

Fox on Securities Class Actions Against Foreign Issuers

Merritt B. Fox, who is Michael E. Patterson Professor of Law at Columbia Law School, has published *Securities Class Actions Against Foreign Issuers* in the last issue of the *Stanford Law Review*.

This Article addresses the fundamental question of whether, as a matter of good policy, it is ever appropriate that a foreign issuer be subject to the U.S. fraud-on-the-market private damages class action liability regime, and, if so, by what kinds of claimants and under what circumstances. The bulk of payouts under the U.S. securities laws arise out of fraud-on-the-market class actions—actions against issuers on behalf of secondary market purchasers of their shares for trading losses suffered as a result of issuer misstatements in violation of Rule 10b-5. In the first decade of this century, foreign issuers became frequent targets of such actions, with some of these suits yielding among the very largest payouts in securities law history.

The law determining the reach of the U.S. fraud-on-the-market liability regime against foreign issuers has since been thrown into flux. The Supreme Court's recent decision in the Morrison case adopted an entirely new approach for determining the reach of Rule 10b-5 in situations with transnational features. This new approach focused on whether the purchase was of a security listed on a U.S. exchange or occurred in the United States, in contrast to the previous focus on whether either conduct or effects of sufficient importance occurred in the United States. In almost immediate response, Congress, in the Dodd-Frank Act, reversed the Court's decision with respect to actions by the government and mandated that the SEC prepare a report concerning the desirability of doing the same with respect to private damages actions.

This Article goes back to first principles to look at the basic policy concerns that are implicated by the reach of fraud-on-the-market class actions for damages, and to determine who, under a variety of circumstances relating to the nationality of the purchasers, the place of the trade, and the place of the issuer's misconduct, is ultimately affected by imposition of this liability regime on foreign issuers. The resulting analysis suggests a simple, clear rule likely to

both maximize U.S. economic welfare and, by also promoting global economic welfare, foster good foreign relations. The U.S. fraud-on-the-market class action liability regime should not as a general matter be imposed upon any genuinely foreign issuer, even where the claimant is a U.S. investor purchasing shares in a U.S. market or where the issuer engages in significant conduct in the United States relating to the misstatement. The only exception would be a foreign issuer that has agreed, as a form of bonding, to be subject to the U.S. regime.

This Article then charts a practical path to reform based on this simple rule. It assesses the attractions of, and problems with, the two competing alternatives—using the Morrison rule and returning to the conduct/effects test—and explores the possibilities for reform through the courts, SEC rulemaking, and legislation.