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This semester we will be thinking about a number of issues relating to financial activity which crosses territorial boundaries. The global financial crisis has provided 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 Federal Reserve provided financial support not just to US banks but also to foreign banks.[2] The G20, international financial institutions and domestic legislators and

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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] *See, e.g.*, Jia Lynn Yang, Neil Irwin & David S. Hilzenrath, Fed aid in financial crisis went beyond U.S. banks to industry, foreign firms, Washington Post (Dec. 2, 2010) at http://www.washingtonpost.com/wp-dyn/content/article/2010/12/01/AR2010120106870.html?hpid=topnews.

regulators have focused on how financial regulation should be changed in the wake of the crisis. Bailouts of banks stressed the economies of many countries, with implications for ratings of their sovereign debt.[3] The Madoff fraud generated numerous lawsuits against entities around the world.[4] In the wake of the global financial crisis, some commentators noted the existence of reverse remittances.[5] 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: post crisis remittances also flowed from poorer countries to richer ones

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 is an example of what is described as an F-cubed securities case (claims brought by foreign investors who bought securities in a foreign

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[3] *See, e.g.*, Sovereign-debt struggles in Europe, Economist Daily Chart (Dec. 28, 2010) at http://www.economist.com/blogs/dailychart/2010/12/sovereign_debt.

[4] *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/.

[5] *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.

issuer based on transactions in a foreign country) and involved claims brought under s10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5.

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. The statute and the rule were considered in Morrison v National Australia Bank Ltd., and the judgments in the Supreme Court and in the Second Circuit are set out below. After the decision in the Supreme Court, Congress enacted the Dodd-Frank Act,[6] which addresses the issue of extraterritorial jurisdiction, including an instruction to the SEC to carry out a study on private rights of action for transnational securities fraud. An excerpt from the SEC's request for comments is set out below at page 34. We will compare the judgments in the case in the Supreme Court and consider how you would respond to the SEC's request for comments.

Morrison v. National Australia Bank Ltd. (Supreme Court 2010)[7]

Justice Scalia: We decide whether § 10(b) of the Securities Exchange Act of 1934 provides a cause of action to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign exchanges.

Respondent National Australia Bank Limited (National) was, during the relevant time, the largest bank in Australia. Its Ordinary Shares -- what in America would be called "common stock" -- are traded on the Australian Stock Exchange Limited and on other foreign securities exchanges, but not on any exchange in the United States. There are listed on the New York Stock Exchange, however, National's American Depositary Receipts (ADRs), which represent the right to receive a specified number of National's Ordinary Shares...[8]

The complaint alleges the following facts, which we accept as true. In February 1998, National bought respondent HomeSide Lending, Inc., a mortgage servicing company headquartered in Florida. HomeSide's business was to receive fees for servicing mortgages (essentially the administrative tasks associated with collecting mortgage payments ...). The rights to receive those fees, so-called mortgage-servicing rights, can provide a valuable income stream... How valuable each of the rights is depends, in part, on the likelihood that the mortgage to which it applies will be fully repaid before it is due, terminating the need for servicing. HomeSide calculated the present value of its mortgage-servicing rights by using valuation models designed to take this likelihood into account. It recorded the value of its assets, and the numbers appeared in National's financial statements.

From 1998 until 2001, National's annual reports and other public documents touted the success

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[6] Pub.L. 111-203 2010 (Jul. 21, 2010) (Dodd-Frank Act).

[7] 130 S. Ct. 2869 (S.Ct. 2010).

[8] See page 17 below for a description of ADRs.

of HomeSide's business, and respondents Frank Cicutto (National's managing director and chief executive officer), Kevin Race (HomeSide's chief operating officer), and Hugh Harris (HomeSide's chief executive officer) did the same in public statements. But on July 5, 2001, National announced that it was writing down the value of HomeSide's assets by $ 450 million; and then again on September 3, by another $ 1.75 billion. The prices of both Ordinary Shares and ADRs slumped. After downplaying the July write-down, National explained the September write-down as the result of a failure to anticipate the lowering of prevailing interest rates (lower interest rates lead to more refinancings, i.e., more early repayments of mortgages), other mistaken assumptions in the financial models, and the loss of goodwill. According to the complaint, however, HomeSide, Race, Harris, and another HomeSide senior executive who is also a respondent here had manipulated HomeSide's financial models to make the rates of early repayment unrealistically low in order to cause the mortgage-servicing rights to appear more valuable than they really were. The complaint also alleges that National and Cicutto were aware of this deception by July 2000, but did nothing about it.

As relevant here, petitioners Russell Leslie Owen and Brian and Geraldine Silverlock, all Australians, purchased National's Ordinary Shares in 2000 and 2001, before the write-downs.[9] They sued National, HomeSide, Cicutto, and the three HomeSide executives in the United States District Court for the Southern District of New York for alleged violations of §§ 10(b) and 20(a) of the Securities and Exchange Act of 1934 .. and SEC Rule 10b-5.. promulgated pursuant to § 10(b). They sought to represent a class of foreign purchasers of National's Ordinary Shares during a specified period up to the September write-down...

Respondents moved to dismiss for lack of subject-matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1) and for failure to state a claim under Rule 12(b)(6). The District Court granted the motion on the former ground, finding no jurisdiction because the acts in this country were, "at most, a link in the chain of an alleged overall securities fraud scheme that culminated abroad."... The Court of Appeals for the Second Circuit affirmed on similar grounds. The acts performed in the United States did not "compris[e] the heart of the alleged fraud.".. We granted certiorari..

Before addressing the question presented, we must correct a threshold error in the Second Circuit's analysis. It considered the extraterritorial reach of § 10(b) to raise a question of subject-matter jurisdiction, wherefore it affirmed the District Court's dismissal under Rule 12(b)(1)... In this regard it was following Circuit precedent, see Schoenbaum v. Firstbrook... The Second Circuit is hardly alone in taking this position..

But .to ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question. Subject-matter jurisdiction, by contrast, "refers to a tribunal's '"power to hear a case."'.. It presents an issue quite separate from the question whether the allegations the plaintiff makes entitle him to relief... The District Court here had jurisdiction .. to adjudicate the question whether § 10(b) applies to National's conduct.

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[9] Robert Morrison, an American investor in National's ADRs, also brought suit, but his claims were dismissed by the District Court because he failed to allege damages. In re National Australia Bank Securities Litigation, No. 03 Civ. 6537 (BSJ).. (SDNY, Oct. 25, 2006). Petitioners did not appeal that decision .. and it is not before us. Inexplicably, Morrison continued to be listed as a petitioner in the Court of Appeals and here.

In view of this error, which the parties do not dispute, petitioners ask us to remand. We think that unnecessary. Since nothing in the analysis of the courts below turned on the mistake, a remand would only require a new Rule 12(b)(6) label for the same Rule 12(b)(1) conclusion.... It is a "longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'"... This principle represents a canon of construction, or a presumption about a statute's meaning, rather than a limit upon Congress's power to legislate .. It rests on the perception that Congress ordinarily legislates with respect to domestic, not foreign matters.. Thus, "unless there is the affirmative intention of the Congress clearly expressed" to give a statute extraterritorial effect, "we must presume it is primarily concerned with domestic conditions." .. The canon or presumption applies regardless of whether there is a risk of conflict between the American statute and a foreign law... When a statute gives no clear indication of an extraterritorial application, it has none.

Despite this principle of interpretation, long and often recited in our opinions, the Second Circuit believed that, because the Exchange Act is silent as to the extraterritorial application of § 10(b), it was left to the court to "discern" whether Congress would have wanted the statute to apply... This disregard of the presumption against extraterritoriality did not originate with the Court of Appeals panel in this case. It has been repeated over many decades by various courts of appeals in determining the application of the Exchange Act, and § 10(b) in particular, to fraudulent schemes that involve conduct and effects abroad. That has produced a collection of tests for divining what Congress would have wanted, complex in formulation and unpredictable in application.

As of 1967, district courts at least in the Southern District of New York had consistently concluded that, by reason of the presumption against extraterritoriality, § 10(b) did not apply when the stock transactions underlying the violation occurred abroad. See Schoenbaum v. Firstbrook.. Schoenbaum involved the sale in Canada of the treasury shares of a Canadian corporation whose publicly traded shares (but not, of course, its treasury shares) were listed on both the American Stock Exchange and the Toronto Stock Exchange. Invoking the presumption against extraterritoriality, the court held that § 10(b) was inapplicable (though it incorrectly viewed the defect as jurisdictional)... The decision in Schoenbaum was reversed, however, by a Second Circuit opinion which held that "neither the usual presumption against extraterritorial application of legislation nor the specific language of [§]30(b) show Congressional intent to preclude application of the Exchange Act to transactions regarding stocks traded in the United States which are effected outside the United States . . . ."... It sufficed to apply § 10(b) that, although the transactions in treasury shares took place in Canada, they affected the value of the common shares publicly traded in the United States.. Application of § 10(b), the Second Circuit found, was "necessary to protect American investors"..

The Second Circuit took another step with Leasco Data Processing Equip. Corp. v. Maxwell, ... which involved an American company that had been fraudulently induced to buy securities in England. There, unlike in Schoenbaum, some of the deceptive conduct had occurred in the United States but the corporation whose securities were traded (abroad) was not listed on any domestic exchange. Leasco said that the presumption against extraterritoriality applies only to matters over which the United States would not have prescriptive jurisdiction... Congress had prescriptive jurisdiction to regulate the deceptive conduct in this country, the language of the Act could be read to cover that conduct, and the court concluded that "if Congress had thought

about the point," it would have wanted § 10(b) to apply...

With Schoenbaum and Leasco on the books, the Second Circuit had excised the presumption against extraterritoriality from the jurisprudence of § 10(b) and replaced it with the inquiry whether it would be reasonable (and hence what Congress would have wanted) to apply the statute to a given situation. As long as there was prescriptive jurisdiction to regulate, the Second Circuit explained, whether to apply § 10(b) even to "predominantly foreign" transactions became a matter of whether a court thought Congress "wished the precious resources of United States courts and law enforcement agencies to be devoted to them rather than leave the problem to foreign countries." Bersch v. Drexel Firestone, Inc....

The Second Circuit had thus established that application of § 10(b) could be premised upon either some effect on American securities markets or investors (Schoenbaum) or significant conduct in the United States (Leasco). It later formalized these two applications into (1) an "effects test," "whether the wrongful conduct had a substantial effect in the United States or upon United States citizens," and (2) a "conduct test," "whether the wrongful conduct occurred in the United States." SEC v. Berger... These became the north star of the Second Circuit's § 10(b) jurisprudence, pointing the way to what Congress would have wished. Indeed, the Second Circuit declined to keep its two tests distinct on the ground that "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." Itoba Ltd. v. Lep Group PLC... The Second Circuit never put forward a textual or even extratextual basis for these tests. As early as Bersch, it confessed that "if we were asked to point to language in the statutes, or even in the legislative history, that compelled these conclusions, we would be unable to respond"..

As they developed, these tests were not easy to administer. The conduct test was held to apply differently depending on whether the harmed investors were Americans or foreigners: When the alleged damages consisted of losses to American investors abroad, it was enough that acts "of material importance" performed in the United States "significantly contributed" to that result; whereas those acts must have "directly caused" the result when losses to foreigners abroad were at issue.. And "merely preparatory activities in the United States" did not suffice "to trigger application of the securities laws for injury to foreigners located abroad."... This required the court to distinguish between mere preparation and using the United States as a "base" for fraudulent activities in other countries.... But merely satisfying the conduct test was sometimes insufficient without "'some additional factor tipping the scales'" in favor of the application of American law... District courts have noted the difficulty of applying such vague formulations... There is no more damning indictment of the "conduct" and "effects" tests than the Second Circuit's own declaration that "the presence or absence of any single factor which was considered significant in other cases . . . is not necessarily dispositive in future cases." IIT v. Cornfeld...

Other Circuits embraced the Second Circuit's approach, though not its precise application. Like the Second Circuit, they described their decisions regarding the extraterritorial application of § 10(b) as essentially resolving matters of policy... While applying the same fundamental methodology of balancing interests and arriving at what seemed the best policy, they produced a proliferation of vaguely related variations on the "conduct" and "effects" tests. As described in a leading Seventh Circuit opinion: "Although the circuits . . . seem to agree that there are some transnational situations to which the antifraud provisions of the securities laws are applicable,

agreement appears to end at that point."..

At least one Court of Appeals has criticized this line of cases and the interpretive assumption that underlies it. In Zoelsch v. Arthur Andersen & Co...(Bork, J.), the District of Columbia Circuit observed that rather than courts' "divining what 'Congress would have wished' if it had addressed the problem[, a] more natural inquiry might be what jurisdiction Congress in fact thought about and conferred." Although tempted to apply the presumption against extraterritoriality and be done with it.. that court deferred to the Second Circuit because of its "preeminence in the field of securities law"...

Commentators have criticized the unpredictable and inconsistent application of § 10(b) to transnational cases... Some have challenged the premise underlying the Courts of Appeals' approach, namely that Congress did not consider the extraterritorial application of § 10(b) (thereby leaving it open to the courts, supposedly, to determine what Congress would have wanted).... Others, more fundamentally, have noted that using congressional silence as a justification for judge-made rules violates the traditional principle that silence means no extraterritorial application...

The criticisms seem to us justified. The results of judicial-speculation-made-law -- divining what Congress would have wanted if it had thought of the situation before the court -- demonstrate the wisdom of the presumption against extraterritoriality. Rather than guess anew in each case, we apply the presumption in all cases, preserving a stable background against which Congress can legislate with predictable effects.

B .Rule 10b-5, the regulation under which petitioners have brought suit, was promulgated under § 10(b), and "does not extend beyond conduct encompassed by § 10(b)'s prohibition.".. Therefore, if § 10(b) is not extraterritorial, neither is Rule 10b-5.

The Second Circuit considered petitioners' appeal to raise only a claim under Rule 10b-5(b), since it found their claims under subsections (a) and (c) to be forfeited... We do likewise.

On its face, § 10(b) contains nothing to suggest it applies abroad... Petitioners and the Solicitor General contend, however, that three things indicate that § 10(b) or the Exchange Act in general has at least some extraterritorial application.

First, they point to the definition of "interstate commerce," a term used in § 10(b), which includes "trade, commerce, transportation, or communication . . . between any foreign country and any State." 15 U.S.C. § 78c(a)(17). But "we have repeatedly held that even statutes that contain broad language in their definitions of 'commerce' that expressly refer to 'foreign commerce' do not apply abroad." ...The general reference to foreign commerce in the definition of "interstate commerce" does not defeat the presumption against extraterritoriality.

Petitioners and the Solicitor General next point out that Congress, in describing the purposes of the Exchange Act, observed that the "prices established and offered in such transactions are generally disseminated and quoted throughout the United States and foreign countries." 15 U.S.C. § 78b(2). The antecedent of "such transactions," however, is found in the first sentence of the section, which declares that "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest."

§ 78b. Nothing suggests that this national public interest pertains to transactions conducted upon foreign exchanges and markets. The fleeting reference to the dissemination and quotation abroad of the prices of securities traded in domestic exchanges and markets cannot overcome the presumption against extraterritoriality.

Finally, there is.§ 30(b) of the Exchange Act, 15 U.S.C. § 78dd(b), which does mention the Act's extraterritorial application: "The provisions of [the Exchange Act] or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States," unless he does so in violation of regulations promulgated by the Securities and Exchange Commission "to prevent . . . evasion of [the Act]." (The parties have pointed us to no regulation promulgated pursuant to § 30(b).) The Solicitor General argues that "[this] exemption would have no function if the Act did not apply in the first instance to securities transactions that occur abroad."...

We are not convinced. In the first place, it would be odd for Congress to indicate the extraterritorial application of the whole Exchange Act by means of a provision imposing a condition precedent to its application abroad. And if the whole Act applied abroad, why would the Commission's enabling regulations be limited to those preventing "evasion" of the Act, rather than all those preventing "violation"?.The provision seems to us directed at actions abroad that might conceal a domestic violation, or might cause what would otherwise be a domestic violation to escape on a technicality. At most, the Solicitor General's proposed inference is possible; but.possible interpretations of statutory language do not override the presumption against extraterritoriality...

The Solicitor General also fails to account for § 30(a), which reads in relevant part as follows: "It shall be unlawful for any broker or dealer . . . to make use of the mails or of any means or instrumentality of interstate commerce for the purpose of effecting on an exchange not within or subject to the jurisdiction of the United States, any transaction in any security the issuer of which is a resident of, or is organized under the laws of, or has its principal place of business in, a place within or subject to the jurisdiction of the United States, in contravention of such rules and regulations as the Commission may prescribe . . . ."..

Subsection 30(a) contains what § 10(b) lacks: a clear statement of extraterritorial effect. Its explicit provision for a specific extraterritorial application would be quite superfluous if the rest of the Exchange Act already applied to transactions on foreign exchanges -- and its limitation of that application to securities of domestic issuers would be inoperative. Even if that were not true, when a statute provides for some extraterritorial application, the presumption against extraterritoriality operates to limit that provision to its terms... No one claims that § 30(a) applies here.

The concurrence claims we have impermissibly narrowed the inquiry in evaluating whether a statute applies abroad, citing for that point the dissent in Aramco... But we do not say, as the concurrence seems to think, that the presumption against extraterritoriality is a "clear statement rule,".. if by that is meant a requirement that a statute say "this law applies abroad." Assuredly context can be consulted as well. But whatever sources of statutory meaning one consults to give "the most faithful reading" of the text.. there is no clear indication of extraterritoriality here. The concurrence does not even try to refute that conclusion, but merely puts forward the same (at best) uncertain indications relied upon by petitioners and the Solicitor General. As the

opinion for the Court in Aramco (which we prefer to the dissent) shows, those uncertain indications do not suffice.

In short, there is no affirmative indication in the Exchange Act that § 10(b) applies extraterritorially, and we therefore conclude that it does not.

IV A Petitioners argue that the conclusion that § 10(b) does not apply extraterritorially does not resolve this case. They contend that they seek no more than domestic application anyway, since Florida is where HomeSide and its senior executives engaged in the deceptive conduct of manipulating HomeSide's financial models; their complaint also alleged that Race and Hughes made misleading public statements there. This is less an answer to the presumption against extraterritorial application than it is an assertion -- a quite valid assertion -- that that presumption here (as often) is not self-evidently dispositive, but its application requires further analysis. For it is a rare case of prohibited extraterritorial application that lacks all contact with the territory of the United States. But the presumption against extraterritorial application would be a craven watchdog indeed if it retreated to its kennel whenever some domestic activity is involved in the case. The concurrence seems to imagine just such a timid sentinel,... but our cases are to the contrary. In Aramco, for example, the Title VII plaintiff had been hired in Houston, and was an American citizen. .. The Court concluded, however, that neither that territorial event nor that relationship was the "focus" of congressional concern.. but rather domestic employment....

Applying the same mode of analysis here, we think that .the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States. Section 10(b) does not punish deceptive conduct, but only deceptive conduct "in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered." ... Those purchase-and-sale transactions are the objects of the statute's solicitude. It is those transactions that the statute seeks to "regulate,"... it is parties or prospective parties to those transactions that the statute seeks to "protec[t],"... And it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies.

The primacy of the domestic exchange is suggested by the very prologue of the Exchange Act, which sets forth as its object "[t]o provide for the regulation of securities exchanges . . . operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges . . . ." We know of no one who thought that the Act was intended to "regulat[e]" foreign securities exchanges -- or indeed who even believed that under established principles of international law Congress had the power to do so. The Act's registration requirements apply only to securities listed on national securities exchanges...

With regard to securities not registered on domestic exchanges, the exclusive focus on domestic purchases and sales is strongly confirmed by § 30(a) and (b), discussed earlier. The former extends the normal scope of the Exchange Act's prohibitions to acts effecting, in violation of rules prescribed by the Commission, a "transaction" in a United States security "on an exchange not within or subject to the jurisdiction of the United States.".. And the latter specifies that the Act does not apply to "any person insofar as he transacts a business in securities without the jurisdiction of the United States," unless he does so in violation of regulations promulgated by the Commission "to prevent evasion [of the Act]." ... Under both

provisions it is the foreign location of the transaction that establishes (or reflects the presumption of) the Act's inapplicability, absent regulations by the Commission.

The same focus on domestic transactions is evident in the Securities Act of 1933 .. enacted by the same Congress as the Exchange Act, and forming part of the same comprehensive regulation of securities trading... That legislation makes it unlawful to sell a security, through a prospectus or otherwise, making use of "any means or instruments of transportation or communication in interstate commerce or of the mails," unless a registration statement is in effect... The Commission has interpreted that requirement "not to include . . . sales that occur outside the United States."..

Finally,.we reject the notion that the Exchange Act reaches conduct in this country affecting exchanges or transactions abroad for the same reason that Aramco rejected overseas application of Title VII to all domestically concluded employment contracts or all employment contracts with American employers: The probability of incompatibility with the applicable laws of other countries is so obvious that if Congress intended such foreign application "it would have addressed the subject of conflicts with foreign laws and procedures."... Like the United States, foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction. And the regulation of other countries often differs from ours as to what constitutes fraud, what disclosures must be made, what damages are recoverable, what discovery is available in litigation, what individual actions may be joined in a single suit, what attorney's fees are recoverable, and many other matters... The Commonwealth of Australia, the United Kingdom of Great Britain and Northern Ireland, and the Republic of France have filed amicus briefs in this case. So have (separately or jointly) such international and foreign organizations as the International Chamber of Commerce, the Swiss Bankers Association, the Federation of German Industries, the French Business Confederation, the Institute of International Bankers, the European Banking Federation, the Australian Bankers' Association, and the Association Francaise des Entreprises Privees. They all complain of the interference with foreign securities regulation that application of § 10(b) abroad would produce, and urge the adoption of a clear test that will avoid that consequence. The transactional test we have adopted -- whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange -- meets that requirement.

B The Solicitor General suggests a different test, which petitioners also endorse: "[A] transnational securities fraud violates [§]10(b) when the fraud involves significant conduct in the United States that is material to the fraud's success."... Neither the Solicitor General nor petitioners provide any textual support for this test. The Solicitor General sets forth a number of purposes such a test would serve: achieving a high standard of business ethics in the securities industry, ensuring honest securities markets and thereby promoting investor confidence, and preventing the United States from becoming a "Barbary Coast" for malefactors perpetrating frauds in foreign markets... But it provides no textual support for the last of these purposes, or for the first two as applied to the foreign securities industry and securities markets abroad. It is our function to give the statute the effect its language suggests, however modest that may be; not to extend it to admirable purposes it might be used to achieve.

If, moreover, one is to be attracted by the desirable consequences of the "significant and material conduct" test, one should also be repulsed by its adverse consequences. While there is no reason to believe that the United States has become the Barbary Coast for those

perpetrating frauds on foreign securities markets, some fear that it has become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets...

As case support for the "significant and material conduct" test, the Solicitor General relies primarily on Pasquantino v. United States.. In that case we concluded that the wire-fraud statute was violated by defendants who ordered liquor over the phone from a store in Maryland with the intent to smuggle it into Canada and deprive the Canadian Government of revenue. ...Section 1343 prohibits "any scheme or artifice to defraud," -- fraud simpliciter, without any requirement that it be "in connection with" any particular transaction or event. The Pasquantino Court said that the petitioners'"offense was complete the moment they executed the scheme inside the United States," and that it was "[t]his domestic element of petitioners' conduct [that] the Government is punishing."....Section 10(b), by contrast, punishes not all acts of deception, but only such acts "in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered." Not deception alone, but deception with respect to certain purchases or sales is necessary for a violation of the statute.

The Solicitor General points out that the "significant and material conduct" test is in accord with prevailing notions of international comity. If so, that proves that if the United States asserted prescriptive jurisdiction pursuant to the "significant and material conduct" test it would not violate customary international law; but it in no way tends to prove that that is what Congress has done.

Finally, the Solicitor General argues that the Commission has adopted an interpretation similar to the "significant and material conduct" test, and that we should defer to that. In the two adjudications the Solicitor General cites, however, the Commission did not purport to be providing its own interpretation of the statute, but relied on decisions of federal courts -- mainly Court of Appeals decisions that in turn relied on the Schoenbaum and Leasco decisions of the Second Circuit that we discussed earlier. ..We need "accept only those agency interpretations that are reasonable in light of the principles of construction courts normally employ.".. Since the Commission's interpretations relied on cases we disapprove, which ignored or discarded the presumption against extraterritoriality, we owe them no deference.

Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States. This case involves no securities listed on a domestic exchange, and all aspects of the purchases complained of by those petitioners who still have live claims occurred outside the United States. Petitioners have therefore failed to state a claim on which relief can be granted. We affirm the dismissal of petitioners' complaint on this ground.

Justice Breyer , concurring in part and concurring in the judgment:

Section 10(b) of the Securities Exchange Act of 1934 applies to fraud "in connection with" two categories of transactions: (1) "the purchase or sale of any security registered on a national securities exchange" or (2) "the purchase or sale of . . . any security not so registered.".. In this case, the purchased securities are listed only on a few foreign exchanges, none of which has registered with the Securities and Exchange Commission as a "national securities exchange."..

The first category therefore does not apply. Further, the relevant purchases of these unregistered securities took place entirely in Australia and involved only Australian investors. And in accordance with the presumption against extraterritoriality, I do not read the second category to include such transactions. Thus, while state law or other federal fraud statutes, see, e.g., 18 U.S.C. § 1341 (mail fraud), § 1343 (wire fraud), may apply to the fraudulent activity alleged here to have occurred in the United States, I believe that § 10(b) does not. This case does not require us to consider other circumstances.

To the extent the Court's opinion is consistent with these views, I join it.

Justice Stevens , with whom Justice Ginsburg joins, concurring in the judgment:

While I agree that petitioners have failed to state a claim on which relief can be granted, my reasoning differs from the Court's. I would adhere to the general approach that has been the law in the Second Circuit, and most of the rest of the country, for nearly four decades.

I Today the Court announces a new "transactional test," .. for defining the reach of § 10(b) ... and SEC Rule 10b-5..: Henceforth, those provisions will extend only to "transactions in securities listed on domestic exchanges . . . and domestic transactions in other securities," .. If one confines one's gaze to the statutory text, the Court's conclusion is a plausible one. But the federal courts have been construing § 10(b) in a different manner for a long time, and the Court's textual analysis is not nearly so compelling, in my view, as to warrant the abandonment of their doctrine.

The text and history of § 10(b) are famously opaque on the question of when, exactly, transnational securities frauds fall within the statute's compass. As those types of frauds became more common in the latter half of the 20th century, the federal courts were increasingly called upon to wrestle with that question. The Court of Appeals for the Second Circuit, located in the Nation's financial center, led the effort. Beginning in earnest with Schoenbaum v. Firstbrook,.. that court strove, over an extended series of cases, to "discern" under what circumstances "Congress would have wished the precious resources of the United States courts and law enforcement agencies to be devoted to [transnational] transactions,"... Relying on opinions by Judge Henry Friendly, 1 the Second Circuit eventually settled on a conduct-and-effects test. This test asks "(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.".. Numerous cases flesh out the proper application of each prong.

The Second Circuit's test became the "north star" of § 10(b) jurisprudence.. not just regionally but nationally as well. With minor variations, other courts converged on the same basic approach. .. Neither Congress nor the Securities Exchange Commission (Commission) acted to change the law. To the contrary, the Commission largely adopted the Second Circuit's position in its own adjudications..

In light of this history, the Court's critique of the decision below for applying "judge-made rules" is quite misplaced.. This entire area of law is replete with judge-made rules, which give concrete meaning to Congress' general commands. "When we deal with private actions under Rule 10b-5," then-Justice Rehnquist wrote many years ago, "we deal with a judicial oak which has

grown from little more than a legislative acorn." Blue Chip Stamps v. Manor Drug Stores... The "'Mother Court'" of securities law tended to that oak.. One of our greatest jurists -- the judge who, "without a doubt, did more to shape the law of securities regulation than any [other] in the country"[10] -- was its master arborist.

The development of § 10(b) law was hardly an instance of judicial usurpation. Congress invited an expansive role for judicial elaboration when it crafted such an open-ended statute in 1934. And both Congress and the Commission subsequently affirmed that role when they left intact the relevant statutory and regulatory language, respectively, throughout all the years that followed... Unlike certain other domains of securities law, this is "a case in which Congress has enacted a regulatory statute and then has accepted, over a long period of time, broad judicial authority to define substantive standards of conduct and liability," and much else besides...

This Court has not shied away from acknowledging that authority. We have consistently confirmed that, in applying § 10(b) and Rule 10b-5, courts may need "to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance." .. And we have unanimously "recogniz[ed] a judicial authority to shape . . . the 10b-5 cause of action," for that is a task "Congress has left to us." .... Indeed, we have unanimously endorsed the Second Circuit's basic interpretive approach to § 10(b) -- ridiculed by the Court today -- of striving to "divin[e] what Congress would have wanted," "Our task," we have said, is "to attempt to infer how the 1934 Congress would have addressed the issue." ...

Thus, while the Court devotes a considerable amount of attention to the development of the case law.. it draws the wrong conclusions. The Second Circuit refined its test over several decades and dozens of cases, with the tacit approval of Congress and the Commission and with the general assent of its sister Circuits. That history is a reason we should give additional weight to the Second Circuit's "judge-made" doctrine, not a reason to denigrate it. "The longstanding acceptance by the courts, coupled with Congress' failure to reject [its] reasonable interpretation of the wording of § 10(b), . . . argues significantly in favor of acceptance of the [Second Circuit] rule by this Court."..

II The Court's other main critique of the Second Circuit's approach -- apart from what the Court views as its excessive reliance on functional considerations and reconstructed congressional intent -- is that the Second Circuit has "disregard[ed]" the presumption against extraterritoriality. .. It is the Court, however, that misapplies the presumption, in two main respects.

First, the Court seeks to transform the presumption from a flexible rule of thumb into something more like a clear statement rule. We have been here before. In the case on which the Court primarily relies, .. Aramco., Chief Justice Rehnquist's majority opinion included a sentence that appeared to make the same move.... Justice Marshall, in dissent, vigorously objected...

Yet even Aramco -- surely the most extreme application of the presumption against extraterritoriality in my time on the Court -- contained numerous passages suggesting that the presumption may be overcome without a clear directive... And our cases both before and after

[10] This is a reference to Judge Friendly.

Aramco make perfectly clear that the Court continues to give effect to "all available evidence about the meaning" of a provision when considering its extraterritorial application, lest we defy Congress' will... Contrary to Justice Scalia 's personal view of statutory interpretation, that evidence legitimately encompasses more than the enacted text. Hence, while the Court's dictum that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none," .. makes for a nice catchphrase, the point is overstated. The presumption against extraterritoriality can be useful as a theory of congressional purpose, a tool for managing international conflict, a background norm, a tiebreaker. It does not relieve courts of their duty to give statutes the most faithful reading possible.

Second, and more fundamentally, the Court errs in suggesting that the presumption against extraterritoriality is fatal to the Second Circuit's test. For even if the presumption really were a clear statement (or "clear indication," ..) rule, it would have only marginal relevance to this case.

It is true, of course, that "this Court ordinarily construes ambiguous statutes to avoid unreasonable interference with the sovereign authority of other nations,".. and that, absent contrary evidence, we presume "Congress is primarily concerned with domestic conditions,"... Accordingly, the presumption against extraterritoriality "provides a sound basis for concluding that Section 10(b) does not apply when a securities fraud with no effects in the United States is hatched and executed entirely outside this country." Brief for United States as Amicus Curiae 22. But that is just about all it provides a sound basis for concluding. And the conclusion is not very illuminating, because no party to the litigation disputes it. No one contends that § 10(b) applies to wholly foreign frauds.

Rather, the real question in this case is how much, and what kinds of, domestic contacts are sufficient to trigger application of § 10(b). In developing its conduct-and-effects test, the Second Circuit endeavored to derive a solution from the Exchange Act's text, structure, history, and purpose. Judge Friendly and his colleagues were well aware that United States courts "cannot and should not expend [their] resources resolving cases that do not affect Americans or involve fraud emanating from America."..

The question just stated does not admit of an easy answer. The text of the Exchange Act indicates that § 10(b) extends to at least some activities with an international component, but, again, it is not pellucid as to which ones. The Second Circuit draws the line as follows: § 10(b) extends to transnational frauds "only when substantial acts in furtherance of the fraud were committed within the United States,".. or when the fraud was "'intended to produce'" and did produce "'detrimental effects within'" the United States, Schoenbaum..

This approach is consistent with the understanding shared by most scholars that Congress, in passing the Exchange Act, "expected U.S. securities laws to apply to certain international transactions or conduct."... It is also consistent with the traditional understanding, regnant in the 1930's as it is now, that the presumption against extraterritoriality does not apply "when the conduct [at issue] occurs within the United States," and has lesser force when "the failure to extend the scope of the statute to a foreign setting will result in adverse effects within the United States."... And it strikes a reasonable balance between the goals of "preventing the export of fraud from America," protecting shareholders, enhancing investor confidence, and deterring corporate misconduct, on the one hand, and conserving United States resources and

limiting conflict with foreign law, on the other..

Thus, while § 10(b) may not give any "clear indication" on its face as to how it should apply to transnational securities frauds... it does give strong clues that it should cover at least some of them.. And in my view, the Second Circuit has done the best job of discerning what sorts of transnational frauds Congress meant in 1934 -- and still means today -- to regulate. I do not take issue with the Court for beginning its inquiry with the statutory text, rather than the doctrine in the Courts of Appeals.. I take issue with the Court for beginning and ending its inquiry with the statutory text, when the text does not speak with geographic precision, and for dismissing the long pedigree of, and the persuasive account of congressional intent embodied in, the Second Circuit's rule.

Repudiating the Second Circuit's approach in its entirety, the Court establishes a novel rule that will foreclose private parties from bringing § 10(b) actions whenever the relevant securities were purchased or sold abroad and are not listed on a domestic exchange. The real motor of the Court's opinion, it seems, is not the presumption against extraterritoriality but rather the Court's belief that transactions on domestic exchanges are "the focus of the Exchange Act" and "the objects of [its] solicitude." .. In reality, however, it is the "public interest" and "the interests of investors" that are the objects of the statute's solicitude.... And while the clarity and simplicity of the Court's test may have some salutary consequences, like all bright-line rules it also has drawbacks.

Imagine, for example, an American investor who buys shares in a company listed only on an overseas exchange. That company has a major American subsidiary with executives based in New York City; and it was in New York City that the executives masterminded and implemented a massive deception which artificially inflated the stock price -- and which will, upon its disclosure, cause the price to plummet. Or, imagine that those same executives go knocking on doors in Manhattan and convince an unsophisticated retiree, on the basis of material misrepresentations, to invest her life savings in the company's doomed securities. Both of these investors would, under the Court's new test, be barred from seeking relief under § 10(b).

The oddity of that result should give pause. For in walling off such individuals from § 10(b), the Court narrows the provision's reach to a degree that would surprise and alarm generations of American investors -- and, I am convinced, the Congress that passed the Exchange Act. Indeed, the Court's rule turns § 10(b) jurisprudence (and the presumption against extraterritoriality) on its head, by withdrawing the statute's application from cases in which there is both substantial wrongful conduct that occurred in the United States and a substantial injurious effect on United States markets and citizens.

III In my judgment, if petitioners' allegations of fraudulent misconduct that took place in Florida are true, then respondents may have violated § 10(b), and could potentially be held accountable in an enforcement proceeding brought by the Commission. But it does not follow that shareholders who have failed to allege that the bulk or the heart of the fraud occurred in the United States, or that the fraud had an adverse impact on American investors or markets, may maintain a private action to recover damages they suffered abroad. Some cases involving foreign securities transactions have extensive links to, and ramifications for, this country; this case has Australia written all over it. Accordingly, for essentially the reasons stated in the Court of Appeals' opinion, I would affirm its judgment.

The Court instead elects to upend a significant area of securities law based on a plausible, but hardly decisive, construction of the statutory text. In so doing, it pays short shrift to the United States' interest in remedying frauds that transpire on American soil or harm American citizens, as well as to the accumulated wisdom and experience of the lower courts. I happen to agree with the result the Court reaches in this case. But "I respectfully dissent," once again, "from the Court's continuing campaign to render the private cause of action under § 10(b) toothless." ...

Notes and Questions

Justice Scalia states (above at p. 10): “it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies.”

What about US investors who purchase securities issued by a foreign issuer on an exchange outside the US? Or US investors who purchase securities issued by US corporations on exchanges outside the US? Can they sue in the US? Should they be able to do so? Does it make a difference whether the securities are listed in the US? Is it a good idea to allow US investors to choose whether or not they have the protection of US securities laws?

The SDNY judgment in Morrison[11] includes an informative note on ADRs:

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 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)...

Why do you think the fact of the ADRs (listed on the NYSE) is not given weight in the court’s decision?

The facts underlying this case involve different jurisdictions. National Australia Bank (NAB), headquartered in Melbourne, Australia, owned HomeSide, a mortgage service provider in Florida.[12] National Australia Bank Limited is the holding company for an

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

[12] 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 .

international financial services group and is regulated in Australia.[13] 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.[14] NAB owned entities are also regulated in the jurisdictions where they carry on business.

The 2nd Circuit judgment below 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..."[15] The SDNY's judgment stated 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).

NAB shares "trade[d] on the Australian Securities Exchange, the London 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.[16] 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?

Morrison v. National Australia Bank Ltd. (2d. Cir. 2008)[17]

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

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[13] As well as National Australia Bank, the NAB Group includes MLC, Clydesdale Bank, Yorkshire Bank, Bank of New Zealand and Great Western Bank.

[14] The 2008 NAB Annual Report refers to NAB's deregistration with the SEC. This report is at http://www.nabgroup.com/vgnmedia/downld/2008AFR_Final.pdf .

[15] 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.

[16] *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

[17] 547 F.3d 167 (2nd. Cir. 2008) (Newman, Calabresi & B.D. Parker).

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 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

[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

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

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

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 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.

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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

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 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

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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.

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 2nd Circuit stated: “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? 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 rejected 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 should not expend our resources resolving cases that do not affect Americans or involve fraud emanating from America."[7]

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

Is this an accurate representation of the decision?

An 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. This amicus brief stated:

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 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 an article in the Wisconsin Law Review in 2009 (an article Justice Scalia cited in his opinion in Morrison) Professors Choi and Silberman[8] 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.

Is this the rule established by the Supreme Court? What are the advantages of such a rule? Does it have any disadvantages? The US Chamber of Commerce advocated this rule in an amicus brief in the Infineon case (the US Chamber of Commerce described the development of the conduct test as the courts' policy choice):[9]

... 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

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

[9] See http://www.chamberlitigation.com/sites/default/files/cases/files/2009/In%20re%20Infineon%20Technologies%20AG%20Securities%20Litigation%20%28NCLC%20Brief%29.pdf

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."
...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[10]:

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

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[10] Plaintiffs won a jury verdict against Vivendi in January 2010 on 57 claims. The majority of the class were f-cubed investors.

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.[11]

In December 2010 the SDNY applied Morrison in **Absolute Activist Value Master Fund Limited v. Homm**.[12] Is the answer the Judge gives in this case the right one?

George B. Dantels, District Judge:

This action involves an alleged pump-and-dump scheme in which Defendants caused Plaintiffs, a group of Cayman Island based hedge funds, to purchase shares of "Penny Stock Companies" not traded on a U.S. domestic exchange at artificially inflated prices.[13] Pending before the Court are Defendants' motions to dismiss the amended complaint. [14] This case is

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[11] Amicus brief in In Re Vivendi Universal, S.A. Securities Litigation.

[12] 2010 U.S. Dist. LEXIS 137150 (Dec. 22, 2010)

[13] According to the Securities Exchange Commission ("SEC"), a pump-and-dump scheme is "the touting of a company's stock (typically microcap companies) through false and misleading statements to the marketplace. After pumping the stock, fraudsters make huge profits by selling [*3] their cheap stock into the market." See http://www.sec.gov/answers/pumpdump.htm According to the SEC, "[t]he term 'penny stock' generally refers to low-priced (below $5), speculative securities of very small companies. While penny stocks generally are quoted over-the-counter, such as on the OTC Bulletin Board or in the Pink Sheets) they may also trade on securities exchanges, including foreign securities exchanges," See http://www.sec.gov/answers/penny.htm.

[14] The Amended Complaint includes claims against each Defendant for (1) misstatement and omissions pursuant to Section 10(b) and Rule 10b-5; claims against Homm, Hunter, Ficeto, Colin

dismissed for lack of subject matter jurisdiction.[15]

Factual Background
The Parties

Plaintiffs are a group of Cayman Island companies registered as mutual (hedge) funds (the "Funds" or "Plaintiffs") that invested on behalf of investors located around the world, including the United States... Defendants are individuals and entities who allegedly caused Plaintiffs to purchase nearly valueless penny stocks issued by companies that were registered with the United States Securities and Exchange Commission (the "SEC")..

Defendant Florian Homm ("Homm") is a German national who also holds a Liberian passport... Homm maintains several residences throughout Europe. . Homm was a founder of Absolute Capital Management Holdings Limited ("ACM"), the investment manager for the Funds.. He served as ACM's Chief Investment Officer, and was responsible for the Funds investments for at least the middle of 2004 until or about September 18, 2007, when he resigned from his position.. Homm invested on behalf of the funds pursuant to a power of attorney... At all relevant times, Homm owned more than 40% of the outstanding shares of ACM through the investment vehicle he controlled and was also a 50% owner of Defendant Hunter World Markets, Inc. ("Hunter").. Homm has previously been fined or otherwise subject to discipline by German financial industry regulators.. Homm has gone "into hiding" and has not responded to the amended complaint..

Defendant Hunter World Markets, Inc. is a California corporation.. Hunter is registered with the Securities Exchange Commission ("SEC") and FINRA as a broker dealer.. At relevant times, Hunter held state registrations as a brokerdealer in California, Florida, Hawaii, Illinois, Massachusetts, Nevada, New Jersey, New York, Ohio, Texas and Washington.. On or about October 1, 2009, Hunter requested a termination of its registrations.. Hunter was an underwriter for or was otherwise involved in the offerings of the Penny Stock Companies whose shares Defendants caused the Funds to purchase. . Hunter was also affiliated with Defendant CIC Global Capital Ltd. ("CIC"), which sold the Funds millions of shares of the Penny Stock Companies. Defendants Todd M. Ficeto and Homm each owned 50% of Hunter..

Heatherington, Craig Heatherington, CIC, the John and Jane Doe(s) and Doe Entities for (2) market manipulation under Section 10(b) and Rule 10b-5; (3) churning under Section 10(b) and Rule 10b-5; claims against each defendant for (4) fraud and fraud conspiracy; and claims against Homm and Ewing on behalf of ACM for (5) breach of fiduciary duty.

[15] Following the filing of the pending motions to dismiss, the Supreme Court released its decision in Morrison v. National Australia Bank, 130 S. Ct. 2869, 2884, 177 L. Ed. 2d 535 (2010), which limited the application of Section 10(b), and by extension, Rule 10b-5, in affirming a ruling that certain claims were not properly brought in the United States pursuant to federal securities laws for lack of subject matter jurisdiction. Defendants in the instant case also move for dismissal for lack of personal jurisdiction pursuant to Fed. R. Civ. P. 12(b)(2), failure to state a claim upon which relief can be granted pursuant to Fed. R. Civ. P. 12(b)(6), improper venue pursuant to Fed. R. Civ. P. 12(b)(3), or in the alternative, to transfer this case to the Northern District of California pursuant to 28 U.S.C. § 1404(a) and the expiration of the statute of limitations under the PSLRA. As the Court has determined that it lacks subject matter jurisdiction over Plaintiffs' claims, it does not consider those issues in this Memorandum Order.

Defendant Todd M. Ficeto ("Ficeto") is a resident of Malibu, California... Ficeto served as President and Director of Hunter. (Id.) At all relevant times, Ficeto held Series 7, 24, 55 and 63 securities licenses issued by the Financial Industry Regulatory Authority ("FINRA") and was a registered securities agent in California, Florida, Illinois, Massachusetts, New Jersey, New York, Texas and Washington.. Ficeto has been previously fined and suspended by securities regulators. He is sued individually and as Guardian for Natalia C. Ficeto and Hunter M. Ficeto, his minor children...At all relevant times. Ficeto was the control person of shares in the Penny Stock Companies held by Natalia C. Ficeto and Hunter M. Ficeto.

Defendant Colin Heatherington is a Canadian national, and a resident of Australia.. Colin Heatherington was an ACM employee who assisted Defendant Homm. (Id.) His final day as an ACM employee was September 17, 2007, the day before Homm resigned. Colin Heatherington was also a principal of defendant CIC Global Capital Ltd...

Defendant Craig Heatherington is a Canadian national, and a resident of Australia. .. He is Colin's brother, and also worked at ACM and was a principal of CIC...

Defendant CIC Global Capital Ltd. is a company that was incorporated in the British Virgin Islands in January 2005. . "CIC" is allegedly an acronym consisting of the initials of the first names of Colin Heatherington, Ida Manly (his wife), and Craig Heatherington. In SEC filings, CIC is sometimes referred to as an affiliate or client of Hunter..

Defendant Sean Ewing ("Ewing") is an Irish national who resides in Spain.. Along with Homm, he was a founder of ACM and served as its Chief Executive Officer and Chairman of the Board from in or around the middle of 2005 until he resigned in August 2007.. At relevant times, Ewing owned a substantial percentage of the outstanding shares of ACM through the investment vehicle he controlled.. Ewing oversaw compliance and risk management in ACM's activities as the investment manager for the Funds..

Defendant ...Angersbach.. is a German national.. Angersbach was a founder of ACM, a Director of ACM until January of 2006, and served as ACM's Head of Investor Relations and Marketing from in or about the middle of 2005 until December 2007. . Prior to the middle of 2005, Angersbach worked closely with Homm and was a founder of FM Fund Management Limited, the hedge fund management company that preceded ACM. . At various times, Angersbach owned a substantial percentage of the outstanding shares of ACM through the investment vehicle he controlled. Angersbach raised approximately $2 billion from approximately 400 professional investors..

Defendants John Does, Jane Does and Doe Entities are persons or entities who participated in the alleged scheme to defraud and whose identities are not presently known to Plaintiffs... omm, Ficeto, Hunter and Colin Heatherington are referred to in the collectively as the "Trading Defendants."..Defendants Homm, Ficeto and Colin Heatherington maintained a close personal relationship that included traveling together and collectively purchasing a boat they named "No Remorse" after a Metallica song of the same name...

The Alleged Scheme
Exercising lawful control over the Funds, Defendants caused the Funds to purchase billions of shares of virtually worthless companies (the "Penny Stock Companies") that were incorporated

in the United States and whose shares were quoted on the Over the Counter Bulletin Board or by Pink OTC Markets Inc. directly from those companies.. The securities at issue were not sold on an exchange, but were rather purchased directly from the companies pursuant to private placements known as PIPE (public investment in private equity) transactions.. The Penny Stock companies were thinly capitalized, and their securities (the "Penny Stocks") were essentially illiquid.. Over a three year period, Defendants caused Plaintiffs to purchase shares in at least eight Penny Stock Companies..

At the times of each purchase, Defendants either (1) already held in their own names, or otherwise controlled, substantial amounts of shares and/or warrants of the Penny Stock Companies, or (2) received shares and/or warrants from the Penny Stock Companies in exchange for causing the Funds to purchase shares from those Companies.. Typically, Defendants paid nothing or almost nothing to acquire these shares and warrants..

The alleged scheme was premised on manipulating and artificially inflating the prices of the Penny Stocks.. This was accomplished, in part, by trading and re-trading the stocks many times over, sometimes on the same day, between and among the Funds.. The alleged fraudulent purposes were twofold: (1) to generate bogus commissions for Homm, Hunter and Ficeto, and (2) to artificially inflate the stock price to the point at which Defendants were free to sell previously untradable shares and exercise certain warrants, which Defendants then sold to the Funds at a profit.. In order to successfully manage the alleged scheme and conceal its existence from ACM and the Funds, Defendants maintained control over each aspect from making trades to brokering the trades, to matching the trades on the back end.. Numerous trades are detailed in the amended complaint, and Plaintiffs allege that they suffered losses on each trade, to the tune of at least $195 million..

The Role of Each Defendant

Hunter served as an underwriter and broker in the alleged scheme.. Its only investors were certain of the Funds, which invested a total of $34 million with Hunter.. Ficeto was the President, Director and 50% owner of Hunter.. He managed all aspects of Hunter's business. .Through his co-ownership of Hunter with Homm and his close personal relationship with Colin Heatherington, Ficeto was able to ensure that the Funds invested in the Penny Stocks he suggested.. Ficeto gained personal benefits by (1) selling the Penny Stock shares he owned personally (and acquired for little of no consideration) to the Funds at artificially inflated prices; (2) paying himself commissions from the trades; and (3) paying himself fees for arranging financing for the transactions..

Colin Heatherington was Homm's "point man" on trading and his "right hand man".. He also had a close personal relationship with Ficeto and played a key role in the alleged scheme by purchasing the Penny Stocks on behalf of the Funds by placing the trades with Ficeto.. Colin Heatherington allegedly gained enormous personal benefits, perhaps as high as $25 million.. He purchased a home for CAD 7.74 million as well as a yacht despite earning a salary of only 65,600 Euros (approx. $80,000).. The primary vehicle through with Colin Heatherington gained these benefits was CIC, a company in which he was a principal and shareholder that sold the Funds millions of shares of the Penny Stock Companies.. Some of these sales occurred as a result of fraudulent exercises of warrants which CIC was issued as part of the Penny Stock transaction..

Craig Heatherington, Colin's brother, worked in ACM's back office.. He was responsible for matching Penny Stock transactions. . He obtained most of the benefits from the alleged fraudulent scheme through his role as a principal and shareholder of CIC, which fraudulently sold Penny Stocks at artificially inflated prices to the Funds.. Craig Heatherington was involved in approving and signing for various transactions related to CIC. He is listed in certain SEC filings as a director of CIC.

Defendant Ewing, an officer of ACM, and Defendant Angersbach allegedly knew of the fraud, yet did not report it to ACM or the Funds. Furthermore, Ewing allegedly made misrepresentations about the funds, and specifically the actions of Homm, to investors in the United States and elsewhere.. Defendant Angersbach also assisted with marketing the funds in the United States and elsewhere.

Jurisdiction

Moving Defendants, with the exception of Ficeto and Hunter, assert that this Court lacks personal jurisdiction over them and seek dismissal pursuant to Fed. R. Civ. P. 12(b)(2). That said, subject matter jurisdiction is a threshold determination that the Court is obligated to consider sua sponte... "The validity of an order of a federal court depends upon the court's having jurisdiction over ... the subject matter" of the dispute...

On June 24, 2010, the day after oral arguments were heard in the instant case, the Supreme Court issued its decision in Morrison v. National Australia Bank.. Morrison involved an "F-Cubed"claim, foreign investors suing foreign (and American) defendants for misconduct relating to securities purchased on a foreign exchange. [16].. The Supreme Court held that § 10(b) of the Exchange Act (and by extension, Rule 10b-5) applies to "only ... [1] the purchase or sale of a security listed on an American stock exchange, and [2] the purchase or sale of any other security in the United States." .. The Supreme Court stated that the jurisdictional provision of the Act .. vested the district court with jurisdiction sufficient to adjudicate the question as to whether § 10(b) applied to the defendants' conduct. However, it does not relate at all to subject matter jurisdiction, which refers to a tribunal's power to hear a case. ... The decision, which was highly critical of then prevailing Second Circuit precedent, limited the scope of §10(b) by stating that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none."

The practical effect of Morrison is the elimination of the "conduct or effect" test previously employed by the Second Circuit. That test sought to determine whether the allegedly offending transaction (1) had a substantial effect on United States markets or upon American citizens, or (2) occurred in the United States... Under Morrison's "transactional test," "F-Cubed" cases may now be swiftly dispatched with for lack of subject matter jurisdiction, even where there is some

[16] Given the facts in the instant case, it is worth noting that the defendant in Morrison was an Australian bank that was publicly traded on the Australian and other stock exchanges, however it was not listed on any American stock exchange. American investors were able to purchase shares of the bank via American Depositary Receipts (ADRs), which permit American investors to purchase shares of foreign corporations on domestic exchanges. See Law Debenture Trust Co. v. Maverick Tube Corp., 595 F.3d 458,463-464 (2d Cir.2010). The defendant bank owned an American mortgage servicing company based in Florida. Plaintiffs alleged that misstatements and omissions attributed to the mortgage servicing company caused the bank's shares to loose value and sought redress under US securities laws despite the bank not listing its shares on any American exchange.

connection to the United States...

Courts in the Southern District have had the opportunity to apply the new "transactional test." For instance, in Cornwell v. Credit Suisse Group, the court determined that sales of securities listed on a foreign exchange, even if purchased by United States residents, were not actionable under § 10(b)... In In re Alstom SA Sec. Litig., the court declined to undertake a "selective and overly-technical reading of Morrison" in ruling that the mere fact that a stock is listed on a domestic exchange does not give rise to a claim under domestic securities laws when the shares were purchased elsewhere ... (citing Morrison, 130 S. Ct. at 2884 for the proposition that the focus of the court's inquiry should be on where the transaction occurs, not the exchange where ministerial pre-purchase activities were directed).

The instant case presents an interesting twist. Plaintiffs are based in the Cayman Islands. Defendants, with the exception of Ficeto and Hunter, are foreign nationals. The corporations that issued the Penny Stocks were registered with the SEC, however, their shares were not traded on a domestic exchange. Instead, the fraudulent scheme alleged involved private offerings (i.e. the "PIPE" transactions) in which the Funds were caused to purchase the illiquid shares directly from the companies through private placements. At no point were the shares released to the general market. In fact, the entire "market" alleged was the trading by and between the Funds. The Funds were based in the Cayman Islands and managed in Europe.

The plain language of the "transaction test" established in Morrison precludes this action from moving forward. Simply put, accepting the allegations of the amended complaint as true: (1) there was no sale of a security listed on an American Exchange as the PIPE (i.e. private placement) transactions involved "Penny Stocks" that were purchased "directly from the company;" [17] and (2) no transaction occurred in the United States.

The instant case involves foreign investors suing foreign and domestic defendants regarding private transactions in securities that were not listed on a United States domestic exchange. This appears to be precisely the type of case the Supreme Court had in mind when it issued Morrison. Permitting this case to move forward on the theory that any trade routed through the United States meets the Morrison standard would be the functional antithesis of Morrison's directive. By all accounts, Plaintiffs took great pains to avoid the regulations imposed by federal securities laws that apply to domestic market transactions. It would be illogical, and inconsistent with Morrison, to allow them to seek redress in this Court. Accordingly, Plaintiffs' claims must be dismissed on the grounds that the Court lacks subject matter jurisdiction.

As mentioned above, Congress reacted to the Supreme Court's Morrison decision in the Dodd-Frank Act. An excerpt from the SEC's request for comments follows:

SEC, Study on Extraterritorial Private Rights of Action (Request for Comments)

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[17] Morrison's treatment of ADRs lends to the conclusion that its holding applies even where companies are registered with the SEC.

(Oct. 25, 2010)[18]

In Morrison, the Supreme Court considered "whether § 10(b) of the Securities Exchange Act of 1934 provides a cause of action to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign exchanges." The text of the Exchange Act had been silent as to the transnational reach of Section 10(b). In a decision issued on June 24, 2010, the Supreme Court said: "When a statute gives no clear indication of an extraterritorial application, it has none." Morrison, 130 S. Ct. at 2878. "[T]here is no affirmative indication in the Exchange Act that § 10(b) applies extraterritorially," the Court found, "and we therefore conclude that it does not." Id. at 2883. Thus, the Court concluded, "it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies." Id. at 2884 (footnote omitted). The Court summarized the test as follows:

> Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States.

Id. at 2888.

The Morrison decision rejected long-standing precedents in most federal courts of appeals that applied some variation or combination of an "effects" test and a "conduct" test to determine the extraterritorial reach of Section 10(b) of the Exchange Act. See, e.g., Alfadda v. Fenn, 935 F.2d 475, 478 (2d Cir. 1991); Itoba Ltd v. LEP Group PLC, 54 F.3d 118, 121-22 (2d Cir. 1995). The effects test centered its inquiry on whether domestic investors or markets were affected as a result of actions occurring outside the United States. Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118, 125 (2d Cir. 1998). See also Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir. 1983). By contrast, the conduct test focused "on the nature of [the] conduct within the United States as it relates to carrying out the alleged fraudulent scheme." Psimenos, 722 F.2d at 1045.

On July 21, 2010, less than a month after the decision in Morrison, President Obama signed the Dodd-Frank Act. Section 929P of the Dodd-Frank Act amended the Exchange Act to provide that the United States district courts shall have jurisdiction over an action brought or instituted by the Commission or the United States alleging a violation of the antifraud provisions of the Exchange Act involving:

(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.[19]

Under section 929Y of the Dodd-Frank Act, the Commission is required to conduct a study to

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[18] The RFC is at http://www.sec.gov/rules/other/2010/34-63174.pdf .

[19] (Fn. 1 in original) With respect to U.S. Government and Commission actions, the Dodd-Frank Act largely codified the long-standing appellate court interpretation of the law that had existed prior to the Supreme Court's decision in Morrison by setting forth an expansive conducts and effects test, and providing that the inquiry is one of subject matter jurisdiction. The Dodd-Frank Act made similar changes to the Securities Act of 1933 and the Investment Advisers Act of 1940.

determine whether private rights of action should be similarly extended.

The report of the study must be submitted and recommendations made to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House not later than January 21, 2012.

III. Request for Comments

Section 929Y(a) of the Dodd-Frank Act directs the Commission to solicit public comment on whether the scope of the antifraud provisions of the Exchange Act in cases of transnational securities fraud should be extended to private rights of action to the same extent as that provided to the Commission by Section 929P, or to some other extent.[20] Section 929Y(b) directs that the study shall consider and analyze, among other things—

> (1) the scope of such a private right of action, including whether it should extend to all private actors or whether it should be more limited to extend just to institutional investors or otherwise;
> (2) what implications such a private right of action would have on international comity;
> (3) the economic costs and benefits of extending a private right of action for transnational securities frauds; and
> (4) whether a narrower extraterritorial standard should be adopted.

Accordingly, we request comment on these issues and questions. We also encourage commenters to:

• Propose the circumstances, if any, in which a private plaintiff should be allowed to pursue claims under the antifraud provisions of the Exchange Act with respect to a particular security where the plaintiff has purchased or sold the security outside the United States. Does it make a difference whether the security was issued by a U.S. company or by a non-U.S. company?

Does it make a difference whether the security was purchased or sold on a foreign stock exchange or whether it was purchased or sold on a non-exchange trading platform or other alternative trading system outside of the United States? Does it make a difference whether the company's securities are traded exclusively outside of the United States?

Should there be an effects test, a conduct test, a combination of the two, or another test? Address whether any such test should be limited only to certain types of private plaintiffs, such as United States citizens or residents, or such as institutional investors. How would such investors be defined?

Identify any cases that have been dismissed as a result of Morrison or pending cases in which a challenge based on Morrison has been filed. Describe the facts of the case.

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[20] (Fn. 2 in original) Section 929Y(a) of the Dodd-Frank Act provides that the Commission "shall solicit public comment and thereafter conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Securities Exchange Act of 1934 (15 U.S.C. 78u-4) should be extended to cover: conduct within the United States that constitutes a significant step in the furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; and conduct occurring outside the United States that has a foreseeable substantial effect within the United States."

Identify any cases brought prior to Morrison that likely could not have been brought or maintained after Morrison. Describe the facts of the case.

In Morrison, the Supreme Court held that in the case of securities that are not listed on an American stock exchange, Section 10(b) only reaches the use of a manipulative or deceptive device or contrivance in connection with the purchase or sale of a security in the United States. Address the criteria for determining where a purchase or sale can be said to take place in various transnational securities transactions. Discuss the degree to which investors know, when they place a securities purchase or sale order, whether the order will take place on a foreign stock exchange or on a non-exchange trading platform or other alternative trading system outside of the United States.

What would be the implications on international comity and international relations of allowing private plaintiffs to pursue claims under the antifraud provisions of the Exchange Act in cases of transnational securities fraud? Identify any studies that purport to show the effect that the extraterritorial application of domestic laws have on international comity or international relations.

Discuss the cost and benefits of allowing private plaintiffs to pursue claims under the antifraud provisions of the Exchange Act in cases of transnational securities fraud, including the costs and benefits to domestic and international financial systems and securities markets. Identify any studies that have been conducted that purport to show the positive or negative implications that such a private right of action would have.

What remedies outside of the United States would be available to U.S. investors who purchase or sell shares on a foreign stock exchange, or on a non-exchange trading platform or other alternative trading system outside of the United States, if their securities fraud claims cannot be brought in U.S. courts?

What impact would the extraterritorial application of the private right of action have on the protection of investors? On the maintenance of fair, orderly and efficient markets in the United States? On the facilitation of capital formation?

Address any other considerations commenters would like to comment on to assist the Commission in determining whether to recommend changes to the extraterritorial scope of the antifraud private rights of action under the Exchange Act.

Notes and Questions

How would you respond to this request for comments (RFC) ? What facts do you think you would need to know to craft a good response? Do you think that this RFC is likely to generate responses which will be useful to the SEC in deciding on the issues?

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. Most Canadian jurisdictions have relaxed their rules for securities actions: Ontario did so in 2005.[21] In December 2009 in 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,[22] 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.[23]

The Ontario statute provides for liability without any need for the plaintiff to establish reliance (what follows are short excerpts from the relevant provisions):[24]

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

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[21] On securities litigation in Canada generally, see NERA Economic Consulting, Trends in Canadian Securities Class Actions: 1997-2008 (Jan. 2009).

[22] 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).

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

[24] 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.

(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[25] (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 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,

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

statement or opinion in the public oral statement..[26]

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[27] 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,[28] but has not produced harmonized principles for liability.

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[26] 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; 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).

[27] 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 .

[28] *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).