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# Morrison v. National Australia Bank: Life After Dodd-Frank

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# *MORRISON V. NATIONAL AUSTRALIA BANK*: LIFE AFTER DODD-FRANK

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## INTRODUCTION

This Note examines the background of foreign-cubed litigation,[1] including its development over the past four decades, its abrogation by the Supreme Court, and its potential future under recently enacted legislation. The Note examines the tests developed by the Court of Appeals in order to determine whether a United States court could adjudicate foreign-cubed litigation. Additionally, it reviews the Supreme Court opinion in *Morrison v. National Australia Bank* and its ultimate rejection of the predominant Second Circuit test for applicability. Finally, the Note discusses "The Dodd–Frank Wall Street Reform and Consumer Protection Act," a provision of which was specifically included to overturn the result in the *Morrison* decision, its potential impact on future foreign-cubed litigation, and how the courts, litigants, and foreign nations should look to proceed in its wake.

## I. FOREIGN-CUBED LITIGATION: BACKGROUND

### A. SECURITIES LAWS: A BRIEF HISTORY

The issues and events surrounding the stock market crash known as

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1. Foreign-cubed ("F-cubed") litigation is generally described as an action between a foreign investor and a foreign issuer whose securities are listed on a foreign exchange. *See e.g.* Donald C. Langevoort, *Private Securities Litigation*, 2009 SEC. L. REV. § 1:5 (2010) (discussing the origin and development of F-Cubed litigation).

"The Great Crash" in 1929 caused a sense of fear and instability among the investing public who questioned the soundness of the nation's financial institutions.[2] Stock prices on the New York Stock Exchange had fallen dramatically in October 1929, culminating in a close of 198 points from a previous high of 381 points in September 1929.[3] While many factors were blamed for the crash, the most commonly accepted reasons were the lack of clarity, honesty, and availability of reliable financial information regarding securities that were being sold.[4] The lack of such information was believed to have prevented investors from making informed investment decisions. In his address to Congress on May 29, 1933, President Roosevelt articulated a need for regulations requiring that "every issue of new securities to be sold . . . be accompanied by full publicity and information . . . ."[5] Shortly thereafter, Congress passed, and the President signed, the Securities Act of 1933, also known as the Truth in Securities Act or more commonly, the '33 Act.[6]

The '33 Act required the registration of the offering and sale of any securities that are to be sold using the means and instrumentalities of interstate commerce, unless an exemption applies.[7] The following year brought the passage of the Securities Exchange Act of 1934 ("'34 Act").[8] Placed in section 2 of the '34 Act were the reasons set forth for regulation of the securities market, including, but not limited to, requiring "appropriate reports, remov[ing] impediments to and perfect[ing] the mechanisms of a national market system for securities . . . ."[9] Among the most important sections of the act is the antifraud

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2. *See Stock Market Crash of 1929*, ENCYCLOPEDIA BRITANNICA, http://www.britannica.com/EBchecked/topic/566754/stock-market-crash-of-1929 (last visited June 19, 2011).

3. *Id.*

4. James M. Landis, *Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30 (1959) (discussing the political and financial atmosphere following the market crash of 1929).

5. *Id.*

6. *See* Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77aa (2006)).

7. *Id.;* 15 U.S.C. §§ 77a (containing the '33 Act registration requirement). *See* § 4(2) for exemptions from registration (codified as amended at 15 U.S.C. §§ 77d (2006)).

8. Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78oo (2006)).

9. *Id.* § 2.

provision under section 10(b).[10] Rule 10b-5, promulgated under section 10(b) allows for criminal and/or private party causes of actions against individuals that scheme to defraud or make any untrue statement of a material fact or omit to state a material fact, or 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.[11] Generally considered the workhorse of public and private securities enforcement, Rule 10b-5 allegations are often brought as class-actions and occasionally by foreign investors for the purchase of foreign securities traded on foreign exchanges, a phenomenon known as "foreign-cubed" ("f-cubed") litigation.[12]

### B. The '33 and '34 Act Within the Scope of F-Cubed Litigation

The mechanism for a foreign investor seeking to avail itself of U.S. law for fraud in the issuance of foreign securities listed on a foreign exchange is found in the interplay of the following sections: under section 11 of the '33 Act, a material misrepresentation or omission in a registration statement will subject an issuer and others associated with an issuer (underwriters and dealers) to rescissory damages (return of purchase price of the security) in a suit brought by purchasers of said securities pursuant to the registration statement.[13] Under section 12(a)(1) of the '33 Act, an issuer who sells or offers to sell a security in violation of section 5 by failing to register said offering or failing to successfully secure an exemption can be liable for rescissory damages as well.[14] Finally, under §17 of the '33 Act, the SEC can bring civil and criminal actions against a party who issues securities and "employ[s] any device, scheme, or artifice to defraud[.]"[15] Assuming a foreign issuer fails to register its offering with the SEC, and that offering somehow (even in a minute manner, as will be examined further) purportedly affects the securities market in the United States, under foreign-cubed jurisprudence, suit may be brought in a U.S. court by

10. *Id.* § 10(b).
11. Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (1948).
12. *See supra* note 1 and accompanying text.
13. *See* Securities Act § 11.
14. *See id.* § 12(a)(2).
15. *See id.* § 17.

foreign plaintiffs.[16]

The most common action brought pursuant to the '34 Act is under Rule 10b-5.[17] This rule provides for wide-sweeping coverage of purchases or sales of a security where a "means or instrumentality" of interstate commerce is used to defraud an investor or by the means of making an "untrue statement" or omission of material information.[18] Often considered the "catch-all" fraud provision under the securities laws, Rule 10b-5 allows foreign investors to seek actual (rather than just rescissory) damages for statements or omissions made in connection with the sale or purchase of a security by arguing that such foreign transactions fit within f-cubed framework.[19]

## II. FOREIGN TRANSACTIONS AND THEIR ACTIONABILITY UNDER THE ANTI-FRAUD PROVISIONS OF THE SECURITIES LAWS

F-cubed actions are generally brought against foreign issuers of securities on behalf of foreign investors who purchased these securities on a foreign exchange.[20] While initial thoughts may be that such claims should be dismissed for lack of subject-matter jurisdiction[21] or forum non-conveniens,[22] courts over the years developed a framework to see if and when such claims should be heard in a U.S. forum.[23] In a similar context, under the Sherman Act, the Supreme Court had permitted the selective application of statutory extraterritorial application of U.S. laws to foreign defendants when it was decided that the activity alleged affected U.S. markets.[24] Such a phenomenon is often referred to as

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16. *See supra* note 1.

17. Securities Exchange Act of 1934 § 78a, 15 U.S.C. §§ 78a-78oo (2006). *See also* James P. Jalil, *Proposals for Insider Trading Regulation After the Fall of the House of Enron*, 8 FORDHAM J. CORP. & FIN. L. 689, 703 (2003) (referring to Rule 10b-5 as the "workhorse of securities enforcement.").

18. *Id.*

19. *See* 6 THOMAS L. HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION 412 (2009).

20. *See supra* note 1 and accompanying text.

21. *See* FED. R. CIV. P. 12(b)(1).

22. *See* 28 U.S.C. § 1404 (1948) (codifying the common law concept of *forum non conveniens*).

23. Langevoort, *supra* note 1, § 1:5.

24. *See* Stephen J. Choi & Linda J. Silberman, *The Continuing Evolution of Securities Cases*, 2009 WIS. L. REV 465, 468 (2009) (discussing the two most recent

"jurisdiction to prescribe."[25] That authority was often cited as warranting extraterritorial reach for U.S. securities laws.[26]

## A. SECOND CIRCUIT DEVELOPS TESTS TO GUIDE EXTRATERRITORIAL APPLICATION OF THE SECURITIES LAWS

### *1. Development and Application of the "Conduct Test"*

Prior to *Morrison*,[27] the Supreme Court had not yet decided whether extraterritorial jurisdiction should be applied in cases of securities fraud. In this void, the lower courts had developed their own set of tests for determining the extraterritorial application of the securities laws.[28] One factor that courts looked to, known as the "conduct test," was articulated in *Bersch v. Drexel Firestone Inc.*, in which Judge Friendly held that there was "no reason to extend [the '34 Act] to cases where the United States activities are *merely preparatory* or take the form of culpable nonfeasance and are relatively small in comparison to those abroad," but rather conduct related to the fraud must have occurred within the United States.[29] The Court posited that when "a court is confronted with transactions that . . . are predominantly foreign, it must seek to determine whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to them rather than leave the problem to foreign countries" to adjudicate on their own.[30]

Judge Friendly held that the amount of activity that occurred within the United States was irrelevant when the securities in question were sold to purchasers within the United States.[31] He was essentially looking for substantial *conduct related to the fraud* to have at least occurred in the United States in order to justify an extraterritorial application of the securities laws to sales that occurred outside of the

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Supreme Court decisions on jurisdiction to prescribe).

25. 1 RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES 237 (1987).

26. *See supra* note 24 and accompanying text.

27. Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869 (2010).

28. *Id.* at 2889 (discussing the development of the "conduct" and "effects" tests).

29. Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir. 1975) (emphasis added).

30. *Id.* at 985.

31. *Id*. at 987.

United States on foreign exchanges from foreign issuers.[32] The test itself was not very clear and often led to court interpretations that relied on determining whether the conduct in question had an adverse effect on American investors and the American securities markets.[33] Shortly after the decision in *Bersch*, the District Court in the Southern District of New York stated that not only must there be some sort of conduct in the United States, it also cannot simply be preparatory conduct, but rather the conduct must have used the United States as a base of operations for manufacturing fraudulent security devices leading to a more difficult standard to satisfy.[34]

Building on the Second Circuit's decision in *Bersch*, the Third Circuit held two years later that even if the sole victim was a foreign entity it would "grant jurisdiction in transnational securities cases where at least some activity designed to further a fraudulent scheme occur[ed] within this country."[35] Failure to apply the law would, from a policy perspective, "embolden those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations."[36] As the test developed further, various courts interpreted the rules to look for different factors within each case. Recently, the court in *Terra Securities ASA Konkursbo v. Citigroup, Inc.* articulated the test in a manner combining the factors of previous cases to decide whether the conduct had occurred in the United States and whether it was sufficient to warrant extraterritorial jurisdiction. Among the various factors the court considered were:

> (1) the conduct in question in relation to plaintiff's theory of fraud; (2) the location of the relevant conduct; (3) the timeline of relevant acts; (4) the materiality or substantiality of the relevant conduct; (5) the causal connection between the domestic conduct and the alleged losses; and (6) considerations of "reasonableness gauged by the intent of congressional policy and principles of fairness in the

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32. *Id.*

33. George K. Chamberlin, Annotation, *Subject Matter Jurisdiction of Securities Fraud Action Based on Foreign Transactions, Under Securities Exchange Act of 1934*, 56 A.L.R. FED. 288 § 4(b) (1982).

34. Venture Fund (Int'l) N.V. v. Willkie Farr and Gallagher, 418 F. Supp. 550, 555 (S.D.N.Y. 1976) (referring to Judge Friendly's decision elaborating on the conduct test in IIT v. Vencap, Ltd., 519 F.2d 1016, 1018 (2d Cir. 1975)).

35. SEC v. Kasser, 548 F.2d 109, 114 (3d Cir. 1977).

36. *Id.* at 116.

> circumstances surrounding the particular case."[37]

Moreover, the court expressed that the factors were not to be "weighed independently of the others; rather they must be considered in conjunction."[38] This decision was the exact opposite of a 1983 Second Circuit decision that held that a plaintiff need only satisfy either the conduct *or* the effects test to support a finding of extraterritorial jurisdiction.[39]

### *2. Development and Application of the "Effects Test"*

While courts were consistently applying and developing the "conduct test," it was often done alongside a test that purported to test the *effects* such a transaction had on domestic markets. This came to be known as the "effects test." In 1968, the Second Circuit held that extraterritorial application also applied to transactions that occurred "outside the United States, at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors."[40] Here the court took an expansive view of the term "effects" and in its determination took into consideration the harm that could occur to the stock price of the American subsidiary of a Canadian corporations stock when certain frauds and misrepresentations were made to affect the value of the Canadian stock.[41] This outlook was tempered by the court's holding in *Bersch* stating that "adverse effects on this country's general economic effects or American security prices" was not sufficient to apply extraterritorial jurisdiction to the foreign defendants.[42]

As discussed earlier, the securities laws were passed in part to restore confidence and stability and to help support fair and honest

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37. Terra Sec. ASA Konkursbo v. Citigroup, Inc., 688 F. Supp. 2d 303, 309 (S.D.N.Y 2010).

38. *Id.*

39. *See* Psimenos v. E.F. Hutton & Co., Inc., 722 F.2d 1041, 1045 (2d Cir. 1983).

40. Schoenbaum v. Firstbrook, 405 F.2d 200, 208 (S.D.N.Y. 1968).

41. *Id.* at 208-09 (holding that " impairment of the value of American investments by sales by the issuer in a foreign country, allegedly in violation of the Act, has in our view, a sufficiently serious effect upon United States commerce to warrant assertion of jurisdiction for the protection of American investors and consideration of the merits of plaintiff's claim").

42. *See* Choi & Silberman, *supra* note 24, at 475-76 (citing *Bersch* and discussing the tempering of the decision in *Schoenbaum*).

markets.[43] However, such a *Wickard*-like application of this test, as found in *Schoenbaum*, was overly broad in that almost any securities transaction that occurred outside of the United States could have conceivably been determined to have had an economic impact on domestic markets and securities prices.[44] In general, the courts tended to use a somewhat tempered view when determining the effects of securities misrepresentations outside of domestic markets. In *In re Parmalat Securities Litigation*, the district court held that even though false statements were made outside the United States regarding a foreign corporation's offerings, the representatives knew that American investors would rely on such information, thus satisfying the effects test.[45]

A more obvious effect on the American markets was on display when a defendant knowingly illegally acquired and operated an American subsidiary and subsequently incorporated the subsidiary's earnings into its financial statements, which were then distributed to Canadian investors.[46] Such illegal conduct negatively impacted the price of both Canadian and American shares, thus satisfying the effects test.[47] Interestingly enough, when the District Court in the Southern District of New York was confronted with the issue of American purchasers of unsponsored American Depositary Receipts ("ADRs")[48] of a foreign corporation (that were trading exclusively on a foreign exchange via an over-the-counter transaction), the court held that since the securities offered were exclusively in Europe by a European corporation on a European exchange "lacking any nexus to American securities markets, [the facts in question were] not enough to satisfy the

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43. *See supra* notes 4-6 and accompanying text.

44. *See generally* Wickard v. Filburn, 317 U.S. 111 (1942) (applying a very broad interpretation of the commerce clause to prevent a farmer from growing wheat for his own consumption outside of price supporting regulation; insisting that allowing such conduct would broadly impair the overall market for wheat and therefore permitted the restraint of such behavior).

45. *In re* Parmalat Sec. Litig., 376 F. Supp. 2d 472, 512 (S.D.N.Y. 2005).

46. *In re* Gaming Lottery Sec. Litig., 58 F. Supp. 2d 62, 74 (S.D.N.Y. 1999).

47. *Id.*

48. The stocks of most foreign companies that trade in the U.S. markets are traded as American Depositary Receipts ("ADRs"). U.S. depository banks issue these stocks. Such investments are often not authorized by the foreign company. *See American Depositary Receipts*, SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/answers/adrs.htm (last visited June 19, 2011)

effects test."[49] While the conclusion seemed logical, the opposing argument could have just as easily been successful given the breadth of the *Schoenbaum* test.

If a foreign corporation has no interest (at least in a specific transaction) in being involved in American exchanges or markets and additionally has not authorized the trading of its stock on OTC markets, it should not be dragged into American courts for transactions that occurred outside its purview.[50] On the other hand, the court basically put Americans who have an interest in trading such securities on notice that they must be aware of the risks, rewards, and uncertain remedies that could come with such an investment.[51]

### *3. Jurisdiction to Prescribe (Extraterritorial Application of U.S. Laws)*

As a general rule, legislation does not reach foreign defendants acting in foreign territories.[52] The Restatement of Foreign Relations Law section 402 states that "a state has jurisdiction to prescribe law with respect to . . . conduct that, wholly or in substantial part, takes place within its territory . . . ."[53] Section 403 then discusses the reasonableness of prescribing jurisdiction when certain factors are present.[54] Factors cited include, but are not limited to, the link of the activity to the regulating state, the interest another state may have in

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49. *In re* European Aeronautic Defence & Space Co. Sec. Litig., 703 F. Supp. 2d 348, 359 (S.D.N.Y. 2010) (quotation altered); *see also* Copeland v. Fortis, 685 F. Supp. 2d 498, 506 (S.D.N.Y. 2010) (holding that unauthorized ADRs purchased in over-the-counter market by American investors failed to have "substantial" effects on domestic markets).

50. "OTC" or Over-the-Counter markets are inter-dealer trades of securities that are not listed on national securities exchanges. Such securities have differing or non-existent reporting requirements in the United States and are not as heavily regulated as the national exchanges. *See Over-the-Counter Markets*, SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/divisions/marketreg/mrotc.shtml (last visited June 19, 2011); *see also OTC 101*, OTC MARKETS, http://www.otcmarkets.com/learn/market-structure (last visited June 19, 2011).

51. *See supra* notes 43-44 and accompanying text.

52. 48 C.J.S. *International Law* § 18 (2010) (except in respect to American nationals, the Constitution of the United States and the laws passed in pursuance thereof have no force in foreign territory).

53. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §402 (1987).

54. *Id.* §403.

regulating such activity, and the likelihood of conflict with regulation by another state.[55] Most importantly, the "presumption that federal law is not meant to have extraterritorial effect is applicable in all cases, whenever a party seeks to give any federal legislation extraterritorial effect, including cases arising under the Securities Exchange Act."[56] The inconsistent application of this presumption is reflected by contrary outcomes in foreign-cubed cases.

In a heavily cited opinion involving the application of Title VII, the Supreme Court held that "[i]t 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."[57] The Court continued that this "canon of construction . . . is a valid approach whereby unexpressed congressional intent may be ascertained" and serves to protect against unintended clashes between "our laws and those of other nations which could result in international discord."[58] Although the case mentioned was a Title VII action, the decision of which was later overturned by statute, the concept is still applicable and was cited by the Court in the *Morrison* decision.[59]

The Supreme Court later stated that while "[a]cts of Congress do not ordinarily apply outside our borders . . . [w]hen it desires to do so, Congress knows how to place [foreign territories] within the jurisdictional reach of a statute."[60] Until the enactment of the "Dodd-Frank" bill post-*Morrison*, neither the '33 Act nor the '34 Act made any mention of extraterritorial application.[61]

## III. MORRISON V. NATIONAL AUSTRALIA BANK - SECURITIES LAW EXTRATERRITORIALITY DECIDED

### A. BACKGROUND

On June 24th, 2010 the Supreme Court finally issued a decision concerning the extraterritorial application of the Exchange Act, turning

55. *Id.* §403(2)(a), (g), (h).
56. 79A C.J.S. *Securities Regulation* § 123 (2010).
57. E.E.O.C. v. Arabian American Oil Co., 499 U.S. 244, 248 (1991).
58. *Id.*
59. 130 S. Ct. 2869 (2010).
60. *See* Sale v. Haitian Ctrs. Council, Inc., 509 U.S. 155, 174 (1993).
61. *See* Dodd-Frank, *infra* note 128; Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (2006); *see also* Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78oo (2006).

decades of precedent on its head.[62] In *Morrison v. National Australia Bank*, the Court addressed an action brought by four Australians[63] against what was at one point the largest bank in Australia.[64] The plaintiffs alleged that in 1998, National Australia Bank ("NAB") bought co-defendant Homeside Lending Inc., a mortgage servicing company, in order to expand NAB's operations.[65] Homeside's business plan depended on the presumption that mortgages would not be prepaid or terminated in any fashion, so that its clients would continue to require its services.[66] As a subsidiary of NAB, Homeside's valuations were dependent on this presumption and subsequently appeared in NAB's consolidated financial statements.[67] On July 5, 2001, NAB announced a "write-down" of Homeside's assets by $450 million citing increased mortgage prepayments.[68] The following quarter brought about another write-down of $1.75 billion.[69]

Following the ensuing decline of NAB's share price on the Australian exchange, as well as a corresponding drop of its (unsponsored) ADRs, plaintiffs brought an action in District Court for the Southern District of New York alleging Homeside's financial models fraudulently predicted prepayment at "unrealistically low" levels.[70] The complaint alleged violations of sections 10(b) and 20(a) of the '34 Act[71] and of SEC Rule 10b-5.[72] Plaintiffs alleged that NAB's

62. *Morrison*, 130 S. Ct. 2869.

63. *Id.* at 2876 (ironically, Morrison, the *Petitioner's* namesake, himself an American, had his case dismissed for failure to state damages, but he continued to be named as the petitioner in the case).

64. *Id.* at 2875.

65. *Id.*

66. Risks can include prepayment for or risk of overall default on the loan being serviced; in such situations, servicing would no longer be necessary for the loan in question. *See* JEFF MADURA, FINANCIAL MARKETS AND INSTITUTIONS 214 (Michelle Baird et al. eds., 8th ed. 2008).

67. For a description of why and how corporations create consolidated financial statements, see BELVERD E. NEEDLES, JR. ET AL., FINANCIAL & MANAGERIAL ACCOUNTING 630-38 (8th ed. 2008).

68. A write down is allowed when an investment is deemed impaired. *See* STEVEN M. BRAGG, WILEY GAAP POLICIES AND PROCEDURES 150 (2d ed. 2008).

69. *Morrison*, 130 S. Ct. at 2875-76.

70. *Id.* at 2876.

71. *See* Securities Exchange Act of 1934 § 78a, 15 U.S.C. § 78a-78oo (2006).

72. *Morrison*, 130 S. Ct. at 2876.

management was aware of this material fallacy and failed to act.[73] Defendants moved to dismiss for lack of subject matter jurisdiction and for failure to state a claim.[74]

The District Court dismissed the claim under Rule 12(b)(6) for lack of subject matter jurisdiction, holding that the conduct alleged was "at most, a link in the chain of an alleged securities fraud scheme that culminated abroad."[75] Moreover, the Court held that the plaintiffs' claim that *but-for* the domestic conduct the fraud would not have occurred, did not fit into the Rule 10b-5 framework.[76] The petitioners, all Australians, had sought to represent a class of foreign purchasers of NAB's shares in a period prior to the write-down.

### B. SUPREME COURT DECISION

Prior to announcing the unanimous decision, Justice Scalia addressed a threshold issue regarding an error that the lower court had made (based on decades of erroneous precedent) regarding whether the question of securities law extraterritoriality was in fact an issue of subject-matter jurisdiction.[77] The Court clarified that the decision of whether section 10(b) reached extraterritorial conduct was actually a merits questions, whereas the question of subject-matter jurisdiction refers "to a tribunal's power to hear a case."[78] While the result in the lower *Morrison* decision would not have changed, the court felt it necessary to clarify that it is without question that the District Court had the jurisdiction to hear the case under 15 U.S.C. § 78aa.[79] The Court refused to remand stating that doing so "would only require a new Rule 12(b)(6) label for the same Rule 12(b)(1) conclusion.[80]

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73. *Id.*
74. *Id.*
75. *See In re* Nat'l. Aus. Bank Sec. Litig., No. 03 Civ. 6537(BSJ), 2006 WL 3844465, at *8 (S.D.N.Y. Oct. 25, 2006).
76. *Id.*
77. *Morrison*, 130 S. Ct. at 2877.
78. *Id.* (internal quotations omitted).
79. *Id.*
80. *Id.* (failure to state a claim upon which relief can be granted versus lack of subject-matter jurisdiction).

### C. PRESUMPTION AGAINST EXTRATERRITORIALITY

After addressing the issue of procedural housekeeping, the Court reiterated its earlier decisions regarding the general application of American law outside of the United States territories.[81] The Court, quoting its decision in *Aramco* and other cases, reaffirmed the notion that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none."[82] This statement set the tone for the rest of the opinion.[83] Justice Scalia proceeded to note that regardless of how many times the Supreme Court had recited the presumption against extraterritoriality in their previous opinions, the Second Circuit, and other circuits following suit, essentially disregarded this precedent and felt it necessary to "discern whether Congress would have wanted the statute to apply" extraterritorially, thereby "divining" a set of tests that were "complex in formulation and unpredictable in application."[84] The Court noted that until 1967 the district courts in the Southern District of New York had stayed within the letter of the law by not interpreting securities laws as applying outside of the United States.[85] However, the Second Circuit's reversal of the District Court in the *Schoenbaum* case set the courts on a path to an application that would soon be expanded in subsequent cases, essentially "excis[ing] the presumption against extraterritoriality" from federal jurisprudence.[86]

Justice Scalia mentioned the development of the conduct and effects tests, with palpable sarcasm, referring to them as the "north star of the Second Circuit's section 10(b) jurisprudence, pointing the way to what Congress would have wished."[87] Moreover, the Court mentioned that while other Circuits had adopted the test, albeit with their own variations, one Court of Appeals had criticized the test and its "interpretive assumptions" but still decided to defer to the Second Circuit because of its "preeminence in the field of securities law[.]"[88]

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81. *Id.* at 2877-78
82. *Id.* at 2878.
83. *Id*.
84. *Id.*
85. *Id.*
86. *Id.* at 2878-79.
87. *Id.* at 2879.
88. *Id.* at 2880 (noting Judge Bork's observation that a "more natural inquiry might be what jurisdiction Congress in fact . . . conferred" rather than assuming (citing Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 32 (D.C. Cir. 1987))).

Concurring with the many scholarly criticisms that had been volleyed against the Second Circuit's line of reasoning, the Court reiterated the wisdom and simplicity of a presumption against extraterritoriality stating that "[r]ather than guess anew in each case" the presumption should be adhered to and provide for the legislative process to take its course.[89]

Continuing in its analysis, the Court maintained that since Rule 10b-5 was promulgated under section § 10(b) of the '34 Act, it is subject to the contours of section § 10 and "[t]herefore, if section § 10(b) is not extraterritorial, neither is Rule 10b-5."[90] After examining the text of the statute, the Court concluded that textually, nothing in the statute points to extraterritorial application.[91] Rejecting the Solicitor General's position that the definition of "interstate commerce" as defined by section § 10(b) includes "trade, commerce, transportation, or communication . . . between *any foreign country and any State* (emphasis added)," the Court held that that this reference to interstate commerce does not defeat the presumption against extraterritorial jurisdiction as set forth in *Aramco*.[92] "[E]ven statutes that contain broad language in the definition of commerce that expressly refer to '*foreign commerce*' do not apply abroad."[93] However, the Court affirmed that liability is possible if an issuer abroad publishes information in the United States, or otherwise uses the means and instrumentalities of interstate commerce to make material misrepresentations that ultimately affect the price of their shares traded on a domestic exchange.[94]

The petitioners and the Solicitor General offered two other bases that support extraterritorial application.[95] The first is that Congress, in its legislative history of the '34 Act, observed that "such transactions are generally disseminated and quoted throughout the United States and foreign countries," thereby suggesting it intended extraterritorial

89. *Id.* at 2880-81 (citing articles that are critical of the Second Circuit's approach to extraterritorial jurisdiction).

90. *Id.* at 2881 (internal quotations omitted) (citing United States v. O'Hagan, 521 U.S. 642, 651 (1997)).

91. *Id.*

92. *Id.* at 2882.

93. *Id.* at 2882 (citing E.E.O.C. v. Arabian American Oil Co., 499 U.S. 244, 251 (1991)).

94. *Id.*

95. *Id.*

application.[96] The second is that § 30(b) of the '34 Act provides that "[t]he provisions of the ['34 Act] shall not apply to any person [that] . . . transacts . . . without the jurisdiction of the United States," unless they transact with the purpose of evading the regulations promulgated under the Act."[97] The Solicitor General argued that such a law would be meaningless if extraterritorial application did not already apply to the securities laws.[98]

The Court responded to the first argument by noting that the same section quoted by the Petitioners and Solicitor General also limited its reach to "transactions . . . conducted upon securities exchanges . . . [that] are affected with a *national public interest*" (emphasis added).[99] The Court asserted that such an interest does not pertain to foreign exchanges, and thereby failed to overcome the presumption against extraterritoriality.[100] Moreover, the Solicitor General's inference that a foreigner's evasion of the securities laws indicate extraterritoriality, while possible, is not sufficient to override the presumption.[101]

In sum, the Court quoted from the '34 Act an actual provision "for [] specific extraterritorial application," stating that the purpose of which "would be quite superfluous if the rest of the Exchange Act already applied to transactions on foreign exchanges," thus confirming its textual analysis of the extraterritorial application of section 10(b), and effectively ruling against it."[102]

### D. CLARIFICATION OF THE ORIGINAL INTENT OF *§10(B)* AND ITS PROPER APPLICATION

The Court then turned to the Petitioner's alternate argument that the Respondent's alleged deceptive conduct and misrepresentations had occurred in Florida and that such action mitigated the need to find an extraterritorial application of the securities laws.[103] The Court

96. *Id.* (internal quotations omitted).

97. *Id.* (internal quotations omitted).

98. *Id.* (the Court specifically points to the fact that the *amicus curiae* brief for the United States makes no mention of a regulation promulgated under §30(b)).

99. *Id.*

100. *Id.*

101. *Id.* at 2883.

102. *Id.* (citing Securities Exchange Act of 1934 § 78dd(a), 15 U.S.C. §§ 78a-78oo (2006)).

103. *Id*. at 2883-84.

responded that "it is a rare case of prohibited extraterritorial applications that lacks *all* contact with the . . . United States," stating that the presumption against extraterritoriality would be utterly anemic if its application was dismissed anytime there was some minutiae of domestic contact.[104]

In *Aramco*, the Court looked to what Congress' concern was at the time legislation was enacted, rather than the historical events leading up to it.[105] The '34 Act applies to deceptive conduct and misrepresentations "in connection with the purchase or sale of any security *registered on a national securities exchange*" (failing to mention that the location of the deception is dispositive when determining application of the law), therefore invoking the presumption against extraterritorial application.[106] The Court makes clear that section 10(b) seeks to regulate only "purchase-and-sale transactions" and the respective parties to those transactions only when they are in securities listed on domestic exchanges.[107] Moreover, the Court adds this phrase in section 10(b) referring to securities registered on "national securities exchanges" would be nonsensical if the presumption against extraterritoriality didn't apply.[108] The phrase could have read more simply "all purchases and sales of securities" and covered all securities sold in all territories.[109] The Court also refers to the '33 Act's registration requirement and how the SEC had interpreted the rule "not to include offer and sales that occur outside the United States."[110] Given that the '33 Act and the '34 Act were enacted within one year of each other and the '34 Act requirements seem to naturally follow out of the securities registered under the '33 Act, the Court naturally assumed that its jurisdiction did so as well.

Finally, the Court turned to the issue of international comity, when

104. *Id.*

105. *Id.* (noting that in E.E.O.C. v. Arabian American Oil Co., 499 U.S. 244 (1991), even though the Title VII plaintiff had been hired in the United States and was a U.S. citizen, the employment situation in question had occurred outside of the United States; Congress' clear intent was on domestic employment and had effectively barred the claim from being heard).

106. *Id.* (citing to Securities Exchange Act of 1934 § 78j(b), 15 U.S.C. §§ 78a-78oo (2006)). *See also* SEC v. Zandford, 535 U.S. 813 (2002).

107. *Morrison*, 130 S. Ct. at 2883-84.

108. *Id.* at 2885.

109. *Id.*

110. *Id.* (citing to 17 C.F.R. § 230.901 (2009)).

it stated that if "Congress intended such foreign application it would have addressed the subject of conflicts with foreign laws and procedures."[111] Citing from the amicus curiae briefs of multiple nations, the Court discussed how each country has its own judicial processes, the likes of which will not always correspond with that of the United States.[112] Moreover, the Court discussed how foreign apprehension at section 10(b)'s application abroad without a bright-line test would interfere with a foreign nation's securities regulation and overall judicial sovereignty.[113]

Ultimately, restricting the '34 Act's application for transactions occurring in the United States or involving securities listed on a domestic exchange reflects the jurisprudential concerns of the Court.[114] The Court rejected the significant conduct test used for decades by the Second Circuit and applied by the SEC,[115] explaining that the Court's function is "to give the statute the effect its language suggests" and nothing more.[116] This decision later came into the sights of Congress while they were drafting the Dodd-Frank Act.

## IV. THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

### A. BACKGROUND: THE CREDIT CRISIS

In the years following a U.S. housing bubble fueled by, among other things, easy access to credit, the U.S. economy weakened while the housing market went into a free-fall, the recovery of which would be years in the making.[117] One of the most significant factors in the

111. *Id.* (internal quotations omitted).

112. *Id.* at 2885-86 (referring to the *amicus curiae* briefs for the United Kingdom, Australia, France, and various foreign chambers of commerce, financial associations, and foreign corporations).

113. *Id.* at 2886.

114. *Id.*

115. *Id.* at 2887-88 (citing to earlier SEC decisions *In re* United Sec. Clearing Corp., 52 S.E.C. 92, 95 n.14, 96 n.16, (1994) and *In re Robert F. Lynch*, Exchange Act Release No. 11,737, 8 SEC Docket 75, 77 n.15 (1975)).

116. *Id.* at 2886 (citing to Brief for United States as *Amicus Curiae* referring to the possibility of the United States becoming a "Barbary Coast" for securities fraud).

117. *See* Ruth Mantell, *Home Prices Off Record 18% in Past Year, Case-Shiller Says*, MARKETWATCH, Dec. 30, 2008, *available at* http://www.marketwatch.com/story/home-prices-off-record-18-in-past-year-case-shiller-says.

housing crisis and ensuing economic meltdown was the wide availability of credit to non-creditworthy individuals in the form of subprime mortgages.[118] Many corporations became enamored with the subprime market and the billions that came with originating and subsequently securitizing these loans.[119] The market for such asset-backed securities was insatiable. The banks that were heavily invested in mortgage backed securities took the largest losses.[120] Case in point: Lehman Brothers and its eventual demise.

### B. LEHMAN FAILS; OTHERS GIANTS BEGIN TO FALTER

Following a weekend of intense negotiation with Treasury Secretary Henry Paulson, government officials, and executives from some of the largest banks in the nation, Lehman Brothers Holdings Inc. was not able to find itself a buyer.[121] Lehman subsequently filed a petition under Chapter 11 of the Bankruptcy Code in the United States District Court for the Southern District of New York in what would become the "largest failure of an investment bank since the collapse of Drexel Burnham Lambert 18 years ago."[122] Underscoring the impact of this crisis, Merrill Lynch & Co Inc. was purchased by Bank of America for $50 billion after suffering significant losses due to the plummeting value of its CDO (collateralized debt obligation) portfolio.[123]

### C. A CALL TO ACTION

During the next few months, Wall Street, and the financial services

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118. *See* Mara Lee, *Subprime Mortgages: A Primer*, NAT'L PUBLIC RADIO (Mar. 23, 2007), http://www.npr.org/templates/story/story.php?storyId=9085408 (discussing subprime mortgages). *See also* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY COMMISSION REPORT (2011), *available at* http://fcic.gov/report.

119. *See generally* ADAM B. ASHCRAFT & TIL SCHUERMANN, UNDERSTANDING THE SECURITIZATION OF SUBPRIME MORTGAGE CREDIT (2008), *available at* http://www.ny.frb.org/research/staff_reports/sr318.pdf.

120. *See* *Mortgage-Backed Securities*, SEC, http://www.sec.gov/answers/mortgagesecurities.htm (last visited June 19, 2011).

121. *See* Andrew Ross Sorkin, *Lehman Files for Bankruptcy; Merrill Is Sold*, N.Y. TIMES, Nov. 29, 2010, at A1; *see also* Sam Mamudi, *Lehman Folds With Record $613 Billion Debt*, MARKETWATCH, Sept. 15, 2008, *available at* http://www.marketwatch.com/story/lehman-folds-with-record-613-billion-debt?siteid=rss.

122. *See* Sorkin, *Lehman Files*, *supra* note 121.

123. *See id.*

sector in general, suffered massive losses leading to the government bailout of many banks that were considered "too big to fail."[124] These events, having had many economic repercussions around the globe, led legislators to call for stronger and more thorough government oversight of the financial markets. On June 17, 2009, in a speech to financial industry representatives at the White House, President Obama called for "a sweeping overhaul of the financial regulatory system, a transformation on a scale not seen since the reforms that followed the Great Depression."[125] The following day, the Treasury Department released a plan with recommendations as to what changes were needed in order to ensure future stability and restoration of "confidence in the integrity of our financial system."[126]

Representative Barney Frank (D-MA) and Senator Chris Dodd (D-CT) spearheaded the initiative to pass legislation in their respective chambers of Congress. The earliest provisions closely paralleled the Obama administration's plan for financial reform.[127] After months of contentious debate and intense media coverage, the House of Representatives passed a version of the financial reform bill, known as the "Dodd–Frank Wall Street Reform and Consumer Protection Act"[128] ("Dodd-Frank" or the "Act") on December 12th, 2009.[129] The Senate followed suit, and on May 20th, 2010 voted in favor of the bill.[130] Thereafter, President Obama signed the Act into law on July 21, 2010—

124. For a thorough (and occasionally riveting) analysis of the Financial and Subprime Credit Crisis, *see generally* ANDREW R. SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM – AND THEMSELVES (2009).

125. President Barack H. Obama, Remarks on Twenty-First Century Financial Regulatory Reform (June 17, 2009), *available at* http://www.whitehouse.gov/the_press_office/Remarks-of-the-President-on-Regulatory-Reform/. *See also Obama's Financial Reform Plan: The Condensed Version*, WASHINGTON WIRE, http://blogs.wsj.com/washwire/2009/06/17/obamas-financial-reform-plan-the-condensed-version/tab/article/ (last visited June 19, 2011).

126. *See* THE DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION (2009), http://purl.access.gpo.gov/GPO/LPS113933 (last visited June 19, 2011).

127. *See supra* note 124 and accompanying text.

128. The Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

129. *See* H.R. Res. 4173, 111th Cong. (2010) (enacted).

130. S. Res. 4173, 111th Cong. (2010) (enacted).

almost a month to the day after the *Morrison* decision.[131]

### D. THE DODD-FRANK ACT'S IMPACT ON SECURITIES FRAUD ACTIONS

In its final form, the Act comprehensively addressed a host of financial regulatory concerns including, for example, the orderly liquidation of unsound institutions[132], the regulation of hedge funds and derivatives[133], and the protection of consumers.[134] For our purposes, however, we draw upon sections 929p and 929y of the Act, discussed in further detail below.

#### *1. Section 929p - Strengthening Enforcement by the Commission*

Section 929p(b)(1) explicitly provides for the extraterritorial *jurisdiction* of the securities laws under section 17(a) of the '33 Act, for alleged violations 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."[135] The law effectively codified the "conduct and effects" test extensively relied upon by the Second Circuit for the past four decades prior to its abrogation by the Supreme Court in *Morrison*.[136] In addition, section 929p(b)(2) codified the "conduct and effects" test with respect to any alleged violations of the antifraud provisions under the '34 Act.[137] Finally, section 929p(b)(3) codified the conduct and substantial effects test for violations of section 206 of the Investment Advisors Act of 1940.[138]

131. Helene Cooper, *Obama Signs Overhaul of Financial System*, N.Y. TIMES, July 21, 2010, *available at* http://www.nytimes.com/2010/07/22/business/22regulate.html?hp.

132. *See* Dodd-Frank Act, *supra* note 128, § 204(a).

133. *See id.* § 723(a)(3) (adding §§ 2(h)(1)(A) and 2(h)(2)(B)(i) to the Commodity Exchange Act, which require clearing of swaps and regulation of swap dealers); *see also id.* § 731 (requiring registration and regulation of swap dealers).

134. *See id.* § 1011 (establishing the independent Bureau of Consumer Financial Protection with the Federal Reserve Board).

135. *Id.* § 929p(b)(1).

136. Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869 (2010).

137. *See* Dodd-Frank Act, *supra* note 128, § 929p(b)(2).

138. *Id.* § 929p(b)(3).

*2. Section 929y - Study on Extraterritorial Private Rights of Action*

Interestingly, under section 929p, the Act only authorizes extraterritorial jurisdiction for actions brought "by the Commission or the United States," and not private party actions. Section 929y, however, cures this apparent defect by mandating the SEC to "solicit public comment and thereafter conduct a study to determine the extent to which private rights of action under the antifraud provisions" should be extended to cover conduct or transactions outside the United States.[139]

The SEC, under the direction of Congress, is tasked with analyzing multiple issues, including:

> (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 apply only 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.[140]

The report is to be submitted no later than eighteen months following the passage of the Dodd-Frank Act.[141]

## V. IMPLICATIONS OF AN EXTENSION OF THE CONDUCT AND EFFECTS TEST TO PRIVATE CAUSES OF ACTION

### A. DODD-FRANK IS INEFFECTIVE IN ITS ATTEMPT AT RESURRECTING F-CUBED LITIGATION

A convincingly strong case could be made that Section 929p of

139. *Id.* § 929y. *See* Study on Extraterritorial Private Rights of Action, Exchange Act Release No. 34-63174 (Oct. 25, 2010), *available at* http://www.sec.gov/rules/other/2010/34-63174.pdf, for further information on the comments being solicited and important dates.

140. Study on Extraterritorial Private Rights of Action, *supra* note 139.

141. Dodd-Frank Act, *supra* note 128, § 929y(c).

Dodd-Frank has not effectively reversed the core holding of *Morrison*. The Dodd-Frank Act states in relevant part that "[t]he district courts of the United States and the United States courts of any Territory *shall have jurisdiction*. . . alleging a violation . . . even if the securities transaction occurs outside the United States and involves only foreign investors . . . ."[142]

Significantly, the legislative text makes no mention of any change in the *application* of the securities laws. Rather it only speaks directly to a court's ability to hear a case, a power fully recognized by the majority in *Morrison*.[143] In a recent publication, the attorney for the respondents in *Morrison* argued that "[t]he [section 929p] provision unambiguously addresses only the '*jurisdiction*' of the 'district courts of the United States' to hear cases involving extraterritorial elements; its language clearly does not expand the geographic scope of any substantive regulatory provision."[144] Indeed, Justice Scalia wrote *in Morrison* that "[s]ubject-matter jurisdiction . . . refers to a tribunal's power to hear a case," summarily finding that the district court enjoyed subject matter jurisdiction over the dispute.[145] The more probing question of "what conduct section 10(b) reaches is to ask what conduct section 10(b) prohibits," Scalia continued, "is a merits question."[146] Congress, in an act of oversight in the Dodd-Frank Act, therefore failed to satisfactorily address the threshold issue in *Morrison* – namely, the extraterritoriality of the U.S. securities laws.

Simply 'extending' a court's jurisdiction to extraterritorial application in foreign cubed cases does not suffice and may (and should) ultimately render section 929p irrelevant unless an amendment is passed to clarify the applicable scope of the securities laws. Admittedly, the Act was poorly and hastily drafted because the legislative history of the Act, found in the Congressional Record, reveals that "the provisions

142. *Id.* § 929p(b)(2) (emphasis added).

143. Writing for the majority, Justice Scalia ruled that the district court had subject matter jurisdiction to hear the dispute. The extraterritorial reach of the securities laws, he added, must be treated as a merit-based (and not jurisdictional) issue. *See* Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869, 2877 (2010).

144. George T. Conway III, *Extraterritoriality After Dodd Frank*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION, http://blogs.law.harvard.edu/corpgov/2010/08/05/extraterritoriality-after-dodd-frank/ (last visited June 19, 2011).

145. *Morrison*, 130 S. Ct. at 2877 (internal quotations omitted).

146. *Id.* (internal quotations omitted).

concerning extraterritoriality . . . are intended to rebut [the Supreme Court's presumption against extraterritoriality] by clearly indicating that Congress intends extraterritorial application in cases brought by the SEC or the Justice Department."[147] And while "given the drafters' extra-statutory statements, some judges may be tempted to find substantive extraterritorial[ity]," the Supreme Court has repeatedly stated that courts:

> must adopt the interpretation of the statute that is most faithful to its text . . . [i]f Congress enacted into law something different from what it intended, then it should amend the statute to conform it to its intent . . . [i]t is beyond our province to rescue Congress from its drafting errors. . . .[148]

It may be possible that this careless drafting has to do with the fact that the total number of lawyer-legislators in Congress has been on the decline, thereby possibly causing a disconnect between legislative intent and judicial interpretation.[149]

Whatever the reason may be for this careless mistake, a district court hearing this case already has precedent, in *Morrison*, to follow in determining whether there is extraterritorial application to the securities laws. Without a clear amendment stating that the securities laws apply to what are essentially purely foreign transactions, a court should rule

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147. 156 CONG. REC. H5235, H5237 (daily ed. June 30, 2010) (statement of Rep. Paul Kanjorski), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?position=all&page=H5237&dbname=2010_record.

148. Harbison v. Bell, 129 S.Ct. 1481, 1494 (2009) (internal quotations omitted).

149. *Compare 110th Congress Lawyers-Legislators: U.S. Senate*, ABANET.ORG, http://www.abanet.org/poladv/documents/lawyerleg110thsenate_nofooter.pdf (last visited Dec. 2, 2010) (listing the percentage of the 110th Senate that are lawyers at 59%) *and 110th Congress Lawyers-Legislators: U.S. House of Representatives*, ABANET.ORG, http://www.abanet.org/poladv/documents/lawyerleg110thhouse_nofooter.pdf (last visited Dec. 2, 2010) (listing the percentage of the 110th House of Representatives that are lawyers at 40%), *with 111th Congress Lawyers-Legislators: U.S. Senate*, ABANET.ORG, http://www.abanet.org/poladv/documents/lawyers111congress_senate.pdf (last visited Dec. 2, 2010) (listing the percentage of the 110th Senate that are lawyers at 58%) *and 111th Congress Lawyers-Legislators: U.S. House of Representatives*, ABANET.ORG, http://new.abanet.org/calendar/ABAday/Documents/LawyersCongressHouse2010.pdf (last visited Dec. 2, 2010) (listing the percentage of the 110th House of Representatives that are lawyers at 36%).

against the application. Borrowing from Justice Scalia's reasoning in *Morrison*, in order for a law to apply extraterritorially it must have "a clear statement of extraterritorial *effect* (emphasis added)." Any amendment referencing jurisdiction and not application of the law only speaks to the power of the court to hear the case, and not whether it can apply the law to particular facts.[150]

Further support for this argument may materialize when we see how the SEC interprets this amendment in prosecuting cases of extraterritorial fraud that occurred prior to Dodd-Frank's enactment. If the SEC argues that the Dodd-Frank amendment actually changes how the courts rule on the merits of an extraterritoriality issue, rather than subject-matter jurisdiction, then there may be a successful defense against *ex-post facto* application of a law, subsequently causing cases to be dismissed. However, if the SEC argues that it is merely jurisdictional (i.e. that the amendment was written to address subject-matter jurisdiction) then the case could be dismissed because *Morrison* rejects extraterritorial application, even while already affirming jurisdiction.

Take for example the recent case of Fabrice Tourre, a former Goldman Sachs employee who is being prosecuted under the antifraud provisions of the federal securities laws for his role in the development and marketing of what the SEC alleges to be a fraudulent CDO.[151] On September 29, 2010, Mr. Tourre's counsel filed a motion for a judgment on the pleadings arguing that the case be dismissed under *Morrison* since the investment in question did not include any transactions that occurred in the United States, was not listed on any exchange, and moreover that the investor was a foreigner.[152] After responding, the SEC was given the opportunity to file an amended complaint, doing so on November 22, 2010, and arguing that Mr. Tourre gave "substantial assistance [to Goldman Sachs] as it misled investors in a product linked to subprime mortgages."[153] Such an argument leads one to believe that

150. *Morrison*, 130 S. Ct. at 2883 (internal quotations omitted).

151. For a thorough explanation of the details and background of this action, see SEC Charges Goldman Sachs With Fraud In Connection With the Structuring and Marketing of a Synthetic CDO, SEC Litig. Release No. 21,489, *available at* http://www.sec.gov/litigation/litreleases/2010/lr21489.htm (last visited June 19, 2011).

152. SEC v. Goldman Sachs & Co., No. 10-CV-3229, 2010 WL 4520689 (S.D.N.Y. Sept. 29, 2010).

153. Joshua Gallu, *Goldman Sachs's Tourre Facing New Claim in SEC Lawsuit*, BLOOMBERG NEWS (Nov. 24, 2010), http://www.bloomberg.com/news/2010-11-24/goldman-sachs-s-tourre-facing-additional-sec-claim-on-subprime-mortgages.html.

the SEC is abandoning its fraud claim in light of *Morrison,* and is taking a different approach, perhaps for the reasons mentioned above.

Therefore, given the apparent lack of effectiveness of section 929p, foreign-cubed litigation brought in federal court should be dismissed under *Morrison*. No extraterritorial effect can be provided to a statute unless its provisions clearly provide for its *application* not only jurisdiction. Unfortunately for the drafters of *Dodd-Frank*, their hastiness in bringing this amendment to vote likely ended up with a bill as impotent as the Second Circuit jurisprudence it was based on.

### B. CONTINUED LACK OF CLARITY: THE NEED FOR A SAFE HARBOR

Assuming the courts reject the above-proffered interpretation of how the *Dodd-Frank* amendment was written, and embrace extraterritorial application for securities laws enforcement, an overarching issue is that, while Congress has seemingly attempted to adopt the conduct and effects tests, what actually constitutes fulfillment of these tests by a foreign issuer is unclear due to the differing court positions on the issue and continued lack of legislative clarity. Moreover, different circuits have applied the effects differently, with some ruling that a satisfaction of both tests is required, whereas some have held that the tests are mutually exclusive of one another.[154]

This issue is extremely important as "[c]urrently, it is unclear to what extent the effects test is applicable [and] [a]s a result, corporations, issuers, lawyers, and the business community do not know what constitutes a substantial effect or what behavior abroad might affect U.S. securities."[155] This has led to "foreign issuers hav[ing] taken great pains to deny the sale of securities to U.S. investors" because they are "wary of being haled into U.S. courts and subjected to broad U.S. discovery procedures should the price of stock fall."[156] Not only is this a detriment to the issuers in that they cannot access the vast wealth of this nation, barring U.S. investors from foreign investments has the effect of preventing them from reaping potentially substantial returns, especially

154. *See supra* notes 29-40 and accompanying text.

155. *See* John D. Kelly, *Let There Be Fraud (Abroad): A Proposal for a New U.S. Jurisprudence with Regard to the Extraterritorial Application of the Anti-Fraud Provisions of the 1933 and 1934 Securities Acts,* 28 LAW & POL'Y INT'L BUS. 477, 493 (1997).

156. *Id.*

with regard to emerging foreign markets who are desperately seeking outside investment.[157] Therefore, if the courts do embrace the intent of Dodd-Frank, and reject a textual reading of the statute, it is imperative that the SEC, either through a rule or release, adopts a set of factors that would provide foreigners a safe harbor to follow in order to avoid costly litigation in U.S. courts.[158] Such a rule would likely ease the concerns of many foreign issuers, who would have an official guide to look to which provides for more foreign opportunities for domestic investors.

### C. ISSUES OF INTERNATIONAL COMITY

Finally, going beyond the textual argument that can be made against extraterritorial application, there are common sense jurisprudential arguments as to why jurisdiction should not be extended. A major issue is comity and whether other nations would respect and enforce the judgments of U.S. federal courts on issues that may have been better off litigated in their respective courts.[159] Applying the securities laws broadly to foreign transactions would "interfere with the regulatory systems of other countries . . . [causing] U.S. interference [to] generate confusion and multiply the costs to investors and issuers.[160] In addition it would cause "tension between the United States and other countries . . . [possibly leading] other countries [to] retaliate, seeking to

157. "Growth in emerging markets will accelerate faster than in developed nations as economies mature and leaders are quicker to make structural changes." Cordell Eddings & Tom Keene, *Emerging Market Growth Gap to Widen, El-Erian Says: Tom Keene*, BLOOMBERG NEWS (July 9, 2010), http://www.bloomberg.com/news/2010-07-09/emerging-developed-world-growth-gap-will-widen-el-erian-says-tom-keene.html.

158. The SEC has much experience providing issuers with safe harbors to follow, especially with foreign securities. *See Regulation S -- Rules Governing Offers and Sales Made Outside the United States Without Registration Under the Securities Act of 1933*, http://taft.law.uc.edu/CCL/33ActRls/regS.html (last visited June 19, 2011) (providing an example of an SEC safe harbor affecting foreign issuers).

159. "Comity, in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws." Hilton v. Guyot, 159 U.S. 113, 163-64 (1895).

160. Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking The International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 914 (1998).

regulate activities of U.S. parties that impact their countries."[161] Courts seeking to apply extraterritorial jurisdiction "must [also] consider the political impact of applying U.S. law on international relations, U.S. foreign policy, and the development of multinational business."[162] Finally, extraterritorial application could "produce undesirable results such as redundant and unnecessarily costly systems of overlapping regulation, [that] would thereby impede the free flow of capital across borders."[163] The SEC must consider these potential political and economic ramifications when applying extraterritorial jurisdiction for both public and (after the conclusion of the Congressionally-mandated study) private actions.

Looking at the number of amicus briefs that were filed in favor of the respondents in the *Morrison* case, it is clear that there is a large group of foreign nations that reject U.S. extraterritoriality in this aspect.[164] The possibility for confusion and conflict of laws between nations is immense in today's global economy. Therefore it is imperative that practitioners, academia, and foreign nations voice their disapproval with this expansion of U.S. judicial power and urge the SEC in this open comment period to restrict extraterritorial application of the securities laws to both governmental and private party causes of action.[165]

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161. *Id.*

162. Jill E. Fisch, *Imprudent Power: Reconsidering U.S. Regulation of Foreign Tender Offers*, 87 NW. U. L. REV. 523, 554 (1993).

163. Kun Young Chang, *Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject-Matter Jurisdiction*, 9 FORDHAM J. CORP. & FIN. L. 89, 102 (2003).

164. Among the groups that filed *amicus* briefs in support of the respondent are the U.K., Australia, France, the New York Stock Exchange, Euronext, The Swiss Bankers Association, Economiesuisse, The Federation of German Industries, The French Business Confederation, The Institute of International Bankers, The European Banking Federation, the Australian Bankers' Association, Securities Industry and Financial Markets Association, the Association for Financial Markets in Europe, the Chamber of Commerce of the United States of America, the United States Council for International Business, the Association Francaise des Entreprises Privees, GC100, European Aeronautic Defence & Space Co. N.V., Alstom SA, Lagardere Groupe SCA, Thales SA, Technip SA, Vivendi SA, and law professors.

165. See Study on Extraterritorial Private Rights of Action, *supra* note 139.

## CONCLUSION

While it is clear that Congress intended to extend the reach of the securities laws and the SEC's ability to enforce them, careless drafting and a lack of clarity probably preclude Dodd-Frank from having the intended effect. Moreover, if the Dodd-Frank amendment is not interpreted by courts textually, but rather by looking to Congress' legislative intent, the SEC should clarify the boundaries and limits of the "conduct" and "effects" tests for the sake of predictability and uniformity among the courts. Finally, for the sake of international comity, restraint should be used when applying laws extraterritorially.