”²⁷ which trade on the Australian Securities Exchange and other foreign exchanges.²⁸ American Depositary Receipts (ADRs)²⁹ of NAB trade on the New York Stock Exchange (NYSE).³⁰ In 1998, NAB purchased HomeSide Lending, Inc. (HomeSide), an American mortgage service provider located in Florida.³¹ In 2001, NAB incurred multiple write-downs totaling nearly \$2.25 billion as a result of faulty valuation models related to valuing HomeSide’s assets.³² NAB’s share price fell sharply upon these disclosures and several foreign individuals who owned NAB shares (the Plaintiffs),³³ brought suit in the Southern District of New York against NAB, HomeSide, and several officers of both companies (collectively, the Defendants).³⁴ The Plaintiffs alleged that, with the knowledge of NAB and its officers, HomeSide misrepresented financial models to inflate the value of the company’s assets, and, as a result, NAB “made materially false and misleading statements in SEC filings, annual reports and press releases regarding HomeSide’s profitability, economic health and its contribution to NAB,” in violation of §§ 10(b) and 20(a) of the Exchange Act and

on similar fact patterns.”); Chang, *supra* note 13, at 117 (“The aggressive and inconsistent judicial response to transnational securities fraud has not ensured predictability in the application of antifraud rules.”).

24. See Choi & Silberman, *supra* note 5, at 468; Chang, *supra* note 13, at 118–21; Kahn, *supra* note 1, at 411–12.

25. Sarah L. Cave, *F-Cubed=0: Supreme Court’s Decision in ‘Morrison v. National Australia Bank,’* N.Y. L.J., July 7, 2010, at 4 (noting that the Court’s opinion was “a more far-reaching ruling than many anticipated”).

26. Kaufman, *supra* note 22 (“[T]he Supreme Court explicitly rejected the ‘conduct and effects’ test articulated by the Second Circuit.”).

27. “Ordinary shares” are the “equivalent of American common stock.” *Morrison v. Nat’l Austl. Bank Ltd.*, 547 F.3d 167, 168 (2d Cir. 2008).

28. *Id.*

29. ADRs represent “one or more shares of foreign stock or a fraction of a share” and give the holders the “right to obtain the foreign stock [they] represent[.]” *American Depositary Receipts*, SEC, <http://www.sec.gov/answers/adrs.htm> (last visited Sept. 29, 2010).

30. *Morrison*, 547 F.3d at 168.

31. *Id.* at 168–69.

32. *Id.* at 169.

33. The initial plaintiffs consisted of both foreign plaintiffs (residents of Australia) who owned NAB ordinary shares, as well as a domestic plaintiff, who owned ADRs trading on the NYSE. The domestic plaintiff’s claims were dismissed in the district court for failing to allege damages and were not appealed. Thus, the Second Circuit and Supreme Court decisions focused solely on the claims of the foreign plaintiffs. *Id.* at 170 n.3.

34. *Id.* at 169.

Securities and Exchange Commission (SEC) Rule 10b-5.³⁵ Actions such as this one, where foreign plaintiffs bring a claim against a foreign issuer over a foreign securities transaction, are referred to as “foreign-cubed” or “f-cubed” litigation.³⁶ The District Court for the Southern District of New York applied the Second Circuit’s “conduct” and “effects” tests,³⁷ and granted the Defendants’ motion to dismiss for lack of subject matter jurisdiction.³⁸

On appeal, the Plaintiffs argued that U.S. securities laws were applicable to their claim by virtue of the conduct test because the fraudulent activity occurred at HomeSide, which was located in the United States.³⁹ The Second Circuit affirmed the decision of the district court, however, and in utilizing the “conduct” and “effects” tests, concluded that jurisdiction could not be asserted over the case for three main reasons: (1) NAB’s actions were “more central to the fraud” than the manipulation of numbers by HomeSide in Florida;⁴⁰ (2) the Plaintiffs did not allege any effect on American markets or investors;⁴¹ and (3) there was a “lengthy chain of causation” between the fraudulent domestic conduct and the harm to the Plaintiffs.⁴² The Second Circuit also *specifically rejected* the adoption of a bright-line rule that subject matter jurisdiction could never be established over “foreign-cubed” securities actions based on the presumption against the extraterritorial application of congressional statutes.⁴³ The Supreme

35. *Id.*

36. See Nicolas Grabar, *Second Circuit Limits Extraterritorial Application of U.S. Securities Laws in Benchmark “Foreign-Cubed” Class Action Decision*, in GLOBAL CAPITAL MARKETS AND THE U.S. SECURITIES LAWS 2009: STRATEGIES FOR THE CHANGING REGULATORY ENVIRONMENT 781 (PLI Litig. & Admin. Prac. Course Handbook Ser. No. 18228) (2009) (defining a “foreign-cubed” action as “a suit by foreign plaintiffs against a foreign issuer based on securities transactions in a foreign country”); James F. Moyle & Steven L. Penaro, *Foreign Bank Issuer, Foreign Plaintiff, Foreign Transaction. Class Action Exposure in the U.S. Under Federal Securities Laws?* 127 BANKING L.J. 458, 459 (2010) (explaining that “‘f-cubed’ cases involve (1) a foreign purchaser; (2) suing a foreign issuer for violations of U.S. securities laws; (3) with respect to securities transactions in foreign countries”).

37. Prior to the Supreme Court’s ruling in *Morrison*, federal courts (erroneously) framed the question of the extraterritorial reach of U.S. securities laws as one of subject matter jurisdiction. See *supra* Part I.

38. *In re Nat’l Austl. Bank Sec. Litig.*, No. 03-6537(BSJ), 2006 WL 3844465, at *11–20 (S.D.N.Y. Oct. 25, 2006) (finding no subject matter jurisdiction because the predominant fraudulent conduct occurred in Australia, rather than in the United States, and the alleged fraud had essentially no effect on the U.S. market).

39. See *Morrison*, 547 F.3d at 175.

40. *Id.* at 176.

41. *Id.*

42. *Id.* at 176–77.

43. See *id.* at 174–75.

Court granted certiorari⁴⁴ and in its decision, focused precisely on the presumption against the extraterritorial application of American laws.⁴⁵

A. THE NEW (AND UNANTICIPATED) “TRANSACTIONAL” TEST

The Supreme Court affirmed the decision of the Second Circuit, but at the same time, rejected and replaced the familiar “conduct and effects” analysis utilized by federal courts for forty years.⁴⁶ First, the Court corrected an error made by lower courts with regard to the threshold issue of the extraterritorial reach of § 10(b) of the Exchange Act, saying that it is not an issue of subject matter jurisdiction, but one on the merits of the case.⁴⁷ The Court then invoked a longstanding principle of statutory interpretation that unless a contrary intent appears, a congressional statute is meant only to apply within the United States.⁴⁸ As such, the Court concluded that § 10(b) does not apply outside the United States because “there is no affirmative indication in the Exchange Act that § 10(b) applies extraterritorially.”⁴⁹ The Court then declared that, since the language of the Exchange Act focuses on the securities transaction in question and not on where the relevant deceptive conduct occurred,⁵⁰ § 10(b) applies only to “transactions in securities listed on domestic exchanges, and domestic transactions in other securities.”⁵¹ Since NAB’s securities were not listed on a U.S. exchange and the relevant transactions did not take place in the United States, the Court found that § 10(b) did not reach the alleged fraud

44. *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 783 (2009), *cert. granted*, 175 L.Ed.2d 513 (U.S. Nov. 30, 2009) (No. 08-1191).

45. *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2877–83 (2010) (criticizing the lower federal courts for disregarding the longstanding presumption against the extraterritorial application of U.S. laws). *See also infra* Part II.A.

46. *See Morrison*, 130 S. Ct. at 2888 (Stevens, J., concurring). *See also* Kahn, *supra* note 1, at 404 (noting that it has “been more than forty years since the decisions in *Schoenbaum* and *Leasco* first applied the conduct and effects tests to determine the jurisdictional reach of the antifraud provisions”).

47. *Morrison*, 130 S. Ct. at 2877 (majority opinion) (“[T]o ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question. Subject-matter jurisdiction, by contrast, ‘refers to a tribunal’s ‘power to hear a case.’ . . . It presents an issue quite separate from the question whether the allegations the plaintiff makes entitle him to relief.”) (internal citations omitted).

48. *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (stating that it is a “longstanding principle 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’”) (citations omitted).

49. *Morrison*, 130 S. Ct. at 2883.

50. *Id.* at 2884 (“[T]he 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. Section 10(b) does not punish deceptive conduct, but only deceptive conduct ‘in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered.’”) (citing 15 U.S.C. § 78j(b) (2006)).

51. *Id.*

and dismissed the action for failure to state a claim.⁵² This new “transactional” test⁵³ overturned nearly forty years of precedential law related to transnational securities fraud in the Second Circuit and in much of the rest of the country.⁵⁴

B. IMPLICATIONS OF THE SUPREME COURT’S DECISION IN *MORRISON*

While the Plaintiffs in *Morrison* struck out under the “conduct” and “effects” tests and the “transactional” test,⁵⁵ many other investors who previously would have had a claim under U.S. securities laws, no longer have a cause of action.⁵⁶ This is the case because the decision reaches beyond just “foreign-cubed” actions.⁵⁷ In fact, “foreign-cubed” cases appear to be fairly uncommon, as evidenced by the Second Circuit’s statement that *Morrison* was “the first so-called ‘foreign-cubed’ securities class action to reach th[e] Circuit.”⁵⁸ The implications of the new “transactional” test articulated by the Court are far broader than affecting just “foreign-cubed” litigation.⁵⁹ In fact, the rights of all American investors who purchase securities abroad are profoundly affected by this decision.⁶⁰ Less certain is

52. *Id.* at 2888 (“This case involves no securities listed on a domestic exchange, and all aspects of the purchases complained of by those petitioners who still have live claims occurred outside the United States. Petitioners have therefore failed to state a claim on which relief can be granted.”).

53. *See id.* at 2886.

54. *See id.* at 2888 (Stevens, J., concurring). *See also* Elizabeth Cosenza, *Paradise Lost: § 10(B) After Morrison v. National Australia Bank*, 11 CHI. J. INT’L L. 343, 356 (2011) (noting that the conduct and effects tests were used by the Second Circuit “[f]or the better part of four decades”).

55. *See Morrison*, 130 S. Ct. at 2888 (finding that the plaintiffs were not entitled to relief under the “transactional” test as § 10(b) does not reach the alleged fraud); *Morrison v. Nat’l Austrl. Bank Ltd.*, 547 F.3d 167, 176–77 (2d Cir. 2008) (finding no subject matter jurisdiction under the “conduct” and “effects” tests).

56. *See infra* Part II.B.1.

57. Ted Farris, Dorsey & Whitney LLP, *Implications of Morrison v. National Australia Bank Ltd.* (June 28, 2010), http://www.dorsey.com/eu_corporate_morrisonvnationalbank_062510/#page=1 (“[T]he rule announced in *National Australia Bank* has far broader application than . . . ‘foreign-cubed’ cases . . . [and is a] broadly stated holding.”).

58. *Morrison*, 547 F.3d at 172. Most securities class actions are brought in the Second Circuit. *See Securities Class Action Filings—2009: A Year in Review*, CORNERSTONE RESEARCH 25 (2010), http://securities.stanford.edu/clearinghouse_research/2009_YIR/Cornerstone_Research_Filings_2009_YIR.pdf. Additionally, as noted in the concurring opinion in *Morrison*, “foreign-cubed” cases “would fail the Second Circuit’s test” anyway, “as they generally should.” *Morrison*, 130 S. Ct. at 2894 n.11 (Stevens, J., concurring).

59. *See* Theodore J. Sawicki & Todd Chatham, *Foreign Cubed Cases: The Supreme Court Contains a Potential Flood in Securities Litigation*, in 27 SEC. LITIG. FORMS AND ANALYSIS § 1:10 (2011) (“[B]ecause *Morrison* turns on a transactions test, the decision will have impacts that extend beyond foreign cubed cases.”); John C. Coffee, Jr., *What Hath ‘Morrison’ Wrought?*, N.Y. L.J., Sept. 16, 2010, at 5 (“*Morrison* affects much more than the ‘f-cubed’ class action.”).

60. Coffee, *supra* note 59 (“*Morrison* . . . will by its terms bar even private actions by American investors who purchase the securities of American issuers on a foreign exchange.”).

whether *Morrison* also limits the power of the SEC to bring enforcement actions against foreign companies.⁶¹

1. Bright-Line Rule Against Americans Investing Abroad

The Supreme Court's holding in *Morrison* is a bright-line rule barring any American investor who purchases securities trading only on a foreign exchange from bringing suit under U.S. securities laws.⁶² As a result, American plaintiffs who purchase securities abroad, who once had a chance to be heard in U.S. courts under the "conduct" or "effects" tests, will now not even be able to get their foot in the door to be heard. This concern is reflected in the concurring opinion to the *Morrison* decision⁶³:

Imagine . . . an American investor who buys shares in a company listed only on an overseas exchange. That company has a major American subsidiary with executives based in New York City; and it was in New York City that the executives masterminded and implemented a massive deception which artificially inflated the stock price—and which will, upon its disclosure, cause the price to plummet . . . [The] investors would, under the Court's new test, be barred from seeking relief under § 10(b).⁶⁴

In this scenario, where there is both wrongful conduct in the United States and injury to U.S. markets and citizens, § 10(b) no longer applies.⁶⁵ Plaintiffs in analogous circumstances were previously able to bring a claim under U.S. securities laws. For example, the American plaintiffs in *Leasco Data Processing Equipment Corp. v. Maxwell*, were fraudulently induced to buy stock in a British company, which did not trade domestically.⁶⁶ The plaintiffs were able to bring suit in the United States under the "conduct"

61. The concurrence in *Morrison* states that the Court's decision leaves the SEC's enforcement power unaffected. *Morrison*, 130 S. Ct. at 2895 n.12. However, the Court did not distinguish between private plaintiffs and the SEC in its holding. See Sawicki & Chatham, *supra* note 59.

62. See Farris, *supra* note 57 (observing that the new test will likely "disallow Rule 10b-5 claims by a US plaintiff purchasing securities abroad of any issuer whether domestic or foreign where the securities are not listed in the United States"). See also Adam Johnson, Jonathan Cary & Alex Bafi, *Foreign-cubed Securities Actions: The End of the Line?*, PRAC. L. CO. (July 28, 2010), <http://finance.practicallaw.com/5-502-8826> (stating that the transactional test "limits the ability of US plaintiffs to bring actions under the anti-fraud provisions of the . . . [Exchange Act] in circumstances where they acquire non-US listed securities and the transactions take place outside the US").

63. Supreme Court Justices Stevens and Ginsburg concurred in the judgment but disagreed with the reasoning of the Court. *Morrison*, 130 S. Ct. at 2888 (Stevens, J., concurring) ("While I agree that petitioners have failed to state a claim on which relief can be granted, my reasoning differs from the Court's.").

64. *Id.* at 2895.

65. See Glen Devalerio & Jeffrey C. Block, *High Court Thumbs Nose at Investors*, PENSIONS & INVESTMENTS ONLINE (Nov. 1, 2010), <http://www.pionline.com/article/20101101/PRINTSUB/311019999> ("[T]he high court wiped out four decades of judicial precedent, severely limiting investors' ability to hold multinational companies accountable for their misdeeds—even those that take place in the United States or hurt U.S. investors.").

66. *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1330 (2d Cir. 1972).

test because of deceptive acts that took place in the United States.⁶⁷ The court in *Leasco* emphasized the importance of protecting American investors.⁶⁸ Under the “transactional” test, however, such plaintiffs are now completely barred from bringing a securities fraud case in U.S. courts.⁶⁹

2. Application of the “Transactional” Test Since *Morrison*

The test articulated in *Morrison* is being applied broadly by district courts⁷⁰ and has already barred many American investors from pursuing securities fraud class actions in the United States.⁷¹ In one of the first securities fraud actions faced by a district court after *Morrison*, a judge in the Southern District of New York held that, in light of *Morrison*, the claims of American plaintiffs who purchased shares of Credit Suisse on the Swiss stock exchange were barred.⁷² Citing *Morrison*, the court held that § 10(b) does “not apply to transactions involving (1) a purchase or sale, wherever it occurs, of securities listed only on a foreign exchange, or (2) a purchase or sale of securities, foreign or domestic, which occurs outside the United States.”⁷³

Since then, plaintiffs’ attorneys have made several creative arguments in an attempt to circumvent the holding in *Morrison*, but have been unsuccessful.⁷⁴ In a securities fraud class action led by an American pension fund against Swiss Reinsurance Co.,⁷⁵ plaintiffs argued that their purchases were actually made in the United States because the buy orders were placed in the United States.⁷⁶ The court rejected this argument and held that “a purchase order in the United States for a security that is sold on a foreign exchange is insufficient to subject the purchase to the coverage of Section 10(b) of the Exchange Act” and dismissed the case.⁷⁷ Similarly, a \$2 billion

67. *Id.* at 1334–35.

68. *See id.* at 1337.

69. *See Morrison*, 130 S. Ct. at 2884 (rejecting the “conduct” and “effects” test and limiting the application of U.S. securities laws to “transactions in securities listed on domestic exchanges, and domestic transactions in other securities”).

70. Fred T. Isquith, *Interpreting Morrison v. National Australia Bank*, LAW 360 (Nov. 3, 2010, 10:58 AM), <http://www.law360.com/classaction/articles/206320>.

71. *See generally* Nathan Koppel & Ashby Jones, *Securities Ruling Limits Claims of Fraud*, WALL ST. J., Sept. 28, 2010, <http://online.wsj.com/article/SB10001424052748703694204575518301351548676.html>; Luke Green, *Securities Class Actions Post Q1 2011: Around the Horn*, ISS GOVERNANCE SECURITIES LITIGATION WATCH BLOG (Apr. 18, 2011, 12:29 PM), <http://blog.issgovernance.com/slw/2011/04/securities-class-actions-post-q1-2011-around-the-horn.html>; Isquith, *supra* note 70.

72. *See Cornwell v. Credit Suisse Grp.*, 729 F. Supp. 2d 620, 623–27 (S.D.N.Y. 2010).

73. *Id.* at 623–24.

74. Isquith, *supra* note 70.

75. Shares of Swiss Reinsurance Co. are only listed on a Swiss stock exchange. *Plumbers’ Union Local No. 12 v. Swiss Reinsurance Co.*, 753 F. Supp. 2d 166, 178 (S.D.N.Y. 2010).

76. *Id.* at 177.

77. *See id.* at 178. In addition to finding that § 10(b) of the Exchange Act did not apply, the court also held that the plaintiff failed to allege fraud with the necessary particularity. *See id.* *See also* Patricia Hurtado, *Swiss Re Wins Dismissal of Credit Default Swaps Suit*, BLOOMBERG, Oct.

securities fraud lawsuit brought by several hedge funds against Porsche, whose stock trades in Germany, was dismissed despite plaintiffs' argument that they used swap agreements that were transacted in the United States, rather than trading in the underlying security.⁷⁸ In another case against UBS, plaintiffs' claims were dismissed where UBS common shares traded both on the NYSE and a foreign exchange.⁷⁹ Despite this, the court held that only the claims based on shares actually trading in the United States could proceed, thus wiping out almost 90 percent of potential damages.⁸⁰ In an action against Alstom SA (Alstom),⁸¹ plaintiffs argued that since the company had ADRs listed on a U.S. exchange, the securities purchased on a French stock exchange should also be covered by § 10(b) for American investors.⁸² This argument was rejected as well, with the court emphasizing that under the "transactional" test, the "focus [is] on where the transaction actually occurs," not whether the company's securities are also listed on a U.S. exchange.⁸³ The claims of Alstom ADR purchasers were not affected by this decision.⁸⁴

4, 2010, <http://www.bloomberg.com/news/2010-10-04/swiss-re-wins-dismissal-of-lawsuit-in-u-s-over-credit-default-swaps.html>.

78. *Elliott Assocs. v. Porsche Auto. Holding SE*, 759 F. Supp. 2d 469, 476 (S.D.N.Y. 2010) ("Plaintiffs' swaps were the functional equivalent of trading the underlying VW shares on a German exchange. . . . Plaintiffs' swap agreements are essentially 'transactions conducted upon foreign exchanges and markets,' and not 'domestic transactions' that merit the protection of § 10(b).").

79. *See In re UBS Sec. Litig.*, No. 07-11225, 2011 WL 4059356, at *5-8 (S.D.N.Y. Sept. 13, 2011); Alison Frankel, *Investors Lose Last, Best Chance to Stem Morrison Bloodbath*, THOMPSON REUTERS NEWS & INSIGHT, Sept. 14, 2011, http://newsandinsight.thomsonreuters.com/Legal/News/2011/09_-_September/Investors_lose_last_best_chance_to_stem_Morrison_bloodbath ("About 12 percent of UBS shares are listed in the United States," thus, "an investor could buy a share of UBS on the Swiss exchange in the morning and trade it on the NYSE in the afternoon.").

80. Frankel, *supra* note 79.

81. Plaintiffs included American investors who purchased Alstom stock on a French stock exchange as well as ADRs on the NYSE. *See In re Alstom SA Sec. Litig.*, 741 F. Supp. 2d 469, 471 (S.D.N.Y. 2010).

82. *See id.* at 471-72; Isquith, *supra* note 70.

83. *See In re Alstom*, 741 F. Supp. 2d at 472. A similar conclusion was reached in an action against Royal Bank of Scotland (RBS), where the court dismissed the claims of plaintiffs who purchased RBS ordinary shares trading on foreign exchanges, despite plaintiffs' argument that RBS ADRs were listed on the NYSE. *In re Royal Bank of Scotland Grp. PLC Sec. Litig.*, 765 F. Supp. 2d 327, 336 (S.D.N.Y. 2011) ("The idea that a foreign company is subject to U.S. Securities laws everywhere it conducts foreign transactions merely because it has 'listed' some securities in the United States is simply contrary to the spirit of *Morrison*.").

84. Isquith, *supra* note 70 (noting that the claims of ADR purchasers were not dismissed). Similarly, in a decision appointing lead plaintiff in a securities class action against Toyota, the court noted that the claims of purchasers of Toyota's stock, which trades on the Tokyo stock exchange, would likely be dismissed, while the claims of ADR purchasers would remain. As a result, however, recoverable losses of the lead plaintiff shrunk from nearly \$17 million to around \$250,000. *See Stackhouse v. Toyota Motor Co.*, No. 10-0922, 2010 WL 3377409, at *1-3 (C.D. Cal. July 16, 2010); Dorothy Heyl, *Federal Courts Apply 'Morrison' Expansively*, N.Y. L.J., Nov. 19, 2010, at 4.

Since the decision in *Alstom*, however, ADR purchasers have been added to the list of those investors excluded from U.S. courts.⁸⁵ In a securities fraud class action against Société Générale (SocGen), the court dismissed not only the claims of U.S. investors who had purchased SocGen stock on a foreign exchange, but also the claims of U.S. investors who purchased ADRs over the counter in the United States.⁸⁶ Further narrowing the rights of American investors, the court stated that § 10(b) was not applicable since the SocGen ADRs were not listed on an “official American securities exchange” and trades in ADRs are considered to be a “predominantly foreign securities transaction.”⁸⁷ There is some inconsistency among the district courts on this issue, however. In a subsequent securities fraud action, the court, without explaining its reasoning, declined to dismiss the claims of plaintiffs who purchased ADRs on a U.S. exchange.⁸⁸ Despite this, many courts appear to be interpreting the holding in *Morrison* expansively,⁸⁹ substantially limiting the ability of American investors to seek redress for losses due to securities fraud.⁹⁰

3. *Morrison* is Harmful Policy and Could Leave American Investors Unprotected

The expansive application of *Morrison* essentially incentivizes companies to ensure that transactions in their securities occur outside of the United States in order to avoid securities fraud liability: “[A]nyone selling complex financial instruments should just insist that buyers complete the transactions out of the borders of the United States. That way, no matter how badly sellers misrepresent the securities, they’re protected by the impermeable heat shield the U.S. Supreme Court erected in *Morrison v. National Australia Bank*.”⁹¹ Indeed, as noted earlier, foreign companies

85. See BNA Sec. Law Daily, *Morrison Ripples Bar Investors’ Suit; SocGen Investors Cannot Use U.S. Courts* (Oct. 5, 2010).

86. The court acted sua sponte in dismissing the claims related to the ADRs, as SocGen had only moved to dismiss against the purchasers of the foreign exchange traded stock. See *In re Société Générale Sec. Litig.*, No. 08-2495(RMB), 2010 WL 3910286, at *8–9 (S.D.N.Y. Sept. 29, 2010); Daniel Snare, *Expanding Morrison to Bar 10(b) Claims for ADR Transactions Made on the OTC*, *THE RACETOTHEBOTTOM.ORG* (Nov. 15, 2010, 6:00 AM), <http://www.theracetothetbottom.org/securities-issues/2010/11/15/expanding-morrison-to-bar-10b-claims-for-adr-transactions-ma.html>.

87. *Société Générale Sec. Litig.*, 2010 WL 3910286, at *7–11 (citations omitted).

88. *Kleinman v. Elan Corp. (In re Elan Corp. Sec. Litig.)*, No. 08-8761 (AKH), 2011 WL 1442328, at *1 (S.D.N.Y. Mar. 18, 2011). It is unclear if trading ADRs on an official exchange, as opposed to an over-the-counter market, was relevant to the court’s decision.

89. See Heyl, *supra* note 84.

90. See Koppel & Jones, *supra* note 71 (“Judges have been interpreting the ruling in *Morrison v. National Australia Bank Ltd.* as preventing fraud claims in U.S. courts by any investor—either from the U.S. or abroad—who purchased shares on foreign exchange.”).

91. Alison Frankel, *Morrison Strikes Again! Goldman Get \$1 B! Fraud Case Tossed*, *THOMPSON REUTERS NEWS & INSIGHT*, July 21, 2011, [http://newsandinsight.thomsonreuters.com/Legal/News/2011/07_-_July/Morrison_strikes_again!_Goldman_get_\\$1_bl_fraud_case_tossed/](http://newsandinsight.thomsonreuters.com/Legal/News/2011/07_-_July/Morrison_strikes_again!_Goldman_get_$1_bl_fraud_case_tossed/).

have already benefitted under the “transactional” test and will likely continue to do so as more companies avoid listing or effecting securities transactions in the United States.⁹²

The legacy of *Morrison* is a shocking loss of protection for American investors, as investment overseas is not uncommon. Indeed, in 2007, about 36 percent of investing Americans owned foreign stocks.⁹³ Many domestic investors are mutual funds and pension plans, which invest in multinational companies and buy stock overseas in order to access more liquidity than they would by purchasing ADRs of foreign companies on a domestic exchange.⁹⁴ BP is an example of a foreign company that stands to save billions, at the expense of American investors, as a result of the Court’s decision.⁹⁵ A few American pension and retirement funds purportedly suffered \$200 million in BP stock losses because BP misled investors about their safety precautions related to drilling.⁹⁶ The decision in *Morrison* shrinks the recoverable losses in U.S. court by more than \$175 million once the losses on stock purchased abroad are stripped out.⁹⁷ *Morrison* also takes aim at investors who prevailed in a jury trial in January 2010 when jurors found that Vivendi was liable for fifty-seven misstatements to shareholders.⁹⁸ A post-trial decision amended the class certification to exclude purchasers of ordinary shares of Vivendi abroad and may reduce potential damages of nearly \$9 billion by as much as 80 percent.⁹⁹ At a time when American investors have suffered severe financial losses due to widespread corporate mishandling and a worldwide economic downturn,

92. Farris, *supra* note 57. *Morrison* gives

issuers and underwriters a bright line test they can potentially use to avoid Rule 10b-5 liability in international securities transactions. For example, foreign issuers selling non US listed securities to US institutions may insist that those purchasers buy their securities in an offshore transaction by a non US affiliate in an effort to remain beyond the reach of Rule 10b-5.

Id.

93. Jeffrey M. Jones, *Public Divided as to Effect of Foreign Investing on U.S. Economy*, GALLUP (Mar. 19, 2007), <http://www.gallup.com/poll/26905/public-divided-effect-foreign-investing-us-economy.aspx>.

94. Koppel & Jones, *supra* note 71.

95. See Greg Stohr, *BP, Vivendi Among Companies that may Save Billions from Ruling*, BLOOMBERG, June 28, 2010, <http://www.bloomberg.com/news/2010-07-28/bp-vivendi-among-companies-that-may-save-billions-after-high-court-ruling.html>.

96. Koppel & Jones, *supra* note 71.

97. *Id.*

98. See Jennifer Thompson, *Vivendi in US Legal Victory Against Investors*, FIN. TIMES, Feb. 23, 2011, <http://www.ft.com/intl/cms/s/0/193a6300-3f5f-11e0-8e48-00144feabdc0.html#axzz1Y2oFuFR>.

99. *Id.*; Chad Bray, *Vivendi Fraud Claims Ruled Limited to ADR Holders*, WALL ST. J., Feb. 22, 2011, <http://online.wsj.com/article/SB10001424052748704071304576160864164657034.html>.

Morrison essentially “gives foreign companies diplomatic immunity when it comes to charges of securities fraud.”¹⁰⁰

C. LIMITS ON EXTRATERRITORIAL ENFORCEMENT POWER OF THE SEC

Although *Morrison* involved a private right of action, since § 10(b) of the Exchange Act and Rule 10b-5, promulgated thereunder, are also used by the SEC to bring enforcement actions,¹⁰¹ the decision in *Morrison* may affect the ability of the SEC to pursue claims against foreign companies on behalf of investors.¹⁰² There is ambiguity, however, as to whether the Court’s decision limits the SEC’s authority because even though the decision did not specifically address the government enforcement of § 10(b),¹⁰³ neither did it expressly protect the SEC’s authority to bring extraterritorial actions under § 10(b).¹⁰⁴ While the concurring opinion in *Morrison* noted that the majority’s opinion did not prevent the SEC from bringing enforcement actions against foreign companies,¹⁰⁵ several commentators believe otherwise.¹⁰⁶

100. Steve W. Berman, *Misguided Supreme Court Decision Gives Foreign Companies Diplomatic Immunity*, SEATTLE POST INTELLIGENCER (Oct. 12, 2010, 2:54 PM), <http://blog.seattlepi.com/steveberman/archives/224511.asp>.

101. See Ronald J. Colombo, *Cooperation with Securities Fraud*, 61 ALA. L. REV. 61, 67 (2009).

102. See Advisory, Stewart D. Aaron et al, Arnold & Porter LLP, US Supreme Court Limits Extraterritorial Reach of the US Securities Laws; Congress Acts (July 2010), http://www.arnoldporter.com/resources/documents/Advisory-US_Supreme_Court_Limits_Extraterritorial_Reach_of_the_US_Securities_Laws_062810.pdf (noting that “because Section 10(b) is also utilized by the SEC as an anti-fraud enforcement mechanism, the Opinion raises significant questions as to the SEC’s authority to pursue companies under Section 10(b) that are not registered on US exchanges”).

103. See Sawicki & Chatham, *supra* note 59 (“*Morrison* does not limit its holding to private plaintiffs. It makes no distinction as to the limits imposed in this context on private plaintiffs and on the SEC.”). Cf. *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2895 n.12 (2010) (Stevens, J., concurring) (stating that the opinion does not affect the SEC’s enforcement power).

104. See Luke Green, *Morrison v. National Australia Bank – The Dawn of a New Age?*, ISS:SEC. LITIG. (June 25, 2010, 5:54 PM), <http://blog.issgovernance.com/slw/2010/06/morrison-v-national-australia-bank---the-dawn-of-a-new-age.html> (“The opinion does not carve out an exception for the extraterritorial reach of SEC . . . actions. Thus, it could be construed to place the same limitations on these agencies as it does on private claimants.”). The SEC, in its amicus brief, urged the Supreme Court to adopt separate tests of extraterritoriality for private plaintiffs and SEC enforcement actions. This request was denied. See Sarah S. Gold & Richard L. Spinogatti, *Applicability to SEC of Private Action Requirements in § 10(b) Cases*, N.Y. L.J., Aug. 11, 2010, at 3.

105. *Morrison*, 130 S. Ct. at 2894 n.12 (Stevens, J., concurring) (“The Court’s opinion does not, however, foreclose the [SEC] from bringing enforcement actions in additional circumstances, as no issue concerning the [SEC’s] authority is presented by this case.”).

106. See Allens Arthur Robinson, *Focus: US Courts’ Extraterritorial Reach in Securities Fraud Cases Reinstated* (Aug. 5, 2010), <http://www.aar.com.au/pubs/ldr/focsraug10.htm> (stating that the transactional test “applie[s] equally to the enforcement activities of the SEC . . . under the Exchange Act”); Farris, *supra* note 57 (suggesting that the decision in *Morrison* “may subject SEC . . . enforcement actions to the Court’s new extraterritoriality test”); Nicholas I. Porritt,

In response to this concern, Congress directly addressed the issue in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or Dodd-Frank).¹⁰⁷ Section 929P(b) of the Dodd-Frank Act¹⁰⁸ amends the Exchange Act to expressly provide extraterritorial jurisdiction for SEC actions under § 10(b), using a modified conduct and effects test.¹⁰⁹ Specifically, it extends U.S. jurisdiction to SEC enforcement actions where there was “(1) 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 (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.”¹¹⁰ While Congress did not interfere with *Morrison* as it applies to private actions, it did acknowledge the importance of the issue by instructing the SEC to solicit public comments and conduct a study¹¹¹ as to whether extraterritorial jurisdiction should be extended to private actions under § 10(b).¹¹²

Supreme Court Observations: Scalia Opinion Rejects “F-Cubed” Securities Suits in Morrison, THE LEGAL PULSE (June 24, 2010), <http://wfllegalpulse.com/2010/06/24/ihigh-court-rejects-f-cubed-suits-in-morrison/> (noting that “the inapplicability of Section 10(b), the primary anti-fraud provision in the Act, is a severe loss to the [SEC] with regard to international fraud”); Gold & Spinogatti, *supra* note 104 (“In light of the Court’s rationale and its holding . . . it is difficult to see how the SEC would not [be] subject to the Morrison analysis.”).

107. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S.C.).

108. Dodd-Frank Act § 929P(b), 124 Stat. 1862 (codified at 15 U.S.C. § 78aa).

109. See Aaron et al, *supra* note 102 (noting that in the Dodd-Frank Act, “Congress provides for U.S. jurisdiction over extraterritorial actions brought by the SEC . . . under the anti-fraud provisions of the US securities laws by codifying a variant of the ‘conduct’ and ‘effects’ test”); Daniel Zinn, *Commentary: “Foreign-Cubed” Redux*, TRADERS MAGAZINE ONLINE NEWS (Sept. 22, 2010), <http://www.tradersmagazine.com/news/sec-foreign-cubed-106356-1.html> (“The [Dodd-Frank] Act directly reverses the Morrison decision as it pertains to regulatory actions brought by the SEC.”); Gold & Spinogatti, *supra* note 104 (“Section 929P of Dodd-Frank specifically amends . . . the Exchange Act to provide extraterritorial jurisdiction for SEC . . . actions under the antifraud provisions of the Exchange Act, thus resolving any uncertainties following Morrison about its applicability to SEC enforcement actions.”).

110. Dodd-Frank Act § 929P(b), 124 Stat. 1862 (codified at 15 U.S.C. § 78aa).

111. The study will analyze:

- the scope of such a private remedy, including whether it should extend to all private actors or should be limited to institutional investors or otherwise;
- the implications such a right of action would have on international comity;
- the economic costs and benefits of extending a private right of action for transnational securities frauds; and
- whether a narrow extraterritorial standard is called for.

BNA Sec. Law Daily, *SEC Seeks Comments on Extension of Private Actions to Global Securities Fraud* (Oct. 27, 2010).

112. This directive is contained in § 929Y of the Dodd-Frank Act and instructs the SEC to report back to Congress with the results of the study within eighteen months after enactment. See Luke Green, *Dodd-Frank: Whistleblowers, Clawbacks, and Morrison Developments*, ISS:SEC.

Unfortunately, the situation is further complicated by the belief that the Dodd-Frank provision, extending extraterritorial jurisdiction to SEC enforcement actions, was incorrectly drafted, and is therefore, ineffective.¹¹³ Specifically, it has been noted that “[t]he provision unambiguously addresses only the ‘jurisdiction’ of the ‘district courts of the United States’ to hear cases involving extraterritorial elements; its language does not expand the geographic scope of any substantive regulatory provision.”¹¹⁴ In other words, this perceived error in the provision hinges on the Supreme Court’s declaration that the extraterritorial application of securities laws is not an issue of subject matter jurisdiction.¹¹⁵ Congress may have erroneously addressed the power of the federal courts to hear a case, rather than the scope of the antifraud provisions of the Exchange Act.¹¹⁶ As a result, not only have American investors lost a private right of action under U.S. antifraud provisions when they invest abroad, but they may have lost the enforcement protection of the SEC in such situations as well.¹¹⁷

LITIG. (Nov. 2, 2010, 12:18 PM), <http://blog.issgovernance.com/slw/2010/11/dodd-frank-whistleblowers-clawbacks-and-morrison-developments.html>.

113. The notion that the provision was ineffective was brought to light by George T. Conway III of Wachtell, Lipton, Rosen & Katz who represented NAB in the *Morrison* litigation. See George T. Conway III, *Extraterritoriality After Dodd-Frank*, HARV. LAW SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Aug. 5, 2010, 8:58 AM), <http://blogs.law.harvard.edu/corpgov/2010/08/05/extraterritoriality-after-dodd-frank>. See also Kevin LaCroix, *Morrison Precludes F-Squared Cases, Too, Court Concludes*, THE D & O DIARY (July 28, 2010), <http://www.dandodiary.com/2010/07/articles/securities-litigation/morrison-precludes-fsquared-cases-too-court-concludes>.

114. See Conway, *supra* note 113; Stephen R. Smerek & Jason C. Hamilton, BNA World Sec. Law Report, *The Extraterritorial Reach of U.S. Securities Law After the Morrison Decision and the Dodd-Frank Act* (Oct. 12, 2010) (“[T]he Dodd-Frank Act did not amend the statutory text upon which the Supreme Court based its new ‘transactional test’ for the extraterritorial application of §10(b). Accordingly, an argument exists that the Dodd-Frank Act does nothing to augment the substantive scope of the Securities Exchange Act or overturn the Supreme Court’s decision in *Morrison*.”).

115. See Genevieve Beyea, *Morrison v. National Australia Bank and the Future of Extraterritorial Application of the U.S. Securities Laws*, 72 OHIO ST. L.J. 537, 570–71 (2011). See also Conway, *supra* note 113 (“In [*Morrison*], the Supreme Court reiterated the longstanding principle that the territorial scope of a federal law does not present a question of ‘jurisdiction,’ of a ‘tribunal’s power to hear a case,’ but rather a question of substance—of ‘what conduct’ does the law ‘prohibit’? The new law does not address that issue, and accordingly does not expand the territorial scope of the government’s enforcement powers at all.”).

116. See Beyea, *supra* note 115, at 571 (“While Congress’s intent in including this language was clearly to preserve the conduct and effects tests, the language of the Act as drafted does not actually do so.”).

117. *Id.* at 571–72 (“[T]he Dodd-Frank Act may not have any effect on the application of Section 10(b), depending on the willingness of courts to overlook the plain language of the statute, even if this language is the result of a simple drafting error.”); Richard Painter, Douglas Dunham & Ellen Quackenbos, *When Courts and Congress Don’t Say What They Mean: Initial Reactions to Morrison v. National Australia Bank and to the Extraterritorial Jurisdiction Provisions of the Dodd-Frank Act*, 20 MINN. J. INTL. L. 1, 19 (2011) (“[T]he SEC still might not fare well before some lower court judges who do not care about the intent of Congress when Congress fails to clearly express that intent. If the Dodd-Frank Act . . . only speaks to jurisdiction, some courts may

D. THE FUTURE FOR AMERICANS INVESTING OVERSEAS

By limiting the extraterritorial application of U.S. securities laws, “the Court narrows the provision’s reach to a degree that would surprise and alarm generations of American investors—and . . . the Congress that passed the Exchange Act.”¹¹⁸ Domestic investors who purchase and sell securities traded only on foreign exchanges are no longer able to invoke U.S. securities laws if they suffer losses due to securities fraud.¹¹⁹ This is not insignificant, as 12.4% of securities class actions filed in the United States in 2009 were against foreign issuers.¹²⁰ These investors, and many before them, relied on the robust nature of U.S. securities laws and court procedures to protect themselves while investing in the transnational marketplace.¹²¹ Going forward, however, domestic investors must consider alternative ways to seek redress for losses caused by securities fraud. Currently, because of *Morrison*, Americans invested overseas have no choice but to seek a remedy under the laws and procedures of the foreign countries in which their securities were purchased.¹²² Commencing a securities fraud action abroad is easier said than done, however, as “most [foreign countries] do not have a class action framework and may not have a developed body of securities law” comparable to that of the United States.¹²³ The next section of this note will examine some of the securities class action procedures in other countries, how they compare to those in the

not be willing to read into the provision what Congress clearly intended: to empower the SEC to bring cases where the conduct was that described in the statute.”)

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

119. See Sawicki & Chatham, *supra* note 59 (“Domestic investors who purchase securities of a foreign issuer on a foreign exchange will no longer enjoy the ability to resort to the U.S. courts and legal remedies in the event that they sustain any loss due to securities fraud.”).

120. In 2008, 13.5% of securities class actions filed in the United States were against foreign issuers, and in 2007, 16.4% of securities class actions filed in the United States were against foreign issuers. *Securities Class Action Filings—2009: A Year in Review*, *supra* note 58, at 11.

121. Kevin M. LaCroix, *Further Implications of Morrison v. National Bank and the Prohibition Against Pursuing Fraud Claims for Securities Purchased on Foreign Exchanges*, CORP. & SEC. L. BLOG (June 28, 2010, 5:00 PM), <http://www.lexisnexis.com/Community/corpsec/blogs/corporateandsecuritieslawblog/archive/2010/06/28/further-implications-of-morrison-v-national-bank-and-the-prohibition-against-pursuing-fraud-claims-for-securities-purchased-on-foreign-exchanges.aspx> (“As the filing levels . . . demonstrate, these investors increasingly had come to rely on the U.S. processes and remedies as a way to seek redress when they felt they had been misled.”); Adam T. Savett, *Globalization in Securities Class Actions: Part 1—Non-US Investor Interest in US Suits*, RISKMETRICS GRP. 4 (Dec. 2008) (“[T]he most robust system for investors seeking recoveries through securities litigation remains here in the US.”).

122. See Sawicki & Chatham, *supra* note 59 (“[I]nvestors are now left to seek redress in a foreign country, under the laws of the issuer’s country and possibly the laws governing the foreign exchange on which the shares are traded.”).

123. Robert Cox, Andrew Lazerow & Tonya Gaskins, *The Supreme Court Slams the Door to U.S. Courts for F-Cubed Litigation*, THE DEFENDER (Summer 2010), http://thedefender.howrey.com/files/FileControl/281c9044-ef01-4294-a524-ae6fc4a12a0e/7483b893-e478-44a4-8fed-f49aa917d8cf/Presentation/File/Defender_072210_final.pdf. See also Choi & Silberman, *supra* note 5, at 484 (stating that few other countries have a class action mechanism as robust as that found in the United States).

United States, and whether, because of *Morrison*, American investors are left without adequate protection against foreign corporate fraud.

III. SEEKING REDRESS FOR SECURITIES FRAUD OVERSEAS

Class actions,¹²⁴ such as the one brought in *Morrison*, overcome collective action problems in situations where many individuals or entities are injured by the conduct of another by “providing an effective and inexpensive procedure for joining large numbers of individual plaintiffs.”¹²⁵ Class actions provide access to justice,¹²⁶ and have “enormous potential to deter institutional and corporate wrongdoing and to shift the balance of power” between individual plaintiffs and powerful corporations.¹²⁷ While class actions are commonplace in the United States, several countries do not have any kind of group litigation procedure.¹²⁸ Without such an option, small injuries to many individual investors go unremedied since the injured are unlikely to be able to incur the cost of litigation alone.¹²⁹ As such, the presence of some type of claim aggregation procedure is thought to be vital to the rights of investors.¹³⁰ While it is true that several countries have adopted some form of group litigation procedure,¹³¹ many of these countries advance various measures, not found in the United States, that present

124. A class action is a civil lawsuit brought by a private actor on behalf of a large number of similarly situated, but absent, parties. Deborah R. Hensler, *The Globalization of Class Actions: An Overview*, in *THE GLOBALIZATION OF CLASS ACTIONS*, 622 ANNALS AM. ACAD. POL. & SOC. SCI. 7, 13 (Deborah Hensler, Christopher Hodges & Magdalena Tulibacka eds. 2009).

125. MELVIN ARON EISENBERG, *CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS* 914–15 (2005) (explaining that class actions overcome the difficulties caused by bringing litigants together using traditional joinder and intervention procedures, which are costly and organizationally difficult). *See also* Yves Heijmans, *Class Actions in Belgium and Europe*, 24 No.3 ACC DOCKET 117 (Mar. 2006) (“Class actions are seen as an effective way to facilitate damages actions by spreading the costs and risks of individual litigation. This can be particularly useful when a large number of persons have suffered a small individual loss.”); Advisory Committee’s Notes to Rule 23 Amendments, 39 F.R.D. 69, 102–03 (1966) (noting that class actions may “achieve economies of time, effort, and expense, and promote uniformity of decision as to persons similarly situated”).

126. RACHAEL MULHERON, *THE CLASS ACTION IN COMMON LAW LEGAL SYSTEMS: A COMPARITIVE PERSPECTIVE* 52–54 (2004) (noting that class actions provide “substantive law with teeth,” allow injured parties to overcome cost-related barriers, and balance an adversarial structure where defendants usually enjoy the upper hand in small scale individual litigation).

127. Hensler, *supra* note 124, at 9.

128. *See* Cox, Lazerow & Gaskins, *supra* note 123.

129. *See* EISENBERG, *supra* note 125, at 915.

130. In the forum non conveniens context, some courts have held that lack of both claim aggregation and opt-out procedures “do not afford a meaningful remedy to class action plaintiffs” and have rendered such jurisdictions inadequate to hear a claim. *See* Buxbaum, *supra* note 2, at 37.

131. Countries that have some sort of representative class action mechanism include “Australia, Canada, Denmark, Finland, France, Germany, Israel, Italy, the Netherlands, Norway, Portugal, South Korea, Spain, Sweden[,] and United Kingdom (England and Wales).” John J. Clarke, Jr. & Keara M. Gordon, *Global Realm of Securities Class Actions*, N.Y. L.J., May 19, 2008, at S4.

significant obstacles to plaintiffs pursuing a group action for securities fraud.¹³²

A. LITIGATION FUNDING MEASURES

One of the major obstacles to bringing litigation abroad is the way litigation is commonly funded outside the United States. Contingency fee agreements are permitted in the United States, whereby plaintiffs' attorneys fund litigation and then receive a percentage of any class settlement or judgment.¹³³ If the plaintiff class is unsuccessful, however, class counsel gets nothing and absorbs the litigation expenses.¹³⁴ Thus, contingency agreements shift the entire financial risk of class action litigation from the class to class counsel.¹³⁵ As a result, lawyers are incentivized to vigorously pursue meritorious class actions since nothing will be recovered if the litigation is unsuccessful.¹³⁶ Countries that prohibit contingency fees—including Australia,¹³⁷ England,¹³⁸ Germany,¹³⁹ India,¹⁴⁰ Japan,¹⁴¹ and the

132. See *infra* Part III.A–D.

133. See MULHERON, *supra* note 126, at 469.

134. See Hensler, *supra* note 124, at 23.

135. See MULHERON, *supra* note 126, at 468.

136. See Wallace Wen-Yeu Wang & Chen Jian-Lin, *Reforming China's Securities Civil Actions: Lessons from PSLRA Reform in the U.S. and Government-Sanctioned Non-Profit Enforcement in Taiwan*, 21 COLUM. J. ASIAN L. 115, 134 (2008) ("Contingency fees provide incentives for lawyers to organize and pursue class actions, and indeed, in the U.S., class actions are often lawyer-initiated and lawyer-driven."); Mike Myers, *Benefits of the Contingent-Fee Agreement*, CONTINGENT FEE BUS. LITIG. BLOG (Aug. 5, 2008, 11:13 AM), <http://www.contingentfeeblog.com/2008/08/articles/contingent-fee-representation/benefits-of-the-contingentfee-agreement/>.

137. Clarke & Gordon, *supra* note 131 (noting that contingent fee agreements are prohibited in Australia but 'no win, no fee' arrangements are permitted). In a "no win, no fee" or "conditional fee" arrangement, if successful, plaintiffs' counsel receives "a time-based rate, increased by a multiplication factor" or uplift that is "typically not tied to a percentage of the award[]." Mallesons Stephen Jaques, *Corporate Class Actions in Australia* (June 2006), <http://www.mallesons.com/publications/2006/Jun/8472865W.htm>; Stefano M. Grace, *Strengthening Investor Confidence in Europe: U.S. - Style Securities Class Actions and the Acquis Communautaire*, 15 J. TRANSNAT'L L. & POL'Y 281, 287 (2006). The "no win, no fee" arrangement, however, decreases the incentive for lawyers to bring class actions. See Hensler, *supra* note 124, at 24. Additionally, a litigation funding system has emerged in Australia where a company may enter an agreement with a plaintiff to fund the litigation in return for an agreed upon percentage of any received award. The company then has "broad discretion to conduct the litigation as [it] see[s] fit." S. Stuart Clark, *Thinking Locally, Swing Globally: The International Frontiers of Mass Tort Litigation in Australia*, 74 DEF. COUNSEL J. 139, 141 (2007).

138. See Clarke & Gordon, *supra* note 131. England, however, does permit "conditional fee" arrangements. Heather Smith, *Is America Exporting Class Actions to Europe?*, THE AMERICAN LAWYER (Feb. 28, 2006), <http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1141047298349>.

139. See Grace, *supra* note 137, at 300.

140. See V. Umakanth, *Shareholder Activism and Class Action Lawsuits*, INDIAN CORP. LAW BLOG (June 1, 2009, 7:41 AM), <http://indiacorplaw.blogspot.com/2009/06/shareholder-activism-and-class-action.html>.

141. See Mark A. Behrens, Gregory L. Fowler & Silvia Kim, *Global Litigation Trends*, 17 MICH. ST. J. INT'L L. 165, 185 (2008–2009). Japan does "permit a success fee, allowing plaintiffs'

Netherlands¹⁴²—essentially prevent access to justice for claimants who are unable to afford attorneys’ fees and other litigation costs up front.¹⁴³

Additionally, in the United States, regardless of the outcome, each party is responsible for paying its own litigation fees and expenses.¹⁴⁴ This is significant, as the class representative is protected from the financial risk of having to pay the defendant’s costs in the event of a loss.¹⁴⁵ The “American rule,” as it is known,¹⁴⁶ is “considered an important measure in removing the barriers to class proceedings.”¹⁴⁷ In contrast, under the “English rule” of fee shifting, the losing party pays the costs of the prevailing party.¹⁴⁸ The “loser pays” rule is a significant disincentive to bringing class action litigation due to the high risk for the representative plaintiff of liability for all of the defendant’s costs if the defendant prevails.¹⁴⁹ A number of countries—including Argentina,¹⁵⁰ Australia,¹⁵¹ Canada,¹⁵² China,¹⁵³ England,¹⁵⁴ Germany,¹⁵⁵ the Netherlands,¹⁵⁶ and Sweden¹⁵⁷—utilize the “English rule” of fee shifting, where “large cost awards against unsuccessful plaintiffs . . . have a chilling effect and [are] likely [to] discourage meritorious class actions.”¹⁵⁸

The absence of contingency fee agreements and the risks associated with “loser pays” rules deter the initiation of class actions, as representative plaintiffs are unlikely to emerge to represent a class if they must bear the entire cost of litigation and risk having to pay the costs of the defendant.¹⁵⁹ Maintenance of legal funding rules such as these “do[es] not . . . accommodate the realities of representative litigation”¹⁶⁰ and presents a

attorneys to be paid a customary hourly rate, regardless of the outcome, as well as an additional payment if the client wins.” *Id.*

142. See Grace, *supra* note 137, at 296.

143. *Id.* at 288.

144. Hensler, *supra* note 124, at 22.

145. MULHERON, *supra* note 126, at 436.

146. *Id.* at 436 n.3.

147. *Id.* at 436 (internal quotations omitted).

148. See MULHERON, *supra* note 126, at 436–37.

149. See Grace, *supra* note 137, at 290.

150. See Héctor A. Mairal, *Argentina*, in THE GLOBALIZATION OF CLASS ACTIONS, 622 ANNALS AM. ACAD. POL. & SOC. SCI. 54, 55 (2009). In exceptional cases, however, the court may order each party to pay their own legal fees if “the controversy [is] sufficiently complex to justify the decision of the loser to litigate.” *Id.*

151. See Clark, *supra* note 137, at 148.

152. See Jasminka Kalajdzic, *Canada*, in THE GLOBALIZATION OF CLASS ACTIONS, 622 ANNALS AM. ACAD. POL. & SOC. SCI. 41, 45 (2009).

153. Wang & Jian-Lin, *supra* note 136, at 128.

154. See Clarke & Gordon, *supra* note 131.

155. See Grace, *supra* note 137, at 300.

156. See *id.* at 296.

157. See *id.* at 295.

158. Kalajdzic, *supra* note 152, at 45.

159. Hensler, *supra* note 124, at 23.

160. *Id.* at 7.

significant obstacle to injured parties pursuing private enforcement in many foreign countries.¹⁶¹

B. OPT-OUT VERSUS OPT-IN PROCEDURES

Another mechanism which may hamper the ability of investors to recover for securities fraud involves the procedure by which investors become part of a class action. Under the opt-out class action regime, which is found in the United States, class members are automatically part of the class, unless they specifically exclude themselves from the litigation within a certain timeframe.¹⁶² If a class member does not opt-out, he is bound by the outcome of the case and shares in any settlement or award.¹⁶³ An opt-out provision is beneficial to investors for a number of reasons: (1) it avoids the possibility of a class member effectively losing his rights simply because he forgot to affirmatively request class membership; (2) it “enhances access to legal remedies for those who are disadvantaged . . . [and] would be unable for one reason or another to take the positive step of including themselves in the proceedings”; and (3) it ensures that defendants are held liable for all losses, rather than avoiding responsibility because some injured investors failed to opt-in to the class.¹⁶⁴ The opt-out procedure ultimately guarantees the inclusion of individuals who might be unable to bring their own action due to cost or lack of resources.¹⁶⁵

The opt-in procedure, on the other hand, requires that those, who wish to be part of an investor class action, take steps to include themselves in the litigation.¹⁶⁶ As such, only claimants who affirmatively opt-in are class members who will share in any award or settlement.¹⁶⁷ In countries such as China,¹⁶⁸ England,¹⁶⁹ Germany,¹⁷⁰ and Sweden,¹⁷¹ which utilize the opt-in

161. Grace, *supra* note 137, at 287–90. An additional type of funding has emerged, known as “no win/no pay” or a “conditional fee,” in which attorneys will fund litigation but the attorneys’ fees “may *not* be a percentage of damages obtained.” Attorneys may only recover their hourly charges and expenses plus a limited premium (or “up-lift”). Hensler, *supra* note 124, at 22; Grace, *supra* note 137, at 287.

162. MULHERON, *supra* note 126, at 34 (explaining that the opt-out model binds people “as members of the class unless they take an affirmative step to indicate that they wish to be excluded from the action and from the effect of the judgment” and “allows a class action to be commenced by the representative plaintiff without . . . the express consent of the class members”).

163. Hensler, *supra* note 124, at 15. Those that do opt-out of the litigation exclude themselves from any class settlement or award and may bring an individual claim against the defendant. *Id.*

164. MULHERON, *supra* note 126, at 35–38. The opt-out procedure also promotes the interests of economy, consistency, and finality by avoiding multiple cases, avoiding different outcomes, and resolving all similar claims against the defendant. *See* Grace, *supra* note 137, at 289.

165. Wang & Jian-Lin, *supra* note 136, at 133.

166. Hensler, *supra* note 124, at 15–16.

167. *Id.* at 16.

168. *See* Wang & Jian-Lin, *supra* note 136, at 129–30.

169. *See* Behrens, Fowler & Kim, *supra* note 141, at 175.

170. *See* Grace, *supra* note 137, at 299.

171. *See id.* at 294–95.

procedure, potential claimants are at risk of losing the benefits of participating in a class action if they are unaware of the class proceeding or are otherwise unable to opt-in.¹⁷²

C. THE FRAUD ON THE MARKET THEORY

The securities laws in other countries, and especially the requirements related to proving the elements of securities fraud, may also prove challenging for U.S. investors bringing suit abroad. The United States has adopted the fraud on the market theory, whereby in securities fraud actions, a plaintiff is presumed to have relied on the defendant's material misstatements by trading in the defendant's stock in an efficient market at a price which reflected the defendant's fraud.¹⁷³ In other words, in securities class actions in the United States, individual proof of reliance on the defendant's fraudulent statements is not required.¹⁷⁴ In contrast to the United States, "most jurisdictions have not adopted the fraud-on-the-market doctrine,"¹⁷⁵ including, Australia,¹⁷⁶ England,¹⁷⁷ France,¹⁷⁸ Germany,¹⁷⁹ New Zealand,¹⁸⁰ and Singapore.¹⁸¹ Thus, in securities class actions in these and other countries, each plaintiff must individually prove reliance on the defendant's misstatements, which, in a class action, is nearly impossible

172. Hensler, *supra* note 124, at 16.

173. See *Basic Inc. v. Levinson*, 485 U.S. 223, 247 (1988) ("[A]n investor [in U.S. markets] who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material representations, therefore, may be presumed for purposes of a Rule 10b-5 action.").

174. Buxbaum, *supra* note 2, at 36.

175. See Brief of *Amici Curiae* of Professors and Students of the Yale Law School Capital Markets and Financial Instruments Clinic in Support of Respondents, *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869 (2010) (No. 08-1191), 2010 WL 748251 at *4.

176. See Eilis Ferran, *Are US-Style Investor Suits Coming to the U.K.?*, 9 J. CORP. L. STUD. 315, 336 (Oct. 2009) (noting that the "[f]raud on the market theory has not been adopted in Australia"); Clarke & Gordon, *supra* note 131 (noting that in Australia, "the availability of the 'fraud on the market' presumption of reliance remains an open question").

177. See Ferran, *supra* note 176, at 327 (noting that the fraud on the market presumption of reliance, developed in the United States, has not been adopted in the U.K.).

178. See Hubert de Vauplane & Odile Simart, *The Concept of Securities Manipulation and its Foundations in France and the USA*, 23 BROOKLYN J. INT'L L. 203, 218 (1997) (noting that the fraud on the market doctrine has not been incorporated in France).

179. See Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AM. J. COMP. L. 31, 71 n.89 (2005) (commenting that individual reliance must be shown under German securities law, in contrast to the fraud on the market theory in the United States).

180. See *Boyd Knight v. Purdue*, [1999] 2 NZLR 278, Lexis 406, at 42-43 (CA Wellington) (rejecting the fraud on the market theory as contrary to the purpose of the New Zealand Securities Act of 1978).

181. See Hans Tjio, *Enforcing Corporate Disclosure*, 2009 SING. J. LEGAL STUD. 332, 349 (2009) (noting that, like the U.K., Singapore has not adopted the fraud on the market theory).

due to high costs and inherent collective action problems.¹⁸² The lack of recognition of the fraud on the market theory is an additional significant hurdle which severely limits the opportunity for recovery by plaintiffs in securities class actions abroad.¹⁸³

D. OTHER LIMITATIONS

In addition to the aforementioned limitations, individual countries may also maintain various procedures and rules, which further restrict the successful implementation of securities class actions. For example, in order to bring a civil action in China, it must be based on an existing administrative sanction or criminal judgment against the defendant.¹⁸⁴ As a result, if no action has been taken against a defendant by a governmental body, claimants have no recourse.¹⁸⁵ In securities class actions in Israel, investors must “convince the judge that they have a likelihood of prevailing” in order to proceed.¹⁸⁶ This provision gives judges significant power in deciding whether a securities class action moves forward.¹⁸⁷ In South Korea, securities class actions are only permitted by a minimum of fifty class members who collectively own at least .01 percent of the defendant’s equity.¹⁸⁸ This minimum shareholding requirement “undercuts . . . class action law” by imposing a considerable barrier to securities class actions against the largest companies.¹⁸⁹ Finally, in Ontario, where most Canadian securities class actions are brought,¹⁹⁰ damages in securities class actions are capped at the greater of \$1 million or 5 percent of the market capitalization of the issuer.¹⁹¹ Damage caps are a setback for plaintiffs who have suffered far greater damages than what is recoverable and will likely

182. See Buxbaum, *supra* note 2, at 44 (commenting that requiring individual proof by each plaintiff in a class action “would be procedurally impossible”); Tjio, *supra* note 181, at 349 (“[I]nvestor actions against issuers are severely hampered by the lack of a fraud on the market theory, which militates against any actions by most investors due to the costs of securities litigation and collective action problems.”).

183. See Buxbaum, *supra* note 2, at 36–37.

184. See Wang & Jian-Lin, *supra* note 136, at 124–25.

185. See *id.* at 125 (explaining that investors cannot bring a cause of action if there is no administrative sanction or criminal judgment against the defendant, “even if regulatory authorities or prosecutors have detected securities fraud but, out of policy considerations, have chosen not to take action”).

186. Gary L. Gassman & Perry S. Granof, *Global Issues Affecting Securities Claims at the Beginning of the Twenty-First Century*, 43 TORT TRIAL & INS. PRAC. L.J. 85, 101 (Fall 2007) (internal quotations omitted).

187. *Id.*

188. *Id.* at 103.

189. Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465, 1522 (Oct. 2004). For example, the Korean company, Samsung, has a market capitalization of \$39.1 billion. In order for claimants to bring a securities class action against Samsung, they would have to collectively own \$3.91 million in equity, which would be extremely difficult to meet. *Id.*

190. Gassman & Granof, *supra* note 186, at 88.

191. Clarke & Gordon, *supra* note 131.

deter American investors from commencing securities class actions Canada.¹⁹²

These various mechanisms—in addition to the prohibitions on contingency fees, prevalence of “loser pays” rules, opt-in procedures, and non-recognition of the fraud on the market theory—serve as barriers to securities class action litigation abroad,¹⁹³ making investor suits impractical and relatively rare outside of the United States.¹⁹⁴ After *Morrison*, since Americans investing overseas have no choice but to turn to these “toothless investor protection schemes abroad,” such investors are significantly disadvantaged and lack sufficient protection from foreign corporate fraud.¹⁹⁵

IV. CONGRESS SHOULD LEGISLATE TO MITIGATE THE EFFECTS OF *MORRISON*

Congress should legislate to mitigate the harmful effects of *Morrison* and restore the applicability of the antifraud provisions to Americans investing outside the United States. Doing so would be consistent with the purpose and intent of the Exchange Act¹⁹⁶ and serve the interests of increased global market integrity and investor confidence.¹⁹⁷

The Congress of the 1930s could not have anticipated the extent to which securities markets, business transactions, and national economies would become globally interconnected.¹⁹⁸ Therefore, the fact that Congress did not explicitly address the issue of the extraterritorial application of § 10(b) is not unreasonable. Despite the lack of an explicit jurisdictional statement, some scholars share the view that Congress “expected U.S. securities laws to apply to certain international transactions or conduct.”¹⁹⁹ Additionally, the antifraud provisions are recognized as being somewhat

192. Emily C. Cole, *Recent Developments in Canadian Securities Class-Action Law*, 20:4 A.B.A. SEC. LITIG. J. 13, 16 (2010), available at http://www.millerthomson.com/assets/files/article_attachments/Emily_C_Cole_Recent_Developments_in_Canadian_Securities_Class-Action_Law.pdf.

193. See Shelley Thompson, *The Globalization of Securities Markets: Effects on Investor Protection*, 41 INT'L LAW 1121, 1143–44 (2007).

194. See *id.* at 1121.

195. See *id.* at 1129 (stating that outside the United States, “it is nearly impossible for investors to seek redress for losses caused by fraud”).

196. See *United States v. O’Hagan*, 521 U.S. 642, 657–59 (1997).

197. See Thompson, *supra* note 193, at 1144 (arguing that increased investor protection is necessary due to the globalization of securities markets).

198. Kahn, *supra* note 1, at 369–70 (noting that it is unsurprising that Congress did not provide for the extraterritorial application of § 10(b) because “the Congress that enacted the securities laws could not have anticipated the future globalization of the American economy”).

199. Buxbaum, *supra* note 2, at 19. See also *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1336 (2d Cir. 1972) (detailing evidence that Congress “meant § 10(b) to protect against fraud in the sale or purchase of securities whether or not these were traded on organized United States markets”).

obscure,²⁰⁰ to the point that the Supreme Court itself has stated that there is “judicial authority to shape . . . the 10b-5 cause of action.”²⁰¹ It is with these considerations in mind, that the Second Circuit sought to understand what Congress would have wanted with respect to the extraterritorial application of securities laws, given today’s transnational marketplace.²⁰² Looking to the congressional history of the Exchange Act, protection of American investors is the focus of § 10(b).²⁰³ The intent behind § 10(b) was “to remedy deceptive and manipulative conduct with the potential to harm the public interest or the interest of investors.”²⁰⁴ This goal of investor protection is clear in the congressional record: “[t]he 1934 Act was designed to protect investors against manipulation of stock prices.”²⁰⁵ This is a compelling justification for Congress to legislate to protect those American investors who are barred from U.S. courts by *Morrison*. For nearly forty years, the lower courts cited the abovementioned justifications in applying the “conduct” and/or “effects” tests to determine the extraterritorial reach of the antifraud provisions.²⁰⁶ In that time, Congress could have legislated to modify the approach outlined by the Second Circuit if it was overly broad or unfaithful to the purpose of the Exchange Act.²⁰⁷ Notably, Congress did not act.

The policy considerations underlying the Exchange Act—encouraging investor confidence and protecting the integrity of the securities markets²⁰⁸—require the extension of U.S. securities laws to fraudulent conduct affecting American investors in the global securities market.²⁰⁹

200. *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2888 (2010) (Stevens, J., concurring) (“The text and history of § 10(b) are famously opaque on the question of when, exactly, transnational securities frauds fall within the statute’s compass.”).

201. *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 508 U.S. 286, 293 (1993).

202. *See Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 (2d. Cir. 1975) (stating that when “a court is confronted with transactions that . . . are predominantly foreign, it must seek to determine whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to them rather than leave the problem to foreign countries”).

203. *See Morrison*, 130 S. Ct. at 2894 (Stevens, J., concurring) (“[I]t is the ‘public interest’ and ‘the interests of investors’” that are the focus of the Exchange Act.) (citing H.R. Rep. No. 1838, 73d Cong., 2d Sess., 32-33 (1934)); S. Rep. No. 1455, 73d Cong., 2d Sess., 68 (1934) (“The Securities Exchange Act of 1934 aims to protect the interests of the public against the predatory operations of directors, officers, and principal stockholders of corporations.”).

204. *Eur. & Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 125 (2d. Cir. 1998) (citing H.R. Rep. No. 1838, 73d Cong., 2d Sess., 32-33 (1934)).

205. *Basic Inc. v. Levinson*, 485 U.S. 224, 230 (citing S. Rep. No. 792, 73d Cong., 2d Sess., 1-5 (1934)).

206. *See Morrison*, 130 S. Ct. at 2888 (Stevens, J., concurring) (noting that the approach used by the Second Circuit has been the law “for nearly four decades”).

207. *See id.* at 2891 (“The longstanding acceptance by the courts, coupled with Congress’ failure to reject [its] reasonable interpretation of the wording of § 10(b) . . . argues significantly in favor of acceptance of the [Second Circuit] rule by this Court.”) (internal citations omitted).

208. *See U.S. v. O’Hagan*, 521 U.S. 642, 657-59 (1997).

209. *See Thompson*, *supra* note 193, at 1127 (“Globalization of the securities markets . . . means that one act of securities fraud will cause investor losses around the globe. Therefore,

Without the availability of “the most comprehensive securities regulation scheme in the world”²¹⁰ to adequately deter and compensate for foreign corporate misconduct, Americans will be reluctant to invest, leading to instability in U.S. markets and further adverse effects on investor confidence.²¹¹

In order to adequately safeguard American investors and markets and provide a remedy for fraudulent conduct occurring abroad, in conformity with the purpose and intent of the Exchange Act, I propose that Congress legislate on the issue and adopt a modified “effects” test in conjunction with a “reasonability” inquiry. Such an approach will return robust investor protection measures to Americans investing in securities abroad, balance issues of international comity and fairness, and hopefully spur the development of stronger investor protections and complementary group litigation procedures overseas.

Under the first part of my suggested approach, the modified effects test, the reach of U.S. antifraud provisions is presumed to extend to any securities-related fraud which has an adverse effect on investors or related interests within the United States, no matter where the securities were purchased or where the fraudulent conduct actually occurred. Thus, any American investor who suffers a loss in a foreign-traded stock due to fraudulent conduct by a foreign issuer is presumptively protected by § 10(b), as is a holder of related securities, such as ADRs and options. A significant number of investors need not be affected in order for American plaintiffs to have a Rule 10b-5 cause of action under this part of the test, and neither would a minimum amount of losses be required. Nevertheless, similar to the “effects” test articulated by the Second Circuit, general claims of an adverse effect on American economic interests would be insufficient to meet this test, as they are too speculative.

The aforementioned presumption would be rebuttable, however, in the second part of my suggested approach, which is an inquiry as to the reasonableness of extending U.S. antifraud provisions to reach the specific situation in question.²¹² This analysis would take into account certain factors, such as the nationalities of the parties, the amount of losses suffered by the claimants, whether there is a private right of action for securities fraud in the issuer’s home country, whether there is a group litigation

securities fraud committed by multinational companies listing on international exchanges will impact the whole world’s capital markets, causing market instability on a global scale.”); Buxbaum, *supra* note 2, at 22 (explaining that countries have an interest in protecting their own citizens and markets from fraudulent activity occurring abroad).

210. See Thompson, *supra* note 193, at 1121 (stating that “the United States has the most comprehensive securities regulation scheme in the world”).

211. See *id.* at 1126 (“[T]he United States should strengthen investor protections, not weaken them leaving investors more vulnerable to risk and making U.S. financial markets less stable.”).

212. This “reasonability” inquiry is loosely based on section 403 of the Restatement (Third) of Foreign Relations. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 403 (1987).

mechanism in the issuer's home country, and whether the procedures related to bringing group litigation in the issuer's home country are prohibitive, to determine the reasonableness of extending U.S. securities laws to reach foreign issuers. Thus, it would likely be unreasonable to extend the reach of U.S. antifraud provisions to situations where the loss suffered by the plaintiffs is very small, the issuer's home country allows a private right of action for securities fraud, some type of group litigation procedure exists there, and the procedures are not overly discouraging of investor group actions. For example, if the issuer's home country was Canada, which permits class actions in Ontario, recognizes a private right of action to recover damages based on false or misleading statements in secondary market disclosures, allows contingency fees, presumes reliance once misrepresentation is established, and the losses to the American plaintiffs were relatively small, even though a "loser pays" system is utilized and there are caps on damages, it would likely be reasonable for the American plaintiffs to bring their action in Canada, and thus, the presumption of the application of U.S. antifraud provisions would be rebutted.

This combined approach mitigates the harmful effects of *Morrison* on Americans investing abroad and presumes that injured American investors have a Rule 10b-5 cause of action in the United States, unless the claimants are likely to be as successful in bringing a similar claim in the issuer's home country. Thus, American investors are sufficiently protected from fraudulent conduct regardless of where the securities are traded, and issues of international comity and fairness are taken into consideration as well. Under this approach, it is hoped that foreign jurisdictions, realizing that U.S. securities laws will control much of the time when Americans invest abroad, will be persuaded to take steps to strengthen their antifraud measures and ease barriers to litigation for investors with meritorious claims.

Nidhi M. Geevarghese*

*B.A., University of Rochester, 2006; J.D./M.B.A. candidate, Brooklyn Law School and Zicklin School of Business at Baruch College, 2013. Thanks to the members of the Brooklyn Journal of Corporate, Financial & Commercial Law, particularly Janine Stanisz and Amy Craiger. Special thanks to Professor Arthur Pinto for his advice and encouragement throughout law school and especially during the note-writing process. I would also like to thank my family and friends for their constant love and support.