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ISSUES IN TRANSNATIONAL INVESTMENT IN SECURITIES

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Although finance is visibly transnational and international the jurisdiction to regulate is limited by territorial borders. The global financial crisis illustrated the transnational characteristics of the financial markets:[1] mortgage loans in the US were used as assets to back

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[1] *See, e.g.*, IMF, Enhancing Surveillance: Interconnectedness and Clusters p. 3 (Mar. 15, 2012) at http://www.imf.org/external/np/pp/eng/2012/031512.pdf ("the global crisis has brought home with devastating force the potential risks of interconnectedness, including that shocks in one part of the system—sometimes seemingly small in proportion to the whole—can be transmitted widely and quickly.")

debt securities that were sold to investors in different parts of the world. Troubled financial institutions had an impact not just on the countries where they were headquartered but on other jurisdictions where they did business.[2] The Federal Reserve provided financial support not just to US banks but also to foreign banks.[3] The G20, international financial institutions and domestic legislators and regulators focused on how to change financial regulation to prevent the recurrence of financial crisis. In particular, policy makers concentrated on how to ensure financial stability. Bailouts of banks stressed the economies of many countries, with implications for ratings of their sovereign debt.[4] During the same period the Madoff fraud generated numerous lawsuits against entities around the world.[5]

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.[6] Issuers of securities may choose to sell their securities in more than one jurisdiction, to increase the pool of prospective investors, and may even list their securities on exchanges based in more than one jurisdiction,[7] but if they do so they become subject to rules in force in the different jurisdictions in which they sell the securities. Sometimes even selling

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[2] 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.

[3] *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.

[4] *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.

[5] *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/.

[6] *See, e.g.*, SEC Charges Four India-Based Brokerage Firms with Violating U.S. Registration Requirements (Nov. 27, 2012) at http://www.sec.gov/news/press/2012/2012-241.htm .

[7] *Cf.* BIS, ECB, IMF, Handbook on Securities Statistics. Part 3: Equity Securities at p. 7 (Nov. 2012) at http://www.imf.org/external/np/sta/wgsd/pdf/112812.pdf ("A dual listing is a way for a corporation to have two equal listings in different marketplaces. This is usually done by creating an ownership structure comprising two holding companies, each of which is listed in a different marketplace. Each of these then owns a percentage of the corporation. Dual listing may be the result of a merger of two corporations listed in different countries, or it may stem from a new listing aimed at gaining access to capital in a larger market. Trading restrictions (e.g. capital or currency controls) can also create a need for dual listing.")

securities outside a particular jurisdiction raises issues of compliance with that jurisdiction's securities laws: the US is concerned that sales of securities to "US persons" should be carried out in conformity with US rules. The development of offshore US dollar denominated markets in Europe (the euromarket) involved issues of US dollar debt securities carried out outside the US, suggested to the Securities and Exchange Commission (SEC) that there was a risk that US investors might come to hold securities which had not been issued with the disclosure required within the US. The SEC developed safe harbors with respect to registration which are set out in Regulation S. Regulation S is designed to ensure that such securities come to rest outside the US.[8] The safe harbors relate to registration and not to fraud liability.

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). The global financial crisis led to an increased emphasis on developing and implementing transnational standards of financial regulation.

In the US, The SEC acts to enforce compliance with the federal securities laws[9] and the

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[8] 17 CFR § 230.901- 203.905.

[9] *See, e.g.*, SEC, BP to Pay $525 Million Penalty to Settle SEC Charges of Securities Fraud During Deepwater Horizon Oil Spill (Nov. 15, 2012) at http://www.sec.gov/news/press/2012/2012-231.htm ("The SEC alleges that the global oil and gas company headquartered in London made fraudulent public statements indicating a flow rate estimate of 5,000 barrels of oil per day. BP reported this figure despite its own internal data indicating that potential flow rates could be as high as 146,000 barrels of oil per day. BP executives also made numerous public statements after the filings were made in which they stood behind the flow rate estimate of 5,000 barrels of oil per day even though they had internal data indicating otherwise. In fact, they criticized other much higher estimates by third parties as scaremongering. Months later, a government task force determined the flow rate estimate was actually more than 10 times higher at 52,700 to 62,200 barrels of oil per day, yet BP never corrected or updated the misrepresentations and omissions it made in SEC filings for investors.") Cf. DOJ, BP Exploration and Production Inc. Agrees to Plead Guilty to Felony Manslaughter, Environmental Crimes and Obstruction of Congress Surrounding Deepwater Horizon Incident. BP shares are listed in London and Frankfurt and it has American depositary shares which are traded on the New York Stock Exchange.

DOJ takes action with respect to criminal charges.[10] The SEC and the DOJ co-operate with authorities in other jurisdictions.[11] Financial regulators enter into Memorandums of Understanding with regulators in other jurisdictions agreeing to co-operate in regulatory enforcement.[12] Police authorities recognize the increasing internationalization of criminal activity and the need to co-operate across jurisdictional borders. As the Director of the FBI said in a speech in 2012:

> Technology has all but erased the borders that once confined crime and terrorism. And yet the traditional nation-state's jurisdictional boundaries remain the same, as do the individual criminal justice systems in these diverse nations.
> Given these constraints, we are often at a disadvantage in addressing global threats.
> How do we prosecute a case where the crime has migrated from one country to the next, with victims around the world? How do we overcome jurisdictional hurdles and distinctions in the law from country to country?[13]

In the US the implied private right of action for securities fraud under section 10(b) of the

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[10] *See, e.g.*, Manhattan U.S. Attorney Announces Guilty Plea Of Irwin Lipkin, Former Controller Of Bernard L. Madoff Investment Securities LLC (Nov. 8, 2012) at http://www.justice.gov/usao/nys/pressreleases/November12/LipkinPleaPR.php.

[11] *See, e.g.*, Serious Fraud Office, International Strategy at http://www.sfo.gov.uk/media/57517/international%20strategy.pdf ("In recent times, the SFO's international focus has extended to casework, policy and capacity building. It developed from a need to obtain overseas evidence and build closer strategic links. It began with engagement, particularly with the United States Department of Justice and the Securities and Exchange Commission but also through international and European networks such as Eurojust, European Justice Network, International Association of Prosecutors (IAP), World Bank and the Justice Assistance Network.")

[12] *See, e.g.*, SEC-ESMA, MOU Concerning Consultation, Cooperation and the Exchange of Information Related to the Supervision of Cross-Border Regulated Entities at http://www.sec.gov/about/offices/oia/oia_bilateral/esma-mou.pdf .

[13] Robert S. Mueller, III, Director Federal Bureau of Investigation, Speech at the American College of Trial Lawyers 2012 Annual Meeting, New York (Oct. 19, 2012) at http://www.fbi.gov/news/speeches/the-transformation-of-the-fbi-and-the-rule-of-law.

Securities Exchange Act of 1934[14] and Rule 10b-5[15] is a significant component of securities law enforcement. In other jurisdictions also investors can sue for damages for securities fraud. Where all of the aspects of the issuance of the securities are connected to one jurisdiction, that is where the investors should sue. But issuers of securities are often multinational firms with connections to many different jurisdictions, and they may issue securities in different jurisdictions. 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 was an example of what is described as an F-cubed securities case (claims brought by foreign investors who bought securities in a foreign 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....

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

[14] 15 USC § 78j(b).

[15] 17 C.F.R. § 240.10b-5.

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 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,[16] 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. The SEC issued a request for comments (excerpts from which are below at p. 50) and published a Study on the issue in April 2012 (see below at p. 53 for excerpts).

Morrison v. National Australia Bank Ltd. (Supreme Court 2010)[17]

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...[18]

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

[17] 130 S. Ct. 2869 (S.Ct. 2010).

[18] See page 22 below for a description of ADRs.

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 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.[19] 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...

[19] 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.

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.

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.

..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.

.. 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.

.. 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.

.. 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"[20] -- 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...

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[20] This is a reference to Judge Friendly.

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."..

.. 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 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. 13): “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 US federal securities laws prevent investors from being able to waive the protections in the statutes: section 14 of the Securities Act of 1933 provides that “[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void.”[21] But US courts have enforced agreements governed by English law under which wealthy US persons agreed to participate in the Lloyds insurance market,.[22] And some courts have treated “Big Boy Agreements” as valid agreements limiting sophisticated investors’ rights.[23]

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[21] 15 U.S.C. 77n. There is a very similar provision in section 29(a) of the Exchange Act, 15 U.S.C. 78cc(a).

[22] *See, e.g.*, Lipcon v Lloyds of London (11th Cir. 1998).

[23] *See, e.g.*, Pharos Capital Partners, L.P. v. Deloitte & Touche (6th Cir. 2013) (“The district court granted summary judgment to the placement agent, Credit Suisse Securities (USA) LLC, finding in pertinent part that: (i) Pharos unjustifiably relied on Credit Suisse's representations in light of the parties' "big boy agreement" in which

Although the Morrison decision relates to section 10(b) and Rule 10b-5 its implications are broader, as the decision is based on the idea that statutes without a clear indication of extraterritorial application do not have extraterritorial application.[24] In the past the US was known for asserting extraterritorial effects of its securities (and other) laws, and other jurisdictions enacted blocking legislation to prevent such effects.[25] But other jurisdictions have since come to appreciate the complexities of reconciling jurisdiction based on ideas of territoriality with the facts of globalization. [26]

The SDNY's judgment in Morrison[27] 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

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Pharos eschews reliance on Credit Suisse in favor of its own due diligence... the district court correctly held that Pharos could not justifiably rely on any statement by Credit Suisse because Pharos was a sophisticated investor, had substantial adverse information about National Century, and, most critically, signed an agreement disclaiming reliance on any statement by Credit Suisse. On appeal, Pharos argues that Credit Suisse had knowledge of material information about National Century's fraud that outside investors—like Pharos—could not discover. Even assuming that this scenario could make Pharos's reliance justifiable, Pharos has not demonstrated that any material information was truly unavailable to a sophisticated investor like Pharos." This decision relates to Ohio's securities law rather than to the federal securities laws.

[24] *See also, e.g.*, Kiobel v. Royal Dutch Petroleum Co., 133 S. Ct. 1659 (S. Ct. 2013) (applying the presumption against extraterritoriality to the Alien Tort Statute, 28 U.S.C. § 1350).

[25] For example, the UK's Protection of Trading Interests Act 1980, 1980 Ch.11.

[26] *See generally, e.g.*, *Developments in the Law: Extraterritoriality*, 124 HARV. L. REV. 1226, 1233 (2011) ("there is no simple descriptive theory of the patterns of American extraterritorial exertion and the international community's response. Congress eagerly legislates beyond American borders — at least in cases of protecting competitive markets and curbing state-sponsored terrorism. Courts have restrained that legislative impulse. But these institutional roles are curiously inconsistent in cases of individual rights. Courts have narrowed statutory remedies for foreign human rights violations but serve as guardians of constitutional protections that Congress has sought to limit beyond U.S. borders. The European Union's posture toward American extraterritorial law is equally inconsistent. Together, these aspects of extraterritoriality do not point to one clear path for global politics and legal theory. Rather, they reflect a continuing search for solutions to a common problem: how to reconcile the premises underlying the Westphalian, state-based order with an increasingly integrated world.")

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

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 (which were listed on the NYSE) is not given weight in the court's decision?

The facts underlying Morrison involved different jurisdictions. National Australia Bank (NAB), headquartered in Melbourne, Australia, owned HomeSide, a mortgage service provider in Florida.[28] National Australia Bank Limited is the holding company for an international financial services group and is regulated in Australia.[29] 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.[30] 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..."[31] 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 do you think non-US persons who purchased shares outside the US which were issued by a non-US issuer would 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

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[28] 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 .

[29] As well as National Australia Bank, the NAB Group includes entities in New Zealand, Asia, the United Kingdom and the United States. See http://www.nab.com.au/about-us.

[30] The 2008 NAB Annual Report refers to NAB's deregistration with the SEC.

[31] 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.

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 (and not just listed issuers) is available through the EDGAR system.[32] An investor might choose to access information about an issuer of securities through EDGAR even if she were to enter into a transaction to buy securities outside the US. Do you think this is relevant to the issue of where an investor should be able to sue?

Consider how the Supreme Court's decision in Morrison differs from the Second Circuit's decision in **Morrison v. National Australia Bank Ltd. (2d. Cir. 2008)**[33]

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 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

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[32] *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 http://www.sec.gov/investor/pubs/edgarguide.htm .

[33] 547 F.3d 167 (2nd. Cir. 2008) (Newman, Calabresi & B.D. Parker).

[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

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 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 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

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

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. Vencap, Ltd.... both written by

[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.

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

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. . . [T]his is a bit of an overstatement: A close examination of the Second Circuit's caselaw reveals that the real test is 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.

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 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]

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

[7] http://www.wlf.org/litigating/case_detail.asp?id=610 The WLF Amicus Brief in the case is accessible from this page.

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

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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

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 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 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

[10] Plaintiffs won a jury verdict against Vivendi in January 2010 on 57 claims. The majority of the class were f-cubed investors. Post-trial and in the light of Morrison, the court narrowed the class of plaintiffs to exclude investors who acquired securities outside the US. *In re Vivendi Universal, S.A. Securities Litigation* 765 F. Supp. 2d 512 (SDNY 2011). A subsequent claim by individual investors who purchased securities outside the US to remedies under the Securities Act 1933 also failed on the basis of a Morrison analysis. *In re Vivendi Universal, S.A. Securities Litigation* 842 F. Supp. 2d 522 (SDNY 2012).

whether the resulting judgment would be recognized abroad.[11]

The Second Circuit considered the application of Morrison in **Absolute Activist Value Master Fund Limited v. Ficeto**.[12]

Katzmann, Circuit Judge:

This case requires us to determine whether foreign funds' purchases and sales of securities issued by U.S. companies brokered through a U.S. broker-dealer constitute "domestic transactions" pursuant to Morrison v. National Australia Bank Ltd... which held that § 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") only applies to "transactions in securities listed on domestic exchanges[] and domestic transactions in other securities."

Plaintiffs-appellants, nine Cayman Islands hedge funds (the "Funds"), appeal from a judgment of the United States District Court for the Southern District of New York (Daniels, J.) dismissing the complaint with prejudice. For the reasons set forth below, while we conclude that the complaint does not sufficiently allege the existence of domestic securities transactions, we conclude that the plaintiffs should be given leave to amend the complaint to assert additional facts suggesting that the transactions at issue were domestic. Specifically, we hold that to sufficiently allege the existence of a "domestic transaction in other securities," plaintiffs must allege facts indicating that irrevocable liability was incurred or that title was transferred within the United States. Because there has been significant ambiguity as to what constitutes a "domestic transaction in other securities," the plaintiffs should have the opportunity to assert additional facts leading to the plausible inference that either irrevocable liability was incurred or that title passed in the United States. Accordingly, we affirm the judgment of the district court in part, reverse the judgment of the district court in part, and remand the case for further proceedings consistent with this Opinion.

...Plaintiffs-appellants are nine Cayman Islands hedge funds that invested in a variety of asset classes on behalf of hundreds of investors around the world, including many investors in the United States. Each of the Funds engaged Absolute Capital Management Holdings Limited ("ACM") from at least the middle of 2004 to act as its investment manager. ACM typically charged each Fund a monthly management fee of 2% per annum based on the particular Fund's net asset value ("NAV") and a monthly performance fee of 20% of the increase in value of the Fund's NAV.

At all relevant times, defendant Florian Homm was the Chief Investment Officer of ACM, and defendants ... Ewing and ...Angersbach were the Chairman/Chief Executive Officer and Head of Investor

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

[12] 672 F.3d 143 (2d. Cir. 2012).

Relations and Marketing, respectively, of ACM. Homm had powers of attorney to invest on the Funds' behalf. Defendants (and brothers) Colin and Craig Heatherington were ACM employees who were principals of defendant CIC Global Capital Ltd. ("CIC"). Defendant-appellee Todd Ficeto, a resident of California and registered securities agent in California, Florida, Illinois, Massachusetts, New Jersey, New York, Texas, and Washington, was the President, Director, and along with Homm, a co-owner of defendant-appellee Hunter World Markets, Inc. ("Hunter"), the SEC-registered broker-dealer incorporated and based in California with offices in Beverly Hills.

The complaint alleges that the defendants engaged in a variation on the classic "pump-and-dump" scheme, causing the Funds to suffer losses of at least $ 195 million through cycles of fraudulent trading of securities. Defendants' fraud allegedly operated as follows: defendants Homm, Ficeto, Hunter, and Colin Heatherington (collectively, the "Trading Defendants") first caused the Funds to purchase billions of shares of thinly capitalized U.S.-based companies (the "U.S. Penny Stock Companies") directly from those companies. All of these companies were incorporated in the United States and their shares (the "U.S. Penny Stocks") were quoted on the Over-the-Counter Bulletin Board or by Pink OTC Markets, Inc.

Over approximately three years, the Trading Defendants allegedly caused the Funds to purchase the U.S. Penny Stocks directly from those companies in subscriptions pursuant to private offerings known as private investment in public equity ("PIPE") transactions. Acting in their capacity as "placement agents," Homm, Ficeto, and Hunter arranged the financing for these transactions and received placement fees in return. At or around the time of these purchases, the U.S. Penny Stock Companies registered their shares with the SEC.

At the time of each of these initial purchases by the Funds, the Trading Defendants either (1) already held in their own names, or otherwise controlled, substantial amounts of shares and/or warrants of the U.S. Penny Stock Companies, or (2) received shares and/or warrants from the U.S. Penny Stock Companies for little to no money in exchange for causing the Funds to purchase shares from those Companies. After causing the Funds to purchase the U.S. Penny Stocks directly from the U.S. issuers, the Trading Defendants then artificially inflated the prices of those stocks by trading and re-trading the U.S. Penny Stocks, often between and among the Funds, each time trading the stock at a higher price to create the illusion of trading volume. For example, on April 30, 2007, the Trading Defendants allegedly inflated the price of shares of ProElite, Inc. by causing one of the Funds, Absolute Return Europe Fund Limited, to sell 100 shares of ProElite, Inc. at $ 12 per share -- 6000 times its valuation just six months earlier. Moreover, this fraudulent trading was typically conducted through Hunter in its function as a broker-dealer.

According to the complaint, the purpose of these fraudulent trades was twofold: (1) to generate substantial commissions for Homm, Hunter, and Ficeto, and (2) to artificially inflate the stock price to

the point at which the Trading Defendants (together with Craig Heatherington) were free to sell previously locked-up shares and exercise warrants to obtain additional shares, which they then sold to the Funds for a windfall, having obtained the shares or warrants for nothing or almost nothing. Once defendants had manipulated the prices of the U.S. Penny Stocks to the desired levels, the Trading Defendants, Craig Heatherington, and CIC sold the shares they had obtained fraudulently to the Funds at inflated prices.

In addition, Ficeto allegedly created a fraudulent vehicle called The Hunter Fund Ltd., the only investors in which were certain of the Funds. The Hunter Fund invested the Funds' money in some of the U.S. Penny Stock Companies. The Funds derived no benefit from the funneling of their money through The Hunter Fund prior to being invested in the U.S. Penny Stocks. Homm and Ficeto merely used The Hunter Fund to earn additional fees and to make loans to the U.S. Penny Stock Companies.

While the Trading Defendants caused the Funds' money to be invested in the U.S. Penny Stocks, other defendants allegedly raised money from investors in furtherance of the fraudulent scheme. As Head of Investor Relations and Marketing at ACM, defendant Angersbach was responsible for courting investors around the globe, including many in the United States. With knowledge of the fraudulent scheme, Angersbach allegedly encouraged further subscription in the Funds, marketing them heavily in the United States and elsewhere. Similarly, with knowledge of the fraudulent scheme, defendant Ewing allegedly traveled to the United States to meet with investors and potential investors in the Funds and to reassure those investors who were concerned about Homm's disciplinary history. Ewing also allegedly facilitated the fraud by misrepresenting the composition of the Funds' investment to investors.

The complaint alleges that the defendants benefited substantially as a result of the fraudulent scheme and at the expense of the Funds. Homm, Ficeto, and Hunter charged millions in fees and commissions on the Funds' loans to, subscriptions in, and other purchases of shares in the U.S. Penny Stock Companies. After inflating the prices of the U.S. Penny Stocks, Homm, Ficeto, Hunter, Colin Heatherington, Craig Heatherington, and CIC profited by causing the Funds to purchase from them U.S. Penny Stocks that they owned and had acquired for pennies (or less). Angersbach, through a corporate entity he controlled, collected proceeds of at least $ 8.8 million through sales of his ACM holdings, and Ewing, through a corporate entity he controlled, collected proceeds of $ 55.3 million. Both Angersbach and Ewing obtained further proceeds by redeeming their holdings in the Funds at a profit. While the defendants reaped enormous profits, the Funds allegedly suffered losses in the amount of $ 195,916,216.

The Funds filed the initial complaint in this action on October 19, 2009, in the United States District Court for the Southern District of New York... The complaint asserted fraud claims under the federal securities laws -- § 10(b) of the Exchange Act ... and Rule 10b-5... and the common law. Certain defendants moved to dismiss the complaint in March and May of 2010 for failure to state a claim, lack of

personal jurisdiction, and improper venue...

On June 23, 2010, the district court heard oral argument on the motions to dismiss. On June 24, 2010, the day after oral argument, the Supreme Court issued its decision in Morrison. Following this decision, although no defendant moved for dismissal under Morrison, on December 22, 2010, the district court dismissed the complaint in its entirety, ruling, sua sponte, that it lacked subject matter jurisdiction over the case pursuant to Morrison.

...In determining whether § 10(b) and Rule 10b-5 could apply extraterritorially, this Court had previously applied the so-called conduct and effects test, which focused on: "(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." See SEC v. Berger ... However, in Morrison, the Supreme Court rejected the conduct and effects test and held that .§ 10(b) and Rule 10b-5 do not apply extraterritorially, but only apply to "transactions in securities listed on domestic exchanges[] and domestic transactions in other securities."

...The Supreme Court first dismissed the notion that the extraterritoriality of § 10(b) raises an issue of subject matter jurisdiction and distinguished subject matter jurisdiction, which relates to a "tribunal's power to hear a case," from the "merits question" of whether § 10(b) applies to particular conduct... Thus, the Supreme Court clarified that the district court did, in fact, have jurisdiction under 15 U.S.C. § 78aa to address whether § 10(b) applied to the defendant's conduct..

Turning to the merits, the Supreme Court, noting. the "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,"... held that.§ 10(b) of the Exchange Act does not apply extraterritorially.. In so holding, the Supreme Court eschewed the Second Circuit's conduct and effects test in favor of a "transactional test," which provides that § 10(b) only applies to "transactions in securities listed on domestic exchanges[] and domestic transactions in other securities."... "With regard to securities not registered on domestic exchanges, the exclusive focus [is] on domestic purchases and sales . . . ."

The case at hand does not concern the first prong of Morrison -- whether a transaction involves a security listed on a domestic exchange. Rather, we must interpret Morrison's second prong and determine under what circumstances the purchase or sale of a security that is not listed on a domestic exchange should be considered "domestic" within the meaning of Morrison... For the reasons that we elaborate below, we hold that transactions involving securities that are not traded on a domestic exchange are domestic if irrevocable liability is incurred or title passes within the United States...

While Morrison holds that § 10(b) can be applied to domestic purchases or sales, it provides little guidance as to what constitutes a domestic purchase or sale. To determine the meaning of a domestic purchase or sale, we first consider how these terms are defined in the Exchange Act. "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire." 15 U.S.C. § 78c(a)(13). Similarly, "[t]he terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of." Id. § 78c(a)(14). While the Supreme Court has previously noted that these definitions "are for the most part unhelpful" because "they only declare generally that the terms 'purchase' and 'sale' shall include contracts to purchase or sell,"....these definitions nonetheless suggest that the act of purchasing or selling securities is the act of entering into a binding contract to purchase or sell securities. Put another way, these definitions suggest that the "purchase" and "sale" take place when the parties become bound to effectuate the transaction.

Our decision in Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876 (2d Cir. 1972), also lends support to the notion that. a securities transaction occurs when the parties incur irrevocable liability. In that case, we held that in the context of a civil trial brought pursuant to Rule 10b-5, the district court correctly instructed the jury that "the time of a 'purchase or sale' of securities within the meaning of Rule 10b-5 is to be determined as the time when the parties to the transaction are committed to one another."... "'Commitment' is a simple and direct way of designating the point at which, in the classic contractual sense, there was a meeting of the minds of the parties; it marks the point at which the parties obligated themselves to perform what they had agreed to perform even if the formal performance of their agreement is to be after a lapse of time."...

Given that the point at which the parties become irrevocably bound is used to determine the timing of a purchase and sale, we similarly hold that the point of irrevocable liability can be used to determine the locus of a securities purchase or sale. Thus, in order to adequately allege the existence of a domestic transaction, it is sufficient for a plaintiff to allege facts leading to the plausible inference that the parties incurred irrevocable liability within the United States: that is, that the purchaser incurred irrevocable liability within the United States to take and pay for a security, or that the seller incurred irrevocable liability within the United States to deliver a security. We note that this test has already been adopted and applied by district courts within this circuit. See SEC v. Goldman Sachs & Co., 790 F. Supp. 2d 147, 159 (S.D.N.Y. 2011); Plumbers' Union, 753 F. Supp. 2d at 177.

However, we do not believe this is the only way to locate a securities transaction. After all, a "sale" is ordinarily defined as "[t]he transfer of property or title for a price." Black's Law Dictionary 1454 (9th ed. 2009); see also U.C.C. § 2-106(1) ("A 'sale' consists in the passing of title from the seller to the buyer for a price."). Thus, a sale of securities can be understood to take place at the location in which title is transferred. Indeed, the Eleventh Circuit has held that, in order to survive a motion to dismiss premised on Morrison, it is sufficient for the plaintiff to allege that title to the shares was transferred within the

United States. See Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1310-11 (11th Cir. 2011) ("Given that the Supreme Court in Morrison deliberately established a bright-line test based exclusively on the location of the purchase or sale of the security, we cannot say at this stage in the proceedings that the alleged transfer of title to the shares in the United States lies beyond § 10(b)'s territorial reach."). Accordingly,.to sufficiently allege a domestic securities transaction in securities not listed on a domestic exchange, we hold that a plaintiff must allege facts suggesting that irrevocable liability was incurred or title was transferred within the United States.

We now turn briefly to the reasons we reject other potential tests proposed by the parties. Plaintiffs suggest that the location of the broker-dealer should be used to locate securities transactions. While we agree that the location of the broker could be relevant to the extent that the broker carries out tasks that irrevocably bind the parties to buy or sell securities, the location of the broker alone does not necessarily demonstrate where a contract was executed. Next, plaintiffs assert that the identity of the securities should be used to determine whether a securities transaction is domestic and that where, as in this case, the securities are issued by United States companies and are registered with the SEC, the transactions are domestic within the meaning of Morrison. However, the plaintiffs' argument is belied by the wording of the test announced in Morrison. The second prong of that test refers to "domestic transactions in other securities," Morrison, 130 S. Ct. at 2884, not "transactions in domestic securities" or "transactions in securities that are registered with the SEC." Thus, we cannot conclude that the identity of the security necessarily has any bearing on whether a purchase or sale is domestic within the meaning of Morrison.

Defendants Ficeto, Hunter, and Colin Heatherington argue that the identity of the buyer or seller should be used to determine whether a transaction is domestic. Where the buyer and seller are both foreign entities, these defendants argue that a transaction cannot be considered domestic. Under this test, the second type of transaction at issue in this case -- the transactions between and among the Funds themselves -- would not be domestic. While it may be more likely for domestic transactions to involve parties residing in the United States,"[a] purchaser's citizenship or residency does not affect where a transaction occurs; a foreign resident can make a purchase within the United States, and a United States resident can make a purchase outside the United States." Plumbers' Union, 753 F. Supp. 2d at 178.

Finally, we consider defendant Ewing's argument that despite the Supreme Court's rejection of the conduct and effects test in favor of a transactional approach, it is still necessary to determine whether each individual defendant engaged in at least some conduct in the United States. Specifically, Ewing contends that even if the U.S. Penny Stock transactions occurred in the United States, it would still be impermissible to apply § 10(b) to him since he did not personally engage in any conduct in the United States. Ewing's lack of contact with the United States may provide a basis for dismissing the case against him for lack of personal jurisdiction -- an argument the district court will consider on remand -- but .the transactional test announced in Morrison does not require that each defendant alleged to be involved in a

fraudulent scheme engage in conduct in the United States. Accordingly, rather than looking to the identity of the parties, the type of security at issue, or whether each individual defendant engaged in conduct within the United States, we hold that a securities transaction is domestic when the parties incur irrevocable liability to carry out the transaction within the United States or when title is passed within the United States.

Having explained what constitutes a domestic transaction, we now turn to whether the complaint alleges facts giving rise to the plausible inference that irrevocable liability was incurred or title was transferred within the United States. The Funds principally argue that because the PIPE offerings described in the complaint were not transactions on a foreign exchange, but direct sales by U.S. companies to the Funds, the complaint sufficiently alleges the existence of domestic purchases. However, upon careful review of the complaint, we conclude that the allegations do not sufficiently allege that purchases or sales took place in the United States.

In the sixty-one page complaint, there are only a few allegations that mention or even hint at the location of the securities transactions at issue in this case. The sole allegation that affirmatively states that the transactions took place in the United States only does so in conclusory fashion: "The fraudulent transactions that Defendants carried out through Hunter took place in the United States." ... Absent factual allegations suggesting that the Funds became irrevocably bound within the United States or that title was transferred within the United States, including, but not limited to, facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money, the mere assertion that transactions "took place in the United States" is insufficient to adequately plead the existence of domestic transactions. The complaint alleges that investors subscribed to the Funds by wiring money to a bank located in New York. However, this allegation, even if true, is inapposite as the case before us was brought by the Funds themselves and is based on the Funds' purchases and sales of U.S. Penny Stocks rather than individual investors' subscriptions to the Funds. Similarly, allegations that the Funds were heavily marketed in the United States and that United States investors were harmed by the defendants' actions, while potentially satisfying the now-defunct conduct and effects test... do not satisfy the transactional test announced in Morrison.

The complaint also alleges that, at all relevant times, defendant Ficeto was a resident of Malibu, California and defendant Hunter was a California corporation with offices in Beverly Hills. However, the fact that two of the defendants resided in California does not lead to the plausible inference that the Funds became irrevocably bound to purchase U.S. Penny Stocks in the United States. Indeed, the complaint alleges that Colin Heatherington and Florian Homm, the other Trading Defendants who purportedly played a role in effectuating the transactions, never resided in the United States. And, in any case, for the reasons discussed above, a party's residency or citizenship is irrelevant to the location of a given transaction. While the complaint further alleges that Hunter "was an underwriter for, or was

otherwise involved, in the offerings of the U.S. Penny Stock Companies whose shares Defendants caused the Funds to purchase,".. absent more detailed factual allegations about Hunter's role in the transactions, this allegation is also insufficient to demonstrate that the transactions occurred in the United States. Similarly, the allegation that "Ficeto carried out his fraudulent activities and caused Hunter to carry out its fraudulent activities in, among other places, the United States,".. does not sufficiently allege that the transactions themselves took place in the United States. As the Supreme Court held in Morrison, "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."

Finally, while the complaint alleges that the U.S. Penny Stocks were issued by United States companies and were registered with the SEC, these facts do not demonstrate that the purchases and sales were "made in the United States." Accordingly, we conclude that the complaint fails to state claims under § 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder because it does not adequately allege the existence of domestic securities transactions...

In this case, we conclude that the Funds should be given leave to amend their complaint. We first observe that the Funds' complaint was filed before the Supreme Court issued its decision in Morrison and before this Court provided guidance about how to adequately plead a domestic purchase or sale. It appears as though the complaint was drafted to satisfy the conduct and effects test, which was in operation when the complaint was filed. After all, the complaint alleges, among other things, that Ficeto and Hunter carried out their fraudulent activities in the United States, that the defendants marketed the Funds in the United States, and that United States investors were injured by the fraud. Given that the Funds understandably drafted their complaint in accordance with pre-Morrison doctrine, they cannot be faulted for their failure to allege facts suggesting that irrevocable liability was incurred within the United States.

Of course, notwithstanding the change in doctrine, it would not be appropriate to grant leave to amend if doing so would be futile. In this case, however, we cannot conclude that amendment would be futile given the Funds' representations made both in their briefs and at oral argument that additional facts could be alleged to show that the transactions were domestic. For example, in their reply brief, the Funds represent that the underlying transactional documents, which are not currently part of the record in this case, demonstrate that the transactions occurred in the United States. Moreover, during oral argument, the Funds claimed to possess trading records, private placement offering memoranda, and other documents indicating that the purchases became irrevocable upon payment and that payment was made through Hunter in the United States.

This decision illustrates the difficulties that arise when Courts change established interpretations of the law. Is the approach in Morrison really clearer than the approach under the conduct and effects tests? Does any additional certainty deriving from the new approach compensate for the

reduced protection that may be afforded to some US investors under the new approach?

Italy approved the extradition of Florian Homm to the US to answer criminal charges relating to the events at issue in this case,[13] but after an appeal he was released and returned to Germany.[14]

In 2014 in **City of Pontiac Policemen's System v. UBS AG** the Second Circuit held that the Supreme Court's decision in Morrison v NAB precluded precludes claims under the Securities Exchange Act of 1934 by purchasers of shares of a foreign issuer on a foreign exchange even if those shares were cross-listed on a United States exchange.[15] The Court stated:

Under plaintiffs' so-called "listing theory," the fact that the relevant shares were cross-listed on the NYSE brings them within the purview of Rule 10(b), under the first prong of Morrison — "transactions in securities listed on domestic exchanges." We conclude that, while this language, which appears in Morrison and its progeny, taken in isolation, supports plaintiffs' view, the "listing theory" is irreconcilable with Morrison read as a whole.

Morrison emphasized that "the focus of the Exchange Act is ... upon purchases and sales of securities in the United States."As the District Court recognized, this evinces a concern with "the location of the securities transaction and not the location of an exchange where the security may be dually listed." Morrison's emphasis on "transactions in securities listed on domestic exchanges," makes clear that the focus of both prongs was domestic transactions of any kind, with the domestic listing acting as a proxy for a domestic transaction. Indeed, the Supreme Court explicitly rejected the notion that the "national public interest pertains to transactions conducted upon foreign exchanges and markets." Furthermore, in Morrison, although the Ordinary Shares at issue were not traded on any domestic exchange, the Court noted that "[t]here are listed on the [NYSE], however, [defendant]'s American Depositary Receipts (ADRs), which represent the right to receive a specified number of [its] Ordinary Shares."This did not affect the Court's analysis of the shares that were purchased on foreign exchanges.

Perhaps most tellingly, in rejecting this Circuit's "conduct and effects" test in favor of a bright-line rule, Morrison rejected our prior holding that "`the Exchange Act [applies] to transactions regarding stocks

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[13] *See, e.g.*, Caroline Winter, Coming to America: Fugitive Financier Florian Homm (Jan. 10, 2014) at http://www.businessweek.com/articles/2014-01-10/coming-to-america-fugitive-financier-florian-homm.

[14] Caroline Winter, Florian Homm, Free Again, Is Back in Germany (Jun. 4, 2014) at http://www.businessweek.com/articles/2014-06-04/florian-homm-free-again-is-back-in-germany.

[15] City of Pontiac Policemen's System V. UBS AG, 752 F. 3d 173 (2d. Cir 2014)

traded in the United States which are effected outside the United States....'"

In sum, Morrison does not support the application of § 10(b) of the Exchange Act to claims by a foreign purchaser of foreign-issued shares on a foreign exchange simply because those shares are also listed on a domestic exchange. Accordingly, we affirm the judgment of the District Court insofar as it dismissed the claims of Union, IFM, and ATP.

In this case the court also held that “the mere placement of a buy order in the United States for the purchase of foreign securities on a foreign exchange” was not “sufficient to allege that a purchaser incurred irrevocable liability in the United States, such that the U.S. securities laws govern the purchase of those securities.”

Some US investors who buy securities issued by foreign issuers in foreign transactions may have chosen to invest offshore to avoid US taxes.[16] The Tax Division of the US Justice Department says that its “top litigation priority is the concerted civil and criminal effort to combat the serious problem of non-compliance with our tax laws by U.S. taxpayers using secret offshore bank accounts - a problem that a 2008 Senate report concluded costs the U.S. Treasury at least $100 billion annually.”[17] The Tax Division concluded a deferred prosecution agreement with UBS with respect to charges that it conspired to defraud the US and the IRS.[18] UBS agreed that in future it would only provide banking and securities services to US resident private clients through its US based subsidiaries, and it also agreed to disclose the names of certain US clients. The Foreign Account Tax Compliance Act (FATCA), enacted in 2010 and in effect as of January 1 2013, is intended to reduce tax avoidance by U.S. citizens and entities through foreign financial institutions.[19]

But US residents who have acquired securities in offshore transactions may not have done so to avoid paying taxes in the US. They may have acquired the securities while resident outside the

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[16] *Cf.* Adam Davidson, *My Big Fat Belizean, Singaporean Bank Account*, New York Times (Jul. 24, 2012).

[17] *See* http://www.justice.gov/tax/offshore_compliance_intiative.htm .

[18] *See* http://www.justice.gov/tax/UBS_Signed_Deferred_Prosecution_Agreement.pdf .

[19] FATCA is Title V of the Hiring Incentives to Restore Employment Act of 2010, Pub. L 111-147 (111th Congress) (Mar. 18, 2010) http://www.gpo.gov/fdsys/pkg/PLAW-111publ147/pdf/PLAW-111publ147.pdf .

US. Or they may have been targeted by foreign fraudsters. Investors may merely have been trying to achieve international diversification of their investment portfolio. And given that investors are institutions such as pension funds, mutual funds and insurance companies as well as individuals it is clear that a significant number of investors which are adopting sound strategies of international diversification of their investment portfolios are affected by the decision in Morrison.[20]

As mentioned above, Congress reacted to the Supreme Court's Morrison decision in the Dodd-Frank Act. Section 929P(b) of the Dodd-Frank Act includes amendments to Section 22 of the 1933 Securities Act and to Section 27 of the 1934 Securities Exchange Act [21] which provide for "extraterritorial jurisdiction. Here is the amendment to the 1934 Act:

EXTRATERRITORIAL JURISDICTION. —.The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of the antifraud provisions of this title 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.''

Does this fix the Morrison problem or not? Consider also **US v Vilar** (2nd. Cir. 2013) where the Court held that section 10(b) of the 1934 Act and Rule 10b-5 do not apply to extraterritorial conduct whether liability is sought criminally or civilly:

It is fair to say that, from the mid-1980s until their arrest in 2005, Vilar and Tanaka were prominent

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[20] *See, e.g.*, Christian J. Ward & J. Campbell Barker, *Morrison v. National Australia Bank The Impact on Institutional Investors* (Feb. 2012) at p 10 ("Because the United States capital markets represent only about half of the world's capital markets, and because the correlation between United States markets and foreign markets is sufficiently low, institutional investors routinely diversify globally, often denominating certain fund amounts to be held in foreign equities. For example, according to its 2010 report, the California Public Employees' Retirement System—the largest state pension fund in the United States— had 24 percent of its investments in international equities, compared to just 21 percent in domestic equities. Moreover, when institutional investors diversify within a specific industry segment, they often cannot avoid buying foreign stocks. An investor seeking broadly diversified holdings in the oil and gas industry, for example, cannot avoid buying foreign stock such as British Petroleum and Royal Dutch Shell"(footnotes omitted).)

[21] And to the Investment Advisers Act.

investment managers and advisers. Prior to the technology market crash of 2000-2001, they were responsible for managing approximately $9 billion in investments for their clients.

Vilar and Tanaka managed their clients' assets through a number of different funds and entities. In 1986, they founded and became the sole shareholders of Amerindo Investment Advisors Inc. ("Amerindo U.S."), an investment adviser registered with the Securities and Exchange Commission ("SEC"). Amerindo U.S. was a California corporation with principal offices in San Francisco and New York City. Vilar and Tanaka also founded and were the sole shareholders of (1) Amerindo Investment Advisors, Inc. ("Amerindo Panama"), a corporation organized under the laws of the Republic of Panama that managed an off-shore investment fund offered to U.S. investors, and (2) Amerindo Investment Advisors (UK) Ltd. ("Amerindo U.K."), a United Kingdom corporation, which managed portfolios of U.S. emerging growth stocks for U.K.-based clients.

From at least July 1986 until May 2005, Vilar and Tanaka offered clients the opportunity to invest in "Guaranteed Fixed Rate Deposit Accounts" ("GFRDAs"). The GFRDA program was made available only to a select group of individual clients, who were generally close friends or family members of Vilar or Tanaka. Vilar and Tanaka promised investors in the GFRDA program that they would receive a high, fixed rate of interest over a set term, and that the overwhelming majority of the GFRDA funds would be invested in high-quality, short-term deposits, including U.S. Treasury bills. The balance of the capital in the GFRDAs—generally no more than twenty-five percent—was to be invested in publicly traded emerging growth stocks Despite Vilar and Tanaka's description of the GFRDA program, they invested all of the funds in technology and biotechnology stocks, presumably in the hopes of meeting or even exceeding the high "guaranteed" rates of return. The downside of this scheme, of course, was that the GFRDAs were volatile and not safe investments at all. And so, when the so-called dot-com bubble "burst" in the fall of 2000, the value of the investments held by the GFRDAs dropped precipitously. Accordingly, Vilar and Tanaka could not pay the promised rates of return and, as a consequence, several GFRDA investors lost millions of dollars.

In June 2002, as the GFRDA scheme was falling apart, Vilar and Tanaka approached a long-standing client, Lily Cates, with the opportunity to invest in a type of venture known as a Small Business Investment Company ("SBIC"). Vilar told Cates that he and Tanaka had been approved for an SBIC license, which would allow the SBIC to obtain matching funds from the federal government's Small Business Administration ("SBA") for the SBIC's investments. In fact, Vilar and Tanaka had never received an SBIC license and, indeed, had been denied such a license multiple times.

On June 20, 2002, Cates invested $5 million in the SBIC formed by Amerindo, and her funds were deposited into an Amerindo bank account at Bear, Stearns & Co., in the name of a Panamanian corporation called "Amerindo Management Inc." ("AMI"). Vilar and Tanaka

quickly drew on these funds in order to meet various personal and corporate obligations. Notably, Vilar and Tanaka made the following transactions: (1) on June 25, 2002, Tanaka transferred $1 million to a personal bank account held by Vilar, and Vilar immediately used that money for a variety of personal expenses, including a substantial donation to his alma mater; and (2) on July 9, 2002, Vilar and Tanaka wired approximately $2.85 million of Cates's money from the AMI account to an account in Luxembourg, as part of a settlement agreement with a former GFRDA investor. Over the next two years—during which Vilar repeatedly assured Cates that her funds were safely in escrow—Vilar and Tanaka continued to use Cates's SBIC investment account for their own needs. For example, in 2003, Tanaka forged Cates's signature to authorize a $250,000 transfer from her SBIC account to one of Vilar's personal accounts. More than $50,000 of that transfer was used by Vilar to make a personal mortgage payment.

In early 2005, Cates requested that Vilar return her money and close her account. Vilar responded that she would have to make her request of Amerindo Panama—an organization with which she had never previously interacted. With her suspicions raised, Cates reported Vilar and Tanaka to the SEC. Vilar made several false statements in response to the SEC's inquiries, hoping to obscure the SBIC scheme.

On August 15, 2006, the Department of Justice indicted Vilar and Tanaka, charging them in twelve counts with: (1) conspiracy to commit securities fraud, investment adviser fraud, mail fraud, wire fraud, and money laundering.... On November 19, 2008, after a nine-week trial, the jury convicted Vilar on all twelve counts...

.Vilar and Tanaka contend that their respective convictions for securities fraud must be reversed because their conduct was extraterritorial, meaning that it "occurr[ed] in the territory of [a] sovereign [other than the United States]," Kiobel v. Royal Dutch Petroleum Co. 133 S. Ct. 1659, 1669 (2013), and therefore was not proscribed by Section 10(b) or Rule 10b-5. They rely on the Supreme Court's holding in Morrison, which was decided after Vilar and Tanaka were convicted, and which limited Section 10(b) and Rule 10b-5 to prohibiting fraud committed in connection with "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." Morrison, 130 S. Ct. at 2884. Observing that Morrison was a civil lawsuit, the government responds that Morrison's geographic limit on the reach of Section 10(b) and Rule 10b-5 applies only in the civil context and therefore is no bar to Vilar and Tanaka's criminal convictions. In the alternative, the government argues that Vilar and Tanaka's illegal conduct was "territorial" within the meaning of Morrison, inasmuch as at least some of the transactions were "domestic transactions in other securities." Although we conclude that Morrison does apply to criminal cases brought pursuant to Section 10(b) and Rule 10b-5, we agree that the record in this case confirms that Vilar and Tanaka did perpetrate fraud in connection with domestic

securities transactions, and we therefore affirm their convictions.

This case does not address Dodd-Frank, but it makes clear that this Court reads Morrison as not just being limited to civil liability. The Dodd-Frank Act provided that the SEC would study extraterritorial private rights of action An excerpt from the SEC's request for comments follows:
SEC, Study on Extraterritorial Private Rights of Action (Request for Comments) (Oct. 25, 2010)[22]

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."... 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." ... 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. ...

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... The effects test centered its inquiry on whether domestic investors or markets were affected as a result of actions occurring outside the United States....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."..

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.[23]

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

[23] (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

Under section 929Y of the Dodd-Frank Act, the Commission is required to conduct a study to 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.[24] 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?

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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.

[24] (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."

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.
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 was likely to generate responses which would be useful to the SEC in deciding on the issues?[25] What sort of people or firms would be likely to be able to comment in response to the RFC? Does this tell you anything about the function and usefulness of the RFC?

The SEC asks about remedies which might be available to US investors outside the US. 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?

SEC, Study on the Cross-Border Scope of the Private Right of Action (April 2012)[26]

In response to the Commission's request for public comments, as of January 1, 2012 the Commission received 72 comment letters (excluding duplicate and follow-up letters) – 30 from institutional investors; 19 from law firms and accounting firms; 8 from foreign governments; 7 from public companies and associations representing them; 7 from academics; and 1 from an individual investor. Of these, 44 supported enactment of the conduct and effects tests or some modified version of the tests, while 23 supported retention of the Morrison transactional test...

The comment letters in support of the transactional test asserted that cross-border extension of Section 10(b) private actions would create significant conflicts with other nations' laws, interfere with the important and legitimate policy choices that these nations have made, and result in wasteful and abusive litigation involving transactions that occur on foreign securities exchanges. Those comment letters argue that, by contrast, retention of the transactional test would foster market growth because the test provides a bright-line standard for issuers to reasonably predict their liability exposure in private Section 10(b) actions.

..The comment letters opposed to the transactional test argued, among other things, that: whether an exchange-traded securities transaction executed through a broker-dealer occurs in the United States or overseas may not be either apparent to U.S. investors or within their control; the transactional test

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[25] Comments are available at http://www.sec.gov/comments/4-617/4-617.shtml .

[26] SEC, Study on the Cross-Border Scope of the Private Right of Action Under Section 10(b) of the Securities Exchange Act of 1934 (April 2012) http://www.sec.gov/news/studies/2012/929y-study-cross-border-private-rights.pdf .

impairs the ability of U.S. investment funds to achieve a diversified portfolio that includes foreign securities because the funds will have to either trade in the less liquid and potentially more costly ADR market in the United States or, alternatively, forgo Section 10(b) private remedies to trade overseas or pursue foreign litigation; and the transactional test fails to provide a private action in situations where U.S. investors are induced within the United States to purchase securities overseas...

The comment letters supporting enactment of the conduct and effects tests argued that doing so would promote investor protection because private actions would be available to supplement Commission enforcement actions involving transnational securities frauds. These comment letters also argued that the conduct and effects tests reflect the economic reality that although a company's shares may trade on a foreign exchange and the company may be incorporated overseas, the entity may have an extensive U.S. presence justifying application of U.S. securities laws. Further, comment letters also argued that the conduct and effects tests ensure that fraudsters operating in the United States or targeting investors in the United States cannot easily avoid the reach of Section 10(b) private liability, and facilitates international comity by balancing the interests of the United States and foreign jurisdictions...

The arguments against the conduct and effects tests largely mirrored those set forth above in favor of the transactional test. In addition, these comment letters argued that: investor protection and deterrence of fraud are sufficiently achieved in the context of transnational securities fraud by Congress having enacted the conduct and effects tests for cases brought by the Commission and DOJ; small U.S. investors do not need the heightened protection of the conduct and effects tests because they generally do not directly invest overseas; the conduct and effects tests' fact-specific analysis bears little relationship to investors' expectations about whether they are protected by U.S. securities laws; and foreign legal regimes already provide sufficient remedies for investors who engage in transactions abroad...

The Staff advances the following options for consideration:

Options Regarding the Conduct and Effects Tests. Enactment of conduct and effects tests for Section 10(b) private actions similar to the test enacted for Commission and DOJ enforcement actions is one potential option. Consideration might also be given to alternative approaches focusing on narrowing the conduct test's scope to ameliorate those concerns that have been voiced about the negative consequences of a broad conduct test. One such approach (which the Solicitor General and the Commission recommended in the Morrison litigation) would be to require the plaintiff to demonstrate that the plaintiff's injury resulted directly from conduct within the United States. Among other things, requiring private plaintiffs to establish that their losses were a direct result of conduct in the United States could mitigate the risk of potential conflict with foreign nations' laws by limiting the availability of a Section 10(b) private remedy to situations in which the domestic conduct is closely linked to the overseas injury. The Commission has not altered its view in support of this standard.

Another option is to enact conduct and effects tests only for U.S. resident investors. Such an approach

could limit the potential conflict between U.S. and foreign law, while still potentially furthering two of the principal regulatory interests of the U.S. securities laws – i.e., protection of U.S. investors and U.S. markets.

Options to Supplement and Clarify the Transactional Test. In addition to possible enactment of some form of conduct and effects tests, the Study sets forth four options for consideration to supplement and clarify the transactional test. One option is to permit investors to pursue a Section 10(b) private action for the purchase or sale of any security that is of the same class of securities registered in the United States, irrespective of the actual location of the transaction. A second option, which is not exclusive of other options, is to authorize Section 10(b) private actions against securities intermediaries such as broker-dealers and investment advisers that engage in securities fraud while purchasing or selling securities overseas for U.S. investors or providing other services related to overseas securities transactions to U.S. investors. A third option is to permit investors to pursue a Section 10(b) private action if they can demonstrate that they were fraudulently induced while in the United States to engage in the transaction, irrespective of where the actual transaction takes place. A final option is to clarify that an off-exchange transaction takes place in the United States if either party made the offer to sell or purchase, or accepted the offer to sell or purchase, while in the United States.

Securities Fraud Claims Outside the US

Investors try to sue for securities fraud in the US in order to avoid restrictions on such claims that apply in other jurisdictions. But as courts in the US have curbed claims arising out of non-US transactions other jurisdictions have changed their rules. For example, most Canadian jurisdictions have relaxed their rules for securities actions: Ontario did so in 2005.[27] 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,[28] and certified a class action based on common law and statutory claims on behalf of a global class of IMAX investors. The class included investors who acquired IMAX securities on the Toronto Stock Exchange and also on NASDAQ. One law firm reacted to the decision as follows:

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

[28] 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).

... 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.[29]

In 2013 the Judge "amended the definition of the Ontario global class by removing all those persons previously within the Ontario global class who accepted to partake in the settlement arising out of the parallel U.S. proceedings, and approved by the U.S. Court. The removal from the Ontario global class of all class members who would partake in the U.S. settlement was a condition of that settlement so as to prevent double recovery from both jurisdictions." and in October 2013 the Ontario Superior Court of Justice upheld this amendment.[30] The Ontario Superior Court' adopted a very deferential approach to the decisions of the Judge responsible for case management and emphasized how careful the Judge had been in her assessment of the issues. For our purposes the decision is most useful as an indication of the complexities involved where there are parallel proceedings in different jurisdictions rather than for the details of the Ontario approach to review of class certification decisions. Here is an excerpt:

Justice van Rensburg's most recent Order reflects the culmination of a series of steps and motions over the course of six years, that began with the certification of a global class and has come full circle to the amendment of that class in light of a settlement in the parallel U.S. action. The decisions of this Court to certify of the global class in Ontario and the content and timing of the Notice of the certified class set the stage and virtually anticipated the eventual need for an amendment to the Ontario global class.

The overriding theme and objective across the six years of litigation has been to create a fair process that would preserve the options of the potential class members open for as long possible, and in any event, until they would be in a position to evaluate those options. Indeed, a hallmark of Justice van Rensburg's decisions was her common sense and fair approach to the issues as they arose...

Given this overall approach, the Order that is the subject of this motion must be situated and evaluated within its broader context and with the full appreciation of how it fits into the overall scheme of these proceedings.

Actions by the plaintiffs were commenced in Ontario and in the U.S. in 2006 against IMAX for alleged

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

[30] See Silver v Imax 2013 ONSC 6751 (Oct. 29, 2013).

misrepresentations as it related to their financial reporting and the recognition of revenue for its theatre systems. Early attempts to settle the litigation were unsuccessful.

In Ontario, the action was certified as a class proceeding in December 2009. The court certified a global class consisting of: "[a]ll persons, other than the Excluded Persons, who acquired securities of IMAX [Corporation] during the Class Period of the TSX and on the NASDAQ, on or after February 17, 2006 and held some or all of those securities at the close of trading on August 9, 2006."

Justice van Rensburg was aware that approximately 85 per cent of the securities acquired by the class members in the Ontario action were purchased on the NASDAQ and therefore, also fell within what at the time was a proposed class in proceedings that were pending in the United States District Court, Southern District of New York. Nonetheless, Her Honour certified the global class with the full knowledge and appreciation that the decision to certify might have to be reviewed at a later stage in the litigation to address or respond to probable conflict of laws issues. In doing so, Her Honour did not want to deprive the plaintiffs of certification. But it was with the express warning that the certification had in it a certain "wait and see" element and a strong likelihood that the legal landscape would eventually change.

That caution, in large measure, arose from the plaintiffs' own expert, Professor Borchers, who noted that parallel proceedings could only continue for so long. Eventually, the parties and the court would have to consider the outcome of the "wait and see." That outcome, Professor Borchers described as the "day of reckoning." As for the period between certification and the "day of reckoning," Her Honour emphasized the need to ensure that the process was fair, especially to the non-resident class members. That care could be accomplished by "paying careful attention to the notice and communications with the non-resident class members."

In the U.S. action, the certification of the proposed class in the U.S. action had a number of false starts with various representative plaintiffs being disqualified. The original first plaintiff, Westchester Capital, (who was eventually disqualified as a lead plaintiff), proposed a definition of the class that was the same as the definition of the Ontario class. As a result of a decision in the U.S. in a different case that excluded purchasers of shares on foreign exchanges from the U.S. securities class action , the proposed class definition in the U.S. action had to be revised to exclude purchasers of IMAX shares on the TSX, thereby confining the U.S. proposed class to the NASDAQ purchasers.

In April 2011, a new Plaintiff, "The Merger Fund" was appointed in the U.S. action. It proceeded with settlement negotiations that were restricted only to the U.S. proceeding. On November 2, 2011, the parties to the U.S. action entered into a preliminary settlement agreement for the benefit of the U.S. settlement class.

On January 26, 2012, the parties to the U.S. Proceedings signed a formal "Stipulation and Agreement of

Settlement" that purported to recover for the U.S. settlement class the sum of US $12 million.

On February 1, 2012, the judge case managing the U.S. action, Justice Buchwald, gave preliminary approval to the proposed settlement and certified the U.S. settlement class for the purposes of the proposed settlement, and directed that the U.S. Settlement Class be given notice of the settlement and of the intention of the plaintiff to schedule a date for a fairness hearing.

On May 3, 2012, IMAX made a "with prejudice" offer to settle the claims of the TSX class for a sum of US $1.33 million, exclusive of costs. The proposed sum was calculated pro rata to the U.S. Action settlement. It also took into account the shorter class period of the Ontario action and the lower trading volume on the TSX.

Turning back to the proceeding in Ontario, IMAX sought leave to appeal the "Certification Decision." That motion was dismissed on February 11, 2011. That enabled the parties to proceed with a motion to approve the form, content, timing and dissemination of the notification of the Ontario class proceeding, and the press release as required by s.138.9 of the Securities Act, R.S.O. 1990, c.S.5.

Although the Court was set to hear the "Notice Motion" in May 2011, various delays meant that the motion did not get underway until the fall of 2011. By then, settlement negotiations were underway in the U.S. proceedings. This resulted in additional submissions over the course of the fall of 2011 and into 2012. The prospect of a U.S. settlement, when previously such was looking very doubtful, put into question the content of the Ontario notice and its relationship or connection to the U.S. Notices.

Ultimately, in the decision regarding the notice requirements, Her Honour began with first principles that govern the content of notice – namely, that the content is to be informed by its purpose. Having regard to the specific facts, Her Honour observed:

> "The purpose of notice at this stage in these proceedings is to inform class members that the proceedings have been certified as a class action, to tell them what the action is about, and to permit class members to act on such notice, by taking such steps as they should be afforded to preserve their "litigation autonomy".
>
> At this stage in the Ontario proceedings, there is no need for a class member [to] elect between participation in these proceedings and participation in the U.S. Proceedings. As both experts agreed, there is no impediment to overlap class members belong to the classes in both proceedings at least until reaches judgment. The only decision required of class members at this stage is whether to opt out of these proceedings. The failure to opt out of these proceedings will not have any impact on the class members' ability to participate in the U.S. Proceedings, or indeed to participate in the U.S. settlement if and when it is approved. As Professor Borchers observed, and as we have seen in the

> proposed notices in the U.S. Proceedings, if and when the U.S. Settlement is approved, class members will receive notice that will make clear that "the day of reckoning" has arrived, information that may be pertinent to their choice, including contact information for counsel in both actions, and that the failure to opt out will preclude their claims, including claims in these proceedings."..."

Echoing the cautions reflected in the "Certification Decision," Her Honour indicated that the Ontario notice should direct the class members to a source of information about the other proceedings, but that such source should not attempt to summarize or evaluate the merits of the U.S. proceedings. Any detailed information about the U.S. proceeding could only confuse the class members and compromise their ability to make the only decision required at that instance – namely, whether or not to opt out or remain in both the Ontario and the U.S. classes.

By "litigation autonomy," Her Honour was focusing on the need to have a notice that provided the class members with the information they would need to make an informed decision. Her Honour specifically highlighted Justice Sharpe's directions in Currie that "if the right to opt out is to be meaningful, the unnamed plaintiff must know about it and that, in turn, implicates the adequacy of the notice afforded the unnamed plaintiff." Her Honour did observe that the U.S. notices would have to contain sufficient information for a class member to make an election.

The notice in the Ontario proceedings was published on April 27, 2012. The opting-out notice relating to the proposed U.S. settlement in the U.S. proceeding was published on April 26, 2012.

The. U.S. Notice made it clear that if the overlapping class members elected to remain bound by the U.S. Settlement their ongoing participation in the Ontario action would be barred. The U.S. Notice in effect, described the "day of reckoning" as follows:

> If the Canada Order is entered and becomes final, you will not be permitted to recover in both cases and if you do not exclude yourself from the U.S. Action, you will automatically be deemed to be a member of the Class in the U.S. Action, and therefore excluded from the Canadian Class in the Canadian Action. For members of the Canadian Class, a detailed description of the Canadian Action as well as details regarding how to exclude yourself from this action (and thereby participate in the Canadian Action) are contained below.

In other words, the class members could not remain in both classes and recover from both classes. They would have to choose between the U.S. settlement class and the Ontario global class.

The distribution of the U.S. Notice was very widespread. In total, 87,934 copies of the notices were sent out to individuals and institutions. That was supplemented with the publication of a summary notice in

various newspapers that included Canada's major publications, both English and French and a website. In the result, seven opt-out letters were received, of which five were from overlapping class members. There was also one objector who was a resident of the U.S. and who raised extensive concerns with reasonableness of the settlement.

Following notification, the U.S. parties proceeded with the Fairness Hearing to seek the court's final approval of the U.S. Settlement. On June 20, 2012, Justice Buchwald concluded that the notice to the members of the class was adequate. Her Honour certified the U.S. Class for purposes of the settlement, and approved the settlement and the plan of allocation. Her Honour reserved on the issue of legal costs and expenses. The settlement Order and the payment of the $12 million compensation remained conditional upon the global class being amended in the Ontario proceeding to exclude all those who chose to benefit from the U.S. Settlement.

The condition of the U.S. Order resulted in the motion that is now the subject of this leave application. The materials before Justice van Rensburg were extensive: 4 motion records from the defendants, a Transcript Brief, 5 volumes of Records from the Plaintiffs, and an expert opinion on cross-border class actions. The motion was argued over two days in July 2012 and resulted in a thorough decision, outlined in 192 paragraphs and 85 footnotes that recognized the U.S. Settlement Order...

Justice van Rensburg was very deliberate in her analysis and her conclusions. Her Honour certified a global class at the outset with the full knowledge of the potential vulnerabilities that lay ahead. She did so, to maximize the litigants' options. In the same vein, Her Honour framed the Notice requirements in a way that would put the best information into the class members' hands so that they could exercise their options as they saw fit. The amendment of the global class became the way to make sense and respond to the developments of the U.S. proceeding appropriately, in a way that was fair and that extended to the parties due process. The overriding concern, to use Professor Borchers' phrase was to resolve the developments in this case in a way so that "no class member should get 'two bites at the apple' against any defendant."

III. ANALYSIS

... in the context of class proceedings, where the motions judge has substantial and intimate familiarity with the file, His or Her Honour ought to be accorded substantial deference....

Justice van Rensburg's decision to amend the global class does not conflict with a decision by another judge or court in Ontario or elsewhere. Her decision was specific to the unique circumstances of these proceedings. Her Honour aimed to respond to developments in the U.S. action and a settlement that had as its only condition, the amendment of the global class so as to remove those Canadian class members who would be benefitting from the U.S. settlement. The reason for the condition was to prevent double recovery by class members in both proceedings. That objective was reasonable and it would not be

desirable for leave to appeal to be granted.

...Does it appear to this court that there is good reason to doubt the correctness of Her Honour's Order of March 19, 2013 and does the proposed appeal involve matters of such importance that in this court's opinion, leave to appeal should be granted?

The short answer to this question is "no". The plaintiffs suggest that there are four errors of law that put into question Justice van Rensburg's Order. Each is reviewed below.

i. Did Justice van Rensburg have the jurisdiction to amend the global class?

The plaintiffs identify three reasons for the judge's lack of jurisdiction. They say that the Order created an impermissible opt-in class. They also say that it was impermissible for the court to extinguish the claims of the NASDAQ purchasers would are members of the global class. Finally, they argue that Order created an impermissible merits-based definition of the class.

All of these arguments were before the motions judge and they were considered very extensively. The same cases that were put before this court were before Her Honour but they were expressly distinguished from the facts and issues in dispute in this case. The analysis was thorough and sound. In their leave submissions, the plaintiffs did not identify any errors in Her Honour's analysis and response to their arguments.

Taking a closer look, with respect to the concerns about the creation of an impermissible opt-in class, Her Honour rejected that proposition and explained that the overlapping class members' procedural rights were not compromised. The "litigation autonomy" that Her Honour spoke of in the "Notice Decision" permeated this analysis as well.... the overlapping class members could accept an immediate compensation via the U.S. action or, they could choose to remain in the Ontario action and await an uncertain outcome.

The amendment of the class would facilitate the exercise of a class member's litigation autonomy. It would not take anything away. Nobody would be forcing a class member to exercise his option on the day of reckoning in one way or another. To the contrary, a refusal to amend the class would effectively extinguish the U.S. settlement completely, and therefore, take away the settlement option from the class members who wanted to settle their claim.

As for the criticism that the class was amended on the basis of an impermissible merits-based inquiry, Justice van Rensburg did not engage in any such analysis. The plaintiffs say that the motions judge's decision hinged on the assertion that NASDAQ purchasers did not have a claim on the merits in the Ontario action because they would be bound by the U.S. Settlement.

With respect, that is not what Her Honour Justice concluded. The analysis on the issue of choosing

between jurisdictions focused on the litigant's autonomy. If they were to be compensated in one jurisdiction, they would have to give up their claim in the other. If they were convinced of the merits of the Ontario action, they could preserve their rights and opt-out of the U.S. Settlement. The litigants would be evaluating the merits of one jurisdiction over the other, not the courts.

In short, there was no error by the motions judge on the issue of the court's jurisdiction to amend the class..

ii. Was the Motion to Amend a Procedural Move by the Defendants and is it precluded by issue estoppel?

If there is one issue that cannot be said to be precluded by issue estoppel it is the possible amendment of the global class in these proceedings. Her Honour couldn't have been more prescient in the cautions that accompanied the Certification Decision. Her Honour expressly anticipated that future developments in the litigation as they related to the conflict of laws issue might result in an amendment to the global class.

Her Honour addressed this very same argument head on in her "Amendment Decision". Relying on Mignacca et al. v. Merck Frost Canada Ltd. et al. Her Honour noted that certification orders were interlocutory that could be amended at a later time, as a case might proceed. But Her Honour went further to engage with the facts in this case to conclude that if at the time of the certification motion there had been a pending settlement in the U.S. Proceeding that encompassed the NASDAQ traders, that would have been a relevant factor in the decision to certify a global class.

There was no settlement underway in the U.S. action that anyone spoke about or put before the court at the time that the certification motion was argued. Information of a possible settlement in the U.S. action surfaced in the course of the "Notice" motion, and more particularly, in the fall of 2011 and into early 2012. The proposed settlement in the U.S. was therefore a new material fact for the court to consider. Against these facts, issue estoppel could not operate to prevent the amendment of the Ontario global class...

The motions judge then went further. As with her overall approach to this litigation Her Honour was cautious to give due consideration to all of the developing facts and nuances of the case given the particular stage of the litigation. At certification, there was "lots" to wait and see. By the time of the Amendment Motion the uncertainties had diminished significantly...

...the fact of the U.S. settlement in the progression of the litigation was crucial as it related to the consideration of due process, judicial comity and common sense. These objectives were the overriding goals at certification. Would the fact of the U.S. settlement meet or be responsive to those goals? As a major development in one of the two parallel proceedings, it is difficult to understand how the U.S. settlement could be anything but relevant to this litigation. The motions judge would have erred if she treated the U.S. settlement as irrelevant. It is hard to speak of an error, much less, require that an

appellate court be tasked to review the decision, on the view that the very reason for seeking the amendment was irrelevant.

iii. Did Justice van Rensburg apply the wrong legal test to determine whether the settlement should be enforced? Should the Court have evaluated the U.S. Settlement to determine if it would be enforceable in Ontario before deciding to amend the class?

On the motion before Her Honour, one of the plaintiffs' primary arguments was that the Ontario court look behind the U.S. settlement and evaluate it on its merits before agreeing to its enforcement, and by implication, as a pre-requisite to the amendment of the class. Her Honour rejected the proposed approach and concluded that it would be contrary to the fundamental principles governing conflict of laws.

Her Honour would not have had a legal basis to go behind Justice Buchwald's Order. Such an analysis would have gone against the case law concerning cross-provincial class actions and would subvert the Supreme Court of Canada's principles of international comity. Her Honour referenced the leading cases on comity to conclude that absent evidence of fraud or a violation of natural justice or of public policy it would not be for the enforcing court to take an interest in the substantive or procedural law of the foreign jurisdiction, in this case, the U.S.[26] On the facts of this case there were no allegations of fraud or conduct that was contrary to public policy or natural justice. Absent such allegations, the plaintiffs could not explain how the Ontario court would get around settled and longstanding authorities on conflict of laws to review the U.S. settlement.

... Her Honour then turned to a preferability analysis. The objective was to determine whether there might be any other impediment to the amendment of the global class. Her Honour explained that she was prepared to accept as a working proposition that if the U.S. Settlement were demonstrated to be improvident when compared to the alternative prospect of litigating the claims of the overlapping class members in Ontario, it might be preferable to refuse the amendment of the class and effectively defeat the U.S. Settlement. That required Her Honour to consider what a likely outcome in Ontario might look like. Its components included the consideration of,

a) the alleged advantages of litigating the claims under Ontario law;

b) the discovery evidence which supports the plaintiffs' claims; and

c) their estimate of the maximum value of the class members' claim.

The plaintiffs contend that a determination of the issues in Ontario would result in a far more substantial award for the class. Her Honour disagreed with that assessment. A substantial part of her decision considered the strengths and weaknesses of the Ontario proceeding. Ultimately, Her Honour concluded that the Ontario legal regime was not demonstrably more advantageous to the overlapping class members' claims.

Her Honour cannot be faulted for that conclusion. The plaintiffs did not advance any evidence to support the contention that the U.S Settlement was improvident. Nor did the plaintiffs file any expert evidence to establish that the Ontario liability regime would be more favourable to the overlapping class members than the U.S. liability regime. The only evidence on the subject was that from Professor Borchers, who was inconclusive in his assessment and suggested that the applicable regimes pulled in each direction. Finally, there were no other court determinations in the Ontario proceedings to guarantee a better outcome in the Ontario proceeding.

Against these deficiencies, Her Honour concluded that her refusal to amend the class would deny the defendants the benefit of the U.S. Settlement, which a U.S. Court found to be fair. Such an outcome would compromise the defendants' and those wishing to partake in the settlement, their right to access to justice and due process.

It is possible that aspects of Her Honour's comparative assessment of the Ontario action might be considered overly cautious by a different judge. For example, on the subject of reliance and whether that could be proven by the efficient market theory or otherwise, others might come to a different, more favourable assessment. However, there is no palpable or overriding error of fact to warrant appellate review. As with every aspect of this litigation what is palpable in Her Honour's analysis is the concern to give full meaning to the parties' access to justice, due process, respect for judicial comity, and common sense....

Justice van Rensburg was the case management motions judge for 6 years. Her Honour presided over a full range of motions and wrote extensive decisions, including the "Certification Decision" and the "Notice Decision." Over the years, she acquired a thorough understanding of the competing facts. Her Honour studied very closely the various expert views that were put before her. She considered the full body of evidence against the various legal requirements. From the very beginning Her Honour set the direction and the foundation for a fair process in an incremental and sequential basis so as to preserve the integrity of the administration of justice.

Against that backdrop Her Honour earned the right to be shown substantial deference for her decision to amend the global class. The case is important. However, in the absence of a conflicting decision or doubts over the correctness of the order to amend the class, there is no basis for its review by the Divisional Court.

In March 2012 in **Abdula v. Canadian Solar Inc.** the Ontario Court of Appeals held the Ontario Securities Act applies to Canadian Solar, a company with a principal place of business in

China and whose shares trade on NASDAQ and not on a securities exchange in Canada:[31]

Alexandra Hoy J:

[1] Canadian Solar Inc. appeals the motion judge's decision that it is a "responsible issuer", as defined in s. 138.1 of the Ontario Securities Act, R.S.O. 1990, c. S.5 (the "OSA"). At issue is whether an issuer that is not a reporting issuer, but that has a real and substantial connection to Ontario within the meaning of the OSA, can constitute a "responsible issuer", and therefore be subject to a statutory cause of action by purchasers in the secondary market for a misrepresentation in the issuer's disclosure pursuant to s. 138.3 of the OSA, if its securities are publicly traded only outside Canada.

[2] I conclude that it can, and that Canadian Solar is a "responsible issuer". In the result, I would dismiss the appeal.

[3] Canadian Solar was originally incorporated in Ontario. It is now a federal corporation governed by the Canada Business Corporations Act, R.S.C. 1985, c. C-44 (the "CBCA"). It is engaged in the design, development, manufacture and sale of solar cell and solar module products that convert sunlight into electricity for a range of uses. Canadian Solar's registered office is in Toronto, Ontario and its principal executive office is in Kitchener, Ontario. Its shares are publicly traded over the NASDAQ exchange, an American electronic securities exchange that has no physical trading floor. Canadian Solar's shares do not trade on the Toronto Stock Exchange or any other Canadian stock exchange.

[4] The respondent, Tajdin Abdula, is a resident of Ontario and the proposed representative plaintiff in a putative class proceeding against Canadian Solar under the Class Proceedings Act, 1992, S.O. 1992, c. 6. The action arises out of alleged misrepresentations contained in press releases, financial statements and an annual report released or presented by Canadian Solar in Ontario and made in the course of investor conference calls. Mr. Abdula alleges that Canadian Solar materially overstated its financial results.

[5] The statutory cause of action created by s. 138.3 of the OSA applies to a misrepresentation by a "responsible issuer". Section 138.1 defines "responsible issuer" as: (a) a reporting issuer, or (b) any other issuer with a real and substantial connection to Ontario, any securities of which are publicly traded;

[6] Canadian Solar does not fall within paragraph (a) of the definition. Canadian Solar is not a reporting issuer in Ontario, and accordingly was not required to file the documents containing the alleged misrepresentations with the Ontario Securities Commission (the "OSC"). It was, however, required to file them, and did file them, with the U.S. Securities Exchange Commission ("SEC") pursuant to the Securities Exchange Act of 1934, 15 U.S.C. s. 78a.

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[31] Abdula v. Canadian Solar Inc. 2012 ONCA 211 at http://www.ontariocourts.ca/decisions/2012/2012ONCA0211.htm.

[7] As Canadian Solar is not a reporting issuer, the question before the motion judge was whether Canadian Solar falls within paragraph (b) of the definition of responsible issuer. The motion judge concluded that it does.

[8] "Issuer" is defined is s. 1(1) of the OSA as "a person or company who has outstanding, issues or proposes to issue, a security". It is common ground that Canadian Solar is an "issuer".

[9] The motion judge found that Canadian Solar has a "real and substantial connection to Ontario" and that finding, with which we agree, is not in issue. In addition to having its registered office and principal executive office in Ontario, Canadian Solar has held its annual meeting in Ontario. The alleged misrepresentations were contained in documents that were released or presented in Ontario. While Canadian Solar's principal place of business is in the People's Republic of China, directly and through its subsidiaries, it has undertaken or engaged in numerous solar projects in Ontario. Canadian Solar has also raised capital from Ontario investors through private placements and has made filings with the Ontario Securities Commission confirming this activity as required by Ontario securities laws. Mr. Abdula placed orders for shares of Canadian Solar through his online discount brokerage, Bank of Montreal InvestorOnline, using the computer at his home in Markham, Ontario. As of August 26, 2010, Canadian Solar had 1253 shareholders in Ontario, who held in the aggregate over one million shares.

[10] As noted above, Canadian Solar's shares are publicly traded on NASDAQ. The motion judge concluded that Canadian Solar's shares did not have to be publicly traded in Canada for it to be within in the definition of "responsible issuer". It is with this conclusion that Canadian Solar takes issue on this appeal.

[11] Specifically, the issue on appeal is whether there is an implied limit on the definition of "responsible issuer" that an issuer's securities must be traded in Canada. The issue of whether or not leave should be granted to permit the proposed statutory cause of action against Canadian Solar was not determined by the motion judge, and is not an issue on this appeal...

[12] The purposes of the OSA are explicitly stated in s. 1.1: The purposes of the Act are, (a) to provide protection to investors from unfair, improper or fraudulent practices; and (b) to foster fair and efficient capital markets and confidence in capital markets...

[13] Subject to various exceptions, the OSA prohibits an issuer from distributing securities to the public unless it has filed a prospectus and obtained a receipt for the prospectus from the Ontario Securities Commission (the "OSC"). A prospectus must provide full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed: OSA, s. 56(1). The OSA has long afforded a right of action for damages for a misrepresentation contained in the prospectus to persons who purchase securities offered by a prospectus during the period of distribution: see OSA, s. 130.

[14] Persons who acquire securities offered by a prospectus are sometimes referred to as having acquired the securities on the primary market. Most investors acquire securities on what are referred to as secondary markets; that is, they purchase the securities from third parties after the period of distribution of the securities under a prospectus...

[15] The concept of a "reporting issuer", introduced in 1978, is fundamental to Ontario securities laws. The term is defined in s. 1(1) of the OSA. The most common ways in which an issuer becomes a reporting issuer in Ontario are by filing a prospectus and having a receipt issued for the prospectus by the OSC, or by having its securities listed for trading on an exchange in Ontario recognized by the Ontario Securities Commission (e.g., the Toronto Stock Exchange.)..

[16] The concept of continuous disclosure was first introduced into the OSA in 1966, when Ontario enacted the Securities Act, S.O. 1966, c. 142, which came into force in 1967. It required periodic disclosure through financial statements, proxy circulars and insider reports.

[17] What is now Part XVIII of the OSA, entitled "Continuous Disclosure", came into force in 1979. Its requirements are broader than those under the 1966 Securities Act. It requires reporting issuers to immediately disclose material changes in their affairs and file annual financial statements and interim financial reports. Only reporting issuers are subject to the continuous disclosure obligations prescribed by Part XVIII. The objective of this continuous disclosure obligation is to ensure that all investors in the secondary market have equal access to material facts and that the securities market operates efficiently and fairly...

[18] More than 25 years after Part XVIII came into force, and after nearly a decade of consultation and reports, detailed later in these reasons under the heading "Legislative History", Part XXIII.1 of the OSA, entitled "Civil Liability for Secondary Market Disclosure", was enacted on December 31, 2005.

[19] Section 138.3 of Part XXIII.1 gives investors in secondary markets a statutory cause of action against a "responsible issuer" for a misrepresentation in a "document" released by it or contained in a public oral statement. Investors are not required to prove that they relied on the misrepresentation.

[20] Pursuant to s. 138.8(1), an action may not be commenced under s. 138.3 without leave of the court.

[21] Part XXIII.1 includes various defences and other limitations, including a cap on a responsible issuer's liability, calculated with reference to its market capitalization. Pursuant to s. 138.7, the cap on a responsible issuer's liability is reduced by "the aggregate of all damages assessed after appeals, if any, against the person or company in all other actions brought under section 138.3, and under comparable legislation in other provinces or territories in Canada in respect of that misrepresentation".

[22] Between December 31, 2006 and October 26, 2008, all of the other provinces and territories of Canada adopted legislation imposing civil liability for secondary market disclosure...

[23] Securities regulation in Canada is decentralized. The 13 securities regulators of Canada's provinces and territories have formed a voluntary umbrella organization known as the Canadian Securities Administrators (the "CSA"). Its objective is to improve, coordinate and harmonize regulation of the Canadian capital markets.

[24] In the United States, investors rely principally on SEC Rule 10b-5, 17 C.F.R. s. 240.10b-5, under s. 10(b) of the Securities Exchange Act of 1934, to bring actions for misrepresentation in continuous disclosure. A plaintiff in a U.S. court must plead and prove "scienter", namely an intent to deceive, manipulate or defraud: Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). However, there is no limit on the damages that may be awarded against the issuer in the U.S.

[25] Canadian Solar submits that paragraph (b) of the definition of "responsible issuer" is confined to issuers with a real and substantial connection to Ontario, any securities of which are "publicly traded in Ontario or in another province or territory of Canada with comparable legislation imposing continuous disclosure obligations on reporting issuers and providing statutory liability for misrepresentation in secondary market disclosure." As comparable legislation has been enacted in all provinces and territories of Canada, the appropriate limitation could currently be worded "publicly traded in Canada."

[26] Canadian Solar's position is that, since its shares are not publicly traded in Canada, it is not a responsible issuer and Mr. Abdula cannot advance a statutory claim against it pursuant to section 138.3 of the OSA.

[27] Canadian Solar argues that the motion judge failed to come to this conclusion because: (1) he incorrectly distinguished Unifund Assurance Co. v. Insurance Corp. of British Columbia, 2003 SCC 40, [2003] 2 S.C.R. 63, and as a result failed to correctly interpret the definition of "responsible issuer" in a manner that confines the OSA to its proper territorial sphere; (2) he did not give effect to the purpose of s. 138.3 as gleaned from its legislative history; and (3) he did not "test" his interpretation against recent decisions of Canadian courts which considered the territorial reach of the statutory cause of action for prospectus misrepresentation...

[28] Canadian Solar argues that this case is analogous to Unifund and the motion judge erred in distinguishing it. Counsel submits that, just as the Supreme Court in Unifund held that the territorial limits on the scope of provincial authority prevented the application of the provisions of the Ontario Insurance Act, R.S.O. 1990, c. I.8, to the Insurance Corporation of British Columbia in respect of a motor vehicle accident that occurred in British Columbia, the provisions of the OSA creating liability for a misrepresentation in secondary market disclosure should be interpreted as inapplicable to an issuer whose securities are only publicly traded on markets outside of Canada.

[29] Counsel for Canadian Solar submits that, applying the principles in Unifund, the definition of responsible issuer properly extends to issuers whose securities are publicly traded in Canada, outside of

Ontario, but not to issuers whose securities are publicly traded outside of Canada. This, counsel explains, is because the other provinces have enacted provisions creating liability for misrepresentation in secondary market disclosure which parallel Ontario's.

[30] Counsel argues that the scheme of inter-connected, parallel legislation in Canada creates a connection between Ontario and the other provinces and territories that is sufficient to support the extra-provincial application of the legislation. For instance, counsel points to s. 138.7 – which reduces the cap on a responsible issuer's liability for a misrepresentation by the damages assessed against the issuer in all actions brought under comparable legislation in other provinces or territories in Canada in respect of that misrepresentation – as showing the inter-connected nature of the liability provisions in the various provinces.

[31] In contrast, counsel argues, while investors can sue in the United States for misrepresentation in secondary market disclosure, the American scheme is not similar enough to, and not inter-connected with, the Ontario scheme so as to create a sufficient connection between Ontario and the United States.

[32] Counsel for Canadian Solar submits that the legislative history of the OSA provisions that create statutory liability for a misrepresentation in secondary market disclosures makes clear that the provisions were enacted to provide "teeth" to the continuous disclosure obligations imposed on reporting issuers under the OSA and comparable legislation in other provinces and territories of Canada. Counsel submits that, given this, the motion judge erred in concluding that Canadian Solar is a "responsible issuer", as Canadian Solar is subject to continuous disclosure obligations in the United States but not in Ontario or another province or territory of Canada with comparable legislation...

[33] Canadian Solar cites four cases which, it submits, stand for the principle that the statutory cause of action in s. 130 of the OSA, and the comparable provision in the securities legislation of each of the other provinces and territories, can only be relied on in respect of the distribution of securities within the province's boundaries. Canadian Solar argues that the motion judge's interpretation of "publicly traded" is inconsistent with the approach of the courts in these cases: Pearson v. Boliden Ltd., 2002 BCCA 624, 222 D.L.R. (4th) 453, at paras. 64-66, leave to appeal to S.C.C. refused, [2003] S.C.C.A. No. 29; Coulson v. Citigroup Global Markets Canada Inc., 2010 ONSC 1596, 92 C.P.C. (6th) 301, at paras. 141 and 145-46, affirmed on other grounds, 2012 ONCA 108; McKenna v. Gammon Gold Inc., 2010 ONSC 1591, 88 C.P.C. (6th) 27, at paras. 116 and 118, leave to appeal refused for claim under s. 130 of the OSA, 2010 ONSC 4068, 103 O.R. (3d) 451 (Div. Ct.); and Dobbie v. Arctic Glacier Income Fund, 2011 ONSC 25, 3 C.P.C. (7th) 261, at paras. 38 and 40...

[34] Counsel for Mr. Abdula argues that the best indicator of legislative intent is the words chosen by the legislature, and the legislature could have, but did not, add the words "in Canada" to paragraph (b) of the definition of responsible issuer.

[35] Counsel submits that the motion judge's interpretation is supported by other provisions of Part XXIII.1. The definition of "document" in s. 138.1 is broadly defined to capture documents that are not filed pursuant to Ontario's continuous disclosure regime or the continuous disclosure regime of any other Canadian province or territory. The definition of "principal market" in s. 250 of General, R.R.O. 1990, Reg. 1015, which is used to determine an issuer's liability limit under Part XXIII.1, contemplates that such market may not be in Canada.

[36] Counsel further argues that the conclusion that Canadian Solar is a responsible issuer accords with the OSA's investor protection objective. The stated purposes of the OSA, counsel notes, refer to the protection of "investors" generally, and not just to the protection of investors in Ontario reporting issuers or in issuers whose securities are listed on a Canadian stock exchange. While one aspect of Part XXIII.1 of the OSA is deterring non-compliance with the continuous disclosure obligations imposed by the OSA on reporting issuers, the courts have recognized that another aspect is partially compensating investors for losses they suffer as a result of misconduct of issuers having a real and substantial connection to Ontario: Silver v. Imax Corp. (2009), 66 B.L.R. (4th) 222 (Ont. S.C.), at para. 293; and Dobbie v. Arctic Glacier, at para. 106.

[37] Unifund, counsel argues, is clearly distinguishable from this case, and the motion judge's interpretation of "responsible issuer" does not result in improper extra-territorial regulation by Ontario.

[38] Moreover, counsel submits that the motion judge did not err in not referring to the cases relied on by Canadian Solar that considered, in the context of motions for class action certification, the very different question of which class members have a statutory right of action under securities legislation for prospectus misrepresentation.

V ANALYSIS

[39] In my view, when the words "publicly traded" in paragraph (b) of the definition of "responsible issuer" are read in their entire context and in their grammatical and ordinary sense, harmoniously with the scheme of the OSA, the object of the OSA and the intention of the legislature, gleaned from the legislative history and the words chosen by the legislature, they do not mean "publicly traded in Canada".

[40] I reach this conclusion for the following reasons, which are explained below:

· Such an interpretation is not required by Unifund.

· The legislative history does not establish that a statutory cause of action under s. 138.3 was intended to arise only if the issuer was subject to continuous disclosure obligations in a province or territory of Canada or if, in addition to having a real and substantial connection to Ontario, some of the issuer's shares traded publicly in Canada.

· The preferred approach to statutory interpretation supports this conclusion.

· The statutory cause of action for prospectus misrepresentation in s. 130 of the OSA is very different from s. 138.3. The analysis in the prospectus misrepresentation cases is not applicable to s. 138.3.

(2) Unifund

[41] I agree with the motion judge that here, unlike in Unifund, there is a sufficient connection between Ontario and Canadian Solar to support the application of Ontario's regulatory regime to Canadian Solar. The general principles with respect to extra-territorial regulation do not require that the definition of "responsible issuer" be interpreted as confined to issuers any of whose securities are publicly traded in Canada.

[42] In Unifund, the Supreme Court of Canada considered the applicability of one province's regulatory scheme to a defendant in another province. Binnie J., for the majority, wrote at paras. 50 and 51:

It is well established that a province has no legislative competence to legislate extraterritorially...This territorial restriction is fundamental to our system of federalism in which each province is obliged to respect the sovereignty of the other provinces within their respective legislative spheres, and expects the same respect in return.

[43] This concern for extra-provincial legislative reach is rooted in the ancient doctrine of territorial limits. At para. 60, Binnie J. cited Lord Russell of Killowen C.J.'s description of the doctrine of territorial limits in R. v. Jameson, [1896] 2 Q.B. 425, at p. 430:

One other general canon of construction is this – that if any construction otherwise be possible, an Act will not be construed as applying to foreigners in respect to acts done by them outside the dominions of the sovereign power enacting...

[44] Binnie J. explained, at para. 55, that the question to be asked to determine whether a provincial legislative scheme applies to an out-of-province defendant is, "whether the 'connection' between Ontario and the [defendant] is sufficient to support the application to the [plaintiff] of Ontario's regulatory regime."

[45] He continued, at para. 56: "What constitutes a 'sufficient' connection depends on the relationship among the enacting jurisdiction, the subject matter of the legislation and the individual or entity sought to be regulated by it". He observed, at para. 58, that "a 'real and substantial connection' sufficient to permit the court of a province to take jurisdiction over a dispute may not be sufficient for the law of that province to regulate the outcome."

[46] Binnie J. concluded that the Ontario Insurance Act was inapplicable in Unifund because the

defendant was not sufficiently connected to Ontario. As the motion judge described, at para. 43 of his reasons:

The issue in Unifund was whether the provisions of the Ontario Insurance Act applied to the Insurance Corporation of British Columbia in respect of a motor vehicle accident that occurred in British Columbia involving a British Columbia defendant and Ontario plaintiffs. Unifund involved an attempt by the plaintiff to have Ontario law apply to a British Columbia defendant arising out of a motor vehicle accident that occurred in British Columbia.

Further, Binnie J. noted, at para. 82 of Unifund, that the Insurance Corporation of British Columbia was not authorized to sell insurance in Ontario and had not in fact sold insurance in Ontario.

[47] Unifund is clearly distinguishable from Mr. Abdula's case. As stated by the motion judge at para. 43 of his reasons, Mr. Abdula's case deals with an Ontario plaintiff seeking to have Ontario law apply to a defendant carrying on business in Ontario.

[48] Territorial limits of provincial authority are respected by applying Ontario law to Canadian Solar in these circumstances. Canadian Solar is not the "foreigner" averted to in R. v. Jameson. It is a CBCA corporation with its registered office, its principal executive office and business operations in Ontario.

[49] The subject matter of Part XXIII.I is a remedy to investors for misrepresentation in certain issuers' secondary market disclosure. In this case, at least some of that disclosure emanated from Ontario. That, together with the relationship of Canadian Solar to Ontario, constitutes a sufficient connection between Ontario and Canadian Solar to potentially subject Canadian Solar to a statutory cause of action pursuant to Part XXIII.I of the OSA. I say "potentially" because, as noted above, pursuant to section 138.8 of the OSA, leave of the court is required before such an action may be commenced and the issue of whether leave should be granted has not yet been determined.

(3) Legislative History

[50] Canadian Solar filed a comprehensive Legislative History Brief with the motion judge and on this appeal. The motion judge carefully recounted and considered the legislative history in his reasons. He concluded, at para. 37 of his reasons: "I have been unable to find any specific reference showing an intent to restrict the definition of 'responsible issuer' to companies whose shares are traded only on other Canadian exchanges. In my view, the history of the legislation indicates to the contrary".

[51] I agree that the legislative history does not establish that the legislature intended that a statutory cause of action under s. 138.3 arise only if the responsible issuer was subject to continuous disclosure obligations in a province or territory of Canada, or if the responsible issuer's shares were publicly traded in Canada.

[52] It is important to note the extent to which legislative history may be considered in determining a law's purpose. The Supreme Court stated in Reference re: Firearms Act (Can.), 2000 SCC 31, [2000] 1 S.C.R. 783, at para. 17, that while a law's purpose is often stated in the legislation, it may also be determined by reference to extrinsic material such as the legislative history, as long as it is relevant, reliable and not assigned undue weight. This court discussed the use of committee reports as indicators of legislative meaning in Kerr v. Danier Leather Inc. (2005), 77 O.R. (3d) 321 (C.A.), at para. 119:

Traditionally, committee reports have been considered a relevant and admissible indicator of legislative purpose but not of legislative meaning...More recently, courts have begun to rely on these reports as evidence of legislative meaning. The weight to be accorded to any particular report must be assessed on a case-by-case basis[.]

[53] With these principles in mind, I will review the relevant legislative history to illustrate why it does not support the restrictive interpretation argued by Canadian Solar.

(a) The Allen Committee report

[54] In the early 1990s, the Toronto Stock Exchange created a committee, under the chairmanship of Thomas I.A. Allen Q.C. and generally known as the Allen Committee, to review continuous disclosure by public corporations in Canada, comment on the adequacy of such disclosure, and determine whether additional remedies should be available to injured investors or regulators if corporations fail to comply with the rules governing corporate disclosure.

[55] In its final report released in March of 1997, the Allen Committee remarked, at page vi, that information is the lifeblood of trading on securities markets. It concluded, on the same page, that there was evidence of a significant number of incidents of disclosure violations and a perception that problems existed with the adequacy of disclosure. Starting at page 63 of its report, it proposed draft legislation that attached civil liability for a misrepresentation in continuous disclosure to reporting issuers, as well as "every issuer any of the securities of which are publicly traded in the jurisdiction in question", subject to limitations.

(b) The CSA's draft legislation

[56] In response to the Allen Committee's report, the CSA published proposed amendments to securities legislation creating a limited statutory civil liability regime for continuous disclosure, first in 1998 and then, after receiving comments from stakeholders, again in 2000.

[57] The CSA's 1998 draft legislation provided that liability would attach to a "responsible issuer" and defined that term as "an issuer that is not a private issuer." There was no requirement that the issuer be a reporting issuer, or that its shares be publicly traded. The Canadian Bankers Association submitted a comment to this definition, proposing a specific exemption for mutual funds. The CSA responded that it

"intended no automatic exemption for mutual funds or any other type of issuer."

[58] The CSA's 2000 draft proposed a definition of "responsible issuer" that is almost identical to that subsequently incorporated in the OSA, namely, a reporting issuer or, "any other issuer with a substantial connection to Ontario any securities of which are publicly traded". The Allen Committee's proposed definition, focusing on whether any of the issuer's securities are publicly traded in the jurisdiction in question, was discarded.

(c) Bill 198

[59] In October 2002, Bill 198 was introduced in the Ontario legislature and included a proposed amendment to the OSA to add civil liability for secondary market disclosure. It incorporated the definition of "responsible issuer" in the CSA's 2000 proposed draft legislation. Bill 198 was never proclaimed.

(d) Draft uniform securities act

[60] In January 2003, the CSA released a proposal for the harmonization of securities laws across Canada. Its goal was to develop a uniform securities act for adoption by each jurisdiction of Canada. It proposed that the uniform act, "provide a right of action for secondary market trades that applies regardless of whether the issuer is a reporting issuer in the jurisdiction in which the security holder resides if the issuer is a reporting issuer in any jurisdiction in Canada."

[61] In December 2003, the CSA released a consultation draft of a proposed Uniform Securities Act and a related commentary. The draft Uniform Securities Act defined "responsible issuer" as follows:

"responsible issuer" means, (a) a reporting issuer or a reporting issuer under extra- provincial securities laws, or (b) any other issuer with a real and substantial connection to [insert local jurisdiction] whose securities are publicly traded;

[62] "Extra-provincial securities laws" in paragraph (a) was defined in the draft Uniform Securities Act as a uniform securities act enacted in another Canadian jurisdiction. As it was envisaged that each jurisdiction in Canada would enact a uniform securities act, paragraph (b) was presumably intended to include issuers who were not reporting issuers in any jurisdiction in Canada. This is reflected in the legislation subsequently enacted by CSA members, discussed below.

[63] The CSA commented on the scope of the definition of "responsible issuer" in footnote 29 of its commentary:

The definition of "responsible issuer" in Bill 198 differs from that proposed in the USA. Bill 198 defines "responsible issuer" to mean a reporting issuer or any other issuer with a real and substantial connection

to Ontario, any securities of which are publicly traded. Part 9 of the USA defines “responsible issuer” to mean a reporting issuer in that particular jurisdiction or any other jurisdiction of Canada. This departure from Bill 198 wording ensures that security holders in a province where the issuer is not a reporting issuer will have the same rights as security holders in jurisdictions where the issuer is a reporting issuer. Ontario intends to maintain the Bill 198 definition of “responsible issuer”. In the OSC’s view, the Bill 198 definition of “responsible issuer” is sufficiently broad to provide a right of action against an issuer who is not a reporting issuer in the investor’s resident province. [Emphasis added.]

[64] In September 2004, the CSA published responses to comments received on its consultation draft. It reported a comment respecting the extent to which secondary market civil liability should apply to non-reporting issuers:

One commenter disagrees with the proposal to extend secondary civil market liability to non-reporting issuers if they have a real and substantial connection to the local jurisdiction and their securities are publicly traded. The commenter is of the view that it is inconsistent with the policy behind current legislation, which does not impose continuous disclosure obligations on non-reporting issuers. The commenter notes that a similar provision has already been passed by the Ontario legislature.

[65] The CSA responded, in part, as follows:

Many issuers have securities that are publicly traded in jurisdictions where they are not reporting issuers. From a public policy perspective, the secondary market civil liability regime should be aimed at protecting all investors that purchase, hold, sell or redeem publicly traded securities, whether or not the issuer of those securities is a reporting issuer in the jurisdiction...

[66] The CSA accepted that civil liability was not tied to having continuous disclosure obligations in the enacting province.

(e) Ontario definition proclaimed in force

[67] In November 2004, Bill 149 was introduced in the Ontario legislature. It contained the definition of “responsible issuer” as it appears in the OSA today. The only difference from the definition of “responsible issuer” in Bill 198 is that the words “real and” appear before the word “substantial”. Bill 149 came into force on December 31, 2005.

[68] The concept of restricting a responsible issuer to an issuer whose securities were publicly traded in the jurisdiction in question was flagged by the Allen Committee, but not included in Bill 149. In my view, this reflects a conscious decision on the part of the legislature.

(f) Other CSA members enact legislation

[69] The CSA did not achieve its goal of developing a uniform securities act for adoption by each jurisdiction in Canada. The CSA officially withdrew the draft Uniform Securities Act, its Uniform Securities Legislation Project, and all related CSA documents on February 19, 2010.

[70] Between December 31, 2006 and October 26, 2008, all of the other provinces and territories of Canada adopted legislation imposing civil liability for secondary market disclosure. All incorporate a definition of "responsible issuer" that includes, as its second prong, any other issuer having a real and substantial connection (or, in the case of Quebec, that is "closely connected") to the province, which has issued securities that are publicly traded. With the exception of the Yukon Securities Act, S.Y. 2007, c. 16, none qualifies where the securities must be traded. The definition in the Yukon Securities Act, at s. 122, specifies that the securities must be "publicly traded in Yukon".

[71] Each of Nova Scotia, Prince Edward Island, Yukon, the Northwest Territories and Nunavut also specifically include reporting issuers under the laws of another province of Canada in paragraph (a) of the definition, making it clear that the issuers referred to in the second prong of the definition are issuers who are not reporting issuers in any jurisdiction of Canada. This, in my view, makes clear that CSA members intended that civil liability for secondary market disclosure not be linked to the issuer being subject to continuous disclosure requirements in Canada.

(4) Statutory Interpretation

[72] The preferred approach to statutory interpretation supports the conclusion that the words "publicly traded" in paragraph (b) of the definition of "responsible issuer" do not mean "publicly traded in Canada".

[73] The preferred approach to statutory interpretation requires that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": Bell ExpressVu Limited Partnership v. Rex, 2002 SCC 42, [2002] 2 S.C.R. 559, at para. 26. The context for interpreting the definition of "responsible issuer" includes the purpose of the definition, the purpose of Part XXIII.1 of the OSA, the purpose of the OSA as a whole, and related provisions of the OSA: see, for example, the approach of this court in Kerr v. Danier Leather, at para. 84.

[74] On its face, the wording of paragraph (b) of the definition of "responsible issuer" does not support a restrictive interpretation of "publicly traded". I agree with counsel for Mr. Abdula that if the legislature intended the second prong of the definition of "responsible issuer" to be confined to issuers that are reporting issuers in Canadian jurisdictions other than Ontario or any of whose securities are listed on Canadian stock exchanges, it would have been a simple task to adopt language which clearly expressed that intent.

[75] Indeed, as counsel for Mr. Abdula notes in his factum, in recent amendments to the insider trading provisions of the OSA, the legislature expanded the definition of “reporting issuer” in ss. 76(5) and 134(7) to include “an issuer that has a real and substantial connection to Ontario and whose securities are listed and posted for trading on the TSX Venture Exchange” (emphasis added).

[76] Section 138.7, which reduces the cap on a responsible issuer’s liability by the damages assessed “under comparable legislation in other provinces or territories in Canada”, further demonstrates that, where the legislature intends to limit the geographical application of a provision, it so specifies.

[77] The fact that s. 138.7 does not reduce the cap by damages assessed under s. 10(b) of the Securities Exchange Act of 1934 does not indicate that s. 138.3 is confined to issuers that are reporting issuers in a Canadian jurisdiction or issuers any of whose securities are listed on a Canadian stock exchange. A significant number of Canadian issuers are listed both on the TSX and an American exchange. Counsel for Canadian Solar agrees that such issuers fall within the definition of “responsible issuer”. They are exposed to litigation under both s. 138.3 of the OSA and s. 10(b) of the Securities Exchange Act of 1934. Damages assessed against them under s. 10(b) of the Securities Exchange Act of 1934 do not statutorily reduce the cap on their liability under s. 138.3 of the OSA. Section 138.3 applies even where the issuer may be sued in both Canada and the U.S.

[78] The motion judge’s conclusion is also supported by related provisions of the OSA, namely the definitions of “document” in s. 138.1, and “principal market” in s. 250 of R.R.O. 1990, Reg. 1015.

[79] A “document” includes any written communication that is not required to be filed with the OSC and “that is filed or required to be filed with a government or an agency of a government under applicable securities or corporate law”. The clause does not, as it easily might have, limit the definition to documents filed with a government of a Canadian province or territory.

[80] The definition of “principal market” contemplates that a responsible issuer’s securities may not be traded on a Canadian market, at least during certain periods.

[81] Further, a stated objective of the OSA is to provide protection to investors from unfair, improper or fraudulent practices. Mr. Abdulla is an Ontario investor who alleges that he suffered damage as a result of a misrepresentation in documents released or presented in Ontario by a corporation based in Ontario. While the legislative history indicates that a purpose of Part XXIII.1 of the OSA is to promote a better standard of continuous disclosure, it also provides a measure of compensation to injured investors. As counsel for Mr. Abdulla submits, the courts recognized this dual purpose in Silver v. Imax, at para. 293, and Dobbie v. Arctic Glacier, at para. 106. Thus, the objectives of both the OSA as a whole and Part XXIII.1 specifically do not support restricting the application of civil liability for secondary market disclosure to those issuers with continuous disclosure obligations in Canada.

(5) Prospectus Misrepresentation Cases

[82] The motion judge did not err in failing to refer to the four cases that Canadian Solar cites with respect to the territorial reach of the statutory cause of action for prospectus misrepresentation. The reasoning in these cases is not applicable to the statutory cause of action for misrepresentations in secondary market disclosure.

[83] In Pearson v. Boliden, at para. 64, Newbury J.A. wrote,

Once the Act of a province applies to regulate (by means of a prospectus requirement) the "distribution" of securities taking place within the province's boundaries, the same Act must surely be looked to for any statutory cause of action for misrepresentation contained in the document.

[84] Perell J. in Coulson v. Citigroup agreed. McKenna v. Gammon Gold and the more recent Dobbie v. Arctic Glacier left that issue to be determined at trial. The certification judge in McKenna v. Gammon Gold Inc., Strathy J., did however conclude that it was not appropriate to include persons who purchased securities from the underwriters or their agents outside of Canada in the class. At para. 116, he wrote: "The acquisition of those securities in a jurisdiction outside Canada would not give rise to a reasonable expectation that the acquiror's rights would be determined by a court in Canada."

[85] As noted by van Rensburg J. in Silver v. Imax Corp. (2009), 86 C.P.C. (6th) 273 (Ont. S.C.), at para. 145, fn 20, the scope of persons who may assert a claim under s. 138.3 does not fit neatly into the analysis in Pearson v. Boliden, which is driven by where the distribution pursuant to which the plaintiff acquired shares took place.

[86] Section 130(1) of the OSA, which establishes liability for misrepresentation in a prospectus, provides as follows:

Where a prospectus, together with any amendment to the prospectus, contains a misrepresentation, a purchaser who purchases a security offered by the prospectus during the period of distribution or during distribution to the public has, without regard to whether the purchaser relied on the misrepresentation, a right of action for damages against, (a) the issuer...

[87] Section 138.3 is very different:

Where a responsible issuer...releases a document that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security...has...a right of action for damages against, (a) the responsible issuer;...

[88] The definition of "responsible issuer" is not confined to persons who are reporting issuers in Ontario and therefore have a continuous disclosure obligation in Ontario. Extra-territorial application is

specifically envisaged by the paragraph (b) of the definition of "responsible issuer", with its reference to issuers with a "real and substantial connection" to Ontario. The neat division of class members, without overlap, contemplated by Pearson v. Boliden and Coulson v. Citibank was not envisaged.

[89] Mr. Abdula, an Ontario resident who placed his order in Ontario for shares of a corporation based in Ontario, would reasonably expect that his claim for misrepresentations in documents released or presented in Ontario would be determined by an Ontario court.

Notes and Questions

Can you explain the differences in approach between the US under Morrison and Ontario as reflected in this decision?

The Ontario statute provides for liability without any need for the plaintiff to establish reliance (what follows are short excerpts from the relevant provisions):[32]

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

(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[33] (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

[32] 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.

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

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, statement or opinion in the public oral statement..[34]

The Ontario statute provides that a responsible issuer means "a reporting issuer, or any other

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[34] 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).

issuer with a real and substantial connection to Ontario, any securities of which are publicly traded". Thus foreign issuers may be sued in Ontario.

In the Netherlands there are two mechanisms for obtaining collective redress.[35] One is a representative action which may be used to obtain declaratory or injunctive relief, and the other is a mass settlement procedure.[36] With respect to the investors in BP who could not bring claims in the US a Foundation was established under Article 3:305a of the Dutch Civil Code ("DCC") to represent the interests of all of its members collectively:

> to protect the interests and rights of all investors in BP plc, the largest British company by market capitalization and one of the world's leading oil exploration and producing companies, particularly regarding the compensation of investor losses sustained as a result of BP's false or misleading shareholder representations and information leading up to and concerning the Deepwater Horizon oil drilling rig explosion and consequential oil spill in the Gulf of Mexico ("Deepwater Horizon Disaster") and the financial consequences for the company and its shareholders.[37]

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 state that "[a]ppropriate 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."[38]

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

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[35] *See, e.g.*, US Chamber Institute for Legal Reform, Collective Redress in the Netherlands (Feb. 6, 2012).

[36] This procedure produced a settlement with respect to Converium. Jeroen van Kwawegen, Converium/SCOR: Dutch Court Further Opens the Door for International Securities Fraud Settlements at http://www.blbglaw.com/news/publications/data/00152/_res/id=sa_File1/AdvocateEuro_Summer2012_Kwawegen.pdf ("Converium was not incorporated in The Netherlands and not listed on the Amsterdam Stock Exchange, and the vast majority of investors who suffered losses and were potentially covered by the settlements were not domiciled in The Netherlands either.")

[37] http://www.investor-claims-against-bp.com/ .

[38] Directive 2004/109/EC, OJ No L 390/38 (Dec. 31, 2004), amended by Directive 2013/50/EU, OJ No. L L 294/13 (Jun. 11, 2013).

harmonized principles of disclosure,[39] but has not produced harmonized principles for liability.

However, although the EU has not specifically addressed issues of harmonizing fraud liability it has begun to move towards establishing systems of collective redress more generally. In 2013 the EU Commission published a **Communication on Collective Redress**:[40]

In economically challenging times, a sound legal environment and efficient justice systems can contribute decisively to the European Union's goal of achieving competitive growth. The major policy objective for the EU is to remain competitive at global level and to have an open and functioning single market, as stressed in the Europe 2020 strategy and in the Single Market Act. Legal certainty and a reliable legal environment are of key importance in this context.

EU justice policy aims to develop a genuine area of freedom, security and justice that serves citizens and businesses. Both citizens and businesses should be able to obtain effective redress, in particular in cross-border cases and in cases where the rights conferred on them by European Union law have been infringed. This may require procedural law solutions on the basis of EU law. Work carried out in the area of procedural law so far has produced a number of solutions facilitating effective redress: the European Small Claims Procedure is a simplified and cost-effective European civil procedure that facilitates consumer claims resulting from cross-border sales. The European Order for Payment Procedure contributes to fast cross-border debt recovery, making it easier for businesses to manage their claims. The Mediation Directive, which is applicable in all cross-border civil disputes, promotes Alternative Dispute Resolution that saves costs and efforts and reduces the time needed for cross-border litigation. In the field of consumer policy[the recently adopted Directive on consumer Alternative Dispute Resolution together with Regulation on consumer Online Dispute Resolution go further by requiring Member States to ensure that contractual disputes between a consumer and a trader arising from the sale of goods or the provision of services can be submitted to an alternative dispute resolution entity.... For the Commission, any measures for judicial redress need to be appropriate and effective and bring balanced solutions supporting European growth, while ensuring effective access to justice. Therefore, they must not attract abusive litigation or have effects detrimental to respondents regardless of the results of the proceedings. Examples of such adverse effects can be seen in particular in 'class actions' as known in the United States. The European approach to collective redress must thus give proper thought to preventing these negative effects and devising adequate safeguards against them.

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[39] *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).

[40] EU Commission, "Towards a European Horizontal Framework for Collective Redress," COM (2013) 401 final (Jun. 11, 2013).

In 2011, the Commission carried out a horizontal public consultation 'Towards a coherent European approach to collective redress'. Its aim was, inter alia, to identify common legal principles on collective redress and to examine how such common principles could fit into the EU legal system and into the legal orders of the 27 EU Member States. The consultation also explored the areas in which different forms of collective redress could help to better enforce EU legislation or protect the rights of EU citizens and businesses....

This Communication reports the main views expressed in the public consultation and reflects the position of the Commission on some central issues regarding collective redress. It is accompanied by a Commission Recommendation, which recommends that all Member States of the European Union have national collective redress systems based on a number of common European principles. The Recommendation advocates a horizontal approach, and its content therefore also applies to the field of competition law, an area for which specific rules – justified by the specificities of competition law – are included in a proposal for a Directive on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union. While the Recommendation encourages all Member States to follow the principles suggested therein, the proposed Directive leaves it to Member States whether or not to introduce collective redress actions in the context of the private enforcement of competition law.

Collective redress is a procedural mechanism that allows, for reasons of procedural economy and/or efficiency of enforcement, many similar legal claims to be bundled into a single court action. Collective redress facilitates access to justice in particular in cases where the individual damage is so low that potential claimants would not think it worth pursuing an individual claim. It also strengthens the negotiating power of potential claimants and contributes to the efficient administration of justice, by avoiding numerous proceedings concerning claims resulting from the same infringement of law.

Depending on the type of claim, collective redress can take the form of injunctive relief, where cessation of the unlawful practice is sought, or compensatory relief, aimed at obtaining compensation for damage suffered. This Communication and the Commission Recommendation accompanying this Communication address both forms of collective redress, without interfering with means of injunctive relief already in place in Member States on the basis of Union law...

1.3. State of play on collective redress in the European Union

EU legislation and international agreements ratified by the EU require Member States to provide for collective injunctive relief in certain areas. In the area of consumer law, as a result of the Directive on Injunctions, qualified consumer protection authorities and consumer organisations are authorised to commence proceedings before the courts or public authorities in all Member States to request the prohibition of practices that infringe national and EU consumer protection rules. In the area of environmental law, the Aarhus Convention requires Member States to ensure access to justice with

regard to infringements of environmental standards. All Member States thus have procedures in place which allow claimant parties, acting in a collective or representative way, to seek an injunction to stop illegal practices.

Procedures to bring collective claims for compensatory relief have been introduced also in a number of Member States, so far as a result of national developments in justice policy. Instruments on collective compensatory relief do not yet exist at EU level. Existing mechanisms whereby compensation can be claimed by a group of individuals harmed by illegal business practices vary between the Member States. Major differences in the mechanisms have to do with their scope, their availability to representative organisations or individuals as claimants, their availability to businesses and in particular SMEs, how the claimants group is formed ('opt-in' or 'opt-out'), how an action is financed and how an award is distributed.

The Commission has worked for several years to develop European standards of compensatory collective redress in the field of competition and consumer law....Stakeholders raised the issue of inconsistencies between the different Commission initiatives on collective redress, a fact which points to the need for a more coherent system. Indeed, collective redress is a procedural tool that can be relevant for EU policies in areas other than competition or consumer protection. Good examples are financial services, environmental protection, data protection or non-discrimination. The Commission therefore deems it necessary to increase policy coherence and to take a horizontal approach on collective redress on the basis of a public consultation carried out in 2011...

The Commission's public consultation on collective redress met with a considerable response: 310 replies were received from other stakeholders, and 300 people attended a public hearing on 5 April 2011. In addition, over 19 000 replies were received in the form of mass mailing from citizens. The quality of most responses demonstrates the substantial interest in and the importance of this issue. The contributions informed the Commission's understanding of the varying positions taken by stakeholders, and highlighted which issues are controversial and which are more consensual.

The primary difference of opinion concerning the benefits that could flow from introducing new mechanisms of collective redress for the enforcement of EU law is between citizens/consumers and business: consumers are generally in favour of introducing new mechanisms, while businesses are generally against. Academics are generally in favour. Lawyers are divided on this issue, although those who are sceptical or opposed outnumber those in favour.

The Member States which responded to the consultation also expressed diverging views, ranging from support for binding EU rules on collective redress to strong scepticism.

Some Member States would consider binding EU rules with regard to specific policy fields or issues only (Denmark – with regard to cross-border collective redress, the Netherlands– with regard to private

international law aspects of collective redress, Sweden – in policy fields with harmonised substantive rules, such as competition, the UK - in the competition field; Latvia would consider a set of binding minimum requirements in the area of consumer and competition law for cross-border cases).

Several contributors, representing various categories of stakeholders, took the view that collective redress as a form of private enforcement should normally be independent of enforcement by public bodies, but that a certain level of coordination is required between public and private enforcement; in effect they should complement each other. Some contributors argued that collective redress should only come into play after public enforcement, as "follow on" actions.

Most stakeholders agree that establishing common principles for collective redress at EU level is desirable. However, such principles should fit into the EU legal system and the legal orders of the 27 Member States, and take into account the practical experience of collective redress systems already operating in several Member States. According to many stakeholders, the principles should ensure effective proceedings, prevent threats of abusive litigation, encourage collective consensual resolution of disputes, and provide a mechanism for the cross-border enforcement of judgments.

More specifically, many stakeholders agree with the following basic parameters of a collective redress system in terms of effectiveness and safeguards: any collective redress mechanism should first and foremost be capable of effectively resolving a large number of individual claims that raise the same or common issues and relate to a single alleged infringement of rights granted under EU law. It should be capable of delivering legally certain and fair outcomes within a reasonable timeframe, while respecting the rights of all parties involved. At the same time, it should incorporate safeguards against abusive litigation and avoid any economic incentives to bring speculative claims. In examining the concrete building blocks needed to ensure effectiveness and safeguards, the public consultation has confirmed that collective redress mechanisms vary significantly amongst Member States. These mechanisms differ from each other as regards the type of available collective action and its main features, such as admissibility, legal standing, the use of an opt-in or an opt-out system, the role of the judge in collective proceedings and requirements on informing potential claimants about a collective action. Furthermore, each collective redress mechanism operates in the broader context of general civil and procedural rules, rules regulating the legal profession and other relevant rules, which also differ amongst Member States. Given this diversity, stakeholders naturally have very different views as to whether any specific national system of collective redress — or its features — may be particularly instructive when formulating EU-wide standards on effectiveness and safeguards....

The main concerns voiced against the introduction of collective judicial redress mechanisms were that it would attract abusive litigation or otherwise have a negative impact on the economic activities of EU businesses. Litigation can be considered abusive when it is intentionally targeted against law-abiding businesses in order to cause reputational damage or to inflict an undue financial burden on them.

There is the risk that the mere allegation of infringements could have a negative influence on the perception of the defendant by its existing or potential clients. Law-abiding defendants may be prone to settle the case only in order to prevent or minimise possible damage. Furthermore, the costs of legal representation in a complex case may constitute substantial expenditure, in particular for smaller economic operators.

'Class actions' in the US legal system are the best known example of a form of collective redress but also an illustration of the vulnerability of a system to abusive litigation. Several features of the US legal system have made class actions a particularly powerful instrument that is, however, feared by those on the defending side, namely trade and industry as it can be used as a forceful tool to compel them to settle a case, which may not necessarily be well-founded. Such features are for instance contingency fees of attorneys or the discovery of documents procedure that allows 'fishing expeditions'. A further important feature of the US legal system is the possibility to seek punitive damages, which increases the economic interests at stake in class actions. This is enhanced by the fact that US class actions are legally 'opt-out' procedures in most cases: the representative of the class can sue on behalf of the whole class of claimants possibly affected without them specifically requesting to participate. In recent years, U.S. Supreme Court decisions have started to progressively limit the availability of class actions in view of the detrimental economic and legal effects of a system that is open to abuse by frivolous litigation....

3.1. The relationship between public enforcement and private collective redress — compensation as an object of collective action

There is a consensus among stakeholders that private and public enforcement are two different means that should normally pursue different objectives. Whereas it is the core task of public enforcement to apply EU law in the public interest and impose sanctions on infringers to punish them and to deter them from committing future infringements, private collective redress is seen primarily as an instrument to provide those affected by infringements with access to justice and — as far as compensatory collective redress is concerned — possibility to claim compensation for harm suffered. In this sense, public enforcement and private collective redress are seen as complementing each other.

Collective damages actions should aim to secure compensation of damage that is found to be caused by an infringement. The punishment and deterrence functions should be exercised by public enforcement. There is no need for EU initiatives on collective redress to go beyond the goal of compensation: Punitive damages should not be part of a European collective redress system.

3.2. Admissibility of collective redress

Conditions for the admissibility of collective actions vary in Member States depending on the concrete type of collective redress mechanism. Typically, the basic conditions are set by the law regulating a given type of collective action. There are also systems leaving the assessment of admissibility to the discretion

of the courts. The extent of discretion given to the court to decide on admissibility conditions varies between Member States, also when the legal conditions are codified in a law.

Some collective actions are available for all types of civil damages claims; others are only available for claims concerning damages for alleged breaches of specific legal rules: consumer protection rules, environmental protection, investor protection, competition law, etc. There are also systems in which particular types of collective action are only admissible once a public authority has established an infringement of the relevant rules: i.e. follow-on actions.

It should be ensured that collective actions for damages (compensatory relief) can only be brought when certain admissibility conditions are fulfilled. In any event, the court should decide on the admissibility of a concrete collective action at a very early stage of the proceedings.

3.3. Legal standing

Legal standing to bring a collective action in the Member States depends on the concrete type of collective redress mechanism. In certain types of collective actions, such as group actions where the action can be brought jointly by those who claim to have suffered harm, the issue of standing is fairly straightforward. In the context of representative actions, the issue of legal standing needs to be defined. A representative damages action is an action which is brought by a representative entity (which in some systems can also be a public authority) on behalf of a defined group of individuals or legal persons who claim to have been harmed by the same alleged infringement. The individuals are not parties to the proceeding; only the representative entity acts on the claimant side. It should therefore be ensured that the representative entity acts genuinely in the best interest of the group represented, and not for own profit. The Commission believes that under a European horizontal framework on collective redress it is desirable that collective actions are available in all Member States to natural or legal persons as a means of collectively asking for injunctions or claiming compensation for harm caused to them by infringements of rights granted under EU law.

There are different systems as regards qualifying criteria for representative entities which are not public authorities. One possible approach is to let the court check whether the representative entity is fit for purpose on a case-by-case basis (ad hoc certification). Another approach is to set certain qualification criteria by law and, thus, define the standing upfront. It can be left to the court to check whether such qualification criteria are met, or an authorisation system can be introduced where a public authority is in charge of checking the fulfilment of qualification criteria. Mass harm situations could span across the border, especially in the context of a further developed digital single market, therefore representative entities originating from other Member States than the one where a collective action is brought before the court should have the possibility to continue performing their role.

Whereas some stakeholders, in particular businesses, are strongly in favour of granting the standing to

bring representative actions only to qualified entities that fulfil express criteria, other stakeholders are opposed to determining standing by law, arguing that this might unnecessarily restrict access to litigation seeking compensation for all those who have potentially suffered harm. The Commission considers it desirable to define the conditions for legal standing in representative actions in the Commission Recommendation.

3.4. ‘Opt-in’ vs. ‘opt-out’

There are two basic approaches to the way in which the represented group is composed: ‘opt-in’, where the group includes only those individuals or legal persons who actively opt in to become part of the represented group, and opt-out’, where the group is composed of all individuals who belong to the defined group and claim to have been harmed by the same or similar infringement unless they actively opt out of the group. In the ‘opt-in’ model, the judgment is binding on those who opted in, while all other individuals potentially harmed by the same or similar infringement remain free to pursue their damages claims individually. Conversely, in the ‘opt-out’ model, the judgment is binding on all individuals that belong to the defined group except for those who explicitly opted out. The ‘opt-in’ model is used by most Member States that provide for collective redress. The ‘opt-out’ model is used in Portugal, Bulgaria and the Netherlands (in collective settlements) as well as in Denmark in clearly defined consumer cases brought as representative actions.

A significant number of stakeholders, in particular businesses, strongly oppose the ‘opt-out’ model, arguing that it is more prone to abuse and that it may be unconstitutional in some Member States, or at least incompatible with their legal traditions. On the other hand, some consumer organisations argue that ‘opt-in’ systems may fail to deliver effective access to justice for all consumers who have been harmed. In their view, the availability of ‘opt-out’ is therefore desirable, at least as an option in appropriate cases and subject to approval by the court.

In the Commission's view, it should be ensured that the represented group is clearly defined so as to allow the court to conduct the proceedings in a manner consistent with the rights of all parties, and in particular with the rights of the defence.

The ‘opt-in’ system respects the right of a person to decide whether to participate or not. It therefore better preserves the autonomy of parties to choose whether to take part in the litigation or not. In this system the value of the collective dispute is more easily determined, since it would consist of the sum of all individual claims. The court is in a better position to assess both the merits of the case and the admissibility of the collective action. The ‘opt-in’ system also guarantees that the judgment will not bind other potentially qualified claimants who did not join.

The ‘opt-out’ system gives rise to more fundamental questions as to the freedom of potential claimants to decide whether they want to litigate. The right to an effective remedy cannot be interpreted in a way that

prevents people from making (informed) decisions on whether they wish to claim damages or not. In addition, an 'opt-out' system may not be consistent with the central aim of collective redress, which is to obtain compensation for harm suffered, since such persons are not identified, and so the award will not be distributed to them.

The Commission therefore takes the view in the Commission Recommendation that under the European horizontal framework on collective redress the claimant party should be formed on the basis of the 'opt-in' method and that any exception to this principle, by law or by court order, should be duly justified by reasons of sound administration of justice.

3.5. Effective provision of information to potential claimants

Effective information on collective action is a vital condition for ensuring that those who could claim to have been harmed by the same or similar alleged infringement learn of the possibility to join a representative action or a group action and, thus, can make use of this means of accessing justice. On the other hand, it cannot be overlooked that advertising (e.g. on TV or via flyers) of the intention to bring collective action may have a negative impact on the reputation of the defendant, which could have adverse effects on its economic standing.

There is a consensus among stakeholders on the importance of rules stipulating that a representative entity has an obligation to effectively inform potential members of the represented group. Many stakeholders suggest that the court should play an active role in checking that this obligation is fulfilled.

For any type of collective action, any rules regarding the provision of information to potential claimants should balance concerns regarding freedom of expression and the right to access information with the protection of the reputation of the defendant. The timing and conditions in which the information is provided will play an important role in ensuring that this balance is kept.

3.6. Interplay of collective redress and public enforcement in specific policy areas

With regard to EU policy fields where public enforcement plays a major role — such as competition, environment, data protection or financial services — most stakeholders see the need for specific rules to regulate the interplay between private and public enforcement, and protect the effectiveness of the latter.

Collective damages actions in regulated policy areas typically follow on from infringement decisions adopted by public authorities and rely on the finding of an infringement, which is often binding on the civil court before which a collective damages action is brought. For example, in the competition field, Regulation (EC) No 1/2003 provides that when national courts rule on issues concerning EU antitrust rules which are already the subject of a Commission decision, they cannot take decisions running counter to the decision adopted by the Commission.

In such cases, follow-on actions essentially concern the questions of whether damage has been caused by the infringement and, if so, to whom and in what amount.

It is necessary to ensure that the effectiveness of public enforcement is not put into jeopardy as a result of collective damages actions or actions that are brought before courts while an investigation by a public authority is still on-going. This may typically require rules regulating access by claimants to documents obtained or produced by the public authority in the course of the investigation, or specific rules on limitation periods allowing potential claimants to wait with a collective action until the public authority takes its decision as regards infringement. Beyond the purpose of protecting public enforcement, rules of this kind also facilitate effective and efficient redress through collective damages actions. Namely, the claimants in a follow-on action can to a significant extent rely on the results of public enforcement and, thus, avoid the (re-)litigation of certain issues. Due account should be taken of the specificities of collective damages actions in policy areas where public enforcement plays a major role, to achieve the twofold goal of protecting the effectiveness of public enforcement and facilitating effective private collective redress, particularly in the form of follow-on collective actions.

3.7. Effective enforcement in cross-border collective actions through private international law rules

The general principles of European international private law require that a collective dispute with cross-border implications should be heard by a competent court on the basis of European rules on jurisdiction, including those providing for a choice of court, in order to avoid forum shopping. The rules on European civil procedural law and applicable law should work efficiently in practice to ensure proper coordination of national collective redress procedures in cross-border cases.

With regard to jurisdictional rules, many stakeholders asked for collective proceedings to be specifically addressed at European level. Views differ, however, as to the desirable connecting factor between the court and the case. A first group of stakeholders advocate a new rule giving jurisdiction in mass claim situations to the court where the majority of parties who claim to have been injured are domiciled and/or an extension of the jurisdiction for consumer contracts to representative entities bringing a collective claim. A second category argues that jurisdiction at the place of the defendant's domicile is best suited since it is easily identifiable and ensures legal certainty. A third category suggests creating a special judicial panel for cross-border collective actions with the Court of Justice of the European Union.

In this respect, the Commission considers that the existing rules of Regulation (EC) No 44/2001 on jurisdiction, recognition and enforcement of judgments in civil and commercial matters ('the Brussels I Regulation'), should be fully exploited. In the light of further experience involving cross-border cases, the report foreseen on the application of the Brussels I Regulation should include the subject of effective enforcement in cross-border collective actions.

Finally, some stakeholders raised the problem that, under the EU's current conflict of law rules, a court

to which a collective dispute is submitted in a case involving claimants from several Member States would sometimes have to apply several different laws to the substance of the claim. The general rule for tort cases is that the law applicable for the obligations arising out of tort is the law of the country in which the event giving rise to the damage occurred. In tort cases concerning product liability, the law is determined by the habitual residence of the person sustaining the damage. Furthermore, for cases on unfair competition, the law applicable is the law of the country where competitive relations or the collective interests of consumers are or are likely to be affected. Admittedly, there can be situations where the conflict of law rules can render cross-border litigation complex, in particular if the court has to apply several compensation laws to each group of persons sustaining the damage. However, the Commission is not so far persuaded that it would be appropriate to introduce a specific rule for collective claims which would require the court to apply a single law to a case. This could lead to uncertainty when this is not the law of the country of the person claiming damages.

3.8. Availability of collective consensual dispute resolution

Stakeholders agree that consensual dispute resolution can provide parties with a fast, low-cost and simple means of resolving their disputes. Consensual dispute resolution can also reduce the need to seek judicial redress. Parties to collective proceedings should therefore have the possibility to resolve their disputes collectively out of court, either with the intervention of a third party (e.g. using a mechanism such as arbitration or mediation) or without such intervention (e.g. settlement among the parties concerned).

The large majority of stakeholders including small and medium enterprises (SMEs) are of the opinion that the consensual collective resolution of disputes should not be a mandatory first step before going to court. Indeed, this approach could trigger unnecessary costs and delays and may in certain situations even undermine the fundamental right of access to justice. Resorting to the consensual collective resolution of disputes should therefore remain voluntary , with due regard to existing EU law in the ADR area. However, judges in collective redress proceedings should not be prevented from inviting the parties to seek a consensual collective resolution of their dispute.

Verification of the legality of the outcome of consensual collective resolution of the dispute and its enforceability is of particular importance in collective cases, as not all members of the group claiming to be harmed by an alleged illegal practice are always able to directly take part in the consensual collective resolution of the dispute. The court should therefore confirm the outcome. The Commission recommends this to the Member States.

The Commission sees therefore that a useful complementary role can be played by consensual dispute resolution mechanisms. Building on the steps that have already taken in this direction, namely the Mediation Directive, Directives on consumer Alternative Dispute Resolution and Regulation on

consumer Online Dispute Resolution, the Commission considers that it is a useful further step to recommend to the Member States to develop collective consensual dispute resolution mechanisms

3.9. Funding of collective action

In the case of collective redress, costs usually borne by parties engaged in civil litigation could be relatively high, in particular where there are many claimants. While lack of funding should not limit access to justice, funding mechanisms available for collective actions should not create incentives for abusive litigation.

3.9.1. Third-party financing

Financial support by a private third party who is not a party to the proceedings could take different forms. Direct third-party financing of collective actions is seen as a potential factor driving abusive litigation, unless it is properly regulated. Legal expenses insurance is perceived by some as more neutral and 'after-the-event' insurance could have some relevance for collective actions.

Contingency or success fees for legal services that cover not only representation, but also preparatory action, gathering evidence and general case management constitute de facto third-party financing. The variety of the solutions adopted in this sphere by the Member States ranges from prohibition to acceptance. Some stakeholders consider the abolition of contingency fees as an important safeguard against abusive litigation while others see contingency fees as a useful method of financing collective actions.

Third-party financing is an area which needs to be designed in a way that it serves in a proportionate manner the objective of ensuring access to justice. The Commission therefore takes the view in the Commission Recommendation that it should be made subject to certain conditions. An inappropriate and non-transparent system of third party financing runs the risk of stimulating abusive litigation or litigation that does little to serve the best interests of litigants.

3.9.2. Public funding

In the public consultation some stakeholders, namely consumer organisations and some lawyers, favoured the creation of public funds that would provide financial support for potential claimants in collective redress cases.

However, given that collective redress would be a procedure arising in the context of a civil dispute between two parties, even if one of them is composed of a number of claimants, and deterrence will be a side-effect of the proceedings, the Commission does not find it necessary to recommend direct support from public funds, since if the court finds that damage has been sustained, the party suffering that damage will obtain compensation from the losing party, including their legal costs.

3.9.3. 'Loser pays' principle

The principle that the losing party should bear the costs of the court proceedings is well embedded in the European legal tradition, although it is not present in every jurisdiction of the European Union and the way in which it is applied differs between jurisdictions.

In the public consultation all stakeholders agreed that the 'loser pays' principle should apply to collective redress cases. The Commission has no doubt that the 'loser pays' principle should form part of the European approach to collective redress, and thus it recommends to follow that principle in collective actions...

Taking into account the complexity on the one hand and the need to ensure a coherent approach to collective redress on the other hand, the Commission adopts, in parallel with this Communication, a Recommendation on the basis of Article 292 TFEU that suggests horizontal common principles of collective redress in the European Union that should be complied with by all Member States. After adoption and publication of the Commission Recommendation, the Member States should be given two years to implement the principles recommended by the Recommendation in national collective redress systems. On the basis of practical experience to be made with the Recommendation, the Commission will, four years after the publication of the Recommendation, assess whether further legislative measures to consolidate and strengthen the horizontal approach reflected in the present Communication and in the Recommendation should be proposed. The Commission will in particular assess the implementation of the Recommendation and its impact on access to justice, on the right to obtain compensation, on the need prevent abusive litigation and on the functioning of the single market, the economy of the European Union and consumer trust.

Notes and Questions

Part of the concern raised by the issues in cases like Morrison is a concern to limit forum shopping by plaintiffs (and their lawyers). Is forum shopping necessarily a bad thing? When we think of this sort of issue in the context of regulation we talk about regulatory arbitrage – the idea that the subjects of regulation can manage their affairs to avoid the application of certain rules. But doesn't Morrison allow businesses to engage in regulatory arbitrage while preventing investors from countering it through forum shopping? Who should be able to pick the rules that apply to them, businesses or consumers?

New York and England are significant jurisdictions for business and commercial litigation, in part because the courts in those jurisdictions have expertise because they are centres for

commercial litigation. Delaware is a significant jurisdiction for corporate law and litigation.

Why do you think different jurisdictions have different rules about securities fraud? Note that differences in the rules involve differences in civil litigation regimes generally and also with respect to securities fraud. Differences in rules about civil litigation generally may relate to the extent to which a jurisdiction thinks litigation is an appropriate means of solving social problems.

Is there a right answer to the question about the circumstances in which investors should be able to sue for remedies for securities fraud or are there many different possible legitimate answers? Who should decide what the rules are ?

Given your answers to these questions and the material you have read, do you think that international harmonization with respect to private claims for securities fraud is possible?

Do you think harmonization of rules providing for criminal liability for fraud is more or less likely?