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ASSIGNMENT FOR THE FIRST WEEK OF CLASS

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Section 10 of the Securities Exchange Act 1934. 3

Rule 10b-5. 3

Morrison v. National Australia Bank Ltd... 4

Notes and Questions. 11

Amicus brief for the Government. 15

In re Infineon Technologies AG Securities Litigation. 22

Ontario statute. 28

This semester we will be thinking about a number of issues relating to financial activity which crosses territorial boundaries. The global financial crisis of the last couple of years provides many illustrations of such activity: mortgage loans in the US were used as assets to back debt securities that were sold to investors in different parts of the world. Financial institutions which suffered financial troubles had an impact on different countries.[1] The G20, international financial institutions and domestic legislators and regulators have focused on how financial regulation should be changed in the wake of the crisis.[2] The Madoff fraud has generated numerous lawsuits against entities around the world.[3] In the wake of the global financial crisis, some commentators have noted the existence of reverse remittances (although there appears to be no real data

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[1] When Icelandic banks failed, customers outside Iceland who had deposited their money with those banks were surprised to learn that their money was not protected by the deposit protection schemes of the countries where they lived.

[2] We will read some material on this topic later.

[3] *See, e.g.*, Kevin LaCroix, It's a World, World, World, World Madoff, D&O Diary (Jun. 8, 2009) at http://www.dandodiary.com/2009/06/articles/madoff-litigation/its-a-world-world-world-world-madoff/.

to indicate the extent of this phenomenon.[4] Before the crisis, policy-makers had noted that there were significant flows of money across borders as immigrant workers in developed economies sent funds home to their families in less affluent economies.

Money and financial claims are transferred easily across territorial boundaries, but the rules which regulate these claims are mostly fixed in particular geographic locations. Financial firms need to be licensed to carry on business by the regulators in the jurisdictions in which they do business. Issuers of securities may choose to sell their securities in more than one jurisdiction, but if they do so they become subject to rules in force in the different jurisdictions in which they sell those securities.

Domestic policy-makers can deal with and affect transnational financial activity in a number of different ways. They can choose to subject foreign firms (such as securities issuers and financial institutions) to local rules even where those rules are different from those in force in the firms' home jurisdictions, they can apply rules to foreign firms which are different from those they apply to domestic firms (or disapply some rules), they can agree to a system of mutual recognition (where they agree with another jurisdiction or jurisdictions to treat each others' rules as equivalent) or they can decide to harmonize their own rules with those in force elsewhere (unilaterally, by agreement with other countries, or through processes such as those in force in the European Union which generate binding harmonization measures through legislative processes which do not require unanimous consent).

We will begin by reading a case which raises issues about when domestic courts do and should exercise jurisdiction over fraud claims involving a mix of foreign and domestic elements. This case (which is an example of what is described as an F-cubed securities case (claims brought by foreign investors who bought securities in a foreign issuer based on transactions in a foreign country)) is currently before the US Supreme Court.[5] The case involves claims brought under s10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5.

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[4] *See, e.g.*, Mark Lacey, Money Trickles North as Mexicans Help Relatives, NY Times (Nov. 15, 2009) at http://www.nytimes.com/2009/11/16/world/americas/16mexico.html?_r=2&ref=todayspaper.

[5] http://origin.www.supremecourtus.gov/docket/08-1191.htm .

Section 10 of the Securities Exchange Act 1934 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--
(a) 1. To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, 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.
2. Paragraph (1) of this subsection shall not apply to security futures products.
(b). To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm- Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rules promulgated under subsection (b) that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities. Judicial precedents decided under section 17(a) of the Securities Act of 1933 and sections 9, 15, 16, 20, and 21A of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities.

Rule 10b-5 provides:

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

Note that the statute and the rule do not expressly state any territorial limitations on their application. But note also that the statute and the Rule do not generally contain

rules establishing conditions for the implied private rights of action the courts have recognized.

Morrison v. National Australia Bank Ltd., 547 F.3d 167 (2nd. Cir. 2008) (Newman, Calabresi & B.D. Parker)[6]

This appeal requires us to revisit the vexing question of the extraterritorial application of the securities laws, Rule 10b-5 in particular. Founded in 1858, headquartered in Melbourne, and incorporated under Australian law, the National Australia Bank ("NAB") calls itself Australia's largest bank. In 2000, its Australian business accounted for roughly 55% of its assets and revenues, with its international operations responsible for the remainder. NAB's approximately 1.5 billion "ordinary shares" (the equivalent of American common stock) trade on the Australian Securities Exchange, the London Stock Exchange, the Tokyo stock exchange, and the New Zealand stock exchange. While NAB's ordinary shares do not trade on United States exchanges, its American Depository Receipts[1] ("ADRs") trade on the New York Stock Exchange.

In February 1998, NAB acquired HomeSide Lending Inc., an American mortgage service provider headquartered in Jacksonville, Florida, for $ 1.22 billion. HomeSide serviced mortgages in exchange for fees. By March of 2000, HomeSide, as a wholly owned subsidiary of NAB, held the rights to service $ 18 billion of mortgages, making it America's sixth biggest mortgage service company.

Following the acquisition, HomeSide's operations were profitable. In HomeSide's first year, it earned A$ 313 2 million in mortgage servicing fees, and contributed to NAB's net profits. In 1999, NAB announced A$ 153 million in profits from HomeSide, which accounted for approximately 5.4% of NAB's A$ 2.82 billion in profits for the year. For the 2000 fiscal year, NAB reported that HomeSide generated A$ 141 million in profits, 4.1% of its total profits of A$ 3.37 billion.

HomeSide's accounting practices spawned this litigation. HomeSide calculated the present value of the fees it would generate from servicing mortgages in future years using a valuation model, booked that amount on its balance sheet as an asset called Mortgage Servicing Right ("MSR"), and then amortized the value of that asset over its expected life.

In 2001, NAB revealed that the interest assumptions in the valuation model used by HomeSide to calculate the MSR were incorrect and resulted in an overstatement in

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[6] You can find the decision here: http://www.ca2.uscourts.gov:8080/isysnative/RDpcT3BpbnNcT1BOXDA3LTA1ODMtY3Zfb3BuLnBkZg==/07-0583-cv_opn.pdf

[1] ADRs are issued by U.S. depository banks and represent "one or more shares of foreign stock or a fraction of a share. If you own an ADR, you have the right to obtain the foreign stock it represents." U.S. Securities and Exchange Commission website at http://www.sec.gov/answers/adrs.htm

the value of its servicing rights. In July 2001, NAB disclosed that it would incur a $ 450 million write-down due to a recalculation in the value of HomeSide's MSR. NAB's ordinary shares and its ADRs both fell more than 5% on the news. In September 2001, NAB announced a second write-down of $ 1.75 billion of the value of HomeSide's MSR, causing NAB's ordinary shares to plummet by 13% and its ADRs to drop by more than 11.5% on the NYSE. In an amended Form 10-Q filed with the SEC in December 2001, NAB restated previously issued financial statements to reflect the July and September adjustments.

Plaintiffs, four individuals who purchased NAB shares, sued NAB, HomeSide, and various individual officers and directors (collectively "Defendants") in the Southern District of New York, alleging violations of Sections 10(b) and 20(a) of the Securities and Exchange Act of 1934... and Rule 10b-5 promulgated thereunder ... The Plaintiffs claimed that "NAB's subsidiary HomeSide knowingly used unreasonably optimistic valuation assumptions or methodologies" and that various of the Defendants 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. HomeSide allegedly falsified the MSR in Florida and then sent the data to NAB in Australia, where NAB personnel disseminated it via public filings and statements.

Three of the plaintiffs who purchased their shares abroad (Russell Leslie Owen, Brian Silverlock, and Geraldine Silverlock) ("Foreign Plaintiffs") sought to represent a class of non-American purchasers of NAB ordinary shares, while the fourth plaintiff, Robert Morrison ("Domestic Plaintiff"), who purchased ADRs, sought to represent a class of American purchasers during a proposed class period of April 1, 1999 through September 3, 2001.

Defendants moved to dismiss the complaint for lack of subject matter jurisdiction under Rule 12(b)(1), and for failure to state a claim under Rule 12(b)(6) of the Federal Rules of Civil Procedure... The district court .. granted the motion, and dismissed the claims of the Foreign Plaintiffs for lack of subject matter jurisdiction and those of the Domestic Plaintiff for failure to state a claim. This appeal followed.

DISCUSSION

I."Determining the existence of subject matter jurisdiction is a threshold inquiry and a claim is properly dismissed for lack of subject matter jurisdiction under Rule 12(b)(1) when the district court lacks the statutory or constitutional power to adjudicate it." ..."A plaintiff asserting subject matter jurisdiction has the burden of proving by a preponderance of the evidence that it exists."..."In reviewing a district court's dismissal of a complaint for lack of subject matter jurisdiction, we review factual findings for clear error and legal conclusions de novo."... "[T]he court must take all facts alleged in the complaint as true and draw all reasonable inferences in favor of plaintiff," ... but "jurisdiction must be shown affirmatively, and that showing is not made by drawing from the pleadings inferences favorable to the party asserting it." ... In resolving a motion to dismiss for lack of subject matter jurisdiction under Rule 12(b)(1) a district court may consider evidence outside the pleadings. ..

"Only Congress may determine a lower federal court's subject-matter jurisdiction."... When Congress wrote the Securities Exchange Act, however, it omitted

any discussion of its application to transactions taking place outside of the United States [4]... Therefore, when faced with securities law claims with an international component, we turn to "the underlying purpose of the anti-fraud provisions as a guide" to "discern 'whether Congress would have wished the precious resources of the United States courts and law enforcement agencies to be devoted to' such transactions."... The underlying purpose of Section 10(b) is "to remedy deceptive and manipulative conduct with the potential to harm the public interest or the interests of investors." ... Harm to domestic interests and domestic investors has not been the exclusive focus of the anti-fraud provisions of the securities laws. As our case law makes clear, we believe that it is consistent with the statutory scheme to infer that Congress would have wanted "to redress harms perpetrated abroad which have a substantial impact on investors or markets within the United States."...

We decided in Psimenos v. E.F. Hutton & Co.... (2d Cir. 1983), that .in determining the extraterritorial reach of Section 10(b) we look to whether the harm was perpetrated here or abroad and whether it affected domestic markets and investors. This binary inquiry calls for the application of the "conduct test" and the "effects test."... We ask: (1) whether the wrongful conduct occurred in the United States, and (2) whether the wrongful conduct had a substantial effect in the United States or upon United States citizens. ... Where appropriate, the two parts of the test are applied together because "an admixture or combination of the two often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court." ... In this case, however, Appellants rely solely on the conduct component of the test.

Under the "conduct" component, subject matter jurisdiction exists if activities in this country were more than merely preparatory to a fraud and culpable acts or omissions occurring here directly caused losses to investors abroad.... Our determination of whether American activities "directly" caused losses to foreigners depends on what and how much was done in the United States and on what and how much was done abroad...

Here, HomeSide allegedly manipulated its internal books and records and sent the falsely inflated numbers from Florida to NAB's headquarters in Australia. NAB, operating from Australia, created and distributed its public filings and related public statements from Australia. These public filings and statements included HomeSide's falsified numbers in two ways. NAB directly included some of the allegedly false HomeSide numbers as stand-alone numbers in public filings. NAB also incorporated allegedly false HomeSide numbers in company-wide figures (e.g., company-wide revenue, profit, and growth numbers), rendering them false to the extent that they depended on the artificially inflated numbers from HomeSide.

Appellants contended that the fraud occurred primarily in Florida because HomeSide was located there and the false numbers at issue were created there. The district court disagreed. In what it described as a "close call," the district court

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[4] We respectfully urge that this significant omission receive the appropriate attention of Congress and the Securities and Exchange Commission.

determined that HomeSide's knowing use of unreasonably optimistic assumptions to artificially inflate the value of its MSR could not serve as a predicate for subject matter jurisdiction because this conduct amounted to, at most, a link in the chain of a scheme that culminated abroad. The district court reasoned that there would have been no securities fraud "but-for (i) the allegedly knowing incorporation of HomeSide's false information; (ii) in public filings and statements made abroad; (iii) to investors abroad; (iv) who detrimentally relied on the information in purchasing securities abroad." ...Accordingly, the district court determined that "[o]n balance, it is the foreign acts -- not any domestic ones -- that 'directly caused' the alleged harm here." ... It concluded that the Plaintiffs failed to meet "their burden of demonstrating that Congress intended to extend the reach of its laws to the predominantly foreign securities transactions at issue here." ...

II. The district court believed that the difficulty of this case is heightened by its novelty. Here, a set of (1) foreign plaintiffs is suing (2) a foreign issuer in an American court for violations of American securities laws based on securities transactions in (3) foreign countries. This is the first so-called "foreign-cubed" securities class action to reach this Circuit.... But despite this unusual fact-pattern, the usual rules still apply. As we noted, subject matter jurisdiction exists over these claims only "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." ...

Our Circuit's current standard for determining whether we possess subject matter jurisdiction over transnational securities fraud largely grew out of a series of opinions we issued between 1968 and 1983.[6] Two of these cases, Bersch v. Drexel Firestone, Inc.... and IIT v. Vencap, Ltd.... both written by Judge Friendly, are particularly helpful.

Bersch involved the offering of shares in IOS, a Canadian mutual fund, to non-Americans via a prospectus distributed outside of the United States, which the

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[6]A degree of confusion appears to exist in the other Circuits regarding our standard. In Zoelsch v. Arthur Andersen & Co...(D.C. Cir. 1987), the D.C. Circuit hypothesized that "[t]he Second Circuit's rule seems to be that jurisdiction will lie in American courts where the domestic conduct comprises all the elements of a defendant's conduct necessary to establish a violation of section 10(b) and Rule 10b-5: the fraudulent statements or misrepresentations must originate in the United States, must be made with scienter and in connection with the sale or purchase of securities, and must cause the harm to those who claim to be defrauded, even though the actual reliance and damages may occur elsewhere." The Fifth Circuit has since taken issue with that characterization. See Robinson v. TCI/US W. Communs. ... (5th Cir. 1997) ("Some courts, including the District of Columbia Circuit in Zoelsch, have suggested that the Second Circuit's test requires all elements of the alleged fraud to have occurred domestically. . . . [T]his is a bit of an overstatement: A close examination of the Second Circuit's caselaw reveals that the real test is simply whether material domestic conduct directly caused the complained-of loss."). To clear up any confusion, we reiterate that our "conduct test" requires that "the defendant's conduct in the United States [be] more than merely preparatory to the fraud, and [that] particular acts or culpable failures to act within the United States directly cause [] losses to foreign investors abroad" for subject matter jurisdiction to exist. Alfadda, 935 F.2d at 478. We disavow the D.C. Circuit's characterization of our test as requiring the domestic conduct to comprise all the elements necessary to establish a violation of Rule 10b-5.

plaintiffs in the action asserted contained misleading statements and omissions... Of the six investment banks that underwrote the offering, two were headquartered in America, as was Arthur Andersen, IOS's primary accounting firm... IOS, the underwriters, and their attorneys and accountants met on many occasions in New York to initiate, organize, and structure the offering; parts of the prospectus were drafted in New York and read over the telephone to personnel at the main business office of IOS in Geneva, Switzerland; and the proceeds of the offering were deposited in New York before being distributed to IOS... We concluded that we did not have subject matter jurisdiction because the fraud itself consisted of the delivery of the fraudulent prospectus to investors and the final prospectus emanated from a foreign source (London, Brussels, Toronto, the Bahamas, or Geneva)... Despite the fact that meetings and work regarding the prospectus took place in New York, we concluded that those actions were "merely preparatory" or took the "form of culpable nonfeasance and are relatively small in comparison to those abroad." ...

In Vencap, which involved the allegedly fraudulent sale of foreign securities to a British investment trust, with certain actions taken in the United States, we determined that the findings of the district court did not provide enough information for us to determine subject matter jurisdiction. We did, however, observe that a fundamental consideration in determining whether conduct gives rise to subject matter jurisdiction is that the United States should not be "used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners," as "[t]his country would surely look askance if one of our neighbors stood by silently and permitted misrepresented securities to be poured into the United States."...

Bersch and Vencap illustrate how to approach subject matter jurisdiction under the "conduct test": identify which action or actions constituted the fraud and directly caused harm -- in the case of Bersch, the act of placing the allegedly false and misleading prospectus "in the purchasers' hands,"... -- and then determine if that act or those actions emanated from the United States.... Since then we have repeatedly applied these principles...

We most recently applied them in SEC v. Berger... (..2003). There, the Manhattan Investment Fund, an offshore investment company organized under the laws of the British Virgin Islands and run by a single active director (Berger), suffered losses in excess of $ 300 million.... Instead of reporting these losses, Berger, working in New York, created fraudulent account statements that "vastly overstated" the market value of the Fund's holdings... Berger sent these fraudulent account statements to the fund administrator in Bermuda and ordered the administrator to send to investors the fraudulent statements rather than the accurate ones supplied by Bear Stearns.... We held that we had subject matter jurisdiction under the "conduct test" because the "fraudulent scheme was masterminded and implemented by Berger in the United States," ... even though the statements that ultimately conveyed the fraudulent information to investors were mailed from Bermuda. The critical factor was that the conduct that directly caused loss to investors -- the creation of the fraudulent statements -- occurred in New York.

Determining what is central or at the heart of a fraudulent scheme versus what is "merely preparatory" or ancillary can be an involved undertaking. Appellees and certain

of the amici curiae urge us to eschew this analysis in favor of a bright-line rule. They urge us to rule that in so-called "foreign-cubed" securities actions, showing domestic conduct should never be enough and subject matter jurisdiction cannot be established where the conduct in question has no effect in the United States or on American investors. They contend that the general "presumption" against the extraterritorial application of American laws bars American courts from exercising subject matter jurisdiction over these types of claims.

In support of their position, Appellees and amici point to a parade of horribles that they claim would result if American courts exercised subject matter jurisdiction over such actions. They contend that this would, among other things, undermine the competitive and effective operation of American securities markets, discourage cross-border economic activity, and cause duplicative litigation. Their principal objection, though, is that entertaining such actions here would bring our securities laws into conflict with those of other jurisdictions. For instance, in Switzerland, no comprehensive federal legislation governs securities fraud, and private remedies are the only ones available. In Canada, securities class actions are recognized, but most provinces do not recognize the fraud on the market doctrine. In various other countries, class actions are either not available or the ability of class actions to preclude further litigation is problematic... In essence, Appellees argue that other countries have carefully crafted their own, individual responses to securities litigation based on national policies and priorities and that opening American courts to such actions would disrupt and impair these carefully constructed local arrangements.

However, the potential conflict between our anti-fraud laws and those of foreign nations does not require the jettisoning of our conduct and effects tests for "foreign-cubed" securities fraud actions and their replacement with the bright-line ban advocated by Appellees. The problem of conflict between our laws and those of a foreign government is much less of a concern when the issue is the enforcement of the anti-fraud sections of the securities laws than with such provisions as those requiring registration of persons or securities. The reason is that while registration requirements may widely vary, anti-fraud enforcement objectives are broadly similar as governments and other regulators are generally in agreement that fraud should be discouraged. As Judge Friendly pointed out in IIT, Int'l Inv. Trust v. Cornfeld ... "[t]he primary interest of [a foreign state] is in the righting of a wrong done to an entity created by it. If our anti-fraud laws are stricter than [a foreign state's], that country will surely not be offended by their application."

Furthermore, declining jurisdiction over all "foreign-cubed" securities fraud actions would conflict with the goal of preventing the export of fraud from America. As the argument goes, the United States should not be seen as a safe haven for securities cheaters; those who operate from American soil should not be given greater protection from American securities laws because they carry a foreign passport or victimize foreign shareholders. A much stronger case would exist, for example, for the exercise of subject matter jurisdiction in a case where the American subsidiary of a foreign corporation issued fraudulent statements or pronouncements from the United States impacting the value of securities trading on foreign exchanges. Moreover, we are leery of rigid bright-line rules because we cannot anticipate all the circumstances in which the

ingenuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction. That being said, we are an American court, not the world's court, and we cannot and should not expend our resources resolving cases that do not affect Americans or involve fraud emanating from America. In our view, the "conduct test" balances these competing concerns adequately and we decline to place any special limits beyond the "conduct test" on "foreign-cubed" securities fraud actions.

The issue for us to resolve here boils down to what conduct comprises the heart of the alleged fraud. Appellants assert that the alleged manipulation of the MSR by HomeSide in Florida made up the main part of the fraud since those false numbers constituted the misleading information passed on to investors through NAB's public statements. According to Appellants, if HomeSide had not created and sent artificially inflated numbers up to its parent company, there would have been no fraud, no harm to purchasers, and no claims under Rule 10b-5. Appellants insist that NAB's creation and dissemination of the public statements in question consisted solely of the mechanical insertion of HomeSide's numbers into the statements and public filings and that the locus of the improper conduct (Florida) and not the place of compilation (Australia) should determine jurisdiction.

The Appellees, on the other hand, argue that the allegedly false and misleading public statements made by NAB constituted the fraud, since, without those statements, no misinformation would have been reported, no investors would have been defrauded, and no actionable claims would have existed under Rule 10b-5. Since NAB's public statements were compiled in Australia and disseminated from there, Appellees contend that the only conduct that directly caused harm to investors occurred in Australia.

We conclude that we do not have subject matter jurisdiction. The actions taken and the actions not taken by NAB in Australia were, in our view, significantly more central to the fraud and more directly responsible for the harm to investors than the manipulation of the numbers in Florida. HomeSide, as a wholly owned, primarily operational subsidiary of NAB, reported to NAB in Australia. HomeSide's mandate was to run its business well and make money. The responsibilities of NAB's Australian corporate headquarters, on the other hand, included overseeing operations, including those of the subsidiaries, and reporting to shareholders and the financial community. NAB, not HomeSide, is the publicly traded company, and its executives -- assisted by lawyers, accountants, and bankers -- take primary responsibility for the corporation's public filings, for its relations with investors, and for its statements to the outside world.

Appellants' claims arise under Rule 10b-5(b), which focuses on the accuracy of statements to the public and to potential investors. Ensuring the accuracy of such statements is much more central to the responsibilities of NAC's corporate headquarters, which issued the statements, than to those of HomeSide, which did not. Liability under Rule 10b-5(b) requires a false or misleading statement. "Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b)." ...NAB's executives possess the responsibility to present accurate information to the investing public and to the holders of its ordinary shares in accordance with a host of accounting, legal and regulatory standards. When a statement or public filing fails to meet these standards, the responsibility, as a practical matter, lies in Australia, not Florida.

Another significant factor at play here is the striking absence of any allegation that the alleged fraud affected American investors or America's capital markets. Appellants press their appeal solely on behalf of foreign plaintiffs who purchased on foreign exchanges and do not pursue the "effects" test. They do not contend that what Appellants allegedly did had any meaningful effect on America's investors or its capital markets. This factor weighs against our exercise of subject matter jurisdiction.

A third factor that weighs against jurisdiction is the lengthy chain of causation between the American contribution to the misstatements and the harm to investors. HomeSide sent allegedly falsified numbers to Australia. Appellants do not contend that HomeSide sent any falsified numbers directly to investors. If NAB's corporate headquarters had monitored the accuracy of HomeSide's numbers before transmitting them to investors, the inflated numbers would have been corrected, presumably without investors having been aware of the irregularities, much less suffering harm as a result. In other words, while HomeSide may have been the original source of the problematic numbers, those numbers had to pass through a number of checkpoints manned by NAB's Australian personnel before reaching investors. While HomeSide's rigging of the numbers may have contributed to the misinformation, a number of significant events needed to occur before this misinformation caused losses to investors. This lengthy chain of causation between what HomeSide did and the harm to investors weighs against our exercising subject matter jurisdiction. As the Supreme Court noted in Stoneridge, "deceptive acts [that] were not communicated to the public" do not suffice to "show reliance . . . except in an indirect chain that we find too remote for liability."...

This particular mix of factors -- the fact that the fraudulent statements at issue emanated from NAB's corporate headquarters in Australia, the complete lack of any effect on America or Americans, and the lengthy chain of causation between HomeSide's actions and the statements that reached investors -- add up to a determination that we lack subject matter jurisdiction.

III. CONCLUSION For all these reasons, the judgment of the district court is affirmed.

Notes and Questions:

The SDNY judgment in this case [1] includes a more informative note on ADRs than that reproduced above:

An ADR is a receipt that is issued by a depositary bank that represents a specified amount of a foreign security that has been deposited with a foreign branch or agent of the depositary, known as the custodian. The holder of an ADR is not the title owner of the underlying shares; the title owner of those shares is either the depositary, the custodian, or their agent. ADRs are tradable in the same manner as any other registered American security, may be listed on any of the major exchanges in the United States or traded over the counter, and are subject to the [federal securities

[1] In re Nat'l Austl. Bank Sec. Litig., 2006 U.S. Dist. LEXIS 94162 (SDNY 2006).

laws.] This makes trading an ADR simpler and more secure for American investors than trading in the underlying security in the foreign market." Pinker v. Roche Holdings Ltd., 292 F.3d 361, 367 (3d Cir. 2002)...

The facts underlying this case involve different jurisdictions. National Australia Bank (NAB), headquartered in Melbourne, Australia, owned HomeSide, a mortgage service provider in Florida.[2] National Australia Bank Limited is the holding company for an international financial services group and is regulated in Australia.[3] NAB makes disclosures about its business in Australia, and, at the time of the securities transactions in the case and until September 2007, NAB also filed reports with the SEC as a foreign issuer.[4] NAB owned entities are also regulated in the jurisdictions where they carry on business.

The judgment tells us that “Three of the plaintiffs who purchased their shares abroad.. sought to represent a class of non-American purchasers of NAB ordinary shares, while the fourth plaintiff...who purchased ADRs, sought to represent a class of American purchasers...”[5] The SDNY’s judgment states that “The Lead Foreign Plaintiffs are residents of Australia, who purchased NAB's ordinary shares on an Australian exchange in 2001.” Why would non-US persons who purchased shares outside the US which were issued by a non-US issuer try to sue for securities fraud in the US? (The “foreign cubed” case).

We are told that NAB shares “trade on the Australian Securities Exchange, the London

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[2] Washington Mutual acquired HomeSide in 2002. In 2008, Wamu suffered the worst bank failure in US history and its assets were acquired by JP Morgan Chase. See FDIC Press Release, JPMorgan Chase Acquires Banking Operations of Washington Mutual (Sep. 25, 2008) at http://www.fdic.gov/news/news/press/2008/pr08085.html .

[3] NAB must comply with the provisions of two Commonwealth statutes in Australia: the Banking Act 1959 (Cth) and the Corporations Act 2001 (Cth). See NAB Annual Report for 2008 *available at* http://nab2008annualreports.textpacific.com.au/resources/downloads/AR/NAB_2008_AFR.pdf .

[4] *See* the 2008 NAB Annual Report, which refers to NAB’s deregistration with the SEC.

[5] The reasoning in the 2nd Circuit applies to the Lead Foreign Plaintiffs. The Lead Domestic Plaintiff was dismissed by the SDNY because he failed to allege that he suffered any damages from the alleged fraud.

Stock Exchange, the Tokyo stock exchange, and the New Zealand stock exchange." Do you think it should make a difference for fraud liability where an investor bought the shares? For example, should an investor who bought in Tokyo only be able to sue in Japan? Would it make a difference whether the investor were a Japanese citizen or resident?

A large amount of information on issuers of securities in the US is available through the EDGAR system.[6] Do you think that a jurisdiction where easily accessible information about an issuer of securities is available is one in which jurisdiction over securities fraud claims should be exercised?

The Court states: "Our Circuit's current standard for determining whether we possess subject matter jurisdiction over transnational securities fraud largely grew out of a series of opinions we issued between 1968 and 1983." Do you think there might be any difficulties in applying standards developed between 1968 and 1983 to acts carried out 20 and more years later? In footnote 4, the Court notes that "When Congress wrote the Securities Exchange Act, however, it omitted any discussion of its application to transactions taking place outside of the United States" and urges Congress to address the issue. Under what circumstances do you think that US rules should apply to transactions taking place outside the US?

The Second Circuit rejects the bright-line rule suggested by amici in favor of a fact based analysis. What are the advantages and disadvantages of this approach?

The Washington Legal Foundation reacted to this decision as follows:

On October 23, 2008, WLF scored a major victory when a three-judge panel of the U.S. Court of Appeals for the Second Circuit unanimously affirmed a ruling by the district court that United States securities laws do not have extraterritorial application to a foreign corporation. This ruling will have an impact on foreign corporations, especially those that have invested in U.S. businesses. In affirming the district court, the appeals court proclaimed, "We are an American court, not the world's court, and we cannot and

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[6] *See* http://www.sec.gov/edgar.shtml. You might want to look at the SEC's document on Researching Public Companies Through EDGAR: A Guide for Investors at

should not expend our resources resolving cases that do not affect Americans or involve fraud emanating from America."[7]

Is this an accurate representation of the decision?

Another amicus brief was filed by the Securities Industry and Financial Markets Association (SIFMA), the Chamber of Commerce of the United States of America, the United States Council for International Business, and the Association Française des Entreprises Privées.[8] This amicus brief states:

The rapid globalization of financial markets in recent years has given rise to new competitive challenges for the United States – challenges recognized not only by amici and their members as market participants, but also by respected scholars in law, economics and finance and by leaders at all levels of government, across the political spectrum. A central component of this ongoing and serious competitive threat to U.S. markets is the risk that securities class actions – litigation with abusive potential long acknowledged by the courts and Congress – will reduce cross-border investment and deter foreign companies from accessing U.S. markets.

This case presents a virtual "Exhibit A" for any foreign jurisdiction seeking to demonstrate, for its competitive advantage, the perils of coming into contact with the United States. An Australian company listed on an Australian exchange, with virtually all of its shareholders outside the United States, faces the possibility of protracted litigation in the U.S. courts for alleged misstatements made to those non-U.S. investors. Perhaps even more damaging, plaintiffs principally rest this unprecedented attempt to expand U.S. jurisdiction, rightly rejected by the district court, on the Australian company's decision to invest in a U.S. subsidiary. In other words, plaintiffs seek to convert the decision to acquire a U.S. business into a securities litigation risk factor for non-U.S. companies – discouraging cross border economic activity even where that activity bears no relation to the interests protected by the U.S. securities laws.

The Supreme Court consistently has taught that courts must approach cases like this one with the "presumption that United States law governs domestically but does not rule the world." Microsoft, Inc. v. AT&T... (2007). This Circuit, as well, has recognized that it should not lightly devote the resources of U.S. courts to predominantly foreign matters and instead should leave the issue to foreign countries. Bersch v. Drexel Firestone, Inc.... (2d Cir. 1975). Moreover, as the Microsoft Court emphasized, it would be especially inappropriate to apply U.S. law to claims arising outside the United States

[7] http://www.wlf.org/litigating/case_detail.asp?id=500 . The WLF Amicus Brief in the case is accessible from this page.

[8] http://www.sifma.org/regulatory/briefs/2007/NAB.pdf .

in areas of law that “may embody different policy judgments.” ... . There can be no question that this case involves just such an area of law – an area fraught with controversy and the potential for abuse even within the U.S. legal system – and where other countries can, and do, make fundamentally different policy decisions.

Whatever the merits of private securities class actions may be, the Supreme Court has recently reiterated that, “if not adequately contained, [they] can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law.” Tellabs, Inc. v. Makor Issues & Rights, Ltd.... (June 21, 2007). The U.S.’ securities-fraud class-action regime stands alone in the world, with its combination of the opt-out class-action procedure, tolerance of contingency fees, expansive and expensive discovery procedures, jury trials and potential for massive and devastating damage awards. Indeed, these very differences between the U.S. system and others have enticed plaintiffs whose claims rightfully belong in other countries to try to find a way into U.S. courts.

...of central importance to amici and their members, the application of domestic law to fundamentally foreign disputes raises a host of policy concerns, as courts and commentators have generally recognized for decades.

• It risks weakening core principles of comity – precluding foreign jurisdictions from establishing liability rules best suited to their markets in an area where U.S. courts and regulators have struggled for decades to strike an appropriate balance between plaintiffs and defendants.

• It risks deterring foreign companies from making acquisitions of U.S. companies – for fear of becoming subject to securities law liability if the target companies have prepared financials that arguably mislead the foreign company and its non-U.S. shareholders.

• It creates a reciprocal risk to U.S. companies – exposing them, should foreign courts adopt similar logic, to securities litigation in virtually any jurisdiction in which they have a subsidiary, even if their shares are traded exclusively by investors in the United States.

• It creates the risk of duplicative litigation – with various plaintiffs seeking out the class action regime most favorable to their case and the possibility of multiple “bites at the apple.”

• Lastly, it creates the risk of arbitrariness and inequity – with different companies subject to different liability regimes dependent solely on tenuous factors arising out of the location of business operations or other considerations unrelated to the investor protection objectives of the U.S. securities laws...

Do you find these arguments persuasive?

In **October 2009, an Amicus brief for the Government** argued that the Court should not grant certiorari in the National Australia Bank case.[9] The brief states:

[9] *See* http://www.sec.gov/litigation/briefs/2009/morrison1009.pdf .

Although the court of appeals erred in treating the question before it as one of “subject matter jurisdiction,” the court correctly concluded that petitioners’ private suit could not go forward. And although the courts of appeals have not been entirely uniform in their analysis of Section 10(b)’s application to transnational frauds, petitioners cite no decision indicating that another circuit would have allowed their suit to proceed. The petition therefore should be denied [10]....

The text of the Exchange Act is silent as to its transnational reach... In the absence of clear congressional guidance, the courts have attempted “[t]o discern whether Congress would have wished the precious resources of the United States courts and law enforcement agencies to be devoted to” such transnational securities transactions. Europe & Overseas Commodity Traders, S.A. v. Banque Paribas London ..(2d. Cir. 1998) ... In applying the Exchange Act to different sets of facts involving alleged transnational frauds, courts have relied in large measure on “policy considerations and the courts’ best judgment.” ...

Respondents rely ... on the “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.’”.... That interpretive rule provides a sound basis for concluding that Section 10(b) does not apply when a fraudulent scheme with no effects in the United States is hatched and executed entirely outside this country. But when a scheme to commit securities fraud is executed in part through domestic conduct and in part through conduct occurring outside the United States, that presumption does not identify the type or amount of domestic conduct that will bring the scheme within the reach of Section 10(b).

In particular, the presumption against extraterritorial application of United States law does not suggest that fraudulent conduct for which this country serves as a base of operations will fall outside Section 10(b)’s coverage just because the effects of the fraud are experienced elsewhere ... Even in cases involving foreign victims who suffer harm overseas, courts have been “reluctant to conclude that Congress intended to allow the United States to become a ‘Barbary Coast,’ as it were, harboring international securities ‘pirates.’” SEC v. Kasser ... In addition, by extending federal securities laws to prohibit fraudulent domestic conduct that injures overseas investors, the United States can reasonably expect other countries to offer comparable protection to American investors... The courts have therefore concluded that Section 10(b) can apply not only when fraudulent conduct has effects within the United States, but also when conduct

[10] (Footnote no. 1 in original) Congress is presently considering a legislative proposal that would address the transnational reach of the antifraud provisions of the Securities Act of 1933, 15 U.S.C. 77a et seq., and the Exchange Act. On October 15, 2009, Representative Paul Kanjorski, a subcommittee chairman on the House Financial Services Committee, introduced the Investor Protection Act of 2009, H.R. 3817, 111th Cong., 1st Sess. Section 215 of this bill would amend both Acts to provide that the district courts of the United States have jurisdiction over violations of the antifraud provisions that involve a transnational fraud if there is “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.” The possibility that Congress may address this issue directly in the relatively near future provides an additional reason for this Court to deny the petition.

relevant to the fraud occurred in the United States but the effects were experienced abroad....
The courts of appeals that have addressed the issue of the transnational reach of Section 10(b) have uniformly described it as one of “subject matter jurisdiction.” ... This Court’s more recent decisions, however, have emphasized the need for greater precision in the use of the term “jurisdiction.”...In Arbaugh, this Court announced a general rule that “when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character.”..
Jurisdiction over suits alleging violations of the Exchange Act is established by 15 U.S.C. 78aa. That provision states without qualification that the district courts and the courts of United States Territories “shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.” ... If a particular suit is otherwise an appropriate means of enforcing a “liability or duty created by” the Exchange Act or rules promulgated thereunder by the Commission, Section 78aa unambiguously vests the district courts with jurisdiction to resolve it. Cf. Arbaugh, 546 U.S. at 514-515 (noting that the statutory provisions governing jurisdiction over Title VII suits did not contain any employee-numerosity requirement, and that the numerosity requirement at issue was set forth in a separate provision that did “not speak in jurisdictional terms”) ...
Thus, under the plain terms of Section 78aa, the geography of an alleged fraudulent scheme—i.e., whether it was conceived and executed in whole or in part outside the United States—is irrelevant to the district court’s subject-matter jurisdiction. Rather, that geography is potentially relevant to two non-jurisdictional issues bearing on the plaintiff’s entitlement to relief. Cf. Arbaugh, 546 U.S. at 503 (noting “the distinction between two sometimes confused or conflated concepts: federal-court ‘subject-matter’ jurisdiction over a controversy; and the essential ingredients of a federal claim for relief”).

First, the determination whether a fraudulent scheme violates Section 10(b) depends in part on the location of the actions taken to effectuate it. Even if the defendant has engaged in the type of conduct at which Section 10(b) is directed—i.e., the use of a “manipulative or deceptive device or contrivance” “in connection with the purchase or sale of [a] security”—Section 10(b) does not apply if the scheme bears an insufficient connection to the United States.
Second, in a private suit like this one, the transnational character of the scheme and any resulting harms may bear on the availability of Section 10(b)’s private right of action. Plaintiffs who invoke this right of action are always required to prove more than that the defendant violated the statute.... In cases involving wholly domestic conduct, a private plaintiff must establish a direct causal link between the defendant’s violation and injury to himself... Similarly, in cases involving transnational fraud, the private plaintiff should be required to demonstrate a direct causal link between his injury and the component of the scheme that occurred in the United States... In effect, the required nexus in such a suit becomes triangulated: it is not merely between this country and the fraud, but between this country’s part of the fraud and the individual’s alleged injury.

In an enforcement action brought by the Commission, by contrast, the transnational character of the fraudulent scheme is relevant only to the question whether the defendants' conduct violated Section 10(b). Under the plain terms of the statutory provisions that govern SEC enforcement suits, "[w]henever it shall appear to the Commission that any person has violated any provision of [the Exchange Act], * * * the Commission may bring an action in United States district court to seek, and the court shall have jurisdiction to impose, upon a proper showing, a civil penalty to be paid by the person who committed such violation." ... The SEC has similarly broad and unqualified authority to bring an action for injunctive relief "[w]henever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of [the Exchange Act]." ... Thus, so long as a particular fraudulent scheme bears a sufficient connection to the United States to bring it within Section 10(b)'s substantive prohibition, the Commission may pursue an enforcement action...

In holding that petitioners' claims should be dismissed, the court of appeals relied on two distinct rationales. First, the court stated that the issue before it "boils down to what conduct comprises the heart of the alleged fraud," ... and concluded that "[t]he actions taken and the actions not taken by NAB in Australia were * * * significantly more central to the fraud * * * than the manipulation of the numbers in Florida," ... That analysis, which suggests that the conduct alleged in this case did not violate Section 10(b), is erroneous. In addition, however, the court reasoned that petitioners sued "solely on behalf of foreign plaintiffs who purchased on foreign exchanges," ... and noted "the lengthy chain of causation between the American contribution to the misstatements and the harm to investors," ... Those aspects of the case provide a sound basis for concluding that petitioners were not entitled to invoke the implied private right of action under Section 10(b)...

The increasing integration of the world's securities markets has expanded legitimate investment and capital-raising opportunities, but it has also created an increased potential for novel transnational securities-fraud schemes. As business transactions and fraudulent schemes become more and more internationally dispersed, cases are increasingly likely to arise in which no single country can meaningfully be described as the "heart" of the fraud... If all countries interpreted their securities laws in accordance with the "heart of the alleged fraud" approach that the Second Circuit articulated here .. the perpetrators of such schemes could escape accountability in any jurisdiction. And even apart from that concern, a "heart of the fraud" approach, which appears to limit Section 10(b)'s coverage to transnational frauds in which domestic conduct predominates, would not adequately protect the government's law enforcement interests. The United States may have a substantial interest in preventing the use of this country as a location for even a minor part of an international fraud...

To address both concerns, Section 10(b)'s coverage should not be limited to transnational frauds in which domestic conduct predominates. Rather, it is sufficient if the scheme involves significant conduct within the United States that is material to the fraud's success. The allegations in petitioners' complaint satisfy that standard. According to those allegations, the false information that was released to the public in Australia was generated in the United States with the expectation that it would be

incorporated into NAB's financial statements. The conduct of HomeSide and its officers within the United States thus was not peripheral or merely preparatory, but was an integral component of the overall scheme. Because the scheme had a sufficient connection to the United States to bring it within Section 10(b)'s substantive prohibition, the SEC could have pursued an enforcement action based on the facts alleged in petitioners' complaint... To the extent the court of appeals concluded that the scheme as alleged did not violate Section 10(b), its analysis is incorrect...

"[B]ecause Congress did not create a private § 10(b) cause of action and had no occasion to provide guidance about the elements of a private liability scheme," crafting the details of the private right of action is of necessity the responsibility of the courts, guided by any available evidence of what restrictions the 1934 Congress would have imposed if it had enacted an express cause of action... The plaintiff in every private Section 10(b) action must allege certain facts, such as economic loss and a causal connection between that injury and the defendant's misconduct, that are not elements of a Section 10(b) violation and that the Commission need not prove in its own enforcement actions... When a foreign plaintiff in a private Section 10(b) suit alleges that he was injured outside the United States by transnational securities fraud, the plaintiff should be required to prove that his loss resulted not simply from the fraudulent scheme as a whole, but directly from the component of the scheme that occurred in the United States.

"[T]his Court ordinarily construes ambiguous statutes to avoid unreasonable interference with the sovereign authority of other nations." ... Application of substantive federal antifraud provisions to transnational schemes usually will not interfere with comity among different nations because there is broad international consensus regarding the need for such regulation. See 1 Restatement (Third) of Foreign Relations Law § 416 note 3, at 301 (1987) ("United States securities regulation ... has not resulted in state-to-state conflict."). The Commission, moreover, routinely works with its overseas counterparts to develop coordinated approaches to transnational securities-fraud enforcement...

Certain aspects of private securities-fraud litigation —e.g., utilization of the fraud-on-the-market theory and the class-action device, both of which are potentially implicated in this case—may, however, create the potential for conflict among nations. ...In addition, other nations might perceive affording a private remedy to foreign plaintiffs as circumventing the causes of action and remedies (and the limitations thereon) that those nations provide their own defrauded citizens, particularly if the plaintiff's principal grievance appears directed at another foreign entity. Absent indications of a contrary congressional intent, the judicially-created private right of action under Section 10(b) should be tailored so as to minimize the likelihood of such international friction.

In addition, invocation of the Section 10(b) right of action by foreign plaintiffs risks diverting the resources of United States courts to the redress of harms having only an attenuated connection to this country. Requiring a direct causal connection between the foreign plaintiff's injury and the United States component of a transnational scheme alleviates that danger. The Commission, by contrast, is a federal law-enforcement agency that can be expected to take account of national interests (including the national

interest in ensuring that this country does not become a safe haven for wrongdoers) when it determines whether particular enforcement suits represent sound uses of its own resources and those of the federal courts.

In this case, the link between HomeSide's alleged false statements and the ultimate harm to petitioners was too indirect to support liability in a private suit. As the court of appeals explained, "while HomeSide may have been the original source of the problematic numbers, those numbers had to pass through a number of checkpoints manned by NAB's Australian personnel before reaching investors." .... In allegedly incorporating the false numbers into NAB's financial reports and other public statements, NAB personnel were not acting under the direction and control of HomeSide, but rather were exercising independent judgment as officers of HomeSide's parent corporation... Petitioners' allegations thus posit a "lengthy chain of causation between what HomeSide did and the harm to investors," .. and that causal chain includes significant intervening events outside this country, including the inflation of the stock price in the Australian trading market. The indirectness of the link between the Florida component of the scheme and petitioners' injuries does not negate the existence of a Section 10(b) violation, but it provides a sound basis for dismissing petitioners' private suit...

Petitioners contend .. that the courts of appeals are divided regarding the amount of domestic conduct necessary to proceed on transnational security-fraud claims in federal court. More specifically, petitioners identify what they contend is a three-way circuit split in which the Third, Eighth, and Ninth Circuits require a "lesser quantum" of conduct; the Second, Fifth and Seventh Circuits "set a mid-course"; and the D.C. Circuit applies "the most restrictive approach." ... In fact, the differences among the circuits are much less pronounced than petitioners contend. For the most part, the circuits have agreed that private Section 10(b) suits may go forward if conduct within the United States is a "significant" or "substantial" part of the fraudulent scheme and the domestic conduct "directly causes" the plaintiff's injury. And while the approaches of the various courts of appeals have not been entirely uniform, petitioners identify no case indicating that any other circuit would have allowed their suit to go forward..

Petitioners' assertion of a circuit conflict rests principally on quotations from two courts of appeals...The Fifth Circuit has suggested that "[t]he circuits are divided" based on its view that the Third, Eighth, and Ninth Circuits require a "lesser quantum of conduct" than the Second Circuit's standard, which the Fifth Circuit adopted... The Seventh Circuit made a similar observation in adopting the Second Circuit's formulation, which requires that an alleged transnational securities fraud with no domestic effect involve domestic conduct that "directly causes the plaintiff's alleged loss" and constitute more than "merely preparatory" action... Neither opinion, however, identifies a concrete (let alone a frequently recurring) fact pattern in which these circuits would reach conflicting results.

Petitioners emphasize ... the Third Circuit's statement in Kasser .. that a securities-fraud plaintiff must show "at least some [domestic] activity designed to further a fraudulent scheme." Contrary to petitioner's suggestion, however, that statement does not purport to define the amount of domestic conduct needed to bring a fraudulent scheme within Section 10(b)'s coverage. Kasser itself involved much more than "some"

domestic activity. The Kasser defendants had “unleash[ed] from this country a pervasive scheme to defraud a foreign corporation”: “significant conduct” had occurred in the United States to advance that scheme, and such conduct “was essential to the plan to defraud.” ... Kasser, moreover, was an SEC enforcement action, and the court held that “a district court does have jurisdiction in an SEC suit for injunctive relief under the federal securities laws, given circumstances such as are presented here.”.. The court thus had no occasion to consider what distinct limitations might apply to private suits brought by foreign plaintiffs...

The Eighth Circuit subsequently concluded that Kasser was consistent with its own requirement that “significant conduct” occur in this country as part of a fraudulent scheme... In holding that the private plaintiffs’ suit could go forward, the court in Continental Grain endorsed the requirements, drawn from Second Circuit precedents, that the defendant’s conduct within the United States must be more than “merely preparatory” and that it must “directly cause the losses.” ... The fraudulent scheme in Continental Grain was “devised and completed in the United States”: domestic letters and telephone calls ensured that material information would be concealed from a prospective buyer, and the resulting contract with that victim was executed in the United States by a United States citizen-resident and a United States corporation....

The Ninth Circuit subsequently “adopt[ed] the Continental Grain test.” . Grunenthal.. The court explained that, under that standard, “[t]he conduct in the United States cannot be merely preparatory . . . and must be material, that is, directly cause the losses.” .. The court further concluded that its “[a]ssertion of jurisdiction under the facts of [Grunenthal] [wa]s not inconsistent with the approach taken by the Second Circuit.” ... In Grunenthal, the pertinent sales contract procured by fraud was executed in the United States immediately after fraudulent conduct in a face-to-face Los Angeles meeting that directly “induced [the victim] to execute the agreement.” ...

Petitioners, by contrast, allege that they suffered losses on an Australian stock exchange because of fraudulent financial statements prepared in and distributed from Australia by an Australian corporation. In none of the circuits discussed above would this conduct have sufficed to allow petitioners’ suit to go forward..

In one respect, the decision below appears to impose a standard more demanding than the approaches previously adopted by the Second Circuit and other courts of appeals. By framing the question before it as “what conduct comprises the heart of the alleged fraud,” .. the court of appeals suggested that Section 10(b) covers only those transnational frauds in which domestic conduct predominates. Other courts of appeals, by contrast, have focused on whether conduct within the United States is “significant” or “substantial” rather than “merely preparatory” to the fraud.

In addition to concluding that Australia was the “heart” of the alleged fraud, however, the court of appeals relied on the “lengthy chain of causation between what HomeSide did [in the United States] and the harm to investors.” .. That aspect of the court’s analysis is consistent with decisions of other circuits, which have required private Section 10(b) plaintiffs to show that conduct within the United States “directly” caused their losses... Petitioners identify no case in which a court of appeals has allowed a private Section 10(b) suit to go forward despite a similarly attenuated link between the

United States component of a fraudulent scheme and the plaintiff's ultimate harm. Because the indirectness of the causal chain in this case provides an independent basis for dismissing petitioners' private suit ... the apparent inconsistency between the court's "heart of the alleged fraud" analysis and decisions of other courts of appeals does not warrant this Court's review.
..In Zoelsch v. Arthur Andersen & Co... (1987), the D.C. Circuit adopted a "more restrictive test" that requires that a defendant's "domestic conduct comprise all the elements ... necessary to establish a violation of section 10(b) and Rule 10b-5." .. The D.C. Circuit's adoption of that standard was based in part on the court's mistaken view that the Second Circuit "seem[ed]" to require that showing.... Zoelsch therefore does reflect a division of authority on the appropriate standard for determining when courts may entertain private Section 10(b) suits alleging transnational securities frauds.6
This case, however, would not be a suitable vehicle for resolving that division. Petitioners do not contend that they could prevail under Zoelsch's restrictive test... Because the court of appeals correctly held that petitioners' suit could not go forward even under the Second Circuit's less demanding approach, the choice between the two standards would not affect the outcome in this case...
The petition for a writ of certiorari should be denied.

In March 2009 the Northern District of California certified a class including investors who purchased securities in the US and in Germany in **In re Infineon Technologies AG Securities Litigation**:[11]

The securities laws of the United States apply where there is "some degree of connection between the [securities] fraud and conduct in, or effects on, the United States." Grunenthal ... For conduct in the United States to act as a predicate for application of the securities laws, the conduct must be "significant with respect to the alleged violation" and further the fraudulent scheme... The domestic conduct cannot be "merely preparatory" to the securities fraud, but must be material in the sense that it directly caused the plaintiff's losses.. At the very least, jurisdiction in transnational securities cases is appropriate "where at least some activity designed to further the fraudulent scheme occurs within [the United States]."
According to the Ninth Circuit in Grunenthal, the fact that the "jurisdictional hook need not be large to fish for securities law violations" is consistent with the "established objectives of the federal securities laws.".. First, limiting application of domestic securities laws in cases involving transnational securities transactions "might encourage those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations and, in effect, create a haven for such defrauders and

[11] The decision is on appeal to the 9th Circuit. The underlying facts are addressed in Infineon's plea agreement with respect to charges of illegal price fixing. See http://www.justice.gov/atr/cases/f206700/206700.pdf .

manipulators." .. Second, and more generally, this rule facilitates a common purpose of the federal securities laws, which is "to achieve a high standard of business ethics in the securities industry." ..

In this case, Defendants contend that Plaintiffs allege neither effects nor conduct in the United States, with respect to the Foreign Purchasers, sufficient to state a securities claim under the Ninth Circuit's standard in Grunenthal..

1. Conduct in the United States

Plaintiffs' Complaint alleges several instances of Defendants' conduct in the United States. The issue is whether this conduct is sufficient to meet the standard articulated by the Ninth Circuit in Grunenthal for application of the federal securities laws.

First, the Complaint alleges that the artificially inflated prices that resulted from Defendants' admitted domestic DRAM price manipulation was a major contributor to Defendants' ability to fraudulently inflate Infineon AG's stock price... In relevant part, the Complaint alleges:

> Deceptive and misleading DRAM prices were publicly circulated to investors and analysts in the United States...The publication failed to disclose that the reported DRAM prices were the result of an illegal price-fixing conspiracy.. Infineon investors purchased securities at prices that were inflated after the publication of misleading DRAM prices, and suffered losses as Infineon's stock declined as a result of the collapse of the price-fixing conspiracy..

The conduct alleged above involved the domestic dissemination of DRAM price information that was artificially inflated by Defendants' participation in an antitrust conspiracy. According to this allegation, Defendants' distribution of this DRAM price data throughout the market, including in the United States, ultimately impacted the stock price of Infineon AG to the detriment of its investors. Such conduct, therefore, "furthered the fraudulent scheme" at issue in this case...

Second, Plaintiffs have evidence that the CEO of Infineon AG, Individual Defendant Schumacher, made three allegedly fraudulent statements in the United States concerning DRAM prices... In all three instances, Schumacher was interviewed in New York, and commented on DRAM prices. On March 14, 2000, Schumacher gave an interview to CNBC's Market Watch, in which he stated that the "DRAM market picked up price-wise in the last quarter." On November 16, 2000, in another CNBC interview, Schumacher stated that "distortion in the inventory levels has driven the prices down. But we expect that to recover pretty soon, most likely in the next quarter." Finally, on May 8, 2001, in a third CNBC interview, Schumacher declared that "inventory levels in the industry are very low . . . which normally is the indicator that in the next quarter the prices go up again." Schumacher's statements, made in the United States to an investor-related media outlet, are further examples of domestic conduct, along with other evidence, could be sufficient to support application of the federal securities laws to the claims of the Foreign Purchaser Plaintiffs.

Third, Plaintiffs' Complaint alleges that Defendants made numerous SEC filings in the United States, each of which contained material misrepresentations. In each case, the Complaint states that the relevant SEC filing was "[f]iled with the SEC by Infineon, made by Infineon's senior officers, including Zitzewitz and signed by Schumacher and

Fischl." .. Defendants contend, however, that these SEC filings were prepared in Germany, and thus cannot operate as the basis for jurisdiction over the Foreign Purchaser Plaintiffs' claims. However, the Ninth Circuit has found that conduct as minimal as fraudulently signing a document in the United States can act as a jurisdictional hook for fraud arising out of otherwise entirely transnational securities sales. Grunenthal.. . Given that federal securities law places great importance on the SEC filings of publicly traded corporations, and given the fact that such filings are relied on by investors, filing such documents in the United States is just as critical in perpetrating a market-wide fraud as the document signing event was to the fraud alleged in Grunenthal. Accordingly, even if the SEC filings were prepared in Germany, the Court is persuaded that "the situs of preparations for SEC filings should not be determinative of jurisdiction questions [because] the protections afforded by the [securities laws could] be circumvented simply by preparing SEC filings outside of the United States."...

Defendants contends that courts have not literally followed Itoba, and have found that under certain circumstances, whether a SEC filing has "emanated from a foreign source" may limit extension of jurisdiction over a class of largely foreign Plaintiffs... Nonetheless, Defendants have not cited any controlling Ninth Circuit authority suggesting that extraterritorially prepared SEC filings cannot operate as conduct sufficient to permit the claims at issue in this case. Furthermore, even if the Court were to find that the SEC filings are not conduct, there is a factual dispute between the parties as to whether the SEC filings were prepared in Germany or in the United States. Given that there is no evidence before the Court as to where these documents were prepared, the Court is unable to conclusively limit their connection to the United States at this time.

Accordingly, the Court finds that Defendants' dissemination of DRAM price data, allegedly misleading statements and fraudulent SEC filings, all in the United States, are instances of conduct that were "significant with respect to the alleged [securities] violation[s]" and "furthered the fraudulent scheme" at issue in this case.

2. Effects in the United States

Given the Court's finding that Plaintiffs have established domestic conduct sufficient to permit the Foreign Purchaser claims under Grunenthal, the Court need not determine whether Plaintiffs have also sufficiently alleged effects in the United States under the alternative second prong of the Ninth Circuit's Grunenthal test. The Court thus refrains from commenting on whether Plaintiffs' "global fraud-on-the-market" theory is a sufficient basis for permitting the securities claims of the Foreign Purchaser Plaintiffs.

In sum, Plaintiffs have established domestic conduct sufficient to extend the reach of the federal securities laws to the claims of the Foreign Purchaser Plaintiffs in this case...

...In this case, the putative class encompasses investors who purchased Infineon stock on both the NYSE and the FSE. As evidence that Infineon securities on both exchanges reacted to the same alleged misrepresentations and subsequent revelations in the same way, Plaintiffs provide a chart showing that Infineon securities on both markets moved in unison....

In an article in the Wisconsin Law Review in 2009 Professors Choi and Silberman[12] argued for a bright-line rule:

We argue for a clear bright-line rule tracking the exchange on which the transaction is executed for when U.S. prescriptive jurisdiction is appropriate. Under an exchange-based rule, foreign investors who transact in foreign securities on an exchange outside the United States would be presumptively excluded from rule 10b-5 litigation. Such a rule allows those who wish to avoid the U.S. regime to do so; although it may be unlikely that they will do so, parties who wish to opt into the U.S. regime are able to do so predictably. Such a rule also reduces the role of judges as decision makers on individual determinations of jurisdictional issues.

What would be the advantages of such a rule? Would it have any disadvantages? The US Chamber of Commerce has advocated this rule in an amicus brief in the Infineon case (the US Chamber of Commerce describes the development of the conduct test as the courts' policy choice):[13]

... the implied right of action under Section 10(b) should extend only to plaintiffs who purchased securities on American exchanges: "Courts should presume jurisdiction over all investors trading in a company's securities within the United States, and presume no jurisdiction for [Section 10(b)] lawsuits for foreign investors trading outside the United States." Stephen J. Choi & Linda J. Silberman, Transnational Litigation and Global Securities Class-Action Lawsuits, 2009 WIS. L. REV. 465, 465. This rule comports not only with the presumptions against extraterritoriality and against the expansion of the Section 10(b) implied right, but also with common sense and the reasonable expectations of investors. And it fits comfortably with this Court's prior private securities extraterritoriality decisions. Indeed, through its simplicity and clarity, this bright-line rule would best prevent American courts from becoming exactly what this Court has emphatically said they should not become—the preferred "host for the world's victims of securities fraud."

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[12] Stephen J. Choi & Linda J. Silberman, *Transnational Litigation and Global Securities Class-action Lawsuits*, 2009 Wisc. L. Rev 465.

[13] http://www.uschamber.com/NR/rdonlyres/eexjtxv5lbrqybksesvv2scdrjn7skywaq34gvdrrrd2n4vbh4eyi3sfwf2n6kww3c4hveqqixqxoegxhv25nx7fhxe/InreInfineonTechnologiesAGSecuritiesLitigation.pdf

...interference with other nations' regulatory authority is manifest here. The design of a securities enforcement system poses a plethora of policy questions that can be, and have been, answered differently by different nations' regulatory regimes. For example: Should public enforcement be supplemented with private lawsuits at all? If so, what are the elements of a private claim? What information is material? What are the duties of disclosure? What level of scienter should be required to establish liability? Must a plaintiff show reliance? If so, how? Should a "fraud-on-the-market" presumption of reliance apply, or must actual, "eyeball" reliance be proven? Should an issuing company, and hence its current shareholders, pay damages for losses suffered by shareholders who did not purchase their shares from the company but from other shareholders on the open market? What is the standard for causation? How do you measure damages? Should there be a "lookback" cap on losses, limiting damages on the basis of a recovery in a security's price after it drops? Who can be sued? Should specialized tribunals hear the cases? Or juries? What are the statutes of limitation and repose? Should class actions be allowed? Opt-out? Or opt-in? Who decides what for the class? Should losers pay winners' attorneys' fees? Should contingency fees be allowed? Other sovereign nations have decided these questions for themselves—and not the way the United States has decided them...
Under plaintiffs' theory here, if a foreign company conducted just five percent of its business in America, or issued just five percent of its stock in America, it would risk global fraud-on-the-market liability in the United States— liability provided for nowhere else in the world—for all trading of its securities, all over the world. That potential for massive liability creates a significant disincentive for foreign businesses to conduct business or to raise capital in the United States. And to the extent foreign firms decline to do either, that harms American businesses and citizens..

Foreign plaintiffs presumably try to obtain remedies for fraud in the US because they perceive that there are advantages to suing in the US. The US Chamber of Commerce stated in its amicus brief in the Vivendi case:

This is the era of global securities litigation. "More and more, overseas investors are seeking redress in United States courts in federal securities class actions." In 2004 and 2005 alone, 48 foreign companies were sued in securities class actions in the United States; many of these cases, like the present one, involve foreign plaintiffs who purchased securities on foreign markets. Andforeign investors moved for lead-plaintiff status in at least 40 U.S. securities fraud class actions between 2002 and 2005.The plaintiffs' bar is doing its utmost to encourage this trend, particularly in Europe, where American lawyers are actively working to recruit investors to participate in class actions in the United States. In part this is because "American securities fraud laws are perhaps the most plaintiff friendly in the world." There are obvious procedural advantages as well: liberal discovery rules; lawyers working on contingency; the absence of a "loser-pays" cost-shifting regime; the right to a jury trial. Most relevant here, however, is the availability of the class action, a device that simply does not exist—at least in its

American form—in much of the rest of the world. Indeed, "most other countries view American class actions as a Pandora's box that they want to avoid opening." This distrust of American-style class actions is neither parochial nor ill considered, but rather is a deliberate policy choice. The prevailing view among European legal experts, for instance, is that "U.S.-style class action litigation" is wasteful, unfair, and fosters an undesirable "litigation-driven society"; accordingly, "Europe neither needs nor wishes to import" this model. Representative adjudication—particularly the "opt-out" class actions permitted by Rule 23(b)(3)— is also at odds with the individualized litigation model that continues to prevail in much of Europe and elsewhere. These countries "believe that the opt-out procedure is a violation of the rights of absent class members." European scholars have also criticized opt-out class actions on the ground that they provide plaintiffs' lawyers with "too much leverage that may encourage large corporate defendants to settle 'speculative claims' in the form of 'legal blackmail.'" This unease is both reflected and expressed in the reluctance of many foreign courts to give res judicata effect to American class action judgments.In particular, the "idea that courts can bind a claimant to a legal judgment based upon inaction, particularly when the claimant received notice of the action only through constructive means, is difficult for foreign courts to accept."
It is thus unsurprising that the question whether foreign claimants may be included in a class action even if they may not be bound by an adverse decision has arisen with increased frequency and importance. The growing globalization of securities litigation makes it necessary to have a clear rule for determining when a class may be certified in the face of uncertainty about whether the resulting judgment would be recognized abroad.[14]

Do you think that it would be a good idea to harmonize the conditions under which plaintiffs could obtain remedies for securities fraud around the world? Do you think that it is likely that different countries might agree to harmonize the conditions for fraud liability?

Although US business groups argue that the US has fraud rules which are more protective of investors than rules in other jurisdictions, there have been some recent changes. Ontario relaxed its rules for securities actions in 2005.[15] In December 2009 in

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[14] Amicus brief in In Re Vivendi Universal, S.A. Securities Litigation at http://www.uschamber.com/NR/rdonlyres/eyeqsdjltiffwlfribenbegq5vrqq3iy42kwnbcn4pgei35nbgnt2gkwsfuy467w5jwnb2uqh5csk25r37env2co24g/inrevivendiuniversal.pdf.

[15] On securities litigation in Canada generally, see NERA Economic Consulting, Trends in Canadian Securities Class Actions: 1997-2008 (Jan. 2009) at http://www.nera.com/image/PUB_Recent_Trends_Canada_0109_Final.pdf .

the Superior Court of Justice of Ontario, in Silver v Imax, Justice Van Rensburg granted leave to bring a claim under Part XXIII.1 of the Ontario Securities Act,[16] and certified a class action based on common law and statutory claims on behalf of a global class of IMAX investors. One law firm reacted to the decision as follows:

> ... the certification of a worldwide class of investors may make Ontario a jurisdiction of choice for future securities class action claims, even when a significant proportion of investors reside outside of the province or even outside of Canada. Although it is anticipated that appellate courts will weigh in on several aspects of the leave and certification decisions, we can expect the increase in securities class action litigation that was sparked by the enactment of Part XXIII.1 of the Act to continue.[17]

The Ontario statute provides for liability without any need for the plaintiff to establish reliance (what follows are short excerpts from the relevant provisions):[18]

> 126.2 (1) A person or company shall not make a statement that the person or company knows or reasonably ought to know,
> (a) in a material respect and at the time and in the light of the circumstances under which it is made, is misleading or untrue or does not state a fact that is required to be stated or that is necessary to make the statement not misleading; and
> (b) would reasonably be expected to have a significant effect on the market price or value of a security...
> (2) A breach of subsection (1) does not give rise to a statutory right of action for damages otherwise than under Part XXIII or XXIII.1...
>
> 138.3[19] (1) Where a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security during the period between the time when the document was released

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[16] The Ontario Securities Act is at http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90s05_e.htm. Similar statutory provisions apply in British Columbia (http://www.bclaws.ca/Recon/document/freeside/--%20s%20--/securities%20act%20%20rsbc%201996%20%20c.%20418/00_96418_01.xml) and Alberta (http://www.qp.alberta.ca/574.cfm?page=S04.cfm&leg_type=Acts&isbncln=9780779745852).

[17] *See* http://www.mondaq.com/canada/article.asp?articleid=91338 .

[18] Before Part XXIII.1 was enacted it was necessary to establish detrimental reliance in Ontario and there was not much litigation with respect to securities fraud as a result.

[19] This provision is in Part XXIII.1 of the statute.

and the time when the misrepresentation contained in the document was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against,
(a) the responsible issuer; (b) each director of the responsible issuer at the time the document was released; (c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document; (d) each influential person, and each director and officer of an influential person, who knowingly influenced, (i) the responsible issuer or any person or company acting on behalf of the responsible issuer to release the document, or (ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the release of the document; and (e) each expert where, (i) the misrepresentation is also contained in a report, statement or opinion made by the expert, (ii) the document includes, summarizes or quotes from the report, statement or opinion of the expert, and (iii) if the document was released by a person or company other than the expert, the expert consented in writing to the use of the report, statement or opinion in the document.

Public oral statements by responsible issuer
(2) Where a person with actual, implied or apparent authority to speak on behalf of a responsible issuer makes a public oral statement that relates to the business or affairs of the responsible issuer and that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security during the period between the time when the public oral statement was made and the time when the misrepresentation contained in the public oral statement was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against,
(a) the responsible issuer; (b) the person who made the public oral statement; (c) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the making of the public oral statement; (d) each influential person, and each director and officer of the influential person, who knowingly influenced, (i) the person who made the public oral statement to make the public oral statement, or (ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the making of the public oral statement; and (e) each expert where, (i) the misrepresentation is also contained in a report, statement or opinion made by the expert, (ii) the person making the public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert, and (iii) if the public oral statement was made by a person other than the expert, the expert consented in writing to the use of the report, statement or opinion in the public oral statement..[20]

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[20] NB. See also s 138.4 , which limits the impact of s 138.3: ... In an action under section 138.3 in relation to a misrepresentation in a document that is not a core document, or a misrepresentation in a public oral statement, a person or company is not liable, subject to subsection (2), unless the plaintiff proves that the person or company, (a) knew, at the time that the document was released or public oral statement was made, that the document or public oral statement contained the misrepresentation; (b) at or before the time that the document was released or public oral statement was made, deliberately avoided acquiring knowledge that the document or public oral statement contained the misrepresentation;

The Ontario statute provides that a responsible issuer means "a reporting issuer, or any other issuer with a real and substantial connection to Ontario, any securities of which are publicly traded". Thus foreign issuers may be sued in Ontario.

The European Union has worked to harmonize much of financial regulation, including securities regulation, but has generally left matters of liability to the Member States. For example, the recitals to the Transparency Directive [21] state:

> Appropriate liability rules, as laid down by each Member State under its national law or regulations, should be applicable to the issuer, its administrative, management or supervisory bodies, or persons responsible within the issuer. Member States should remain free to determine the extent of the liability.

So, although jurisdictions in Canada have moved closer to the US approach to private securities litigation we have not yet seen any major moves to organized harmonization of rules in this area. IOSCO, the International Organization of Securities Commissions, has worked to develop harmonized principles of disclosure,[22] but has not produced harmonized principles for liability.

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or (c) was, through action or failure to act, guilty of gross misconduct in connection with the release of the document or the making of the public oral statement that contained the misrepresentation. 2002, c. 22, s. 185; 2004, c. 31, Sched. 34, s. 13 (1).

[21] Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ No. L 390/38 (Dec. 31, 2004) http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0057:EN:PDF .

[22] *See, e.g.*, IOSCO Technical Committee, Principles for Periodic Disclosure by Listed Entities, Consultation Report (Jul. 2009) *availalble at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD298.pdf (seeking views on proposed principles).