

## NOTE

### FRAUD ON THE GLOBAL MARKET: U.S. COURTS DON'T BUY IT; SUBJECT-MATTER JURISDICTION IN F-CUBED SECURITIES CLASS ACTIONS

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## INTRODUCTION

The news that Lehman Brothers faced imminent failure spread globally on a Sunday, a day when financial markets around the world were closed.<sup>1</sup> Mere knowledge of Lehman's looming demise had bankers worldwide bracing for what would happen when global markets opened on Monday morning.<sup>2</sup> Indeed, Lehman's failure turned out to be a trigger that would turn an American financial meltdown into a crisis of global proportions.<sup>3</sup> As the Dow plummeted, so too did markets around the world: by Thursday, for example, stocks in Hong Kong and Tokyo had dropped 4.7% and 2.2% respectively.<sup>4</sup> Although the focus of this Note is not the current financial crisis, the global market reaction to news of a U.S. bank's failure illustrates in plain terms what U.S. courts are reticent to acknowledge: in today's interconnected, globalized, and computerized world, information travels rapidly and affects securities prices around the world, irrespective of where the information is disseminated.

The ability of publicly available information to affect stock prices coupled with the globalization of the world's economies has ushered in an era of transnational securities fraud. The United States, with its unique<sup>5</sup> class-action mechanism, has become an increasingly attractive forum not only for U.S. investors seeking to recoup their losses against foreign defendants but also for foreign investors seeking to vindicate their own rights in American courts. Consequently, our courts must grapple with difficult questions regarding whether to hear claims by foreign plaintiffs regarding transactions that are predominantly foreign—a question traditionally viewed by U.S. courts as one of subject-matter jurisdiction.<sup>6</sup> This Note will examine how courts decide whether to exercise subject-matter jurisdiction over the claims of foreign purchasers in an increasingly common form of securities class

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<sup>1</sup> See Nelson D. Schwartz, *In Europe, Panic Spread When Lehman Went Under: A Crisis in Finance*, INT'L HERALD TRIB., Oct. 11, 2008, at 12.

<sup>2</sup> See *id.*

<sup>3</sup> *Id.*

<sup>4</sup> Joe Nocera, *36 Critical Hours; Playing Out in Places Most People Can't See, the Credit Crisis Was Driven by Fear, Not Greed, and Shook the Financial World to Its Core*, INT'L HERALD TRIB., Oct. 3, 2008, at 1.

<sup>5</sup> Although U.S.-style class actions are unique, several other countries have begun to authorize forms of collective action. See *infra* notes 12–13 and accompanying text.

<sup>6</sup> See, e.g., *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206–08 (2d Cir. 1968). The appropriateness of characterizing the question as one of subject-matter jurisdiction, however, has been criticized. See, e.g., Brief for the United States as Amicus Curiae at 5, *Morrison v. Nat'l Austl. Bank Ltd.*, No. 08-1191 (Oct. 27, 2009) (“[T]he court of appeals erred in treating the question before it as one of ‘subject matter jurisdiction’ . . . .”); Erez Reuveni, *Extraterritoriality as Standing: A Standing Theory of the Extraterritorial Application of the Securities Laws*, 43 U.C. DAVIS L. REV. (forthcoming 2010) (manuscript at 3–8, on file with author), available at <http://ssrn.com/abstract=1496049> (arguing that the question is not one of subject-matter jurisdiction, but rather of statutory standing).

action called the “F-cubed” (short for “foreign-cubed”) action—that is, a class action brought against a foreign issuer on behalf of a class that includes foreign investors who transacted on a foreign exchange.<sup>7</sup>

Federal securities class actions involving foreign elements are hardly new to U.S. courts. Indeed, the Second Circuit faced the F-cubed jurisdictional conundrum in *Bersch v. Drexel Firestone, Inc.*<sup>8</sup> in 1975. This decades-old question has received considerable attention since the decision in *Bersch* but warrants renewed analysis for several reasons. First, although cross-border transactions—and indeed, securities litigation involving cross-border transactions—may have been exceptional when the Second Circuit decided *Bersch*, such transactions are now commonplace. To be sure, the number of federal securities class actions targeting foreign issuers has skyrocketed since the mid-1990s. Between 1996 and 2002 alone, the number of such cases more than tripled.<sup>9</sup> Furthermore, the most recent PricewaterhouseCoopers Securities Litigation study indicates that in 2008, federal securities class actions filed against foreign private issuers “hit an all-time high.”<sup>10</sup> Another study suggests that an international institutional investor has served as the lead plaintiff in ninety-eight cases since 1999.<sup>11</sup> Second, collective-action mechanisms may soon become more widely accepted outside of the United States. The European Union and several individual countries have begun to “seriously consider collective litigation alternatives.”<sup>12</sup> By way of example, the Italian Parliament recently passed a law introducing into the Consumer Code a provision allowing certain consumer groups and associations to sue collectively for tort liability, unfair trade practices, and anticompetitive

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<sup>7</sup> See *In re Elan Corp. Sec. Litig.*, No. 08-cv-08761, 2009 WL 1321167, at \*2 (S.D.N.Y. May 11, 2009) (defining “foreign-cubed” securities class actions as “actions 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” (internal quotation marks omitted)); Stuart M. Grant & Diane Zilka, *The Current Role of Foreign Investors in Federal Securities Class Actions*, in SECURITIES LITIGATION & ENFORCEMENT INSTITUTE 2007, at 11, 17 (2007) (explaining that “a foreign investor who purchased securities of . . . a foreign corporation . . . that traded on a foreign securities exchange” is colloquially referred to as a “foreign cubed” plaintiff).

<sup>8</sup> 519 F.2d 974 (2d Cir. 1975).

<sup>9</sup> See Michael D. Torpey et al., *Defending Securities Claims*, in 2008 ALI-ABA SECURITIES LITIGATION PROGRAM 3 (2008).

<sup>10</sup> PRICEWATERHOUSECOOPERS LLP, 2008 SECURITIES LITIGATION STUDY 43 (2009).

<sup>11</sup> See Peter M. Saporoff & Katharine Coughlin Beattie, *The Benefits of Including Foreign Investors in U.S. Securities Class Action Suits*, SEC. LITIG. J., Winter 2008, at 1, 11 (“In each year since 1999, at least one international institutional investor has sought to serve as the lead plaintiff in a securities class action, and, overall, did so 182 times in 98 different cases during that period.”).

<sup>12</sup> PRICEWATERHOUSECOOPERS LLP, 2007 SECURITIES LITIGATION STUDY 61 (2008). For a useful overview of the various collective-redress regimes in European countries, see Rachael Mulheron, *The Case for an Opt-out Class Action for European Member States: A Legal and Empirical Analysis*, 15 COLUM. J. EUR. L. 409, 415–27 (2009).

behavior.<sup>13</sup> Going forward, therefore, U.S. courts ought to enunciate clear rules regarding the application of domestic securities laws to foreign claims. Third—and perhaps most importantly—the federal securities laws remain silent as to their extraterritorial application,<sup>14</sup> leaving a growing mess of lower-court precedent on how to apply a pair of judicially created jurisdictional tests: the “effects test” and the “conduct test.”<sup>15</sup> The recent decision of the Second Circuit—by most standards, the authority on federal securities law<sup>16</sup>—in *Morrison v. National Australia Bank Ltd. (NAB II)*<sup>17</sup> did not provide clarity to the puzzle. In fact, the Second Circuit’s decision in that case stands in contrast to prior decisions in F-cubed cases. In November 2009, the Supreme Court granted certiorari to review *NAB II*,<sup>18</sup> and the Court is now preparing to hear oral argument.

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<sup>13</sup> See Vittorio Scognamiglio et al., *Italy’s New Class-Action Law*, MONDAQ BUS. BRIEFING, Mar. 27, 2008; see also Mulheron, *supra* note 12, at 419–20 (discussing the operation of the new Italian collective-action law).

<sup>14</sup> See, e.g., *In re Royal Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 355 (D. Md. 2004) (“The Securities Act of 1933 and the Securities Exchange Act of 1934 are silent as to whether they apply extraterritorially, and Congress has provided little guidance on the issue.” (citing *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 30 (D.C. Cir. 1987))); Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 COLUM. J. TRANSNAT’L L. 14, 18–19 (2007) (“[T]he anti-fraud provisions of the federal securities laws do not speak directly to the scope of their application in the international context.”); Sherrie R. Savett, *Plaintiffs’ Vision of Securities Litigation: Current Trends and Strategies*, in SECURITIES LITIGATION & ENFORCEMENT INSTITUTE 2008, at 143, 203 (2008) (“The Securities Act of 1933 and the Securities Exchange Act of 1934 are silent as to whether they apply to transactions occurring in foreign jurisdictions, or with foreign exchanges, companies, or investors.”). Congress, however, may finally rectify this omission. In December 2009, a bill was introduced in the House of Representatives that included provisions regarding extraterritorial jurisdiction under both the Securities Act and the Exchange Act. See H.R. 4173, 111th Cong. § 7216 (as introduced, Dec. 2, 2009) (expanding jurisdiction to actions under the principal antifraud provisions of the securities laws involving “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”). As certified by the House and sent to the Senate, however, the bill gives U.S. courts this broad jurisdiction only in SEC enforcement actions. See H.R. 4173, 111th Cong. § 7216 (as passed by House, Dec. 11, 2009) (limiting the amendment to “any actions or proceedings brought or instituted by the [Securities and Exchange] Commission or the United States”); H.R. 4173, 111th Cong. § 7216 (as referred in Senate to committee, Jan. 20, 2010) (same).

<sup>15</sup> Courts addressing jurisdictional questions in securities actions involving transnational elements traditionally apply one of two different tests—the “effects test,” which focuses on the location of the conduct’s effects, and the “conduct test,” which is based on the location of the allegedly fraudulent conduct. See, e.g., *Grant & Zilka*, *supra* note 7, at 33–35. Lower federal courts, however, are split on how to apply these tests. See *id.* A more detailed discussion of the effects and conduct tests appears *infra* Part II.

<sup>16</sup> See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting) (noting that the Court of Appeals for the Second Circuit is “regarded as the ‘Mother Court’” in the area of securities law).

<sup>17</sup> 547 F.3d 167 (2d Cir. 2008).

<sup>18</sup> 78 U.S.L.W. 3319 (U.S. Nov 30, 2009) (No. 08-1191).

The solution to the F-cubed puzzle is far from straightforward, and the Supreme Court has a difficult task before it. Should the Court decide the case narrowly and leave the larger question to the legislature, Congress ought to consider a complete overhaul of the federal securities laws, including a clear pronouncement about their extraterritorial reach. However, should the Court decide to tackle the problem head-on, it might consider articulating new jurisdictional tests (or modifying the old ones) in response to criticisms that the effects test and conduct test, both nearly forty years old, are simply outdated and no longer workable in today's world of interconnected securities markets.<sup>19</sup> If the Court chooses to take on the problem itself, it will no doubt address the normative question about the extraterritorial reach of the federal securities laws—that is, beyond the *logical* arguments advanced in this Note about market efficiency, the Court will doubtless consider how far the securities laws *should* reach.

The purpose of this Note is to explore how courts have traditionally approached subject-matter jurisdiction in F-cubed cases and to assess the wisdom of most courts' rejection of jurisdiction over the claims of F-cubed plaintiffs. Part I provides an overview of the federal securities laws, with a particular focus on their antifraud provisions. Part II is a discussion of the effects test and the conduct test, the traditional judicial approaches to subject-matter jurisdiction under the federal securities laws. Part III introduces the "fraud-on-the-global-market" theory, recently advanced by F-cubed plaintiffs in an effort to satisfy the conduct test. Part III argues that the theory, which draws on the traditional fraud-on-the-market doctrine, is too quickly dismissed by federal courts and that, given the realities of today's global marketplace, the theory is sufficient to support the exercise of subject-matter jurisdiction over the claims of F-cubed plaintiffs.

## I

### BACKGROUND ON THE FEDERAL SECURITIES LAWS

In order to situate the debate on the extraterritorial reach of the federal securities laws, this Part presents a basic overview of the Securities Act and the Exchange Act, focusing on their purpose and the guidance they provide as to their application to foreign claims and transactions. This Part then addresses the elements of a claim for securities fraud under the Exchange Act, paying particular attention to the market-efficiency hypothesis and the fraud-on-the-market doctrine.

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<sup>19</sup> See, e.g., Buxbaum, *supra* note 14, at 41–42 (arguing not only that the consolidation of financial markets, increase in cross-border transactions, and the facility of information transmission have rendered the tests' focus on location archaic, but also that the tests have failed to keep up with "the evolution of the substantive law governing securities fraud").

### A. Purpose of the Federal Securities Laws

Investors seeking to recover damages caused by securities fraud typically bring claims in federal court under the Securities Act of 1933 (Securities Act)<sup>20</sup> or under the Securities Exchange Act of 1934 (Exchange Act).<sup>21</sup> Congress enacted these laws in the aftermath of the Great Depression to protect the public from misrepresentations on the securities markets.<sup>22</sup> More particularly, the federal securities laws (1) “implement a philosophy of mandatory full disclosure that requires market participants to reveal material information pertaining to the securities they are offering, selling, or purchasing”; (2) “maintain market integrity by protecting investors from fraud”; and (3) “promote ethical standards of honesty and fair dealing” through the creation of civil liability.<sup>23</sup>

### B. The Antifraud Provisions of the Federal Securities Laws

The Securities Act regulates the public offering of securities and generally requires that an issuer file a registration statement and prospectus with the Securities and Exchange Commission (SEC) prior to offering or selling securities. Sections 11 and 12 are the principal antifraud provisions in the Securities Act. Section 11 provides a cause of action to purchasers in a registered offering if the registration statement contains material misstatements or omissions.<sup>24</sup> Section 12(a)(2) provides for the liability of any issuer who offers or sells a

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<sup>20</sup> 15 U.S.C. § 77a–aa (2006).

<sup>21</sup> *Id.* § 78a.

<sup>22</sup> See Brian P. Murray & Maurice Pessa, *The Accident of Efficiency: Foreign Exchanges, American Depository Receipts, and Space Arbitrage*, 51 *BUFF. L. REV.* 383, 383 (2003).

<sup>23</sup> Michael J. Calhoun, *Tension on the High Seas of Transnational Securities Fraud: Broadening the Scope of United States Jurisdiction*, 30 *LOX. U. CHI. L.J.* 679, 683 (1999) (footnotes and internal quotation marks omitted).

<sup>24</sup> Section 11(a) provides, in pertinent part:

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may . . . sue— (1) every person who signed the registration statement; (2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted; (3) every person who, with his consent, is named in the registration statement as being or about to become a director, . . . or partner; (4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, . . . with respect to the statement in such registration statement, . . . which purports to have been prepared or certified by him; (5) every underwriter with respect to such security.

15 U.S.C. § 77k(a)(1)–(5).

security by means of a prospectus or oral communication containing material misstatements or omissions.<sup>25</sup> Section 17 is the general antifraud provision of the Securities Act and prohibits fraudulent interstate transactions.<sup>26</sup>

The Exchange Act prohibits certain types of conduct in the markets and provides the SEC with disciplinary powers. The most important antifraud provision in the Exchange Act is section 10(b).<sup>27</sup> In fact, the “overwhelming majority”<sup>28</sup> of securities-fraud class actions are brought under section 10(b) and its implementing regulation, Rule 10b-5. The SEC promulgated Rule 10b-5 pursuant to the authority that the Exchange Act grants the agency to issue rules and regulations that it deems “necessary or appropriate in the public interest or for the protection of investors.”<sup>29</sup> Section 10(b) and Rule 10b-5 together prohibit manipulation or deception in the offer or sale of any security.<sup>30</sup>

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<sup>25</sup> Section 12(a)(2) provides, in pertinent part:

Any person who . . . offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable . . . to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

*Id.* § 77l(a).

<sup>26</sup> Section 17(a) provides, in pertinent part:

It shall be unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly— (1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

*Id.* § 77q(a).

<sup>27</sup> See Kun Young Chang, *Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject-Matter Jurisdiction*, 9 FORDHAM J. CORP. & FIN. L. 89, 93 (2003).

<sup>28</sup> Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1302 (2008).

<sup>29</sup> 15 U.S.C. § 78j(b).

<sup>30</sup> See *id.* 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, (a) To employ any device,

### C. Basic Principles: Securities-Fraud Claims, Fraud-on-the-Market, and Market Efficiency

To state a claim for securities fraud under Rule 10b-5, a plaintiff must allege each of the following elements: (1) the defendant made a material misrepresentation or omission; (2) the misrepresentation or omission was in connection with the purchase or sale of a security; (3) there was a causal connection between the defendant's material misrepresentation or omission and the plaintiff's loss (referred to as "loss causation"); (4) the plaintiff relied on the defendant's misrepresentation or omission; (5) the defendant acted with a wrongful state of mind (referred to as "scienter"); and (6) the plaintiff suffered economic loss.<sup>31</sup>

#### 1. *Reliance in Fraud-on-the-Market Cases*

The element of reliance—that is, establishing that the defendant's misrepresentation or omission was a substantial factor in the purchaser's decision to trade in the defendant's stock—is of particular importance in the context of securities class actions. An individual plaintiff bringing a 10b-5 suit may be capable of establishing the reliance prong directly—by showing, for example, that he read and relied on the defendant's SEC filings containing the alleged misrepresentation. But in the class-action context, where the class may be composed of thousands of individual plaintiffs, "a requirement of 'individualized' proof [of reliance] by each plaintiff would be procedurally impossible."<sup>32</sup> Thus, the Supreme Court in *Basic Inc. v. Levinson*<sup>33</sup> held that the requirement of reliance in a securities-fraud class action under section 10(b) and Rule 10b-5 could be satisfied using the "fraud-on-the-market" theory.<sup>34</sup> Under this theory, plaintiffs need not overcome the practically insurmountable hurdle of proving individual reliance on a defendant's misstatement or omission. Rather, in a fraud-on-the-market case, plaintiffs may invoke a rebuttable presumption of reliance.<sup>35</sup>

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scheme, or artifice to defraud, (b) 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 (c) 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.

17 C.F.R. § 240.10b-5 (2009).

<sup>31</sup> See *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005).

<sup>32</sup> Buxbaum, *supra* note 14, at 44.

<sup>33</sup> 485 U.S. 224 (1988).

<sup>34</sup> See *id.* at 243–50.

<sup>35</sup> See *id.* at 250.

## 2. *Market Efficiency*

To better understand the rationale behind affording plaintiffs this presumption, which significantly eases their burden of proof, one must examine the concept of market efficiency. According to the *Basic* Court, plaintiffs may invoke the presumption of reliance only if they prove that the corporate defendant's shares "traded on an efficient market."<sup>36</sup> Although the Court provided no express definition, an "efficient market" is generally defined as "a market where there are large numbers of rational, profit-maximizers actively competing, with each trying to predict future market values of individual securities, and where important current information is almost freely available to all participants."<sup>37</sup> The efficient-market hypothesis assumes that "'in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business.'"<sup>38</sup> Put somewhat differently, the hypothesis states that, at any given time, securities prices in an efficient market fully reflect all publicly available information, including information regarding events that have already occurred and events that the market expects to take place in the future.<sup>39</sup> Accordingly, fraudulent misstatements or omissions about a security, if such information is disseminated in an efficient market—for example, the New York Stock Exchange (NYSE) or the NASDAQ—will be reflected in the market price for that security.

The efficient-market hypothesis thus forms the basis for the *Basic* "fraud-on-the-market" doctrine:

Misleading statements will . . . defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.<sup>40</sup>

In sum, the presumption of reliance in an efficient market is logical because investors who transact in securities at prices set by the market

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<sup>36</sup> *Id.* at 248 n.27 ("The Court of Appeals [below] held that in order to invoke the presumption, a plaintiff must allege and prove: (1) that the defendant made public misrepresentations; (2) that the misrepresentations were material; (3) that the shares were traded on an efficient market; (4) that the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and (5) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed. Given today's decision regarding the definition of materiality as to preliminary merger discussions, elements (2) and (4) may collapse into one." (citation omitted)).

<sup>37</sup> Eugene F. Fama, *Random Walks in Stock Market Prices*, 21 *FIN. ANALYSTS J.* 55 (Sept.–Oct. 1965), reprinted in RICHARD A. POSNER & KENNETH E. SCOTT, *ECONOMICS OF CORPORATION LAW AND SECURITIES REGULATION*, 156, 157 (1980).

<sup>38</sup> *Basic*, 485 U.S. at 241 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160 (3d Cir. 1986)).

<sup>39</sup> See Fama, *supra* note 37, at 157.

<sup>40</sup> *Basic*, 485 U.S. at 241–42 (quoting *Peil*, 806 F.2d at 1160–61).

do so in reliance on the *integrity* of those prices; because publicly available information is reflected in market price, investors' reliance on misrepresentations by the issuer may be presumed in a Rule 10b-5 case.<sup>41</sup> Thus, the fundamental assumption behind the fraud-on-the-market theory is that placing an efficient market between the buyer and seller obviates the need to prove individualized reliance.<sup>42</sup>

#### D. Statutory Silence as to Extraterritorial Application

Currently, the federal securities laws do not expressly define the extent to which they apply outside the territory of the United States.<sup>43</sup> The Securities Act, for example, in its provision on jurisdiction, provides only that

[t]he district courts of the United States . . . shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto . . . of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.<sup>44</sup>

The Exchange Act is similarly vague as to its application to foreign claims and cross-border transactions.<sup>45</sup> Section 10(b) "makes no overt mention of securities violations involving foreigners"<sup>46</sup> but merely refers to "'any person' who uses interstate commerce."<sup>47</sup> Some scholars have pointed out that this silence leads to two opposing interpretations regarding the law's transnational reach: one argument reasons that nothing in the statutory language of section 10(b) authorizes U.S. courts to give the Exchange Act extraterritorial force, while a second argument reads the Act implicitly to provide for broad extra-

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<sup>41</sup> See *id.* at 247.

<sup>42</sup> See Murray & Pessa, *supra* note 22, at 387–88.

<sup>43</sup> See *supra* note 14 and accompanying text.

<sup>44</sup> 15 U.S.C. § 77v(a) (2006).

<sup>45</sup> See, e.g., *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 121 (2d Cir. 1995) ("It is well recognized that the Securities Exchange Act is silent as to its extraterritorial application."); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 30 (D.C. Cir. 1987) (referring to the Exchange Act as "relatively barren" and noting that it provides "no specific indications of when American federal courts have jurisdiction over securities law claims arising from extraterritorial transactions"); Buxbaum, *supra* note 14, at 18–19; Savett, *supra* note 14, at 203; see also Katherine J. Fick, *Such Stuff as Laws Are Made on: Interpreting the Exchange Act to Reach Transnational Fraud*, 2001 U. CHI. LEGAL F. 441, 447 (2001).

<sup>46</sup> Fick, *supra* note 45, at 449.

<sup>47</sup> *Id.* (quoting 15 U.S.C. § 78(j) (1994 & Supp. 2000)).

territorial application because it defines “interstate commerce” to include commerce “between any foreign country and any State.”<sup>48</sup>

## II

### TRADITIONAL JUDICIAL APPROACHES TO SUBJECT-MATTER JURISDICTION UNDER FEDERAL SECURITIES LAWS

Courts have not given credence to either of these text-based arguments.<sup>49</sup> In fact, “[n]umerous courts have candidly recognized that the extraterritorial application of securities laws involves policy considerations and the courts’ best judgment rather than clear statutory guidance.”<sup>50</sup> Faced with this “insurmountable textual ambiguity,” courts have developed two tests, the effects test and the conduct test, in an attempt to give effect to the supposed intent of the enacting legislature and to determine whether the exercise of subject-matter jurisdiction in a particular case is proper.<sup>51</sup> This Part sets forth the requirements of the effects test and conduct test, including a discussion of the different ways courts have applied them. What emerges is a mess of jurisdictional standards. Perhaps, then, it is no surprise that courts apply the tests unpredictably and even arbitrarily in some cases. Or perhaps courts are beginning to view the tests as increasingly irrelevant as concerns about jurisdictional overreach take precedence.

#### A. The Effects Test

Under the effects test, courts focus their attention on the impact of foreign conduct on U.S. investors and markets.<sup>52</sup> This test was originally articulated in *Schoenbaum v. Firstbrook*,<sup>53</sup> the first major securities-fraud case to extend subject-matter jurisdiction extraterritorially. In *Schoenbaum*—a shareholder derivative suit, not a class action—an American shareholder of a Canadian corporation brought suit under section 10(b) of the Exchange Act, alleging that the corporation’s di-

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<sup>48</sup> *Id.* at 450 (quoting 15 U.S.C. § 78c(17)). For a discussion of the second argument, see John D. Kelly, Note, *Let There Be Fraud (Abroad): A Proposal for a New U.S. Jurisprudence with Regard to the Extraterritorial Application of the Anti-Fraud Provisions of the 1933 and 1934 Securities Acts*, 28 LAW & POL’Y INT’L BUS. 477, 480 (1997). One proponent of the second construction of the Exchange Act is Norimasa Murano, *Extraterritorial Application of the Antifraud Provisions of the Securities Exchange Act of 1934*, 2 INT’L TAX & BUS. L. 298, 299 (1984) (“The statutory framework of the 1934 Act clearly gives the federal courts subject-matter jurisdiction over extraterritorial securities transactions.”).

<sup>49</sup> See Fick, *supra* note 45, at 451 (“Courts have not taken the jurisdictional implications of either text-based argument to their logical extreme.”).

<sup>50</sup> Torpey et al., *supra* note 9, at 3.

<sup>51</sup> Fick, *supra* note 45, at 452.

<sup>52</sup> See *In re Rhodia S.A. Sec. Litig.*, 531 F. Supp. 2d 527, 538 (S.D.N.Y. 2007) (citing *Eur. & Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 128 (2d Cir. 1998)).

<sup>53</sup> 405 F.2d 200 (2d Cir. 1968).

rectors conspired to defraud the corporation by failing to disclose material information in order to transact in treasury shares at an artificially low market price.<sup>54</sup> Even though “the sales in question . . . took place in Canada between foreign buyers and sellers,”<sup>55</sup> the Second Circuit reversed the district court’s holding on subject-matter jurisdiction and concluded that the plaintiff had rebutted the traditional presumption against extraterritorial jurisdiction<sup>56</sup> by showing that the defendants’ foreign conduct adversely affected U.S. purchasers and markets.<sup>57</sup> The court predicated this holding on its belief that Congress intended the Exchange Act to have extraterritorial application in the interest of protecting American investors.<sup>58</sup> The effects test has since been supplemented by substantiality and specificity requirements: a court may properly exercise subject-matter jurisdiction over a securities-fraud case if conduct outside the United States has a substantial effect on specific American investors.<sup>59</sup>

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<sup>54</sup> *Id.* at 204–06.

<sup>55</sup> *Id.* at 206.

<sup>56</sup> There is a general presumption in statutory interpretation against applying congressional legislation extraterritorially. *See, e.g.*, *Equal Employment Opportunity Comm’n v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (“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.’” (quoting *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949))). Indeed, in a seminal case on the extraterritorial application of U.S. law, *F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, an antitrust class action brought on behalf of foreign and domestic purchasers of vitamins, the Supreme Court held that the Sherman Act was not applicable to claims based on foreign harm. 542 U.S. 155, 164 (2004). The Court based its conclusion principally on the concept of comity, relying on the rule of statutory construction that requires courts to construe statutes to avoid unreasonable interference with the sovereign authority of other nations. *See id.* at 164–73. A distinction between *Empagran* and securities class actions such as *NAB*, however, is that *Empagran* treated the antitrust laws as “a legislative effort to redress *domestic* antitrust injury that foreign anticompetitive conduct has caused,” *id.* at 165, whereas courts deciding securities class actions have long acknowledged that the securities laws are designed not only to prevent fraud affecting domestic purchasers but also to prevent the United States from being used “as a base for manufacturing fraudulent security devices for export,” *Itoha Ltd. v. Lep Group PLC*, 54 F.3d 118, 122 (2d Cir. 1995) (citation and internal quotation marks omitted).

<sup>57</sup> *Schoenbaum*, 405 F.2d at 206.

<sup>58</sup> *Id.* (“We believe that Congress intended 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.”).

<sup>59</sup> *See Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 989 (2d Cir. 1975) (“[T]here is subject matter jurisdiction of fraudulent acts relating to securities which are committed abroad only when these result in injury to purchasers or sellers of those securities in whom the United States has an interest, not where acts simply have an adverse affect [sic] on the American economy or American investors generally.” (footnotes omitted)); *In re Royal Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 360 (D. Md. 2004) (“Under the effects test, courts have subject matter jurisdiction over foreign transactions related to securities if the transactions resulted in direct, adverse injury to specific American investors and parties within the United States. Allegations that the foreign conduct generally affected the U.S. market will not satisfy the effects test.” (citations omitted)).

Although I address this point in more detail below, note for now only that some courts have suggested that the effects test is not applicable to F-cubed actions. Such courts reason that the effects test focuses on the adverse impact on *American* investors; F-cubed claimants, the argument goes, cannot establish any relationship between their particular claims and those American effects.<sup>60</sup>

### B. The Conduct Test

Under the conduct test, courts focus their attention not on foreign conduct that adversely affects domestic traders and markets but rather on the extent and nature of the defendant's *U.S.-based conduct* and whether such conduct was part of a fraudulent scheme resulting in losses to investors abroad.<sup>61</sup> *Leasco Data Processing Equipment Corp. v. Maxwell*,<sup>62</sup> a case in which American and British plaintiffs sued British defendants under section 10(b) of the Exchange Act, was the first case to apply what would later become known as the conduct test. In *Leasco*, the plaintiffs alleged that the defendants had conspired to cause them to buy securities of a British corporation at prices in excess of their true value.<sup>63</sup> Unlike *Schoenbaum*, where fraudulent acts committed *abroad* harmed American investors, *Leasco* involved what the court described as a "significant" or "extensive" amount of *domestic* conduct—sufficient, in the court's view, to confer subject-matter jurisdiction.<sup>64</sup> Again, the *Leasco* court predicated its holding on its interpretation of congressional intent:

Still we must ask ourselves whether, if Congress had thought about the point, it would not have wished to protect an American investor if a foreigner comes to the United States and fraudulently induces him to purchase foreign securities abroad—a purpose which its words can fairly be held to embrace.<sup>65</sup>

*Leasco* thus provides that the exercise of subject-matter jurisdiction in a transnational securities-fraud case must be supported by "extensive" U.S. conduct by defendants that forms an "essential link" in the chain of causation resulting in plaintiffs' losses.<sup>66</sup> The Second Circuit has revisited the conduct test myriad times since *Leasco* and has refined the test into its current form, which requires that "substantial acts"

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<sup>60</sup> See *infra* note 107; see also *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 346, 369 (S.D.N.Y. 2005) ("The effects test . . . has no bearing in an action involving the claims of foreign purchasers of a foreign company's securities on foreign exchanges . . .").

<sup>61</sup> See Buxbaum, *supra* note 14, at 23.

<sup>62</sup> 468 F.2d 1326 (2d Cir. 1972).

<sup>63</sup> *Id.* at 1330.

<sup>64</sup> *Id.* at 1334–35.

<sup>65</sup> *Id.* at 1337. The court then concluded: "[W]e think it tips the scales in favor of applicability when substantial misrepresentations were made in the United States." *Id.*

<sup>66</sup> *Id.* at 1335.

relating to the fraud occur in the United States.<sup>67</sup> This U.S.-based conduct must (1) be more than merely preparatory to the fraud and (2) directly cause the plaintiff's loss.<sup>68</sup> Although this Note uses the Second Circuit's current version of the test as a basis for discussion, one should note that there is a substantial division among the circuits on how precisely to apply the conduct test.<sup>69</sup>

### C. Effects and Conduct Combined?

Traditionally, a court must find *either* the effects test *or* the conduct test satisfied in order to properly exercise subject-matter jurisdiction.<sup>70</sup> Nevertheless, according to some courts, subject-matter jurisdiction may be based on a combination of the effects and conduct tests.<sup>71</sup> As the Second Circuit explained in *Itoba Ltd. v. Lep Group PLC*, "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."<sup>72</sup> It is at least arguable that allowing some combination of the two tests to satisfy the requirements for subject-matter jurisdiction necessarily relaxes plaintiffs' bur-

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<sup>67</sup> See Calhoun, *supra* note 23, at 709.

<sup>68</sup> See *Morrison v. Nat'l Austl. Bank Ltd. (NAB II)*, 547 F.3d 167, 171 (2d Cir. 2008) ("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." (citations omitted)); *In re Vivendi Universal, S.A. Sec. Litig.*, 381 F. Supp. 2d 158, 169 (S.D.N.Y. 2003) ("Under the 'conduct test' . . . this Court has subject matter jurisdiction over the claims of foreign investors abroad (1) if the defendant's conduct in the United States was more than merely preparatory to the fraud, and [(2)] particular acts or culpable failures to act within the United States directly caused losses to foreign investors abroad." (internal quotation marks omitted)).

<sup>69</sup> See, e.g., *In re CP Ships Ltd. Sec. Litig.*, 578 F.3d 1306, 1313 n.8 (11th Cir. 2009) (acknowledging "less stringent formulation[s]" of the conduct test than the Second Circuit's approach); *In re Cable & Wireless, PLC, Sec. Litig.*, 321 F. Supp. 2d 749, 757-58 (E.D. Va. 2004) ("Other circuits in the Courts of Appeals are split as to how to apply the conduct test."). Michael Calhoun likewise explains that "the circuits disagree on the precise degree of domestic conduct required to grant subject matter jurisdiction to domestic federal courts." Calhoun, *supra* note 23, at 697. He outlines three different approaches taken by the courts—a "restrictive" approach, a "broad" approach, and a "balancing" approach. *Id.* at 698-719.

<sup>70</sup> See *In re AstraZeneca Sec. Litig.*, 559 F. Supp. 2d 453, 465 (S.D.N.Y. 2008) ("A plaintiff must satisfy *one* of two tests to establish subject matter jurisdiction over transnational securities fraud claims." (emphasis added)); *Tri-Star Farms Ltd. v. Marconi, PLC*, 225 F. Supp. 2d 567, 573 (W.D. Pa. 2002) ("Satisfaction of either test may independently establish jurisdiction."); see also *S.E.C. v. Berger*, 322 F.3d 187, 195 (2d Cir. 2003) (holding that, because jurisdiction existed under the conduct test, the court need not reach the question of whether the effects test provided an independent basis for exercising jurisdiction).

<sup>71</sup> See Fick, *supra* note 45, at 459 ("While courts conventionally apply either the conduct or the effects test when deciding whether to confer jurisdiction, the Second Circuit has held that these inquiries are not mutually exclusive.").

<sup>72</sup> *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 122 (2d Cir. 1995).

den of proof, resulting in the expansion of U.S. law.<sup>73</sup> Perhaps recognizing this fact, some courts have required that plaintiffs not only fully satisfy one of the tests but also establish “additional tipping factors” beyond the requirements of the test itself that favor the exercise of jurisdiction.<sup>74</sup> That is, under some circumstances, plaintiffs must do more than merely satisfy one of the tests. As one court explained:

That misrepresentation and reliance may occur on U.S. soil and still fail to implicate federal jurisdiction emphasizes that a simple mechanical application of the jurisdictional tests is insufficient. A proper analysis should focus on the policy considerations that led to the extraterritorial application of these laws in the first place—protecting or punishing U.S.-parties and markets.<sup>75</sup>

Nevertheless, many courts reject the “tipping factors” approach and find the search for additional tipping factors unnecessary if a traditional jurisdictional test is plainly satisfied.<sup>76</sup> Thus, anyone looking at the case law in this area is likely to come away with a sense that courts simply engage in an “I know it when I see it”<sup>77</sup> approach to subject-matter jurisdiction in these cases.

#### D. The Tests as Applied: Arbitrary Line Drawing

Although articulation of the effects and conduct tests is easy, recent case law demonstrates that their application is anything but straightforward.<sup>78</sup> Or, perhaps, courts bungle what would otherwise be a straightforward application of the tests by focusing on the wrong

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<sup>73</sup> See Buxbaum, *supra* note 14, at 25 (“Such an approach might be used to expand the reach of U.S. law, since courts could view the jurisdictional test as satisfied by a combination of conduct and effects that standing alone would not be sufficient.”).

<sup>74</sup> See, e.g., *Interbrew S.A. v. Edperbrascan Corp.*, 23 F. Supp. 2d 425, 432 (S.D.N.Y. 1998) (“Thus, the question is whether, in addition to [defendant’s] U.S.-based activity, there is ‘some additional factor tipping the scales in favor of our jurisdiction . . . .’” (quoting *Eur. & Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 129 (2d Cir. 1998))).

<sup>75</sup> *Id.* at 429.

<sup>76</sup> See, e.g., *In re Gaming Lottery Sec. Litig.*, 58 F. Supp. 2d 62, 75–76 (S.D.N.Y. 1999) (“The fraudulent activity allegedly engaged in by [defendant] within the United States stands in sharp contrast to the mere filing of SEC statements with no intention to victimize American shareholders, suggesting that there may be no need to search for additional ‘tipping factors’ as there was in *Interbrew*.”).

<sup>77</sup> Justice Potter Stewart famously stated in his concurring opinion in *Jacobellis v. Ohio*, a case about obscenity, “I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description [“hard-core pornography”]; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it . . . .” 378 U.S. 184, 197 (1964) (Stewart, J., concurring).

<sup>78</sup> See, e.g., *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 346, 368 (S.D.N.Y. 2005) (“Articulation of the rule is easy. The rub, like God and the devil, is in the details of its application.”); see also *In re Nat’l Austl. Bank Sec. Litig. (NAB I)*, No. 03-6537, 2006 WL 3844465, at \*3 (S.D.N.Y. Oct. 25, 2006) (“While articulation of the conduct test is easy, its application is not.”).

factors, a digression that easily leads to counterintuitive outcomes. To illustrate the unpredictability with which courts apply the tests in F-cubed cases, a comparison of two recent cases is useful.

*In re National Australia Bank Securities Litigation*<sup>79</sup> involved a class-action suit under section 10(b) and Rule 10b-5 by a class of plaintiffs consisting of both foreign and domestic investors against National Australia Bank (NAB), its CEO, and certain officers of HomeSide, a Florida-based NAB subsidiary, which was a mortgage service provider at the time of its acquisition by NAB in 1998.<sup>80</sup> The plaintiffs alleged that NAB made various false and misleading statements in SEC filings, in its annual reports, and in statements to the press regarding HomeSide's operations and its contribution to NAB's overall profitability.<sup>81</sup> Moreover, according to the plaintiffs, those statements were based on financial models for valuing HomeSide's future cash flow that were known by the defendants to yield unrealistic results.<sup>82</sup> When, in the summer and fall of 2001, the defendants announced that the bank would incur two write-downs due to a recalculation of the value of HomeSide's servicing rights, and the bank's true financial condition became clear to the public, the price of NAB ordinary shares on the Australian market and American Depository Receipts (ADRs) on the NYSE tumbled.<sup>83</sup> The plaintiffs alleged a fraudulent scheme whereby HomeSide falsified the value of its future cash flow in Florida and then sent the data to NAB in Australia, where NAB personnel incorporated the information into statements and filings disseminated to the public.

The district court dismissed for lack of subject-matter jurisdiction the claims of non-U.S. residents who purchased their NAB shares abroad.<sup>84</sup> The court began its analysis under the effects test. It stated:

To begin, the alleged fraud had very little—if any—demonstrable effect on the United States market. . . . Moreover, because the aggregate value of the ADRs represented a mere 1.1% of NAB's nearly one-and-a-half billion ordinary shares, any effect on the United States market from the alleged fraud pales in comparison to the effect on the foreign markets.<sup>85</sup>

Finding the effects test unsatisfied, the district court then turned to the conduct test and rejected the arguments advanced by the plaintiffs on that front as well. Despite the plaintiffs' allegations of HomeSide's misconduct in the United States—improperly valuing its future cash

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79 *NAB I*, 2006 WL 3844465.

80 *Id.* at \*1.

81 *Id.*

82 *Id.* at \*2.

83 *Id.*

84 *Id.* at \*3.

85 *Id.* at \*4.

flow by using a knowingly unreliable valuation model—the court characterized the domestic conduct as merely “a link in the chain of an alleged overall securities fraud scheme that culminated abroad” and agreed with the defendants that the securities fraud, if it occurred at all, took place when NAB distributed the allegedly false information to foreign purchasers abroad.<sup>86</sup>

On appeal to the Second Circuit, the plaintiffs sought to characterize the domestic conduct as “at very least ‘part of a single fraudulent scheme’ to inflate [HomeSide’s future cash flow] and, in turn, NAB’s stock price”<sup>87</sup> and stressed that “the misstatements made in Australia merely repeated and transmitted false information created in the United States.”<sup>88</sup> The plaintiffs argued that the district court had converted the conduct test into a “from where the misstatements originated and emanated” test and that this standard would allow foreign entities with U.S. subsidiaries to turn a blind eye to their subsidiaries’ U.S.-based misconduct and enjoy immunity from U.S. securities laws simply by creating and disseminating their public statements abroad.<sup>89</sup>

The Second Circuit, however, affirmed the district court’s ruling,<sup>90</sup> and its reasoning illustrates the difficulty with which courts apply the effects and conduct tests. The court began by characterizing the jurisdictional analysis as a “binary inquiry” that requires a court to “look to whether the harm was perpetrated here or abroad *and* whether it affected domestic markets and investors.”<sup>91</sup> Repeatedly casting the effects and conduct tests as two prongs of the same test, the court effectively condemned the plaintiffs’ argument from the outset.<sup>92</sup> The Second Circuit emphasized that the fraudulent statements at issue emanated from NAB’s headquarters in Australia, and it

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<sup>86</sup> *Id.* at \*8.

<sup>87</sup> Brief and Special Appendix for Plaintiffs-Appellants at 33, *Morrison v. Nat’l Austl. Bank Ltd. (NAB II)*, 547 F.3d 167 (2d Cir. 2008) (No. 07-0583-cv) [hereinafter *NAB II Plaintiffs’ Brief*] (citation omitted).

<sup>88</sup> Reply Brief for Plaintiffs-Appellants at 2, *NAB II*, 547 F.3d 167 (No. 07-0583-cv).

<sup>89</sup> *NAB II Plaintiffs’ Brief*, *supra* note 87, at 33.

<sup>90</sup> *NAB II*, 547 F.3d at 177.

<sup>91</sup> *Id.* at 171 (emphasis added).

<sup>92</sup> Indeed, the court went so far as to indicate that the lack of allegations satisfying the effects test weighed *against* the exercise of subject-matter jurisdiction. *Id.* at 176. As discussed above, however, courts do not require that plaintiffs satisfy *both* the effects test and the conduct test. *See supra* note 70 and accompanying text. Even courts that require plaintiffs to allege “additional tipping factors” to justify the exercise of subject-matter jurisdiction do not treat the effects and conduct tests as “binary.” For instance, the court in *Europe & Overseas Commodity Traders, S.A. v. Banque Paribas London* noted that it had previously “found jurisdiction over a predominantly foreign securities transaction under the conduct test when, in addition to communications with or meetings in the United States,” other additional tipping factors existed. 147 F.3d 118, 130 (2d Cir. 1998). These factors could take the form of “a transaction on a U.S. exchange, economic activity in the U.S., harm to a U.S. party, or activity by a U.S. person or entity meriting redress.” *Id.* That is, the court,

noted “the striking absence of any allegation” by the plaintiffs that what the defendants did “had any meaningful effect on America’s investors or its capital markets.”<sup>93</sup> These factors, in the court’s view, merited a decision affirming the district court. The first factor that the Second Circuit used to justify its decision—that NAB disseminated its public statements in Australia—is particularly noteworthy in light of the plaintiffs’ argument that the conduct test is not a “from where the misstatements originated and emanated” test, and also in light of previous cases, discussed in more detail below. The court allowed the place of compilation of the public statements (Australia), rather than the place of improper conduct (Florida), to determine jurisdiction. Underlying the court’s reasoning was its contention that the focus of Rule 10b-5 is on “the accuracy of *statements* to the public” and that “[e]nsuring the accuracy of such statements is much more central to the responsibilities of [NAB’s] corporate headquarters, which issued the statements, than to those of HomeSide, which did not.”<sup>94</sup>

The outcome of both *NAB* decisions is remarkable in comparison to *In re Alstom SA Securities Litigation*,<sup>95</sup> an F-cubed action with very similar facts, decided the year before *NAB I*. *Alstom* involved claims under the Securities Act and the Exchange Act against a French company involved in diverse businesses, including rail and marine transportation.<sup>96</sup> *Alstom*’s shares traded on the NYSE, the London Stock Exchange, and the Paris Exchange.<sup>97</sup> Although the court ultimately dismissed for lack of subject-matter jurisdiction the claims of the F-cubed plaintiffs as to one of two allegedly fraudulent schemes (the “Marine/Turbine Fraud”), it retained subject-matter jurisdiction over the claims of those purchasers as to another allegedly fraudulent scheme (the “ATI Fraud”).<sup>98</sup> The following discussion focuses on the court’s analysis with respect to the ATI Fraud, as its reasoning stands in stark contrast to the later reasoning of the *NAB* courts.

The ATI Fraud concerned allegations by the plaintiffs that *Alstom* knowingly, recklessly, or negligently incorporated into its financial statements fraudulent results that were based on the underreporting of costs on railcar construction projects at ATI, a wholly owned subsidiary of *Alstom* located in New York.<sup>99</sup> According to the plaintiffs, the purpose of this nondisclosure was to cause ATI to appear more profit-

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even while requiring something above and beyond satisfaction of the conduct test, did not go so far as to require a simultaneous satisfaction of the effects test.

<sup>93</sup> *NAB II*, 547 F.3d at 176.

<sup>94</sup> *Id.*

<sup>95</sup> 406 F. Supp. 2d 346 (S.D.N.Y. 2005).

<sup>96</sup> *See id.* at 353.

<sup>97</sup> *See id.*

<sup>98</sup> *See id.* at 397.

<sup>99</sup> *See id.* at 387.

able than the company's other sectors.<sup>100</sup> In essence, the plaintiffs argued that the nondisclosure of costs associated with the ATI railcar-construction contracts in SEC filings and other statements made those statements misleading as to Alstom's financial condition and artificially inflated the price of Alstom's securities.<sup>101</sup>

First, as to the effects test, the court early in its opinion held the test to be wholly inapplicable as a source of subject-matter jurisdiction over the claims of F-cubed plaintiffs.<sup>102</sup> This holding stands in contrast to the *NAB II* court's later characterization of the subject-matter inquiry as "binary" and its implication that, had the plaintiffs alleged sufficient adverse effects on American purchasers, their case would have been stronger. The *Alstom* court, however, saw a "piggyback" problem with applying the effects test in an F-cubed action. The court stated:

Plaintiffs suggest that this Court look to the harm the alleged frauds at Alstom caused domestic investors and the drastic decline in the share price of Alstom ADSs on the NYSE, and consider these facts in determining whether the Court has jurisdiction over the claims of an entirely separate set of individuals: the foreign investors who purchased their Alstom shares on foreign markets. The Court does not agree with Lead Plaintiffs that the foreign purchasers of Alstom shares listed on exchanges abroad may piggyback on the harm caused by the alleged fraud to investors and markets in the United States and thus bring their claims in United States courts.<sup>103</sup>

Turning then to the conduct test, the *Alstom* court *retained* subject-matter jurisdiction over F-cubed claims as to the ATI Fraud. The court's reasoning, to reiterate, is remarkable in juxtaposition with the later reasoning of the *NAB II* court resolving a case with nearly identical facts. The *Alstom* court reasoned that the allegedly fraudulent underreporting of costs occurred in the United States at ATI's New York office.<sup>104</sup> ATI concealed mounting costs associated with its railcar contracts and sent the inaccurate financial data to Alstom's headquarters in France, where the false or misleading information was incorporated into Alstom's corporate financial statements.<sup>105</sup> Consequently, the *Alstom* court, unlike the *NAB II* court, concluded that the allegedly fraudulent conduct occurred within the United States:

ATI is located in New York and the fraud, if any in fact occurred, was concocted and executed within ATI. . . . The false documents may have been sent to Alstom headquarters in France and incorpo-

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<sup>100</sup> See *id.*

<sup>101</sup> See *id.* at 387–88.

<sup>102</sup> See *id.* at 369.

<sup>103</sup> *Id.*

<sup>104</sup> *Id.* at 394.

<sup>105</sup> *Id.* at 394–95.

rated into the Company's financial reports, but[ ] . . . the mailing of the fraudulent documents for publication outside of the United States does not render the conduct in the United States any less of a cause of plaintiffs' losses.<sup>106</sup>

Thus, although the *NAB II* court allowed the place of compilation of the public statements to determine jurisdiction, the *Alstom* court focused on the place of improper conduct. As the foregoing makes clear, courts do not apply the effects and conduct tests predictably. Rather, courts manage to reach opposite outcomes, even in cases involving comparable claims and facts.

### III

#### APPLYING A "FRAUD-ON-THE-GLOBAL-MARKET" THEORY TO SUPPORT EXERCISING SUBJECT-MATTER JURISDICTION IN F-CUBED ACTIONS

This Part seeks to link the foregoing discussions of market efficiency, fraud-on-the-market, and judicial treatment of subject-matter jurisdiction by examining a recent argument made by plaintiffs: that a "fraud-on-the-global-market" theory ought to support the exercise of subject-matter jurisdiction in F-cubed actions on the basis of the conduct test. This Part concludes that the "fraud-on-the-global-market" argument, though almost universally rejected by courts, not only is viable but also almost necessarily follows from the Supreme Court's decision in *Basic v. Levinson* and ought to be accepted by courts to support the exercise of subject-matter jurisdiction in F-cubed actions. The opposite conclusion forces courts into the illogical position of accepting the efficiency of the global market for an issuer's securities for some purchasers but not for others. Moreover, to reject the theory by citing concerns about jurisdictional "overreach" (as many courts do) makes little sense because no one quarrels with the extraterritorial application of the securities laws for plaintiffs who can show direct reliance.

#### A. The "Fraud-on-the-Global-Market" Argument in Context

Foreign purchasers typically seek to establish subject-matter jurisdiction under the conduct test.<sup>107</sup> As discussed above, plaintiffs do so

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<sup>106</sup> *Id.* at 396.

<sup>107</sup> *See Pension Comm. v. Banc of Am. Sec., LLC*, 592 F. Supp. 2d 608, 620 (S.D.N.Y. 2009) ("Where the court is determining whether the claims of foreign plaintiffs should be dismissed, the relevant analysis is the conduct test."); *see also supra* text accompanying notes 102–03 (highlighting the *Alstom* court's position that the effects tests is inapplicable as a source of subject-matter jurisdiction over the claims of F-cubed plaintiffs). Hannah Buxbaum has noted that arguments by foreign investors seeking to establish subject-matter jurisdiction on the basis of the *effects* test have "uniformly failed" and that "[d]ue to the difficulties in satisfying the effects test, most investors whose claims arise from foreign-

by alleging that a defendant engaged in certain conduct in the United States—for instance, filing an SEC statement containing a misrepresentation or omission—that materially advanced the defendant’s fraudulent scheme and caused the plaintiffs’ losses. Using the Second Circuit’s standard as a model, this argument requires plaintiffs to show that the defendant’s U.S.-based conduct (1) was more than merely preparatory to the fraud and (2) directly caused the plaintiffs’ losses.<sup>108</sup> The first prong focuses on the amount and nature of the defendant’s acts in the United States. The second prong requires plaintiffs to establish causation through reliance on the defendant’s misstatements. Thus, F-cubed plaintiffs have proposed—with little success—that a fraud-on-the-global-market<sup>109</sup> theory ought to establish reliance and satisfy the conduct test in cases involving cross-border transactions in much the same way that the traditional fraud-on-the-market theory operates to create a rebuttable presumption of reliance, as established in *Basic*.<sup>110</sup> No doubt, this argument draws on the efficient-market hypothesis, expanded into the global arena: to link misrepresentations in the United States with effects on securities prices abroad, F-cubed plaintiffs argue that information publicly available in one country will affect the price of the issuer’s securities in other countries as well.

*In re AstraZeneca Securities Litigation*<sup>111</sup> is a particularly illustrative case. A typical F-cubed class action, *AstraZeneca* involved claims under section 10(b) and Rule 10b-5 against AstraZeneca, a U.K.-based pharmaceutical company, with the plaintiffs alleging that an anticoagulant drug developed by AstraZeneca was not as safe or effective as the company’s statements suggested and that certain risks associated with the drug were not disclosed to the public.<sup>112</sup> These alleged nondisclosures and misstatements, the plaintiffs argued, caused the price of As-

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market transactions rely on U.S. conduct as a jurisdictional basis.” Buxbaum, *supra* note 14, at 42, 43. As one court explained, foreign plaintiffs who purchased a defendant-issuer’s securities on a foreign exchange typically have trouble establishing subject-matter jurisdiction on the basis of the effects test because they cannot show that the relevant U.S. effects have any relation to their claims: “These investors were not American investors, they did not purchase their securities on an American exchange, and they did not suffer the effects of [defendant’s] alleged conduct within the United States. Therefore, there is no domestic effect of [defendant’s] conduct *in relation to these plaintiffs*.” *Tri-Star Farms Ltd. v. Marconi, PLC*, 225 F. Supp. 2d 567, 573 (W.D. Pa. 2002) (emphasis added).

<sup>108</sup> See Calhoun, *supra* note 23, at 697–98, 709–13.

<sup>109</sup> See Hannah L. Buxbaum, *Transnational Regulatory Litigation*, 46 VA. J. INT’L L. 251, 262 (2006) (“[The F-cubed plaintiffs] suggested a sort of ‘fraud on the global market’ theory: even if they did not rely directly on the fraudulent SEC filings . . . , the statements in those filings would necessarily have affected the price of shares in the foreign markets.”).

<sup>110</sup> See *Basic Inc. v. Levinson*, 485 U.S. 224, 250 (1988).

<sup>111</sup> 559 F. Supp. 2d 453 (S.D.N.Y. 2008).

<sup>112</sup> *Id.* at 456–57.

traZeneca's stock, which traded on the NYSE, the London Stock Exchange, and the Stockholm Exchange,<sup>113</sup> to be artificially inflated, so that when the FDA ultimately revealed these risks and denied approval of the drug, the plaintiffs suffered losses resulting from the stock-price decline.<sup>114</sup> The plaintiffs argued that the court had subject-matter jurisdiction over the claims of F-cubed members of the class on the basis of the conduct test. As to the first prong of the conduct test, the plaintiffs alleged that numerous misleading press releases were produced at AstraZeneca's office in Delaware, that several alleged misrepresentations took place at the Annual Business Review in Delaware, that the defendants filed a misleading annual report with the SEC, and that the defendants conducted several meetings with analysts and investors in the United States.<sup>115</sup> To satisfy the second prong of the conduct test, the plaintiffs, rather than alleging specific reliance on the defendant's fraudulent acts in the United States, invoked the fraud-on-the-market doctrine with a global twist: they argued that AstraZeneca stock traded in an efficient global market, shown by allegations that the stock prices on all three exchanges "tracked one another" during the relevant period and that "AstraZeneca's stock price dropped materially on all three exchanges when the FDA exposed the previously undisclosed data about [the drug] and declined to approve the drug."<sup>116</sup> Moreover, because AstraZeneca was followed by analysts at major brokerage firms whose reports were publicly available, "the market for AstraZeneca's securities promptly digested current information regarding AstraZeneca from all publicly available sources and reflected such information in AstraZeneca's stock price on each exchange upon which it was traded."<sup>117</sup> Thus, even if foreign purchasers had not relied directly on AstraZeneca's alleged misstatements, given the efficiency of the global market for AstraZeneca stock, fraudulent misstatements or omissions made in the United States would necessarily affect the price of AstraZeneca stock on foreign exchanges and cause harm to individuals who purchased their shares abroad. The plaintiffs hoped that this argument would satisfy the "direct causation" prong of the conduct test.

#### B. Fraud-on-the-Global-Market Rejected

Despite finding that the plaintiffs had satisfied the first prong of the conduct test by adequately alleging that AstraZeneca's U.S. con-

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<sup>113</sup> *Id.*

<sup>114</sup> *Id.* at 457.

<sup>115</sup> *Id.* at 465.

<sup>116</sup> Plaintiffs' Opposition to All Defendants' Motions to Dismiss the Amended Complaint at 37, *AstraZeneca*, 559 F. Supp. 2d 453 (No. 05-CV-2688) [hereinafter *AstraZeneca Motion to Dismiss Opposition*].

<sup>117</sup> *Id.* at 42.

duct was more than merely preparatory to the fraud, the *AstraZeneca* court rejected the plaintiffs' suggestion that a fraud-on-the-global-market theory was sufficient to satisfy the second prong.<sup>118</sup> Accordingly, the court dismissed for lack of subject-matter jurisdiction the claims of foreigners who acquired AstraZeneca stock on foreign exchanges.<sup>119</sup> The court noted simply:

Courts that have rejected a global fraud-on-the-market theory have not done so because they believe the theory does not hold true on a global level, but rather because of a concern that allowing foreign purchasers on foreign exchanges to plead reliance in this manner would extend the jurisdictional reach of the United States securities laws too far.<sup>120</sup>

Thus, even in the face of a robust argument in support of the theory—indeed, the court conceded the plaintiffs' "valid point" about market efficiency<sup>121</sup>—the court's decision turned on its concern about jurisdictional overreach. The question of how far our securities laws ought to reach is no doubt a valid inquiry. Nevertheless, the court misdirected this concern by expressing it in response to plaintiffs' fraud-on-the-global-market argument, an argument made to satisfy the second prong of the conduct test (the "direct causation" prong). By finding the first prong (the "more than merely preparatory" prong) satisfied, the court ought to have allayed any concern it had about jurisdictional overreach. That is, by finding the U.S. conduct sufficient to satisfy the first prong, the court should have moved on to the second prong and considered the fraud-on-the-global market argument free of any worry about jurisdictional overreach.

Another representative case is *In re Baan Co. Securities Litigation*,<sup>122</sup> an F-cubed action that predates *AstraZeneca* by several years but involved a similar (and similarly unsuccessful) attempt by plaintiffs to advance the fraud-on-the-global-market argument. Remarkable, however, is the absence of any analysis of market efficiency by the court. In *Baan*, the plaintiffs brought a section 10(b) action against a Dutch corporation whose securities traded both in the United States and abroad.<sup>123</sup> The class alleged that the defendant company inflated its reported revenue and earnings through a "consignment sale[ ]" scheme in which the company booked revenue on sales it knew were not final.<sup>124</sup> Moreover, according to the plaintiffs, the company failed to disclose that the consignment sales were being treated as revenue

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118 *AstraZeneca*, 559 F. Supp. 2d at 465–66.

119 *Id.* at 466.

120 *Id.*

121 *Id.*

122 103 F. Supp. 2d 1 (D.D.C. 2000).

123 *Id.* at 4.

124 *Id.* at 6.

in annual and quarterly reports filed with the SEC, in press releases disseminated over the internet, and in statements to the press.<sup>125</sup> The plaintiffs argued that, because “Baan shares worldwide traded in tandem on efficient markets,” fraudulent conduct perpetrated in the United States would “simultaneously manifest itself here and abroad.”<sup>126</sup> Thus, misstatements contained in U.S. filings would necessarily affect both the price of Baan’s stock on foreign exchanges, causing harm to individuals who purchased their securities abroad, and the price of Baan’s stock on domestic exchanges, causing harm to individuals purchasing in the United States.

The court in *Baan* rejected the plaintiffs’ argument and granted the motion to dismiss for lack of subject-matter jurisdiction as to those plaintiffs who neither resided in the United States nor purchased Baan stock in the United States.<sup>127</sup> In a hasty dismissal, the court stated merely that “employing [a fraud-on-the-global-market] doctrine to fulfill the requirements of the conduct test would extend the reach of the 1934 Act too far.”<sup>128</sup> Thus, like the *AstraZeneca* court, the court here too was principally concerned with congressional intent as to the extraterritorial application of the Exchange Act. Again, although this concern is certainly valid, the court misdirected its concern by discussing it in the context of the “direct causation” prong of the conduct test, rather than addressing it as part of the first prong. In using jurisdictional overreach as a response to the plaintiffs’ fraud-on-the-global-market argument, the court simply gave itself permission to dismiss the argument without considering it at all. Indeed, nowhere in its opinion does the court even mention market efficiency. This omission is surprising considering that the plaintiffs alleged in their complaint<sup>129</sup> and argued in opposition to the motion to dismiss<sup>130</sup> that the worldwide market for Baan securities was an efficient one. As proof, the plaintiffs noted that “Baan shares worldwide traded in tandem”<sup>131</sup>

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<sup>125</sup> *Id.*

<sup>126</sup> Memorandum of Law in Opposition to Defendants Baan Company, William O. Grabe, David G. Hodgson, Amal M. Johnson, Tom C. Tinsley and N.M. Wagenaar’s Motion to Dismiss the Consolidated Amended Complaint at 26, *Baan*, 103 F. Supp. 2d 1 (No. 98-CV-02465) [hereinafter *Baan* Motion to Dismiss Opposition].

<sup>127</sup> *Baan*, 103 F. Supp. 2d at 4.

<sup>128</sup> *Id.* at 10. In another F-cubed action, *Tri-Star Farms Ltd. v. Marconi, PLC*, 225 F. Supp. 2d 567, 579, 581 (W.D. Pa. 2002), the district court cited *Baan* and, using nearly identical language, summarily granted defendant’s motion to dismiss for lack of subject-matter jurisdiction the claims of foreign purchasers. The court simply stated that “[e]mploying the ‘fraud-on-the-market’ doctrine to satisfy the conduct test in this type of class action lawsuit involving overwhelmingly foreign transactions would extend the jurisdictional reach of the securities laws too far.” *Id.* at 579.

<sup>129</sup> See Amended Consolidated Complaint for Violation of the Securities Exchange Act of 1934 at 64, *Baan*, 103 F. Supp. 2d 1 (No. 98-CV-02465) [hereinafter *Baan* Complaint].

<sup>130</sup> *Baan* Motion to Dismiss Opposition, *supra* note 126.

<sup>131</sup> *Id.* at 26.

and that Baan stock was followed by securities analysts at major brokerage firms whose reports entered the public marketplace.<sup>132</sup> In sum, according to the plaintiffs, “the market for Baan securities promptly digested current information regarding Baan from all publicly available sources and reflected such information in Baan’s securities prices. Under these circumstances, all purchasers of Baan securities during the Class Period suffered similar injury.”<sup>133</sup> Despite such arguments, the court rejected the fraud-on-the-global-market argument without any discussion of market efficiency.

### C. Viability of the Fraud-on-the-Global-Market Argument

Given the interconnectedness of today’s securities markets, the fraud-on-the-global-market theory should be a viable argument. In establishing the appropriateness of applying a rebuttable presumption of reliance supported by the traditional fraud-on-the-market theory, the *Basic* Court stated: “The modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases, and our understanding of Rule 10b-5’s reliance requirement must encompass these differences.”<sup>134</sup> Why, then, should our understanding of Rule 10b-5’s reliance requirement not take into account the fact that securities transactions now involve the cross-border exchange of millions of shares every day? In fact, it is illogical to assume that the reasoning in *Basic* does not extend to a worldwide market for a particular issuer’s stock when the worldwide market has the necessary indicators for efficiency. The *Basic* Court premised its holding on the understanding that, in an open and developed securities market, the propagation of material misstatements or the withholding of material information affects the price of securities.<sup>135</sup> If a market is open and developed, this economic principle surely holds true whether that open and developed market is wholly domestic or encompasses exchanges in more than one country. As the plaintiffs in *AstraZeneca* argued, “if securities reacted to information only within the United States, global traders would take advantage of the price differential and buy on one exchange to sell on another.”<sup>136</sup>

The current financial crisis is proof positive that the market effect of information disseminated in the United States is not restricted to U.S. securities markets. As discussed above, news that Lehman Broth-

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<sup>132</sup> Baan Complaint, *supra* note 129.

<sup>133</sup> *Id.* at 64–65.

<sup>134</sup> *Basic Inc. v. Levinson*, 485 U.S. 224, 243–44 (1988) (footnote omitted).

<sup>135</sup> *See id.* (citing *Peil v. Speiser*, 806 F.2d 1154, 1161 (3d Cir. 1986)).

<sup>136</sup> *AstraZeneca* Motion to Dismiss Opposition, *supra* note 116, at 41–42 (citation omitted).

ers would fail leaked on a Sunday, a day when markets around the world were closed.<sup>137</sup> Global markets reacted to the news upon opening the very next morning, and Lehman's demise turned out to be a trigger for a global financial crisis. The financial crisis makes plain that in today's interconnected world, information travels rapidly and can affect securities prices around the globe, no matter where that information is disseminated. Courts, however, by dismissing the claims of F-cubed plaintiffs for lack of subject-matter jurisdiction, ignore the global nature of the securities markets.

One particular problem with U.S. courts' almost systematic rejection of the fraud-on-the-global-market doctrine is that any rule restricting the doctrine to domestic markets creates a logical logjam. Courts—and defendants, for that matter—in F-cubed actions routinely concede the courts' subject-matter jurisdiction over the claims of three distinct investor groups: (1) U.S. residents who purchased their shares on a U.S. exchange; (2) non-U.S. residents who purchased their shares on a U.S. exchange; and (3) U.S. residents who purchased their shares on a foreign exchange.<sup>138</sup> Thus, courts accept that the fraud-on-the-market theory suffices to establish reliance for some investors whose claims arise from foreign transactions (for example, those in Group 3, U.S. residents purchasing abroad). This reasoning puts courts in the illogical position of finding that the global market is efficient for U.S. purchasers but not for many foreign purchasers.<sup>139</sup> Indeed, in *In re Bayer AG Securities Litigation*,<sup>140</sup> the court found itself in this very position after dismissing the claims of foreign

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<sup>137</sup> See *supra* notes 1–4 and accompanying text.

<sup>138</sup> See, e.g., *In re China Life Sec. Litig.*, No. 04 Civ. 2112, 2008 WL 4066919, at \*1 (S.D.N.Y. Sept. 3, 2008) (“The court rules that it has no subject matter jurisdiction over foreigners who purchased on the Hong Kong exchange. As to purchasers on the New York Stock Exchange or any other exchange in the United States, or Americans who purchased anywhere, there is subject matter jurisdiction.”); *In re SCOR Holding (Switzerland) AG Litig.*, 537 F. Supp. 2d 556, 560 n.3 (S.D.N.Y. 2008) (“It has not been suggested that this Court lacks subject matter jurisdiction over the claims of U.S. residents who purchased Converium shares on the SWX [Swiss Exchange], or over the claims of any person who purchased Converium ADSs on the NYSE. . . . [T]his Court does indeed possess such jurisdiction.”); *Tri-Star Farms Ltd. v. Marconi, PLC*, 225 F. Supp. 2d 567, 571 n.6 (W.D. Pa. 2002) (“Defendants do not challenge the court’s subject-matter jurisdiction over the claims of the City of Miami Fire Fighters’ and Police Officers’ Retirement Trust Fund or the putative class of persons who purchased Marconi ADRs on the NASDAQ market during the class period. This would include foreign as well as American purchasers of Marconi ADRs. . . . [T]he court agrees that it has subject-matter jurisdiction over these persons under the Exchange Act.”).

<sup>139</sup> See *Astrazeneca Motion to Dismiss Opposition*, *supra* note 116, at 42 n.33 (“[W]ithout the ability to rely on the doctrine to find causation for foreign purchasers, courts would be forced to make the illogical choice of either arbitrarily cutting off such claims of U.S. citizens for failure to establish reliance, or finding that foreign markets are efficient for U.S. investors but not foreign ones.”).

<sup>140</sup> 423 F. Supp. 2d 105 (S.D.N.Y. 2005).

purchasers of Bayer securities on foreign exchanges.<sup>141</sup> The court subsequently certified a class consisting of purchasers of Bayer shares on the U.S. over-the-counter market and purchasers of Bayer ADRs on the NYSE, as well as U.S. citizens or residents who purchased Bayer ordinary shares or ADRs on any other exchange;<sup>142</sup> presumably, then, the court satisfied itself that it had subject-matter jurisdiction over the claims of such investors.<sup>143</sup> Yet, as one commentator points out, “if the market in the issuer’s securities is in fact an efficient, global market, then the jurisdiction plaintiffs seek to establish over only a subset of claims based on foreign transactions . . . should—under the conduct test—be established over all claims based on foreign transactions.”<sup>144</sup> The only way out of this seemingly illogical position would be for the court to cut off such claims by U.S. purchasers for failure to establish reliance,<sup>145</sup> but this approach would no doubt fly in the face of *Basic* and would, moreover, ignore the realities of today’s efficient securities markets.

More troubling than the courts’ dismissal of a valid economic theory, though, is their tendency to do so because of concerns about jurisdictional overreach.<sup>146</sup> Cases like *Baan* and *AstraZeneca* illustrate a common fear among U.S. courts that allowing foreign purchasers on foreign exchanges to plead reliance through the fraud-on-the-global-market theory would extend the jurisdictional reach of the federal securities laws too far. As discussed above, this concern is properly addressed not by considering fraud-on-the-global-market, but by considering the defendant’s U.S.-based conduct. Furthermore, the conclusion of the *Baan* and *AstraZeneca* courts makes little sense for the F-cubed plaintiff who pleads *direct* reliance. If pleading reliance through the fraud-on-the-global-market theory would extend the reach of the federal securities laws too far, then why is the same not true if the plaintiff pled reliance the old-fashioned way? Why would the securities laws apply to a foreign purchaser on a foreign exchange who read and directly relied on a defendant’s statements<sup>147</sup> but not to

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<sup>141</sup> *Bayer*, much like *AstraZeneca*, concerned alleged misrepresentations and omissions about the safety and commercial viability of a drug manufactured, distributed, and promoted by the defendant, an international corporation headquartered in Germany whose shares traded both abroad and in the United States. *Id.* at 106–07. And, like the *AstraZeneca* court, the *Bayer* court dismissed the claims of F-cubed plaintiffs. *Id.* at 115.

<sup>142</sup> See *In re Bayer AG Sec. Litig.*, No. 03 Civ. 1546, at 2 (S.D.N.Y. Feb. 22, 2006) (order certifying class).

<sup>143</sup> The court, however, simply signed an order granting plaintiffs’ motion for class certification, depriving both sides of the reasoning behind its decision to do so. See *id.* at 3.

<sup>144</sup> Buxbaum, *supra* note 14, at 47–48.

<sup>145</sup> See *AstraZeneca* Motion to Dismiss Opposition, *supra* note 116, at 42 n.33.

<sup>146</sup> See *supra* notes 118–21, 127–28 and accompanying text.

<sup>147</sup> See, e.g., *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972).

a foreign purchaser on a foreign exchange who took advantage of the presumption of reliance afforded to him by *Basic*? U.S. courts have yet to address this question.

#### CONCLUSION

As the *NAB* plaintiffs argued in their certiorari petition, “[t]he Exchange Act and its role in transnational securities fraud is too important an issue in the current world-wide economic crisis to allow the lower courts to continue floundering in disarray with divergent standards.”<sup>148</sup> The arbitrariness with which U.S. courts apply the effects and conduct tests in F-cubed class actions is highly problematic, and without guidance from the legislature or the Supreme Court, lower courts have been free to engage in the kind of artificial line drawing that comparable cases with opposite outcomes such as *NAB II* and *Astom* exemplify. Furthermore, lower courts are quick to dismiss the fraud-on-the-global-market argument by citing concerns about jurisdictional overreach. The proper way to address this concern, however, is through consideration of the first prong of the conduct test, which involves the amount and nature of a defendant’s U.S.-based conduct, not through consideration of the second prong, where fraud-on-the-global-market comes into play.

The Supreme Court is finally set to consider this important question. To decide the case, the Court will no doubt have to pronounce a rule of decision. Whether it adopts the approach of the Second Circuit to decide the facts of *NAB* or whether it announces an entirely different standard remains to be seen. For example, the Court could choose to adopt a transaction-based approach, limiting subject-matter jurisdiction under the antifraud provisions to claims arising out of transactions on U.S. markets; but such an approach would exclude from a putative class any U.S. citizens who happened to purchase their shares abroad. Arguably, though, the globalization of securities markets has resulted in an increased need for investor protection. Denying class membership to American investors, then, is not ideal.

Instead, the Court could adopt the approach of the *NAB II* and *AstraZeneca* courts and require dismissal only of the claims of foreigners purchasing on foreign exchanges. As discussed above, however, this approach completely ignores the global nature of today’s securities markets. It is simply illogical to suggest that a particular issuer’s securities trade in an efficient worldwide market with respect to certain purchasers (U.S. citizens purchasing abroad) but not with respect to others (foreigners purchasing abroad). Furthermore, this ap-

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<sup>148</sup> Petition for a Writ of Certiorari at 5, *Morrison v. Nat’l Austl. Bank Ltd.*, No. 08-1191 (Mar. 23, 2009).

proach fails to take seriously the premise of *Basic v. Levinson*. In an efficient market—any efficient market—publicly available information determines securities prices. If the market for a particular issuer’s securities is an efficient one, it does not stop being so simply because certain investors happen to be non-U.S. residents or happen to have purchased their shares on a non-U.S. exchange.

This Note has attempted to show that the fraud-on-the-global-market doctrine is a logical extension of the traditional fraud-on-the-market theory and that, where there is an efficient worldwide market for an issuer’s securities, the doctrine ought to satisfy the second prong of the conduct test. Nevertheless, more than logic is at play, and when the Supreme Court tackles *NAB*, it will likely take a fresh look at the question of how far the securities laws *should* apply. In doing so, it need not choose between extending the reach of the securities laws too far and denying the economic validity of the fraud-on-the-global-market doctrine. If the Court retains the two-pronged conduct test, it ought to address any concerns about jurisdictional overreach as it considers the defendant’s U.S.-based conduct. If the Court finds the U.S.-based conduct sufficient—using whatever standard it deems appropriate, whether it is the Second Circuit’s “more than merely preparatory” test or an alternative approach—this finding should appease any worry about extending the reach of the securities laws too far. Free of any such concern, the Court should then consider the fraud-on-the-global-market argument in connection with the conduct test’s second prong. As I have attempted to show, the fraud-on-the-global-market doctrine is a viable theory given the interconnectedness of today’s securities markets, and the Court ought to accept it as a way to satisfy the conduct test’s “direct causation” prong.

