INTERNATIONAL FINANCE SPRING 2013

SECURITIES LITIGATION AND TRANSNATIONAL INVESTMENT IN SECURITIES

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This semester we will be studying issues which arise in connection with financial activity which crosses territorial boundaries. 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 debt securities that were sold to investors in different parts of the world. Troubled

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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.")

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] The Madoff fraud generated numerous lawsuits against entities around the world.[5] In the wake of the global financial crisis, some commentators noted the existence of reverse remittances.[6] Before the crisis, policy-makers had noted that there were significant flows of money across borders as immigrant workers in developed economies sent funds home to their families in less affluent economies: post crisis remittances also flowed from poorer countries to richer ones. Remittances from developed economies to developing economies are estimated to amount to over $400 billion in 2012.[7]

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

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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.*, Mark Lacey, Money Trickles North as Mexicans Help Relatives, NY Times (Nov. 15, 2009) at http://www.nytimes.com/2009/11/16/world/americas/16mexico.html?_r=2&ref=todayspaper.

[7] Migration and Remittances Unit Development Prospects Group, World Bank, Migration and Development Brief 19 (Nov. 20, 2012) at http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1288990760745/MigrationDevelopmentBrief19.pdf. Regulation such as anti-moneylaundering (AML) rules may contribute to increasing the cost of sending remittances. *Id.* at 8.

do business.[8] 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,[9] but if they do so they become subject to rules in force in the different jurisdictions in which they sell the securities.

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.[10]

In the US, The SEC acts to enforce compliance with the federal securities laws[11] and the

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[8] *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 .

[9] *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.")

[10] *See, e.g.*, G20, Declaration on Strengthening the Financial System (Apr. 2, 2009) at http://www.g20.utoronto.ca/2009/2009ifi.html.

[11] *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

DOJ takes action with respect to criminal charges.[12] The SEC and the DOJ co-operate with authorities in other jurisdictions.[13] Financial regulators enter into Memorandums of Understanding with regulators in other jurisdictions agreeing to co-operate in regulatory enforcement.[14] 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 recent speech:

> 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?[15]

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

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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

[12] *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.

[13] *See, e.g.*, Serious Fraud Office, International Strategy at http://www.sfo.gov.uk/about-us/our-policies-and-publications/international-strategy.aspx ("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.")

[14] *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 .

[15] 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[16] and Rule 10b-5[17] 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 is 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.

Rules promulgated under subsection (b) that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) and rules promulgated thereunder that prohibit fraud,

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[16] 15 USC § 78j(b).

[17] 17 C.F.R. § 240.10b-5.

manipulation, or insider trading, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities. Judicial precedents decided under section 17(a) of the Securities Act of 1933 and sections 9, 15, 16, 20, and 21A of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities.

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 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,[18] 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. 47) and published a Study on the issue in April 2012 (see below at p. 50 for excerpts).

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

Morrison v. National Australia Bank Ltd. (Supreme Court 2010)[19]

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...[20]

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

[19] 130 S. Ct. 2869 (S.Ct. 2010).

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

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.[21] 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...

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....

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[21] 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.

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"[22] -- 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...

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,

[22] This is a reference to Judge Friendly.

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. 14): “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?

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. 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.[23] But other jurisdictions have since come to appreciate the complexities of reconciling jurisdiction based on ideas of territoriality with the facts of globalization. [24]

The SDNY's judgment in Morrison[25] 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 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

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

[24] *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.")

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

the court's decision? NAB's ADRs are now traded on the "Pink Sheets" electronic platform.[26] After the Morrison decision there has been some uncertainty about whether purchasers of ADRs of foreign issuers can bring claims under s 10(b) and rule 10b-5. In **In re BP P.LC. Securities Litigation**[27] the Southern District of Texas faced claims arising out of the oil spill:

> Lead Plaintiffs are Thomas P. DiNapoli, Comptroller of the State of New York, as Administrative Head of the New York State and Local Retirement Systems and sole Trustee of New York State Common Retirement Fund, and four Ohio systems. They are the Ohio Public Employees Retirement System, the State Teachers Retirement System of Ohio, the School Employees Retirement System of Ohio, and the Ohio Police & Fire Pension Fund, along with their statutory litigation counsel, Ohio Attorney General Mike DeWine.. The NY/OH Plaintiffs bring their consolidated class action on behalf of the following proposed plaintiff class: (1) all persons and entities who purchased or acquired BP ADSs (the "ADS Purchasers")[28] ...[in] the "Class Period" ..and (2) all persons and entities who purchased or acquired BP ordinary shares in domestic transactions executed on foreign exchanges (the "Ordinary Share Purchasers") during the Class Period.

The court dismissed the claims by the ordinary share purchasers (BP shares were "registered on the NYSE, but, as Plaintiffs concede, the shares never traded on a U.S. exchange and were listed on the NYSE solely to comply with SEC requirements governing BP's ADS program") but refused to dismiss the claims by the holders of ADRs.

The facts underlying Morrison involved different jurisdictions. National Australia Bank (NAB), headquartered in Melbourne, Australia, owned HomeSide, a mortgage service provider in Florida.[29] National Australia Bank Limited is the holding company for an international financial

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[26] *See* http://www.nab.com.au/wps/wcm/connect/nab/nab/home/About_Us/20/5/. And http://www.sec.gov/answers/pink.htm .

[27] 852 F. Supp. 2d 767 (S.D. Tex. Feb. 2012).

[28] These are American Depositary Shares -- like ADRs.

[29] 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

services group and is regulated in Australia.[30] 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.[31] 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..."[32] 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 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.[33] 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

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http://www.fdic.gov/news/news/press/2008/pr08085.html .

[30] As well as National Australia Bank, the NAB Group includes MLC, Clydesdale Bank, Yorkshire Bank, Bank of New Zealand and Great Western Bank. NAB has recently opened branches in Shanghai and Mumbai. NAB Annual Review 2012 available from http://www.nab.com.au/wps/wcm/connect/nab/nab/home/about_us/20/3/8.

[31] The 2008 NAB Annual Report refers to NAB's deregistration with the SEC. This report is at http://www.nabgroup.com/vgnmedia/downld/2008AFR_Final.pdf .

[32] 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.

[33] *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 .

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)**[34]

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 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

[34] 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

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 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

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

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 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

[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. . . . [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.

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 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 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.

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

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 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

[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

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

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[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).

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 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. Homm**.[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

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

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

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 Sean Ewing and Ullrich Angersbach were the Chairman/Chief Executive Officer and Head of Investor 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?

Some US investors who buy securities issued by foreign issuers in foreign transactions may have chosen to invest offshore to avoid US taxes.[13] The Tax Division of the US Justive 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."[14] The Tax Division has concluded a deferred prosecution agreement with UBS

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[13] *Cf.* Adam Davidson, *My Big Fat Belizean, Singaporean Bank Account*, New York Times (Jul. 24, 2012) http://www.nytimes.com/2012/07/29/magazine/my-big-fat-belizean-singaporean-bank-account.html?pagewanted=all&_r=0.

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

with respect to charges that it conspired to defraud the US and the IRS.[15] 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.[16]

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 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.[17]

As mentioned above, Congress reacted to the Supreme Court's Morrison decision in the Dodd-Frank Act. An excerpt from the SEC's request for comments follows:

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

[16] 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 . *See, e.g.*, http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx ; http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-%28FATCA%29 .

[17] *See, e.g.*, Christian J. Ward & J. Campbell Barker, *Morrison v. National Australia Bank The Impact on Institutional Investors* (Feb. 2012) at http://www.cii.org/UserFiles/file/CII_Morrison_FINAL%20VERSION.pdf 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).)

SEC, Study on Extraterritorial Private Rights of Action (Request for Comments) (Oct. 25, 2010)[18]

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.[19]

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

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

[19] (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 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.

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.[20] 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?

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

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[20] (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."

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?[21] 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)[22]

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 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

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

[22] 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 .

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.[23] 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,[24] and certified a class action based on common law and statutory claims on behalf of a global class of IMAX investors. One law firm reacted to the decision as follows:

... 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

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

[24] 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).

action litigation that was sparked by the enactment of Part XXIII.1 of the Act to continue.[25]

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:[26]

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;

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

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

[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.

[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):[27]

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[28] (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,

[27] 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.

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

(a) the responsible issuer; (b) each director of the responsible issuer at the time the document was 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..[29]

[29] 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).

The Ontario statute provides that a responsible issuer means "a reporting issuer, or any other 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.[30] One is a representative action which may be used to obtain declaratory or injunctive relief, and the other is a mass settlement procedure.[31] With respect to the investors in BP who cannot bring claims in the US there is a Foundation which has been established under Article 3:305a of the Dutch Civil Code ("DCC") representing 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.[32]

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[33] state:

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[30] *See, e.g.*, US Chamber Institute for Legal Reform, Collective Redress in the Netherlands (Feb. 6, 2012) at http://www.instituteforlegalreform.com/sites/default/files/Collective_Redress_Netherlands.pdf .

[31] 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.")

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

[33] Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ

Appropriate 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.

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 harmonized principles of disclosure,[34] 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.[35] In 2011 the European Commission carried out a consultation on collective redress:[36]

Private enforcement of EU law can be pursued, first of all, by way of individual redress: natural or legal persons could initiate individually legal proceedings to enforce their EU law rights. Recent EU legislation has established accelerated procedures which allow parties to swiftly obtain an enforceable title in cross-border small and uncontested claims. Moreover, procedural guarantees are provided to parties attempting to resolve their cross-border disputes amicably through mediation. Minimum common standards relating to legal aid ensure that effective access to justice in cross-border disputes is secured independently of the claimant's financial resources. However, where the same breach of EU law harms a

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No. L 390/38 (Dec. 31, 2004) http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0057:EN:PDF .

[34] *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).

[35] In 2012 the UK Government consulted on developing collective redress in competition law. BIS, Private Actions in Competition Law: a Consultation on Options for Reform at p. 4 (Apr. 2012) at http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/p/12-742-private-actions-in-competition-law-consultation (“While the public competition authorities are at the heart of the regime, they have finite resources and cannot do everything. A greater role for private actions would complement public enforcement, enhancing the benefits of the competition regime to our economy. What is needed from Government is to create the legal framework that will empower individual consumers and businesses to represent their own interests.”)

[36] Commission Staff Working Document Public Consultation: Towards a Coherent European Approach to Collective Redress SEC(2011)173 final (Feb. 4, 2011) at http://ec.europa.eu/justice/news/consulting_public/0054/ConsultationpaperCollectiveredress4February2011.pdf.

large group of citizens and businesses, individual lawsuits are often not an effective means to stop unlawful practices or to obtain compensation for the harm caused by these practices: Citizens and businesses are often reluctant to initiate private lawsuits against unlawful practices, in particular if the individual loss is small in comparison to the costs of litigation. As a result, continued illegal practices cause significant aggregate loss to European citizens and businesses. In addition, as acknowledged by the Digital Agenda for Europe7, enforcement of EU Law in the Digital Environment appears sometimes to be difficult because of the lack of clarity on the applicable rights especially for consumers. Uncertainty and perceived difficulty to access redress is one important factor undermining confidence and thus constitutes an obstacle to the development of cross-border electronic commerce.

Moreover, where breaches of EU law do trigger multiple individual lawsuits, the procedural laws of many Member States often leave the courts ill-equipped to deal with the case load efficiently and within reasonable delay. This can be true for injunctive collective redress, but in particular for claims to obtain compensation. For these reasons, mechanisms of collective redress could be considered to remedy the current shortcomings in the enforcement of EU law.

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?