Transnational Securities Litigation In The U.S. Courts After *Morrison v. National Australia Bank:* An "F-Cubed" Regression Analysis

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"In [the U.S. Supreme Court's] restructuring of United States securities law, the Second Circuit's conduct and effect doctrine took a great fall. And neither the Plaintiffs' law horses nor this Court's pen can put the pieces together again." – Cornwell v. Credit Suisse Group, 2010 WL 3069597, at *6 (S.D.N.Y. July 27, 2010) (Marrero, J.).

I. Introduction

For more than 40 years, American trial and appellate court jurisprudence gave extraterritorial reach to section 10(b) of the U.S. Securities Exchange Act of 1934 ("Exchange Act")[2] -- the principal anti-fraud provision of that statute -- and Rule 10b-5 promulgated by the Securities and Exchange Commission thereunder.[3] Accordingly, both U.S. residents and investors from around the world engaged in U.S. federal court litigation against American and non-American companies, sometimes pertaining to alleged wrongdoing, and other times securities transactions, that occurred completely outside of the U.S. Among these litigants were Canadian plaintiffs (with Canadian investors sometimes serving as class representatives and lead plaintiffs[4]) and Canadian

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[2] 15 U.S.C. §78j(b).

[3] 17 CFR § 240.10b-5.

[4] *See, e.g., In re Cable & Wireless, PLC Sec. Litig.*, 217 F.R.D. 372, 376 (E.D. Va. 2003) (Ontario Teachers' Pension Plan Board serving as lead plaintiff); *In re Nortel Networks Corp. Sec. Litig.*, 2003 WL 22077464, at *7 (S.D.N.Y. 2003) (Ontario Public Employees' Union Pension Trust Fund serving as lead plaintiff and class representative).

defendants (including defendants with parallel securities suits pending against them in Canada).[5] In June 2010, in *Morrison v. National Australia Bank*,[6] the U.S. Supreme Court ruled that the interpretation of the U.S. securities laws underpinning the past four decades of caselaw was incorrect.

Specifically, prior to *Morrison*, in assessing whether a transnational case fell under the ambit of the Exchange Act, courts applied a so-called "conduct test" and an "effects test." U.S. courts asked: "(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."[7] In certain circumstances, courts considered an "admixture or combination" of both tests in assessing subject-matter jurisdiction.[8]

Morrison was a so-called "foreign-cubed" or "f-cubed" case,[9] in which "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."[10] In

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[5] *See, e.g.*, *Nortel*, 2003 WL 22077464, at *7 (certifying class and rejecting Nortel's argument that foreign investors who purchased on Canadian exchanges should be excluded from the class); *In re CP Ships Ltd., Sec. Litig.*, 578 F.3d 1306 (11th Cir. 2009) (approving U.S. class action settlement despite parallel Canadian action).

[6] 130 S. Ct. 2869 (June 24, 2010).

[7] *Morrison* v. *Nat'l Australia Bank*, 547 F.3d 167, 171 (2d Cir. 2008), *rev'd*, 130 S.Ct. 2869 (June 24, 2010).

[8] *See, e.g.*, *Itoba Ltd. v. Lep Group PLC*, 54 F. 3d 118, 122 (2d Cir. 1995).

[9] The term apparently originated with Stuart M. Grant and Diane Zilka, *The Role of Foreign Investors in Federal Securities Class Actions*, in PLI Corporate Law and Practice Handbook Series, No. B-1442, at 91, 96 (2004).

[10] *Morrison* v. *National Australia Bank*, 547 F.3d 167, 171 (2d Cir. 2008), *rev'd*, 130 S.Ct. 2869 (June 24, 2010).

Morrison, U.S. Supreme Court Justice Antonin Scalia's majority opinion, in the words of one judge, "stretch[ed] outside the bounds of the case so as to trash the Second Circuit's conduct and effect doctrine so unceremoniously and then fashion[ed] an entirely new rule cut out of whole cloth."[11] Justice Scalia based his rejection of the previous tests primarily on a textual analysis of the Exchange Act, but also out of concern that application of those tests, at times had seemingly led to unpredictable or even inconsistent results. Justice Scalia reasoned that the text of the Exchange Act did not reveal any extraterritorial application or intent; and he announced a new, purportedly bright-line "transactional test" that, on its face, would have application in non-"f-cubed" cases, as well. Lower courts already have had to interpret *Morrison* in a variety of different fact scenarios.

In this paper, we analyze how *Morrison* and its progeny have revolutionized the law, as well as some of *Morrison*'s possible implications, especially for Canada; and we review not only the questions that the cases have begun to answer, but also some of the questions that remain outstanding, including in a variety of "f-squared" situations.

The main question we address is: what are the outcomes of the new "transactional test" under a variety of "f-squared" or "pure f" scenarios? The cases applying *Morrison* to date have been uniform in the view that the focus of the "transactional test" is solely on the location of the transactions at issue -- and that all other factors are irrelevant.

[11] *Cornwell v. Credit Suisse Group*, 2010 WL 3069597, at *5 (S.D.N.Y. July 27, 2010) (Marrero, J.), *reconsideration denied*, 2010 WL 3291800 (S.D.N.Y. Aug. 11, 2010), *mot. for certification of appeal denied*, 2010 WL 3825695 (S.D.N.Y. Aug. 20, 2010).

Thus, cases involving exchange-based transactions seem easily predictable, as courts have looked at the location of the exchange upon which the transactions occurred. Cases involving non-exchange-based securities transactions, in contrast, are more complicated, as they depend on more thorough and nuanced evaluations of the facts. We will also consider *Morrison*'s impact beyond the Exchange Act and how *Morrison* may affect securities litigation by Canadians and in Canada.

II. The Extraterritorial Reach of U.S. Securities Laws Before *Morrison*

Given its significant economic ties with the U.S., it is perhaps not surprising that Canada played a starring role in the opening act of transnational securities jurisprudence in the U.S. In *Schoenbaum v. Firstbrook*, a U.S. investor brought a shareholder derivative action for insider trading under the Exchange Act. The *Schoenbaum* plaintiffs alleged that a Canadian oil company had sold treasury stock to its controlling shareholder, another Canadian corporation, while that controlling shareholder possessed material non-public information about the issuer's business. The company's stock traded on both the Toronto Stock Exchange and the American Stock Exchange.

The District Court dismissed the case for a lack of subject-matter jurisdiction because all of the relevant conduct had taken place in Canada:

> It is a standard canon of construction that "legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States. It is based on the assumption that Congress is primarily concerned with domestic conditions." In the two cases where this Court has considered the extra-territorial effect of the Exchange Act, it has held that there is nothing in the statute or its legislative history suggesting that the statute was

designed to apply outside the territorial jurisdiction of the United States.[12]

The District Court supported this view by referencing section 30(b) of the Exchange Act, which provides:

> The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person in so far as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.[13]

The District Court reasoned that the Exchange Act's inapplicability to securities transactions outside of the U.S followed logically from section 30(b)'s exception for persons transacting a business in securities outside of the U.S.[14]

The United States Court of Appeals for the Second Circuit also ultimately dismissed the substantive allegations -- but it disagreed as to the existence of, and test for determining, the federal courts' subject matter jurisdiction to hear a Section 10(b) claim. The Second Circuit held that the Exchange Act *did* apply to extraterritorial transactions -- and, in the process, for the first time enunciated the "effects test." The Court reasoned 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."[15] Rather, according to the Court: "Congress intended

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[12] *Schoenbaum v. Firstbrook*, 268 F. Supp. 385, 392 (S.D.N.Y. 1967) (citations omitted), *aff'd in part, rev'd in part*, 405 F.2d 200 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969).

[13] 15 U.S.C. § 78dd(b).

[14] *Schoenbaum*, 268 F. Supp. at 392.

[15] 405 F.2d 200, 206 (2d Cir. 1968).

the Exchange Act to have extraterritorial application *in order to protect domestic investors* who have purchased foreign securities on American exchanges and *to protect the domestic securities market from the effects* of improper foreign transactions in American securities."[16]

The introduction of the "conduct test" came in 1972 in *Leasco Data Processing Equipment Corp. v. Maxwell*[17] -- the first of several Second Circuit decisions concerning the extraterritoriality of the securities law by the eminent jurist, Judge Henry Friendly. In *Leasco*, an American company had been fraudulently induced to buy shares of a British company on the London Stock Exchange. Much of the conduct associated with the fraud had occurred in the U.S. Like *Schoenbaum* before, Judge Friendly disregarded the presumption against extraterritoriality. He reasoned that even if the Exchange Act lacked the "clearest language" on the issue of extraterritoriality, the intent of Congress could nevertheless be gleaned.[18] According to Judge Friendly, "[I]f Congress had thought about the point," it would have wished the Exchange Act to cover such significant fraudulent conduct perpetrated upon its soil.[19]

Judge Friendly elaborated further on this point in another Canadian-related case, *Bersch v. Drexel Firestone, Inc.*[20]:

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[16] *Id.* at 217 (emphasis added).

[17] 468 F.2d 1326 (2d Cir. 1972).

[18] *Id.* at 1334-1337. Judge Friendly used the example of fraudulent misrepresentations about securities of a "mine in Saskatchewan" to illustrate Congress' intent.

[19] *Id.* at 1337.

[20] 519 F.2d 974 (2d Cir. 1975). In *Bersch*, the Court found that there was "effects"-based jurisdiction in connection with Canadian offerings. Plaintiff Bersch was one of only 386

> [I]f we were asked to point to the language in the statutes, or even in the legislative history, that compelled these conclusions, we would be unable to respond. The Congress that passed these extraordinary pieces of legislation in the midst of the depression could hardly have been expected to foresee the development of off-shore funds thirty years later…. Our conclusions rest on case law and commentary concerning the application of the securities laws and other statutes to situations with foreign elements and on our best judgment as to what Congress would have wished if these problems had occurred to it.[21]

Justice Scalia identified *Bersch* and its twin case, *IIT v. Vencap, Ltd.*[22] (decided at the same time) as marking the beginning of inconsistent application of U.S. securities laws.[23] In *Bersch*, Judge Friendly determined that there was insufficient *conduct* to apply the Exchange Act "where the United States activities are merely preparatory or take the form of culpable nonfeasance and are relatively small in comparison to those abroad."[24] Judge Friendly articulated the rationale for this view in *Vencap*: "We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners." [25]

Americans -- out of roughly 10,000 investors world-wide -- who bought stock in a Canadian corporation which subsequently went bankrupt. The Canadian corporation's shares were not traded on any American exchange; efforts were made to prevent the sale of stock to any Americans; and the prospectuses stated that the offerings had not been registered under U.S. securities laws. Nonetheless, Judge Friendly found that there was subject matter jurisdiction under the "effects test" because the prospectuses had somehow been sent to a number of American investors.

[21] *Id.* at 993. In *Morriso*n, Justice Scalia seized upon this candid acknowledgement by Judge Friendly that such an intent-based formulation of the law lacked textual support in the Exchange Act or its accompanying rules, as justification for overruling *Bersch* and its line of precedent. *See Morrison*, 130 S. Ct. at 2879.

[22] 519 F.2d 1001 (2d Cir. 1975).

[23] *Morrison*, 130 S. Ct. at 2879.

[24] *Bersch*, 519 F.2d at 987.

[25] *Vencap*, 519 F.2d at 1017.

In subsequent cases, courts grappled with the legacy and application of these tests, including introducing the additional test of an "admixture or combination" of the "conduct" and "effects" tests, because this test "often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court."[26] In addition, a split developed among the Circuits regarding the nature and extent of U.S.-based conduct that would be necessary for the exercise of jurisdiction. One court summarized the split as follows: "The Second, Fifth and Seventh Circuits adopted a restrictive approach, requiring that the domestic conduct be material to the fraud's success, while the Third, Eighth, and Ninth Circuits adopted a more lenient standard that required only some 'significant' domestic conduct."[27] The D.C. Circuit also deferred to the Second Circuit's test because of the latter's "preeminence in the field of securities law" -- but not without reservation -- in *Zoelsch v. Arthur Andersen & Co.*[28] In that case, Judge Robert Bork foreshadowed Justice Scalia's opinion in *Morrison* by expressing doubt as to the courts' "divining what 'Congress would have wished' if it had addressed the problem" and observing that "[a] more natural inquiry might be what jurisdiction Congress in fact thought about and conferred."[29]

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[26] *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 122 (2d Cir. 1995).

[27] *In re Banco Santander Sec.-Optimal Litig.*, 2010 WL 3036990, at *5 (S.D. Fla. July 30, 2010) (citations omitted).

[28] 824 F.2d 27, 29-32 (D.C. Cir. 1987).

[29] *Id.* at 32.

III. ***Morrison v. National Australia Bank***

National Australia Bank ("NAB") is an Australian bank whose ordinary shares traded on exchanges only outside the U.S.[30] -- but whose American Depository Receipts ("ADRs")[31] traded on the New York Stock Exchange ("NYSE"). In 1998, NAB purchased HomeSide Lending, Inc. ("HomeSide"), a company based in Florida that serviced mortgages. After years of bullish public statements about HomeSide's success, NAB announced a write-down of HomeSide's assets by more than $2 billion in 2001. The prices of NAB's shares and ADRs fell, allegedly in response to this news.

a. The District and Circuit Court Decisions: The Twilight of the "Conduct" and "Effects" Tests

A putative class action was brought in the Southern District of New York, on behalf of all worldwide purchasers of NAB securities against NAB, HomeSide and various executives of both companies, for alleged violations of sections 10(b) and 20(a)

[30] NAB's shares traded on the Australian Securities Exchange, the London Stock Exchange, the Tokyo Stock Exchange and the New Zealand Stock Exchange.

[31] "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." *In re Nat'l Australia Bank Sec. Litig.*, 2006 WL 3844465, at *1 n.3 (S.D.N.Y. Oct. 25, 2006) (citing *Pinker v. Roche Holdings Ltd.*, 292 F.3d 361, 367 (3d Cir. 2002)); *see also* American Depository Receipts, Securities Act Release No. 6894, Exchange Act Release No. 29226, 1991 WL 294145 (May 23, 1991) (discussing the underlying deposited securities).

of the Exchange Act.[32] The complaint alleged that the defendants fraudulently manipulated HomeSide's financial models to make the mortgage servicing rights appear more valuable than they actually were, and that this artificially inflated the price of NAB's securities.

Robert Morrison, an American investor who had purchased NAB's ADRs, sought to serve as lead domestic plaintiff representing ADR purchasers. His claims were dismissed by the District Court for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6) because he failed to adequately plead damages.[33] Morrison did not appeal, nor did the other plaintiffs avail themselves of the leave granted to substitute a new lead domestic plaintiff.

After Morrison's claims were dismissed, the District Court had to evaluate whether federal court jurisdiction remained, for what was now a purely "f-cubed situation": (1) Australian plaintiffs whose (2) ordinary shares had been purchased only on exchanges outside of the U.S., and who were (3) suing an Australian company. Absent any viable ADR claims, the "effects test" was not satisfied.[34] Nor was there sufficient "conduct" for the District Court to exercise jurisdiction, as the acts within the U.S.

[32] 15 U.S.C. § 78t(a). Under § 20(a), "control person" liability for a violation of § 10(b) (or another provision), may be imposed upon a person who does not engage in the primary violation of Section 10(b) but who "directly or indirectly, controls any person liable under any provision of [the Exchange Act]," "unless the controlling person acted in good faith and did not directly or indirectly induce the act or act constituting the violations or cause of action." A discussion of the "culpable participation" test for such liability (*see, e.g.*, *Boguslavsky v. Kaplan*, 159 F.3d 715, 720 (2d Cir. 1998)) is beyond the scope of this paper.

[33] *In re Nat'l Australia Bank Sec. Litig.*, 2006 WL 3844465, at *9 (S.D.N.Y. Oct. 25, 2006).

[34] *Id.* at *4.

represented "at most, a link in the chain of an alleged overall securities fraud scheme that culminated abroad."[35]

On appeal, the Second Circuit affirmed the dismissal. Plaintiffs' arguments on appeal only addressed the "conduct test."[36] The Second Circuit rejected those arguments, agreeing that the defendants' acts in the U.S. did not "compris[e] the heart of the alleged fraud."[37] While the Second Circuit recognized the novelty of its first "f-cubed" case, it eschewed the request of the defendants and various *amici curae* to bar all "f-cubed" cases.[38] The U.S. Supreme Court, in the exercise of its discretion, granted *certiorari*.

b. Morrison at the Supreme Court: Justice Scalia's "Transactional" Revolution

While it was not surprising that the Supreme Court agreed to hear the case (given the above-referenced split in the Circuits) -- or indeed that the Court upheld the dismissal -- the Court's holding and rationale were far from expected. One might have anticipated a response like that of Justice John Paul Stevens in his concurrence, adopting the existing tests, recognizing their genesis from the "'Mother Court' of securities law" (the Second Circuit) and their long-time application.[39] But Justice Scalia's majority opinion instead chose to overrule the previous jurisprudence and to announce a new "transactional test"

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[35] *Id.* at *8.

[36] *Morrison* v. *Nat'l Australia Bank*, 547 F.3d 167, 171 (2d Cir. 2008).

[37] *Id.* at 175-176.

[38] *Id.* at 174-175.

[39] *Morrison*, 130 S. Ct. at 2989 (Stevens, J., concurring).

that by its terms extended beyond the "f-cubed" scenario.

First, Justice Scalia examined whether this was a question of "subject matter jurisdiction" at all. The prior case law had analyzed this as a question of jurisdiction under Federal Rule of Civil Procedure 12(b)(1). Justice Scalia rejected such analysis and instead viewed the question as whether a claim had been stated under Rule 12(b)(6).[40]

The Court then held: "[T]here is no affirmative indication in the Exchange Act that § 10(b) applies extraterritorially, and we therefore conclude it does not."[41] The majority decision found fault in the prior Circuit Court decisions for having inferred some Congressional intent that section 10(b) should apply extraterritorially and for having failed to defer to the presumption against extraterritoriality. Justice Scalia noted various judicial and academic criticisms of the "unpredictable and inconsistent application of § 10(b) in transnational cases."[42] He then wrote:

> 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.[43]

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[40] *See id.* at 2876-2877 (Scalia, J.). The distinction is not academic. For example, if the issue is failure to state a claim, a defendant who does not move against or answer the complaint may be subject to entry of a default judgment against it. A court without subject matter jurisdiction would not have authority to enter a default judgment. *See Cedeno v. Intech Group, Inc.*, 2010 WL 3359468, at *3 and n.4 (S.D.N.Y. Aug. 25, 2010). That Court, relying on *Morrison*, held that the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968, did not reach extraterritorial conduct and granted the appearing defendants' motion to dismiss -- but it entered a default judgment against non-appearing defendants.

[41] *Morrison*, 130 S. Ct. at 2883.

[42] *Id.* at 2880-2881 (citations omitted).

[43] *Id.* at 2881.

The majority continued:

> 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.[44]

In support of this conclusion, Justice Scalia also provided a textual analysis of the statute. Drawing on the aforementioned acknowledgment by Judge Friendly and others as to the absence of language of extraterritorial application in that Exchange Act provision, Justice Scalia emphasized that nothing in section 10(b) suggests that it applies abroad. As *Schoenbaum* had done, Scalia examined section 30(b) of the Exchange Act:

> [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"?[45]

He added that in contrast to section 10(b), Congress had demonstrated that it knew how to indicate extraterritorial application when it wanted to, in section 30(a), by applying the Exchange Act to broker-dealers who contravene the statute in transactions in securities of U.S. companies on foreign exchanges.[46] To further punctuate his conclusion about the lack of textual support for extraterritorial application in the Exchange Act, Justice Scalia also reached out to and addressed the Securities Act,[47] emphasizing that it, too, does not have extraterritorial application:

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[44] *Id*. at 2884.

[45] *Id.* at 2882.

[46] *See id.* at 2883.

[47] 15 U.S.C. §§ 77a – 77bbbb.

> The same focus on domestic transactions is evident in the Securities Act of 1933, 48 Stat. 74, enacted by the same Congress as the Exchange Act, and forming part of the same comprehensive regulation of securities trading. *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 170-171, 114 S. Ct. 1439, 128 L.Ed.2d 119 (1994). 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. 15 U.S.C. § 77e(a)(1). The Commission has interpreted that requirement "not to include ... sales that occur outside the United States." 17 CFR § 230.901 (2009).[48]

Finally, the majority opinion imposed a new "transactional test" to fit the foregoing interpretation of the statute: section 10(b) will only apply if a "purchase or sale [of a security] is made in the United States, or involves a security listed on a domestic exchange."[49] Justice Scalia also offered an alternative formulation of the test: "it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which §10(b) applies."[50] In support of this test, he also referred to the "obvious" "probability of incompatibility with the applicable laws of other countries," under the "conduct" and "effects" tests, as demonstrated by the number of *amicus* briefs filed by foreign governments (not including Canada) and foreign industry associations, urging the Court to adopt a "clear" rule against extraterritorial application.[51]

In response to Justice Scalia's scathing criticisms, Justice Stevens' concurrence defended the rationale and history of the "conduct" and "effects" tests. Justice Stevens

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[48] *Morrison*, 130 S. Ct.at 2885. For a fuller analysis of *Morrison*'s impact on the Securities Act, *see* Prof. John C. Coffee, Jr., *What Hath "Morrison" Wrought?*, 9/16/2010 N.Y.L.J. 5 (col. 2).

[49] *Morrison*, 130 S. Ct. at 2886.

[50] *Id*. at 2884.

[51] *Id.* at 2885-2886.

noted that U.S. securities law is replete with "judge-made-rules" which had been countenanced in many prior Supreme Court cases, citing specifically to the fact that the Supreme Court had in fact read-in an implied right of action to Rule 10b-5 itself and had thereafter fashioned the contours of the same.[52] Justice Stevens also cautioned that American investors and the Congress that passed the Exchange Act would be shocked and dismayed at the effect of the majority's opinion. And he suggested scenarios, highlighting the possible impact of the new "transactional test":

> 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).[53]

Justice Scalia did not respond to this point. Nonetheless, it did not take long for Justice Steven's hypotheticals to approach or become jurisprudential reality.

IV. *Morrison*'s Progeny: Placing the Focus on the Location of the Transaction

A host of decisions have been issued in the approximately four months since *Morrison* was decided, as numerous parties have moved for reconsideration of rulings denying dismissal or have supplemented their briefing on pending motions to dismiss. And a clear consensus has emerged that "the Court [in *Morrison*] was concerned with the

[52] *Id.* at 2889.

[53] *Id.* at 2895.

territorial location where the purchase or sale was executed…. § 10(b)'s focus would not encompass purchases and sales of covered securities that occur outside of the United States," regardless of other factors urged by plaintiffs.[54] This test has been fairly easily and consistently applied to exchange-based transactions. For non-exchange-based transactions, however, it has implicated a more complex, fact-specific inquiry.

a. "Transactional Test" Outcomes – Exchange-Based Transactions

As *Morrison* was an "f-cubed" case, it was initially unclear what the decision would mean for "f-squared" actions. Although there are several "f-squared" permutations, the most frequently litigated one in post-*Morrison* cases involves a *U.S.* plaintiff suing (1) a foreign company for alleged violations of U.S. securities laws with respect to (2) securities transactions on a foreign exchange. In this first wave of post-*Morrison* cases, U.S. resident plaintiffs in pending cases have repeatedly: (i) argued that any language in *Morrison* (which involved Australian plaintiffs) applying the new transactional test to dismiss claims of U.S. resident purchasers was dictum; (ii) sought to exploit a professed ambiguity in the "transactional test" from Justice Scalia's silence as to any precise definition of a "domestic transaction" (in the second prong of his test); and seized on his reference, in the first prong, to "securities *listed* on a domestic exchange"[55] (or "any security *registered* on a national securities exchange"[56]) to describe securities that could be the subject of a § 10(b) claim. Decisions of the district courts have not been

[54] *In re Alstom SA Sec. Litig.*, 2010 WL 3718863, at *3 (S.D.N.Y. Sept. 14, 2010).

[55] *Morrison*, 130 S.Ct. at 2884.

[56] *Id*. at 2885 n.10.

receptive to plaintiffs' arguments in this regard; and to date, the appellate courts have not had occasion to weigh in on these arguments.

1. The Courts Have Dismissed Claims of U.S. Residents Who Purchased Securities on Foreign Exchanges

The first post-*Morrison* "f-squared" decision arose out of a motion for appointment of lead plaintiff in a putative securities class action -- not a motion to dismiss the complaint -- in *Stackhouse v. Toyota Motor Co.*,[57] which involved Toyota's alleged failure to disclose supposed design defects in accelerators. The "transactional test" was implicated because the common stock of Toyota trades only on the Tokyo Stock Exchange, but its ADRs trade on the NYSE. With respect to what constitutes a "domestic transaction," the court opined (with a certain internal inconsistency) on different views that could, and should, be asserted as to its meaning:

> One view of the Supreme Court's holding is that if the purchaser or seller resides in the United States and completes a transaction on a foreign exchange from the United States, the purchase or sale has taken place in the United States. However, *an alternative view is that because the actual transaction takes place on the foreign exchange, the purchaser or seller has figuratively traveled to that foreign exchange – presumably via a foreign broker – to complete the transaction*. Under this second view, "domestic transaction" or "purchase[s] or sale[s]… in the United States" means purchases and sales of securities explicitly solicited by the issuer within the United States rather than transactions in foreign-traded securities where the ultimate purchases of seller has physically remained in the United States."[58]

The Court reasoned that the latter position was better supported by *Morrison*, because the Supreme Court had emphasized that the Exchange Act did not apply to claims of purchasers on foreign exchanges. As a result, the Court appointed the Maryland State

[57] 2010 WL 3377409 (C.D. Cal. July 16, 2010).

[58] *Id*. at *1 (emphasis added).

Retirement and Pension System as lead plaintiff, as it had alleged the largest ADR (i.e., on-a-U.S.-exchange) loss. The *Toyota* Court expressly limited its ruling to the issue of appointment of a lead plaintiff.[59]

Almost immediately thereafter, Judge Victor Marrero of the U.S. District Court for the Southern District of New York authored a much broader opinion. In *Cornwell v. Credit Suisse Group*,[60] Judge Marrero granted a motion to dismiss claims of U.S. residents who had purchased Credit Suisse Group ("CSG") common stock on the Swiss Stock Exchange ("SWX") (although the action was not dismissed in its entirety, because persons who purchased CSG ADRs on the NYSE continued to have viable post-*Morrison* claims). The SWX purchaser-plaintiffs argued that *Morrison*'s reach was limited to "f-cubed" cases (as that was all that the Supreme Court had before it in *Morrison*); and that the "conduct" and "effects" tests essentially remained applicable to "f-squared" cases, where "f-squared" was a foreign issuer and a foreign exchange, and the missing f-factor was a foreign purchaser. The SWX plaintiffs argued that they had viable claims because each had "made an investment decision and initiated a purchase of CSG from the U.S." and "took the CSG stock into its own account in the U.S. and incurred an economic risk in the U.S." Judge Marreo disagreed, citing *Toyota* and opining:

> The Supreme Court roundly (and derisively) buried the venerable "conduct or effect" test…. Yet here, Plaintiffs seek to exhume and revive the body…. Plaintiffs' cosmetic touch-ups will not give the corpse a new life. The standard the *Morrison* Court promulgated to govern the application of § 10(b) in

[59] *Id.* at *1.

[60] 2010 WL 3069597, at *8 (S.D.N.Y. July 27, 2010), *reconsideration denied*, 2010 WL 3291800 (S.D.N.Y. Aug. 11, 2010), *mot. for certification of appeal denied*, 2010 WL 3825695 (S.D.N.Y. Aug. 20, 2010).

> transnational securities purchases and sales does not leave open any of the back doors, loopholes or wiggle room to accommodate the distinction Plaintiffs urge to overcome the decisive force of that ruling on their § 10(b) claims here.[61]

Judge Marrero then interpreted and summarized *Morrison* as holding that: "[Section] 10(b) would not apply to transactions involving (1) a purchase or sale, wherever it occurs, of securities listed only on a foreign exchange, or (2) a purchase or sale of securities, foreign or domestic, which occurs outside the United States."[62] This latter comment also strongly suggested that another type of "f-squared" plaintiff -- (1) foreign purchasers of U.S. companies' securities (2) on foreign exchanges (or in foreign transactions) -- no longer have viable claims, either.

Thus far, courts and litigants (albeit the decisions directly on point have issued only from the Southern District of New York) have "uniformly" agreed with *Credit Suisse*'s interpretation of *Morrison* as holding that transactions in securities traded on a foreign exchange -- regardless of the issuer, or where else the securities may trade -- do not fall within the reach of the Exchange Act, regardless of the location of the investors.[63] In *Sgalambo v. McKenzie,*[64] the parties conceded and the court accepted -- citing *Credit Suisse* -- that *Morrison* barred claims of all who purchased shares of the defendant Canadian Superior Energy Inc. ("Canadian Superior") on the Toronto Stock Exchange

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[61] *Id*. at *2.

[62] *Id*. at *3.

[63] *See Cornwell v. Credit Suisse Group*, 2010 WL 3825695, at *1 (Aug. 20, 2010) (Marrero, J.) (denying motion for certification of appeal and collecting cases).

[64] 2010 WL 3119349 (S.D.N.Y. Aug. 6, 2010) (Scheindlin, J.).

("TSX") regardless of whether they were U.S. residents or foreigners.[65] Indeed, the Court so ruled based on the situs of the transactions, notwithstanding the fact that Canadian Superior shares were also "listed" on the American Stock Exchange and *Morrison*'s "first prong" had referenced whether the shares were "listed" on a U.S. exchange.[66] In *Terra Securities ASA Konkursbo v. Citigroup, Inc.*,[67] Judge Marrero referenced his previous decision in *Credit Suisse* and dismissed the § 10(b) claims of Norwegian and Italian plaintiffs on the ground that the shares in the funds at issue were purchased in transactions on the Irish Stock Exchange.

Most recently, the Court in *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*,[68] dismissed § 10(b) claims by a U.S. resident lead plaintiff on behalf of a putative class of U.S. residents and citizens where the common shares at issue were only listed on the SWX and were traded on the virt-x exchange (later known as the SWX Europe), a London-based subsidiary of the SWX. The Court provided a succinct summary of what is *irrelevant* to the "transactional test":

> 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. *Nothing in*

[65] *Id.* at *17.

[66] In the case of a dual-listed security, if the "locus of the purchase" controls, then even if the named plaintiff bought on a U.S. exchange, others who purchased only on the foreign exchange should not be included in the class, since: (i) they could not personally state a claim and (ii) under the Rules Enabling Act, 28 U.S.C. § 2072(b), a Federal Rule of Civil Procedure (such as Rule 23, governing class actions) cannot "abridge, enlarge or modify any substantive right."

[67] 2010 WL 3291579, at *4-*5 (S.D.N.Y. Aug. 16, 2010).

[68] 2010 WL 3860397, at *6-*10 (S.D.N.Y. Oct. 4, 2010) (Koeltl, J.) (citing *Credit Suisse* and *Toyota*).

> *Morrison or the text of the Exchange Act allows for any identity-based inquiry in determining the location of a transaction.*
>
> ***
>
> For the same reasons, *the fact that an investor may have decided to purchase a stock in the United States has no bearing on where the stock was ultimately purchased.*
>
> ***
>
> Similarly, *the location of the harm to a plaintiff is independent of the location of the securities transaction that produced the harm*. Just as the situs of a defendant's allegedly deceptive conduct is irrelevant to the transactional test, so too is the situs of a plaintiff's alleged injury.
>
> ***
>
> The place from which [plaintiffs'] traders placed [plaintiffs'] orders or executed the trades also does not affect the location of [plaintiffs'] purchase, for the reasons discussed above. For the purposes of determining whether a securities transaction is a "domestic" transaction under *Morrison*, the country in which an investor happened to be located at the time that it placed its purchase order is immaterial.[69]

While the above line of authorities appears at first blush to symbolize doom for "f-squared" plaintiffs, it does nonetheless strongly suggest that certain "f-squared" claims do remain viable: specifically, claims arising out of U.S.-exchange-based transactions in dual listed common stock or, more typically, in U.S.-exchange listed and traded ADRs of foreign issuers, remain viable even after *Morrison*, even if the plaintiff purchaser is foreign; indeed, defendants have conceded this issue in many of the referenced cases and in others. Unfortunately for class action plaintiffs (or their counsel), however, ADRs do not generally trade at anywhere near the volume of foreign-traded common shares; and ADR claims alone thus are generally likely to yield much smaller damages and might not provide sufficient economic incentive to bring these cases to court. For instance, in

[69] *Id.* at *9-*10 (all emphasis added).

Toyota, the court, in appointing the Maryland State Retirement and Pension System as lead plaintiff, noted that its *non*-ADS damage claim was between eight and seventeen million dollars, whereas its ADS loss -- the largest alleged by any putative class representative -- was only $257,577.33.

2. U.S. "Listing" and "Registering" of Common Shares Underlying ADR Programs Should Not Be "Trojan Horses," Providing Entry to U.S. Courts for Claims Arising Out of Foreign Purchases of Those Common Shares

Plaintiffs have also tried to use the structure of certain ADR programs as a backdoor to establish the viability of securities law claims arising out of purchases of other classes of foreign-exchange-traded securities -- in particular, the ADR issuer's common stock. Many issuers have sponsored ADR programs where, in addition to registering and listing the ADRs themselves on a U.S. exchange, the issuers register the underlying common shares with the S.E.C and list such shares on a U.S. exchange, although *not* for trading. These common shares are held by the depositary bank to support any conversion of the ADRs into common shares tradable on the foreign exchange.[70] In a number of cases involving such ADR programs, plaintiffs have argued that such listing of the underlying common shares on a U.S. exchange opens the door for claims based on purchases of common shares of that class in transactions on foreign exchanges, under the test articulated in *Morrison*. Specifically, they have argued that viable claims can be stated as to purchases of common stock on exchanges outside of the U.S. because: (i) Justice Scalia, in the first prong of his test, referred to § 10(b) applying

[70] *See, e.g.*, Deutsche Bank Group, *Depositary Receipt Services* (2009), https://adr.db.com/drweb/public/en/content/faqs_by_investors.html; *see also* n. 31, *supra*.

to claims arising out of securities that are "listed" or "registered" on U.S. exchanges, and (ii) common stock is registered or listed to support these ADR programs, even though such listed common shares *cannot* be *traded* on the exchange on which they are listed.

One such case was *In re Alstom SA Securities Litigation*.[71] Plaintiffs there argued that the registration and listing (but not trading) of Alstom's common stock on the NYSE -- to support the listing and trading of Alstom's ADRs on the NYSE -- made transactions in Alstom's ordinary shares on the Euronext in Paris subject to § 10(b) claims. Judge Marrero rejected these arguments as "a selective and overly-technical reading of *Morrison* that ignores the larger point of the decision;" and he dismissed the claims of plaintiffs who purchased ordinary shares on foreign exchanges.[72] The District Court explained that the Supreme Court test in *Morrison*, was not directed at "the stock exchange where ministerial pre-purchase activities were directed;" rather:

> *the Court was concerned with the territorial location where the purchase or sale was executed* and the securities exchange laws that governed the transaction. The "statute's solicitude" is directed at "transactions" and the statute seeks to "regulate" "transactions." *That the transactions themselves must occur on a domestic exchange to trigger application of § 10(b) reflects the most natural and elementary reading of Morrsion.*[73]

In *Morrison*, Justice Scalia did not provide or reference -- and to our knowledge, no court has yet considered -- any definitions of "listed" in connection with their analyses. However, were they to do so, we believe that the relevant definitions support the conclusion reached in *Alstom*. Both the definition of "listed" in the S.E.C. regulations

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[71] 2010 WL 3718863 (S.D.N.Y. Sept. 14, 2010).

[72] *Id.* at *2.

[73] *Id.* at *2-3 (emphasis added, citation omitted).

promulgated under the Exchange Act and the common meaning of "listed security" militate against the common-stock-underlying-the-ADRs-as-a-Trojan-horse argument -- because both refer to *trading* as the determinative factor in "listing." Specifically, the S.E.C. defines "listed" as "*admitted to full trading privileges*."[74] Similarly, Black's Law Dictionary defines a "listed security" as "[a] security *accepted for trading on a securities exchang*e."[75] As the common stock underlying many ADRs is not listed for trading, but instead is merely listed for technical purposes, such listing should not fall within the ambit of *Morrison*'s "transactional test" and, thus, should not support viable U.S. securities law claims arising out of non-U.S.-purchases of such common stock.[76]

b. "Transactional Test" Outcomes – Non-Exchange-based Transactions

Outside of the exchange-based transaction context, a close examination of all of the facts becomes quite important in applying the "transactional test." Judge Marrero recognized as much in *Anwar v. Fairfield Greenwich Ltd.*[77] That case involves plaintiffs of unspecified national origin suing certain of Bernie Madoff's so-called feeder funds.

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[74] 17 C.F.R. 240.3b-1 (emphasis added).

[75] BLACK'S LAW DICTIONARY 1477 (9th ed. 2009) (emphasis added).

[76] Defendants in *In re Satyam Computer Serv. Ltd. Sec. Litig*., No. 09 MD 2027 (BSJ) (S.D.N.Y.), have recently raised such arguments in connection with a recently-briefed motion to dismiss under *Morrison*. Satyam's common stock traded only on Indian stock exchanges; but Satyam maintained an American Depository Share program, by which American Depository Shares were listed and traded on the NYSE, and its common shares were listed but did *not* trade. Weil is counsel in that action for the former outside director defendants; and author Irwin H. Warren is the lead partner.

[77] 2010 WL 3341636 (S.D.N.Y. Aug. 18, 2010).

The funds at issue were listed on the Irish Stock Exchange but did not have an active trading market. Their operations were not based in the U.S., but they had a U.S. head office where, it is alleged, the investors' subscriptions were processed: therefore plaintiffs asserted that the relevant transactions took place within the U.S. In the face of these complex and unclear facts, Judge Marrero deferring ruling, rather than granting a motion to dismiss the Exchange Act claims:

> As this case allegedly does not involve securities purchases or sales executed on a foreign exchange, it presents a novel and more complex application of *Morrison* 's transactional test. Given the uniqueness of the financial interests, structure of the transactions and relationships among the parties, the Court finds that a more developed factual record is necessary to inform a proper determination as to whether Plaintiffs' purchases of the Offshore Funds' shares occurred in the United States.[78]

In another non-exchange case, albeit also dealing with Madoff -- *In re Banco Santander Securities Optimal Litigation*[79] -- the Court provided some insight into what facts a court would *not* consider as part its analysis. There, foreign plaintiffs who invested in the Optimal investment funds based in the Bahamas, which in turn invested in Madoff feeder funds, sued various financial institutions connected with those Bahamian investment funds. The only American defendants named were a Florida-based subsidiary of Banco Santander and PricewaterhouseCoopers LLP. Plaintiffs asserted various causes of action including § 10(b) claims, associated with the defendants' alleged breaches of duties to the plaintiffs by their alleged failure to perform adequate due diligence and ignoring supposed red flags about Madoff's activities. The Court dismissed the § 10(b)

[78] *Id.* at *19.

[79] 2010 WL 3036990 (S.D.Fla July 30, 2010).

claims on the basis of *Morrison*, because "the Plaintiffs neither purchased shares on an American stock exchange, nor did they purchase shares in the United States. They made off-shore purchases in off-shore Bahamian investment funds closed to United States investors."[80] Of note, the *Banco Santander* Court also disagreed with arguments raised about plaintiffs' intent to ultimately own U.S. securities through the referenced investment procedures, stating:

> [L]ooking to the subjective intent of foreign investors to determine whether the securities act applies is clearly contrary to *Morrison*…. Adopting the unpredictable and subjective criterion suggested by the Plaintiffs (i.e., a foreign investor's intent to ultimately own United States securities) would eliminate the doctrinal clarity that the Supreme Court provided in *Morrison*.[81]

Similarly, in *Quail Cruises Ship Management Ltd. v. Agencia De Viagens CVC TUR Limitada*, [82] Bahamian plaintiffs asserted § 10(b) claims against various defendants (most of whom were foreign, but some of whom were American individuals and companies) arising out of a transaction in off-shore securities which resulted in plaintiffs acquiring a Bahamian corporation whose principal asset was a foreign-flagged ship. The *Quail Cruises* plaintiffs argued that the case involved a U.S. transaction because the parties intended the closing to occur at the Miami office of the U.S. law firm for one of the parties. The Court dismissed this argument, and the case, citing *Banco Stantander*'s

[80] *Id.* at *5.

[81] *Id.* at *6.

[82] 2010 WL 3119908 (S.D. Fla. Aug. 6, 2010).

holding about the irrelevance of the parties' intent and explaining that this was essentially an "f-cubed" case.[83]

Most recently, *Morrison* was applied to uphold fraud claims (as proved by the S.E.C.) on motion for summary judgment. In *S.E.C. v. Credit Bancorp, Ltd.*,[84] the Court declined to overturn a prior § 10(b) judgment against defendant Thoman Rittweger. Rittweger argued that fraudulent transactions had occurred in Europe, thus barring the claims under *Morrison*. The Court found that *Morrison* was satisfied because, *inter alia*, the purchasers sent their investment agreements and the stock certificates in question to the defendants in New Jersey for receipt and investment: "This exchange served as the transaction through which investors joined the… Program…. Plainly, the transactions of securities through which domestic investors entered the… Program… took place within the United States."[85]

[83] *Id.* at *2-*3. *Accord*, *Tradex Global Master Fund SPC Ltd v. Rieden*, slip op., No. 09 CV 6395 (S.D.N.Y. July 23, 2010) (Daniels, J.). Plaintiff, a British Virgin Islands entity, had invested in a Bahamian company, which in turn invested in a Cayman Islands entity, which in turn invested in Madoff funds. The complaint asserted only state common law claims; but plaintiff sought leave to amend, to drop the state law claims and assert federal securities claim. The court, in a brief order, denied the motion as "futile," in light of *Morrison*'s "transactional test": the "amended complaint involves no securities listed on a domestic exchange, nor any securities purchased in the United States." Slip op. at 2.

[84] 2010 WL 3582906 (S.D.N.Y. Sept. 13, 2010), *order adhering* (Sept. 30, 2010) (Sweet, J.).

[85] *Id.* at * 20 (The Court also held that as the securities were "listed on domestic exchanges," that the *Morrison* test was met, as well. *Id.* at *20.)

c. "Transactional Test" Outcomes – Some Outstanding Issues

The foregoing cases remain the tip of the iceberg of the post-*Morrison* era. The courts are already faced with (and can expect many other) novel arguments and fact situations to present themselves for resolution. Distinguishing exchange-based transactions from non-exchange transactions, where facts become more critical to the analysis, might not always be so clear.

One example is the aforementioned *In re Satyam Computer Service Ltd. Securities Litigation*[86] Among the plaintiffs in that case is a former Satyam employee who allegedly acquired American Depository Shares -- but did so directly from Satyam through the exercise of options granted under one or more of Satyam's five employee option plans, and not in any exchange-based transaction. The *Satyam* defendants have not raised a *Morrison* challenge to the claims of foreign plaintiffs who purchased American Depository Shares on the NYSE; but they have moved to dismiss the claims of the employee, arguing that he does not meet *Morrison*'s "transactional test." In addition to the "definitional" argument about the term "listed" (as discussed above), defendants argue that by the terms of the option plan documents, in order to effectively exercise the options, the option exercise notice and payment had to be received by Satyam in India; therefore, the purchase of the American Depository Shares occurred in India. The court has not yet ruled on the motion to dismiss.

Another issue is whether an *off*-exchange, over-the-counter purchase of an ADR survives *Morrison* scrutiny. The very recent decision of *In re Société Générale Securities*

[86] No. 09 MD 2027 (BSJ) (S.D.N.Y.).

Litigation[87] dealt with these facts: and the Court there *sua sponte* dismissed the ADR claim. In that case, the parties briefed the issue of whether American investors who had purchased Société Générale ordinary shares on the Euronext Paris could state a claim under *Morrison*, but the defendants conceded that U.S. plaintiffs who had traded Société Générale ADRs "on the over-the-counter market in New York" could bring claims.[88] The Court dismissed the claims of the Euronext purchasers, citing the *Toyota*/*Credit Suisse* line of precedent.[89] However, the Court also unexpectedly considered the ADR claims *sua sponte* and held that they, too, should be dismissed, because they were effectively foreign transactions.[90] In this regard, the Court did not conduct its own detailed analysis into the particular facts of the case. Instead, the Court found § 10(b) inapplicable on the basis of a pre-*Morrison* case -- *Copeland v. Fortis* -- which had stated that "[t]rade in ADRs is considered to be a 'predominantly foreign securities transaction.'"[91]

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[87] 2010 WL 3910286 (S.D.N.Y. Sept. 29, 2010) (Burman, J.).

[88] *Id.* at *1.

[89] *Id.* at *5-*6.

[90] *Id.* at *6-*7.

[91] *See id.* at *6 (citing *Copeland v. Fortis*, 685 F. Supp. 2d 498, 506 (S.D.N.Y. 2010) (quoting *In re SCOR Holding (Switzerland) AG Litig.*, 537 F. Supp. 2d 556, 562 (S.D.N.Y. 2008)). The *Société Générale* Court noted that these were over-the-counter ADRs -- but cited to *Credit Suisse* for the proposition that "courts have also held that Section 10(b) is inapplicable to transactions in which a plaintiff purchases ADRs on a U.S. exchange." *Id.* at *6 n.5.

d. Dodd-Frank Act – The Conduct and Effect Tests Revived for the S.E.C./D.O.J. (and Maybe Others, Someday)?

Morrison's holding may have a very short-lived application, at least as to the U.S. Government, thanks to legislative abrogation. On June 25, 2010, the day after *Morrison* was handed down, a U.S. House-Senate conference committee proposed the Dodd-Frank Wall Street Reform and Consumer Protection Act,[92] the omnibus post-crisis financial reform statute which includes an attempted partial abrogation of *Morrison*. After passing the House and Senate, President Obama signed Dodd-Frank into law on July 21, 2010.

Dodd-Frank purports to amend the Exchange Act and Securities Act by restoring their extraterritorial reach and reinstituting the "conduct" and "effects" test -- but only for actions brought by S.E.C. and U.S. Department of Justice ("D.O.J."). [93] With respect to private actions and claims, Dodd-Frank does not overturn *Morrison*, and instead simply directs the S.E.C. to study and report to Congress within 18 months as to whether private rights of action under the Exchange Act should be given the same reach.[94]

Certain commentators have criticized Congress for a "drafting error" that may render these provisions reinstating extraterritorial reach a nullity.[95] Specifically, the provisions grant U.S. courts "jurisdiction" if the S.E.C. and D.O.J. satisfy the conduct or effects tests. But as discussed above, *Morrison* is unequivocal that the extraterritorial reach of the Exchange Act is *not* a matter of "jurisdiction," but rather, of whether a claim

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[92] Pub. L. 111-203, Jul. 21, 2010, 124 Stat. 1376.

[93] *Id.* § 929P(b).

[94] *Id.* § 929Y.

[95] *See* George T. Conway III, *Extraterritoriality After Dodd-Frank* (Aug. 5, 2010), http://blogs.law.harvard.edu/corpgov/2010/08/05/extraterritoriality-after-dodd-frank.

is stated; and the bill does not reference the latter concept. Whether this alleged "drafting error" will actually be held to limit the S.E.C. and D.O.J.'s abilities to bring "extraterritorial" cases remains to be seen.

e. *Morrison*'s Impact Beyond the Federal Securities Laws

Almost any decision of the U.S. Supreme Court can be expected to have far reaching effects, but *Morrison* may have an even more pronounced influence. As a federal securities law decision, *Morrison* will necessarily affect related areas of law which intersect with that legislation, such as: state common law-based securities claims and the doctrine of *forum non conveniens*. For example, plaintiffs with large enough claims can be expected to try to assert claims based on state common law, notwithstanding the absence of the "fraud on the market" doctrine (which creates a presumption of reliance on the alleged fraud, on which plaintiff may predicate both individual and especially class-wide claims).[96]

Similarly, even if § 10(b) claims pass *Morrison*'s test, they likely are now more susceptible to dismissal under the doctrine of *forum non conveniens*. There is precedent for deferring to Canadian courts on *forum non conveniens* grounds in securities cases.[97] However, in general, U.S. courts have denied *forum non conveniens* motions in securities

[96] *See Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

[97] *See Howe v. Goldcorp Invs., Ltd.*, 946 F.2d 944 (1st Cir. 1991) (Breyer C.J.) , *cert. denied*, 502 U.S. 1095 (Feb. 24, 1992) (dismissing putative securities class action brought by American investors against a Canadian corporation whose shares traded exclusively on Canadian stock exchanges, on *forum non conveniens* grounds).

cases, citing the U.S.'s "great interest" in enforcing its securities laws.[98] *Morrison*'s more restricted interpretation of the extraterritorial scope of the U.S securities laws will quite likely color future *forum non conveniens* analyses. Moreover, when non-U.S. issuers are sued but a significant part of the class' transactions were effected on foreign exchanges, *Morrison*'s effect of paring down the number of foreign investors able to recover under U.S. law, and the amount of cognizable damage claims may very well militate in favor of deferring to the forum with the largest number of plaintiffs and/or with the greatest damages (as well as most of the witnesses and evidence).

Beyond the securities realm, *Morrison*'s vociferous reiteration of the presumption against extraterritoriality in U.S. legislation affects the manner in which courts generally engage in statutory interpretation. Already, cases have cited *Morrison* to limit the extraterritorial reach of non-securities statutes. For instance, in *Norex Petroleum Ltd. v. Access Industries, Inc.*,[99] the Second Circuit Court of Appeals cited *Morrison* in deciding the that the Racketeer Influenced and Corrupt Organizations Act[100] ("RICO") did not have extraterritorial reach because it lacked an express indication of extraterritorial

[98] *See, e.g, In re CINAR Corp. Sec. Litig.*, 186 F. Supp. 2d 279, 300 (E.D.N.Y. 2002) (denying motion to dismiss, on *forum non conveniens* grounds, an action against Canadian corporation whose securities were cross-listed and traded both in Canada and on NASDAQ in favor of parallel Canadian class action, because "[t]he United States has a great interest in adjudicating this case because it involves fraud on American investors"); *In re Corel Corp. Inc. Sec. Litig.*, 147 F. Supp. 2d 363, 367 (E.D. Pa. 2001) (denying motion to dismiss securities fraud action against Canadian corporation cross-listed in Canada and on NASDAQ, based on *forum non conveniens*, because "the alleged misstatements were disseminated throughout the United States…. Moreover, there is a 'local interest' in affording the protections of the federal securities laws to injured U.S. investors.").

[99] 2010 WL 3749281 (2d Cir. Sept. 28, 2010)

[100] 18 U.S.C. §§ 1961-1968.

application. In that case, the Court dismissed the RICO Act claims of Norex, a Canadian petroleum company, against various Russian defendants who allegedly had forced Norex out of its controlling interest in a Russian oil company through a widespread racketeering and money laundering scheme. The Court held that because RICO (like the Exchange Act) did not have language reflecting extraterritorial application, it could not cover the alleged conduct which occurred mainly outside of the United States.

VI. Morrison's Impact on Litigation in Canada: Will Canada be a New Center of Transnational Securities Litigation?

As noted at the throughout this paper, there is a long history of Canadian-American ties in securities litigation. *Morrison* does not mark an end -- but it will certainly change the dynamics -- of cross-border litigation (securities and otherwise, as *Norex* illustrates) between the two countries. *Morrison* may help accelerate the pace and increase the scope of Canada as a transnational securities litigation center (or perhaps more aptly, centre).

One consequence of *Morrison* for Canada is that parallel securities suits arising from the same facts and transactions are very likely here to stay and will increase. There are many cross-listed issuers between the two countries.[101] Because of the availability of

[101] In particular, facilitated by special S.E.C. exemptions, Canadian public companies have increasingly sought financing through listing on stock exchanges in Canada and concurrently in the United States. In 1991, the S.E.C and Canadian regulators adopted the Multijurisdictional Disclosure System ("MJDS"). Under this system cross-listed issuers can use Canadian disclosure documents to satisfy American requirements and vice-versa. Currently, only Canadians can avail themselves of the MJDS system in the U.S., as the S.E.C. abandoned its original plan to extend it to other countries, recognizing that Canadian securities laws bear the closest similarity to U.S. laws of all foreign nations. *See* Thomas Lee Hazen, *The Law of Securities Regulation,* 905-906 (4th ed. St.

similar (though certainly not identical) class action mechanisms in both countries, many competing securities cases against such cross-border issuers have proceeded on parallel tracks in Canadian and American courts over the last two decades. Before *Morrison*, some Canadian plaintiffs saw fit to bring parallel securities suits in Canada against such cross-listed issuers even though they could assert viable claims in the U.S. Now that any Canadian who does not trade on the U.S. exchange (or otherwise in a U.S. transaction) does not have a claim under the U.S. securities laws post-*Morrison*, plaintiffs will be even more motivated to bring parallel securities suits in Canada.

Non-Canadian investors may also join the litigation party in Canada if present trends continue. Many have taken note that a Canadian court has certified Canada's first global securities class in *Silver v. IMAX Corp.*,[102] another parallel proceeding with an American analogue. *IMAX* involves Canadian representative plaintiffs who purchased IMAX common shares on the TSX, suing a Canadian corporation whose shares trade on both the TSX and NASDAQ. Of note, Madame Justice van Rensburg expressly outlined in her certification decision that, "The appropriate approach in this litigation is to 'wait and see' how the conflict of law issues may develop."[103] How those issues develop in *IMAX* will be closely watched in the U.S. and elsewhere.

Paul: West, 2002). Recently, however, the S.E.C. and Australian regulators signed a memorandum of understanding, which may lead to a similar system. *See* S.E.C., *S.E.C., Australian Authorities Sign Mutual Recognition Agreement* (Aug. 25, 2008), http://www.sec.gov/news/press/2008/2008-182.htm.

[102] 2009 CanLII 72334 (Ont. S.C.J.).

[103] *Id.* at ¶ 164 (citations omitted).

In addition to the possibility of global classes, Canada could become the jurisdiction of choice for transnational securities litigation if the *Morrison* approach is not followed by Canadian courts, and the provincial securities statutes instead are found to provide for extraterritorial application to issuers not listed on Canadian exchanges. The issue is pending in *Juniper v. A.I.G., Inc.*,[104] a Canadian "f-squared" case in the Ontario Superior Court of Justice, in which a Canadian plaintiff, on behalf of a putative class of Canadian residents, is suing (1) a *foreign* issuer, over shares purchased (2) on a *foreign* exchange. *A.I.G.* may determine if the test in Canada is one of jurisdiction, *Morrison* notwithstanding. Specifically, the secondary market liability provisions in Ontario, Manitoba and Alberta -- the three provinces with statutory secondary market liability -- purport to subject "responsible issuers" to civil liability.[105] This concept captures two types of companies: (1) "reporting issuers" (in essence, a company that has qualified a prospectus for an issuance of securities and is subject to the accompanying continuous disclosure obligations in that province); and (2) issuers with "real and substantial connections" to those provinces. The "real and substantial connection" test comes from the basic Canadian personal jurisdiction test as articulated by the Supreme Court of Canada in *Morguard Investments Ltd. v. De Savoye*.[106] We are unaware of any case that has yet applied the "real and substantial connection" test to determine subject-matter

[104] C-1094-08 (Ont. S.C.J.) (Taylor J.). Weil is U.S. counsel to defendants A.I.G. and A.I.G. Financial Products in this and related matters. Author Matthew Howatt is part of the team working on that case.

[105] *Securities Act*, R.S.O. 1990, c. S.5, ss. 138.1 – 138.14; Securities Act, C.C.S.M. c. S50, ss.176-197; *Securities Act*, R.S.A. 2000 c.S-4, Part 17.01

[106] [1990] 3 S.C.R. 1077.

jurisdiction in the transnational securities context; but, that is the main issue in *A.I.G.*, where the defendants have moved to dismiss the suit for a lack of jurisdiction -- and which has been adjourned indefinitely until the Supreme Court of Canada rules on the Ontario Court of Appeal's reformulation of the jurisdiction test in *Van Breda v. Village Resorts Limited*.[107]

Defendants in *A.I.G.* cite to *Morrison* as support for their alternative argument that the Canadian case should be dismissed for *forum non conveniens*, in favor of the pending putative securities class action in the U.S., for comity and reciprocity reasons. The *A.I.G.* defendants assert that in the "mirror hypothetical" of *A.I.G.* (where a U.S. resident brings a claim for secondary market misrepresentation in relation to shares of a Canadian issuer purchased over a Canadian exchange), a U.S. court would now dismiss the case because of *Morrison*. The fact that the court in *A.I.G.* will have to address these arguments shows that *Morrison* will not only affect the practical realities of securities litigation for Canadians in American and Canadian courts but will also likely be directly considered, as Canadian courts handle cases under Canadian securities laws.

VII. Conclusion

Morrison's analysis was revolutionary in regressing to the 1967 *Schoenbaum* trial court's analysis of the Exchange Act as not applying extraterritorially -- thereby, as one judge put it, "trash[ing]" 40 years of U.S. jurisprudence in transnational securities law. The lower courts appear to agree that under *Morrison*'s "transactional test," it is not "f-

[107] 2010 ONCA 84, *leave to appeal granted*, [2010] S.C.C.A. No. 174.

cubed" or "f-squared" that matters but only the "f" relating to whether the location of the transaction was foreign. These courts therefore also seem to universally agree with the *Toyota*/*Credit Suisse* approach that § 10(b) no longer applies to securities transactions on non-U.S. exchanges, regardless of other factors. In the non-exchange context, the inquiry into where the transaction occurred is much more fact-intensive and less easily generalized -- but still focused on the situs of the transaction, not the identity of the plaintiff or defendant. More important, however, we have not yet heard from any appellate courts on precise applications of *Morrison* to securities cases. Nor do we yet know what Congress has really done, or what it might do in the future, about *Morrison* and its progeny. Finally, *Morrison*'s ripple effects on the law outside the federal securities laws -- such as *forum non conveniens* and state common law fraud claims -- and including litigation in Canada and elsewhere -- are only beginning to surface. Perhaps the United States will have to begin to share even more, the international securities litigation spotlight with other forums, especially north of the border.