Morrison, Securities Liability and Corporate Governance

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In the recent decision *Morrison v. National Australia Bank*, the U.S. Supreme Court has developed a new test for the extraterritorial applicability of U.S. securities liability. According to this new approach, the Securities Exchange Act 1934 applies only to litigation involving (1) transactions in securities listed on an American exchange, or (2) other securities, where the transaction took place in the territory of the U.S. The case was dismissed since it involved only plaintiffs who bought their shares on a foreign (Australian) exchange, and who sued an Australian issuer.

We believe that this decision is a major step in the right direction and that the case was correctly decided. The new test is certainly more appropriate than the legislative solution envisaged by the recently proposed Dodd-Frank Wall Reform and Consumer Protection Act (H.R. 4173 (111^{th} Cong. 2d Sess.). In essence, this Act would reinstate the previous case-law, which had been chiefly developed by the Second Circuit. Nevertheless, we think that the doctrinal concept behind the Supreme Court's reasoning is not entirely satisfactory.

The new test bears surprising resemblance with the *lex mercatus* criterion, which has been discussed under European securities liability rules. According to this concept, the liability claim is governed by the law of the place where a securities transaction had been carried out. Such a test can lead to arbitrary results, especially where a security is traded in several markets or is cross-listed.

In a recent working paper, we develop an alternative concept for determining an appropriate conflicts-of-law rule. We start from the insight that there is another dimension to international jurisdiction in securities litigation, which has not garnered a lot of attention so far: Securities liability is a major corporate governance enforcement mechanism. Hence, the question of the applicable law in securities claims has important implications for corporate governance and should be viewed in the broader context of the rules governing the applicable corporate governance regime.

We propose a global approach to the problem that departs from the role securities litigation plays for corporate governance. We show that, even though there are important differences between U.S. and European corporate governance, securities litigation in both systems fulfills the crucial function of ensuring that capital markets can exercise a control over corporate management by pricing and thereby judging the economic expediency of business decisions. Securities liability can be seen as only one facet of the larger regulatory context of corporate governance. From this starting point, we propose a holistic approach according to which the law governing securities fraud actions should be determined in the bigger context of the corporate governance regime applicable to a given issuer. The liability rules of a country should only be attached to such issuers that are subject to its disclosure duties in the first place because liability is only the mechanism to enforce the primary corporate governance (i.e. disclosure) rules. The consequence of this proposed 'bundling' between disclosure duties and liability would be that U.S. securities liability is only triggered where an issuer is subject to U.S. securities law because it is either registered with the SEC or intends to target a sufficient number of U.S. investors. By contrast, issuers who offer their shares in the U.S. according to Regulation S, or whose shares are only traded by third parties, do not bind themselves to the standards of U.S. law and hence should not be subjected to U.S. liability rules, even if the transaction takes place in the United States.

Our paper is available for download here (comments on this post and the paper generally should be made on *conflictoflaws.net*).