Extraterritorial Reach of U.S. Securities Law? What Extraterritorial Reach?

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Even from this side of the Atlantic, I could hear the cheers of many European scholars and practitioners – not to mention corporations – greeting the U.S. Supreme Court's decision in *Morrison*. That decision foreclosed one particularly difficult kind of transnational securities case, the "foreign-cubed" class action (foreign investor, foreign defendant, foreign investment transaction). That much was expected by virtually all observers – after all, as the Justices recognized during oral argument, it's hard to understand why Australia's regulatory choices should be displaced by U.S. law in a case involving Australian investors, an Australian issuer, and an Australian exchange. But the Court went substantially further, adopting the bright-line test that had been proposed by the respondents: it held that Section 10(b) of the Securities and Exchange Act of 1934 – the source of the implied right of action for investors harmed by securities fraud – applies only to fraud in connection with securities transactions *that occur within the United States*. In other words, the only plaintiffs who can sue under Section 10(b) are those who purchase their securities on U.S. exchanges or in other transactions in the United States. This test then bars not only foreign-cubed claims, but some forms of "foreign-squared" claims (e.g., U.S. investor, foreign defendant, foreign investment transaction) as well.

At one level, I find the result in the case gratifying. As I have argued here and here, the application of U.S. law in cases that are so closely connected to other countries brings our private enforcement mechanism into unwelcome conflict with foreign regulatory regimes. Various aspects of U.S. substantive and procedural law are viewed as unacceptable in most other legal systems: the lack of a loser-pays rule; contingency fees; opt-out class actions; our discovery rules; and – critical in these securities claims – our use of fraud-on-the-market as a substitute for a showing of actual reliance. In situations presenting such conflict between the interests of different countries, principles of international comity, as well as international-law limits on the application of domestic law, would dictate restraint.

Yet I find the Court's *rationale* in the case somewhat less gratifying. The decision is presented as one that rests on the presumption against extraterritoriality. Justice Scalia's opinion for the majority begins by quoting *Aramco* on that presumption: "legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States." The presumption can be overcome by a showing that the legislation in question was in fact meant to apply beyond U.S. territory. But hasn't that showing been made? The classic form of "extraterritoriality," after all, is *effects-based* regulation — the application of U.S. law to conduct that occurs in another country on the basis of the harm that results within the United States. (This form of extraterritorial regulation was not at issue in *Morrison*, which involved U.S. conduct, not U.S. effects.) The majority would presumably permit this kind of extraterritoriality, since it would permit the application of U.S. law to fraudulent conduct abroad as long as that conduct occurred in connection with a U.S. transaction in securities. In other words, in the Court's view, the issue is not that 10(b) can't apply to foreign *fraud* — it's that Section 10(b) can't apply to any fraud at all (foreign or domestic) in connection with a foreign *transaction*. This is really not a question of extraterritoriality – it's a question of the category of interests that, in the view of the majority, Section 10(b) is designed to protect. In defining the "objects of the statute's solicitude" as domestic exchanges and transactions alone, the Court is cutting back on the scope of that section. Thus, the decision appears to flow not so much from a concern about international conflict (though the Court does mention that), but from a more general concern about the overuse of the private right of action under Section 10(b). To that extent, as Justice Stevens notes in his concurrence, it is simply one more step in the Court's "continuing campaign to render the private cause of action under Section 10(b) toothless" (see, for instance, Central Bank of Denver (eliminating aiding and abetting liability), Dura Pharmaceuticals (heightening pleading requirements for allegations of loss causation), and Tellabs (raising the threshold for pleading scienter)).

Recognizing that the presumption against extraterritoriality had been overcome would not necessarily have led to a different result in this case. In his fine dissenting opinion in the 1993 *Hartford Fire* antitrust case, Justice Scalia notes that "if the presumption against extraterritoriality has been overcome …, a second canon of statutory construction becomes relevant: '[A]n act of congress ought never to be construed to violate the law of nations if any other possible construction remains.'" On that basis, keeping in mind principles of international comity and the need to avoid unnecessary interference with the interests of other nations, the Court could have concluded (properly, as I have argued) that it would be unreasonable to apply U.S. securities law in cases so closely connected with other jurisdictions. This approach would have brought the Court to the same result in *Morrison*, but in a way that linked more closely with its previous jurisprudence in the antitrust context, and that focused more closely on the relevant international conflicts. In my view, such an analysis would have been preferable.

The outcome in *Morrison* will do a lot of good – it will bring much-needed clarity to jurisdictional analysis under the U.S. securities laws, and will eliminate regulatory conflict with other countries. Yet it is also somewhat unsatisfying, for the reasons I gave in my article when describing the bright-line test as a "second-best solution:" it retreats to an artificially territorial approach rather than grappling with the messy reality of the global capital markets. What if, as is often the case with foreign defendants, there's a group of U.S. holders of ADRs as well as foreign holders of common stock? Wouldn't there be efficiencies to be gained in avoiding duplicative litigation in multiple jurisdictions? Or what if a dual-listed foreign company deliberately releases fraudulent information in the United States, knowing that even after paying resulting damages to its U.S. investors, it would come out ahead because foreign investors wouldn't be able to mount a successful private action? Wouldn't there be a U.S. interest in deterring such fraud, reducing private enforcement costs within the United States? There are U.S. (and shared) regulatory interests at stake in such situations that cannot be accommodated by the bright-line test. Perhaps, after all, we must await legislation for the final accounting of those interests – as in Section 7216 of the proposed financial reform bill, which would preserve a broader scope of application of U.S. antifraud law at least in public enforcement proceedings.