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The antifraud provisions of the U.S. securities laws have remained silent as to their extraterritorial reach since their enactment in the early 1930's. In the absence of clear Congressional guidance, U.S. courts have struggled to determine when and to what extent there should be subject matter jurisdiction over predominantly foreign claims. Each circuit that has addressed the issue has adopted some version of the "conduct test" established by the Second Circuit, but no version of this test has been applied consistently or without implicating serious foreign policy concerns. For the first time since the enactment of the securities laws, the Supreme Court has granted certiorari to address this issue. This article addresses the infirmities contained in current versions of the conduct test and concludes that the conduct test should include a reliance requirement that cannot be satisfied through the application of the fraud-on-the-market theory.

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I. INTRODUCTION

It now has been more than thirty years since Judge Friendly, in *Bersch v. Drexel Firestone, Inc.*,¹ provided a roadmap to navigate the extraterritorial application of the antifraud provisions of the U.S. securities laws. Over the past several decades, each circuit that has addressed this "vexing"² and "nebulous"³ issue has adopted some version of the Second Circuit's "conduct test" and "effects test" to aid in a determination of "whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to [predominantly-foreign claims] rather than leave the problem to foreign countries."⁴ Yet a true understanding of these jurisdictional tests seems even less accessible today.

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¹. 519 F.2d 974 (2d Cir. 1975).
⁴. *Bersch*, 519 F.2d at 985.
than when they first were derived and have become only more complicated in the face of rapidly developing technology and an increasingly global economy.

While the circuits have uniformly applied the effects test, there has been a split among the circuits in how they define and apply the conduct test. The split, however, has not been a conscious decision by the courts to apply a different standard for the conduct test. Instead, a closer look at the circuits’ decisions reveals that they all were attempting to follow the Second Circuit’s standard, and they were not nearly as divided at the outset as later courts have claimed. The current disagreement and divide rests not in a difference of opinion among the circuits, but rather in the ambiguity of the definition of the conduct test itself, which to this day remains a mystery to most who attempt to apply it.

The confusion engendered by the manner in which each circuit has interpreted and applied the conduct test implicates serious concerns, both as an administrative matter and as a policy matter. Administratively, no circuit has been able to consistently apply its own version of the conduct test, raising serious doubt as to whether any one of them should be the chosen standard. On the policy front, when any version of the conduct test is applied to actions brought on behalf of a class of unnamed foreign purchasers against a foreign defendant involving a foreign transaction—the so-called “foreign-cubed” class action—there is doubt as to whether the outcome would be recognized by a foreign jurisdiction, and whether such recognition would even be desirable.

Until now, neither the Supreme Court nor Congress has weighed in on the extraterritoriality of the antifraud provisions of the securities laws. For the first time since the enactment of the securities laws, this issue appears primed for resolution, or at least attention, at the hands of both the legislature and judiciary. In its 2008 decision, Morrison v. National Australia Bank Ltd., the Second Circuit became the first and only circuit to address the serious administrative and policy concerns raised by foreign-cubed class actions, upholding the district court’s refusal to assert subject matter jurisdiction, but vastly expanding the Second Circuit’s conduct test in the process.5 The Morrison plaintiffs appealed the decision, and on Novem-

5. Morrison, 547 F.3d at 175.
ber 30, 2009, the Supreme Court granted certiorari. The Supreme Court heard oral arguments on March 29, 2010.

Congress also shattered its seventy-five-year silence on the extraterritoriality of the antifraud provisions. The recent financial crisis has underscored glaring inadequacies with the world’s ability to regulate, detect, and police financial fraud. In the past year, there has been a deafening demand for accountability and retribution against those responsible for the crisis, and a corresponding push by the Obama Administration and Congress to revamp the financial laws on a massive scale to prevent it from reoccurring. Included in this rainstorm of reform is the extraterritoriality of the antifraud provisions. A recent proposal by the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises would codify the most lenient of the circuit standards—the version attributed to the Third, Eighth, and Ninth Circuits. The proposal eventually was limited by the House to cover only actions brought by the SEC.

Yet neither the decision in Morrison nor the proposals by Congress, if enacted, alleviate the serious infirmities contained in the conduct test. This article addresses the policy and administrative concerns associated with the conduct test, and proposes a version of the test to minimize these concerns. Section II provides a backdrop to the legislative and judicial treatment of the extraterritorial application of the antifraud provisions, and explains why the proposal by Congress to endorse what it believes to be the Third, Eighth and Ninth Circuits’ test is actually a test that those courts never adopted in the first place. Section III discusses the questions that have gone unanswered by the courts over the past forty years of case law, and the serious concerns implicated by those questions. Section IV addresses the Second Circuit’s attempt to answer those questions in its Morrison decision, and the concerns that remain for the Supreme Court to address. Lastly, Section V posits a solution to redress the problems with the conduct test; namely, that the conduct test should be refined to include a reliance requirement, as several district courts have interpreted it to

6. See Morrison, Docket No. 08-1191.
do, and that plaintiffs should not be permitted to satisfy this requirement by resort to the fraud-on-the-market theory.  

II.
The Genesis and Evolution of the Conduct and Effects Tests

A. Congressional Silence

In reaction to the stock market crash of 1929 and the Great Depression that followed, Congress passed the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act") to protect American investors from the type of fraud and manipulation that led to the financial crisis in the first place. In so doing, Congress did not provide for the extraterritorial application of the antifraud provision contained in either Act. This is perhaps unsurprising, as the Congress that enacted the securities laws could not have anticipated the future globalization of the American economy. As the D.C. Circuit noted in 1987, "[f]ifty years ago, Congress did not consider how far American courts should have jurisdiction to decide cases involving predominantly foreign securities transactions with some link to the United States. The web of international connections in the securities market was then not nearly as extensive or complex as it has

7. Although the antifraud provisions of the Securities Exchange Act and the Securities Act have both been subjected to the same conduct and effects tests, see, e.g., Bersch, 519 F.2d at 993 (fashioning a standard for the antifraud provisions of both the Securities Act and the Exchange Act), most of the courts that have addressed the extraterritoriality of the antifraud provisions have done so in the context of Section 10(b) of the Exchange Act, and its corresponding Rule 10b-5. This likely is a result of the fact that the Supreme Court has interpreted the Exchange Act as implying a private right of action under the antifraud provisions, while "there is sparse authority" for such implied right of action with respect to the Securities Act's antifraud provisions. Thomas Lee Hazen, The Law of Securities Regulation § 7.1 (5th ed. 2005); see also id. at § 12.2; Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 & n.9 (1971). As a result, this article focuses on the cases that address the extraterritoriality of the antifraud provisions of the Exchange Act.

8. See Hazen, supra note 8, at § 1.2[3].

9. See, e.g., Itoha 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.").
The web of international connections has grown exponentially since 1987, further validating this statement. As one commentator noted, "[h]ardly a day passes without the emergence of some new evidence of the interconnectedness of the world's financial markets."11

Despite this increasingly global economy, the regulation of the world's markets has remained largely a discrete sovereign task. Each nation has been left to grapple with the foreign policy considerations involved in deciding when, and to what extent, it should intervene in financial transactions involving both it and another country. As a result, and in the face of continued congressional silence on the matter, the inherently executive and legislative policy decision of whether the American securities laws should reach beyond U.S. borders, and exactly how far, has been surrendered to the judiciary for the past seventy-five years.

However, just as the Great Depression spawned drastic regulatory reform, the recent financial crisis and its devastating impact on the American public has led the Obama Administration and Congress to move financial regulatory reform to the forefront of their agenda. On June 17, 2009, the Treasury Department released an eighty-eight page White Paper—Financial Regulatory Reform: A New Foundation—in which the Administration details its plan to "restore confidence in the integrity of our financial system."12 Part of this reform plan includes "strengthen[ing] the SEC's authority to protect investors."13 The Administration delivered its Investor Protection

10. Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 30 (D.C. Cir. 1987); see also Bersh, 519 F.2d at 993 ("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 offshore funds thirty years later.").


Act to Congress on July 10, 2009. The Administration’s draft does not include any language regarding the extraterritoriality of the antifraud provisions, but on October 1, 2009, Congressman Kanjorski (D-Pa.), the Chairman of the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, released a discussion draft of the Investor Protection Act that does. The Kanjorski bill provides for the extraterritorial application of the antifraud provisions of the securities laws whenever there is either (i) “conduct within the United States that constitutes significant steps in furtherance of [a] violation, even if the securities transaction occurs outside the United States and involves only foreign investors” or (ii) “conduct occurring outside the United States that has a foreseeable substantial effect in the United States.”

The House eventually amended this language to apply only to actions brought by the SEC or the U.S. It is unclear how this provision will be reconciled with the Senate version, which does not amend the antifraud provisions to address extraterritoriality. It is also unclear when and if this legislation will even reach the White House. In the meantime, the courts are left to continue acting without Congressional guidance, a task with which they are quite familiar.

B. The Courts Fill the Gap Created by Congress: The Circuit Split That Never Was

While it is often the case that the judiciary interprets the rules promulgated by Congress, the Investor Protection Act reverses the trend. The courts have spent the last forty years devising an appropriate benchmark to determine whether and when the antifraud provisions of the securities laws should apply to the claims in a partially foreign case. There is currently

14. Id.
a perceived circuit split among the eight circuits that have weighed in on the issue. The Wall Street Reform and Consumer Protection Act seizes upon the one viewpoint that would give the greatest reach to the antifraud provisions—that attributed to the Third, Eighth, and Ninth Circuits. Yet a closer look at the cases in which these Circuits “adopted” this standard reveals that their test is not nearly as lenient as courts now portray it to be, and that there may never have been a circuit split in the first place.

1. The Birth of the Conduct and Effects Tests

In the absence of clear Congressional guidance, the courts took up the mantle of discerning the circumstances in which the antifraud provisions should apply to foreign transactions. The courts, however, recognized the murkiness of “the dubious but apparently unavoidable task of discerning a purely hypothetical legislative intent.”

The Second Circuit was the first to address the application of the antifraud provision to a partially foreign transaction in Schoenbaum v. Firstbrook, where the court applied an effects test to assert jurisdiction, and then again four years later in Leasco Data Processing Equipment Corp. v. Maxwell, where the court ap-

18. MCG, Inc. v. Great W. Energy Corp., 896 F.2d 170, 173 (5th Cir. 1990) (“When Congress drafted the securities laws, it did not consider the issue of extraterritorial applicability, requiring that the federal courts fill the void.”); Cont'l Grain (Austl.) Pty. Ltd. v. Pac. Oilseeds, Inc., 592 F.2d 409, 416 (8th Cir. 1979) (“In the absence of any guidance from legislative history, the courts have looked to general principles of international law, the language of the securities statutes, and the remedial purpose of these statutes.”) (internal citation omitted); Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968) (“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.”).


20. Schoenbaum, 405 F.2d at 207-08; see also Cont'l Grain, 592 F.2d at 417 n.12 (“The effects test was first stated in [Schoenbaum,] 405 F.2d at 208.”).
plied a nascent version of the conduct test to assert jurisdiction.21 Although Schoenbaum and Leasco can be credited for first applying the conduct and effects tests to determine a court's subject matter jurisdiction over predominantly-foreign claims arising under the antifraud provisions, it was not until 1975 that the Second Circuit, in two decisions issued on the same day, fashioned a standard to help courts determine "whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to [such claims] rather than leave the problem to foreign countries."22

Bersch, a 1975 decision written by Judge Friendly, involved a Canadian company that delivered misleading prospectuses to American and foreign purchasers of the company's stock, who then brought a class action against the company.23 The court held that in such partially-foreign cases, there would be subject matter jurisdiction over the claims of the American and foreign purchasers if the moving party were able to demonstrate sufficient U.S. conduct or sufficient U.S. effects, and created "tests" to determine when that burden has been satisfied. With respect to the conduct test, the court held that the antifraud provisions of the federal securities laws "[d]o not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses."24 Applying this test to the facts of the case, the court found that although United States lawyers, accountants and underwriters participated in preparing the prospectuses and organizing the underwriting, these actions were "merely preparatory" to the fraud, and insufficient to warrant the exercise of jurisdiction

21. Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1333-39 (2d Cir. 1972); see also Psiminos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir.1983) ("This [conduct] test was originally applied by us in Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326 (2d Cir.1972)."); Cont'l Grain, 592 F.2d at 417 (noting that the Leasco court was the first to apply a conduct test in the securities laws context).


23. Bersch, 519 F.2d at 977-80.

24. Id. at 993.
over the claims brought by the putative class of foreign purchasers.\textsuperscript{25}

With respect to the effects test, the court held that "there 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 effect on the American economy or American investors generally."\textsuperscript{26} The court held that the plaintiffs in \textit{Bersch} had not satisfied that standard, and rejected plaintiffs' contention that jurisdiction attached based on the adverse effect of the foreign conduct on U.S. markets and investors who were not a party to the case.

That same day, the court issued its decision in \textit{ITT v. Ven-cap, Ltd.}\textsuperscript{27} In that case, which involved a fraud carried out by a U.S. citizen, the Second Circuit remanded so that the district court could determine where the allegedly fraudulent conduct took place.\textsuperscript{28} The court rejected the contention that subject matter jurisdiction attached merely because the defendant was a U.S. citizen and conducted substantial non-fraudulent business in the United States.\textsuperscript{29} Additionally, the court was not persuaded by the fact that the plaintiff corporation had U.S. citizens and residents as fund-holders, since such a derivative claim impacted only 300 American investors.\textsuperscript{30} However, to the extent there was a "concoction of securities frauds in the United States for export," the court would have subject matter jurisdiction over a claim brought by a foreign individual.\textsuperscript{31}

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\textsuperscript{25} \textit{Id.} at 987.
\textsuperscript{26} \textit{Id.} at 989.
\textsuperscript{27} 519 F.2d 1001.
\textsuperscript{28} \textit{Id.} at 1018-19.
\textsuperscript{29} \textit{Id.} at 1011 ("It suffices to say at this point that insofar as the court relied on the facts that Pistell 'spends much of his business time in New York City purportedly on Vencap's business' and 'conducted the business of Vencap in the Southern District during the material times in the allegations', such reliance would not assist on subject matter jurisdiction if these references are to activities subsequent to the closing, as they seem to be, and if the fraud had been completed then."); see also \textit{id.} at 1016 ("It is simply unimaginable that Congress would have wished the anti-fraud provisions of the securities laws to apply if, for example, Pistell while in London had done all the acts here charged and had defrauded only European investors.").
\textsuperscript{30} \textit{Id.} at 1016-17.
\textsuperscript{31} \textit{Id.} at 1017-18.
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Like in Bersch, the court’s decision was “limited to the perpetration of fraudulent acts themselves and [did] not extend to mere preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries.”

What emerged from Bersch and ITT were conduct and effects tests that, if met, would trigger jurisdiction over a predominantly foreign transaction. Notably, the court in Bersch and in ITT limited its holdings to individual actions and actions brought by the SEC.

Following on the heels of these decisions, six other circuits adopted some formulation of the conduct and effects tests. There has never been much of a disagreement surrounding the effects test, perhaps due to the simplicity of its application. The conduct test, on the other hand, has proved to be not so straightforward. Even though all the circuits that have addressed the issue have employed the same requirements propounded by the Second Circuit, there is a divergence in the courts’ dicta. Therefore, despite a uniform application of the Second Circuit’s standard, the perception of a circuit split emerged.

2. The Third, Eighth and Ninth Circuits: The Development of the “More Lenient” Standard

Two years after Bersch and ITT provided a standard for navigating the extraterritorial application of the securities laws, the Third Circuit confronted the issue in SEC v. Kasser. The court undertook the Second Circuit’s analysis, concluding that the U.S.-based fraud in Kasser “was much more substantial than the United States-based activities in ITT. It thus would appear that ITT supports jurisdiction over this SEC suit, which is primarily for injunctive relief.” According to the Kasser court, it was clear that the acts within the United States did “directly cause” the claimed losses because “the defendants’ conduct occurring within the borders of this nation was essential to the plan to defraud the Fund. . . . In sum, the prior pronouncements of this Court and those of the Second Circuit, a court with especial expertise in matters pertaining to

32. Id. at 1018.  
34. Kasser, 548 F.2d at 115 (citation omitted).
securities, lend great support for a holding of jurisdiction here.\textsuperscript{35}

Despite describing and applying the Second Circuit's standard, the Third Circuit stated that, "[t]he federal securities laws, in our view, do grant jurisdiction in transnational securities cases where at least some activity designed to further a fraudulent scheme occurs within this country."\textsuperscript{36} Whether or not the Third Circuit actually intended to create a more relaxed standard with this statement than the standard created by the Second Circuit, later courts interpreted it as so doing, and as a result the holding in \textit{Kasser} represented the first step towards the apparent circuit split that exists today.

In 1979, in \textit{Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.}, the Eighth Circuit seized on the \textit{Kasser} language and asserted that \textit{Kasser} "extended the boundaries of the necessary domestic conduct required to find subject matter jurisdiction as defined in \textit{Bersch-II}."\textsuperscript{37} The \textit{Continental Grain} court appeared to adopt what it viewed as the Third Circuit's more relaxed version of the conduct test.\textsuperscript{38} When the court concluded its analysis, it reiterated a modified version of this standard, stating that, "where defendants' conduct in the United States was in furtherance of a fraudulent scheme and was significant with respect to its accomplishment, and moreover necessarily involved the use of the mails and other instrumentalities of interstate commerce, the district court has subject matter jurisdiction."\textsuperscript{39}

Yet despite pronouncing a standard more lenient than the one applied by the Second Circuit, the \textit{Continental Grain} court performed its analysis under the Second Circuit's test just as the \textit{Kasser} court had done. According to the \textit{Continental Grain} court, "[t]he conduct in the United States cannot be 'merely preparatory,' and must be material, that is, 'directly cause the losses.' In our opinion, finding subject matter jurisdiction after such an analysis is consistent with the subjective

\textsuperscript{35} \textit{Id.} (internal citation omitted).
\textsuperscript{36} \textit{Id.} at 114.
\textsuperscript{37} 592 F.2d 409, 418-19 (8th Cir. 1979).
\textsuperscript{38} \textit{Id.} at 415 ("The federal securities laws, in our view, do grant jurisdiction in transnational securities cases where at least some activity designed to further a fraudulent scheme occurs within this country.") (quoting \textit{Kasser}, 548 F.2d at 114).
\textsuperscript{39} \textit{Cont'l Grain}, 592 F.2d at 421 (internal citation omitted).
territorial principle of international law, the intent of Congress and the remedial purpose of the federal securities laws.\textsuperscript{40} 

The Ninth Circuit followed suit in \textit{Grunenthal GmbH v. Hotz},\textsuperscript{41} when it adopted the Third and Eighth Circuits’ version of the conduct test, stating that it believed that this test “advances the policies underlying federal securities laws.”\textsuperscript{42} Again, however, like the Third and Eighth Circuits before it, the test that the \textit{Grunenthal} court expressly adopted and applied contained the very same requirements as those found in the Second Circuit’s conduct test—i.e., that “[t]he conduct in the United States cannot be merely preparatory... and must be material, that is, directly cause the losses.”\textsuperscript{43}

Thus, despite language by the Third, Eighth and Ninth Circuits suggesting that they intended to broaden the jurisdictional reach of the antifraud provisions as previously outlined in \textit{Bersch} and \textit{ITT}, each court applied the Second Circuit standard in arriving at its holding, requiring that the U.S. conduct be “more than merely preparatory” and that it “directly cause” the claimed losses.

3. \textit{The D.C., Fifth, Seventh, and Eleventh Circuits: Solidifying the Circuit “Split”}

The \textit{Grunenthal} decision in 1983 represented the last time that there was any confusion about whether a circuit court was attempting to broaden the application of the antifraud provisions beyond the boundaries established by the Second Circuit. The next four circuits to address the issue—the D.C., Fifth, Seventh, and Eleventh Circuits—all expressly adopted the Second Circuit’s version of the conduct test. In the process, those courts also solidified the perception of a circuit split.

By the time the D.C. Circuit’s decision in \textit{Zoelsch v. Arthur Andersen & Co.}\textsuperscript{44} was handed down in 1987, there was already a perceived divide between the circuits resulting from the Third, Eighth, and Ninth Circuits’s expansive dicta. The court in

\textsuperscript{40} Id. at 420 (internal citations omitted).
\textsuperscript{41} 712 F.2d 421 (9th Cir. 1983).
\textsuperscript{42} Id. at 424.
\textsuperscript{43} Id. (quoting \textit{Cont’l Grain}, 592 F.2d at 420).
\textsuperscript{44} 824 F.2d 27 (D.C. Cir. 1987).
Zoelsch described the landscape as involving "[s]everal tests," each dealing in their own way with the issue of "when American courts have jurisdiction over domestic conduct that is alleged to have played some part in the perpetration of a securities fraud on investors outside this country."\(^4\) According to the court, "[t]he Second Circuit has set the most restrictive standard,"\(^4\) while "[t]he Third, Eighth, and Ninth Circuits appear to have relaxed the Second Circuit's test."\(^4\) Yet despite announcing a divide between these courts, the D.C. Circuit acknowledged that these three courts, in fact, did follow the Second Circuit's lead by asserting "jurisdiction only when the conduct in this country 'directly causes' the losses elsewhere."\(^4\)

Ironically, just as the Third, Eighth, and Ninth Circuits had described a more lenient standard only to apply the Second Circuit's, the Zoelsch court described a more restrictive standard only to apply the Second Circuit's standard in the end. According to the court, "[t]he Second Circuit's rule seems to be that jurisdiction will lie in American courts where the domestic conduct comprises all the elements of a defendant's conduct necessary to establish a violation of section 10(b) and Rule 10b-5: the fraudulent statements or misrepresentations must originate in the United States, must be made with scienter and in connection with the sale or purchase of securities, and must cause the harm to those who claim to be defrauded, even though the actual reliance and damages may occur elsewhere."\(^4\) The court went on to "adopt what we understand to be the Second Circuit's test for finding jurisdiction based on domestic conduct."\(^5\)

Yet again, however, the Zoelsch court's dicta regarding what it believed to be the appropriate standard did not deter it from accurately describing and applying the Second Circuit's conduct test: "To put the matter in the Second Circuit's terminology, [the defendant's] alleged misrepresentations. . . were

\(^{45}\) Id. at 30.
\(^{46}\) Id.
\(^{47}\) Id. at 31.
\(^{48}\) Id. (citing SEC v. Kasser, 548 F.2d 109, 115 (3d. Cir. 1977); Cont'l Grain, 592 F.2d at 418-20; Grunenthal, 712 F.2d at 424).
\(^{49}\) Id.
\(^{50}\) Id. at 33.
'merely preparatory' to any fraud perpetrated on [the plaintiffs], and did not 'directly cause' their losses."\textsuperscript{51}

Ten years later, in \textit{Robinson v. TCI/US West Communications Inc.}, the Fifth Circuit also adopted the Second Circuit's standard as "the better reasoned of the competing positions."\textsuperscript{52} Like the court in \textit{Zoelsch}, the Fifth Circuit described the holdings by the Third, Eighth and Ninth Circuits as "requir[ing] some lesser quantum of conduct [than that required under the Second Circuit's version of the test]. To the extent that these cases represent a common position, it appears to be that the domestic conduct need be only significant to the fraud rather than a direct cause of it."\textsuperscript{53} However, the \textit{Robinson} court expressly rejected the D.C. Circuit's interpretation of the Second Circuit's conduct test as requiring all elements of a 10b-5 action to occur in the United States.\textsuperscript{54} Despite what it viewed to be misguided dicta by the D.C. Circuit, the \textit{Robinson} court nonetheless concluded that the D.C. Circuit righted the ship by adopting and properly applying the correct Second Circuit standard.\textsuperscript{55}

The Seventh Circuit joined the D.C. and Fifth Circuits in 1998 in \textit{Kauthar v. Sternberg},\textsuperscript{56} and cemented the apparent division among the circuits: "Although the circuits that have confronted the matter seem to agree that there are some transnational situations to which the antifraud provisions of the securities laws are applicable, agreement appears to end at that point."\textsuperscript{57} Like the courts before it, the Seventh Circuit categorized the Third, Eighth and Ninth Circuits's test as less stringent than that employed by the Second, Fifth and D.C. Circuits. Unlike the Fifth Circuit, the \textit{Kauthar} court did not view as harmless dicta the D.C. Circuit's statement that every element of a 10b-5 action must occur within the United States, but rather viewed this as a doctrinal divide between the D.C. Circuit on the one hand and the Second and Fifth Circuits on

\textsuperscript{51} \textit{Id.} at 35 (citing Bersch v. Drexel Firestone Inc., 519 F.2d 974, 992-93 (2d Cir. 1975)).

\textsuperscript{52} 117 F.3d 900, 906 (5th Cir. 1997).

\textsuperscript{53} \textit{Id.}

\textsuperscript{54} \textit{Id.} at 905 n.10.

\textsuperscript{55} \textit{Id.}

\textsuperscript{56} 149 F.3d 659 (7th Cir. 1998).

\textsuperscript{57} \textit{Id.} at 665.
the other. Among the three apparently distinct approaches to the conduct test, the *Kauthar* court believed that "[t]he Second and Fifth Circuit’s iterations of the test embody a satisfactory balance of the competing [policy] considerations."59

For more than ten years after the Seventh Circuit’s decision in *Kauthar*, no new circuit addressed the issue. But in August 2009, the Eleventh Circuit quietly adopted the Second Circuit’s version of the conduct test in *In re CP Ships Ltd. Securities Litigation*.60 In *In re CP Ships*, the parties had reached a settlement that was ratified by the district court. The Eleventh Circuit affirmed the ratification, and rejected the argument of an objector to the settlement who claimed that the court did not have subject matter jurisdiction over the claims of foreign purchasers of the defendant company’s stock.61 Although not expressly stating that it was adopting the Second Circuit’s version of the conduct test, in undertaking its analysis, the Eleventh Circuit cited only Second Circuit cases for support, and held that the conduct test is satisfied “whenever (1) the defendant’s activities in the United States were more than merely preparatory to a securities fraud conducted elsewhere and (2) the activities or culpable failures to act within the United States directly caused the claimed losses.”62 In so holding, the Eleventh Circuit became the most recent addition to the Second, Fifth, Seventh and D.C. Circuits’ side of the divide.

So despite dicta by the Third, Eighth, and Ninth Circuits that appeared to expand the Second Circuit’s version of the conduct test, and dicta by the D.C. Circuit appearing to constrict it, each and every circuit that has addressed this issue has held that subject matter jurisdiction exists where the U.S. conduct is “more than merely preparatory” and “directly causes” the claimed losses.63 Yet the perception of a circuit split has led to a very real split at the district court level. Although sev-

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58. Id. at 665-66.
59. Id. at 667.
60. 578 F.3d 1306, 1313 (11th Cir. 2009).
61. Id. at 1310, 1313-17.
62. Id. at 1313 (quoting SEC v. Berger, 322 F.3d 187, 193 (2d Cir. 2003)).
eral courts in the Third Circuit have recognized that the language in those earlier circuit decisions was pure dicta, there are a number of courts that have applied that dicta as the operative standard. Even more problematic, however, is the fact that each version of the conduct test has been inadequately defined for decades, and as such poses serious concerns.

III. THE QUESTIONS PRESENTED BY THE CONDUCT TEST AND THE FORTY YEARS OF JURISPRUDENCE THAT HAVE LEFT THEM UNANSWERED

The majority of the circuits, and all that have addressed the extraterritorial reach of the antifraud provisions of the U.S. securities laws since 1983, have adopted the Second Circuit’s version of the conduct test, requiring that the U.S. conduct be “more than merely preparatory” and that it “directly cause” the claimed losses abroad. Even the three circuits in the minority have employed these factors in their jurisdictional analysis. This apparent harmony, however, has not translated into a workable jurisdictional standard. To the contrary, three fundamental questions underlying the conduct test remain unanswered: (1) what is the type and amount of U.S. conduct that is necessary to trigger subject matter jurisdiction over a foreign claim; (2) what link between the U.S. conduct and the foreign claim is required to confer jurisdiction;

Kasser, 548 F.2d 109, 115 (3d Cir. 1977); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987, 993 (2d Cir. 1975).

64. See, e.g., Tri-Star Farms Ltd. v. Marconi, PLC, 225 F. Supp. 2d 567, 576 (W.D. Pa. 2002) (“[T]he United States-based conduct in Straub and Kasser was so extensive that jurisdiction was likely proper under any standard, including that applied in Bersch. Thus, the facts in Straub and Kasser did not require the court of appeals to decide the issue of whether direct causation is a necessary element of the ‘conduct test.’”).

and (3) do the answers to questions 1 and 2 depend at all on whether the action is an individual one, voluntarily brought by the foreign claimant, as opposed to a class action, brought on behalf of unnamed foreign claimants who have not affirmatively chosen to bring their claims in the United States?

These questions strike at the core of the conduct test, and their answers could have a transformative effect on the jurisdictional boundaries of the antifraud provisions. Yet since the pronouncement of the varying standards for the conduct test, most of the circuits have not revisited the issue of the extraterritoriality of the antifraud provisions at all, much less to address these three questions. The Third and Eighth Circuits have not rendered a decision on the extraterritoriality of the antifraud provisions in over thirty years, while the Fifth, Seventh and Ninth Circuits have not addressed it in over ten. Only the Second Circuit has confronted the issue on more than several occasions, deciding seven cases in the thirty-plus years following Bersch and IIIT. While the Second Circuit has provided guidance on the type of conduct required to establish subject matter jurisdiction over the claims of foreign plaintiffs, until its decision in Morrison, it had not provided direction with respect to the second two questions.

A. The Type of Conduct Required to Satisfy the Conduct Test

All of the circuits that have addressed the extraterritoriality of the antifraud provisions have held that in order to trigger subject matter jurisdiction by a U.S. court, the conduct must be "more than merely preparatory."66 The question, however, is what type of conduct represents conduct that is "more than merely preparatory." The Second Circuit has provided guidance on this issue, including in Bersch.67 The line drawn is a simple one: conduct that is carried out to create the fraudulent statement is "merely preparatory," while the act of filing, mailing or releasing the false statement is more than merely preparatory, and therefore is the relevant conduct for

66. See In re CP Ships, 578 F.3d at 1313; Kauthar, 149 F.3d at 667; Robinson, 117 F.3d at 907; Zoelsch, 824 F.2d at 35; Grunenthal, 712 F.2d at 424-25; Cont'l Crain, 592 F.2d at 420; Kasser, 548 F.2d at 115; Bersch, 519 F.2d at 987.
67. See, e.g., Bersch, 519 F.2d at 987 ("The fraud, if there was one, was committed by placing the allegedly false and misleading prospectus in the purchasers' hands.").
purposes of the conduct test. In short, if the filing, mailing or the release occurs from within the United States, the first prong of the conduct test is met.

However, in at least one instance, the Second Circuit came to the opposite conclusion, holding that it was the preparation of the false statement, and not the actual release of the statement, that mattered for purposes of the conduct test. In *SEC v. Berger*, the Second Circuit held that the conduct was not the conveyance of the fraudulent materials, which were sent to investors from Bermuda, but rather the creation of the fraudulent statements, which occurred inside the United States. The court explained this deviation by the fact that, “[a]lthough the statements that ultimately conveyed the fraudulent information to investors were prepared and mailed in Bermuda, the preparation and mailing of these inaccurate statements was not itself fraudulent: The Fund Administrator [that sent the fraudulent statements to investors] was simply acting under Berger’s instruction in preparing the monthly account statements, which provided a means for Berger to distribute false information that he had already fraudulently concocted in the United States.” Effectively, the dissemination of the false statements occurred when Berger conveyed the false information from the United States to the Fund Administrator in Bermuda, and when Berger, from the United States, instructed the Administrator to ignore accurate account statements and to send out the false statements to investors. In addition, it is likely that the Second Circuit’s decision in *Berger* also was influenced by the unique circumstances of that case; namely, that the plaintiff was the SEC, that the defendant had already pled guilty in a criminal proceeding to masterminding

68. See id.; Morrison v. Nat’l Austl. Bank Ltd., 547 F.3d 167, 176 (2d Cir. 2008) (“Appellants’ claims arise under Rule 10b-5(b), which focuses on the accuracy of statements to the public and to potential investors.”); see also id. at 175 (“A much stronger case would exist, for example, for the exercise of subject matter jurisdiction in a case where the American subsidiary of a foreign corporation issued fraudulent statements or pronouncements from the United States impacting the value of securities trading on foreign exchanges.”).
69. See id., 547 F.3d at 176.
71. Id.
72. Id. at 195.
73. Id. at 189.
a pervasive fraudulent scheme that was based in the United States, and that the defendant had fled the United States and, at the time of the Second Circuit's decision, was a fugitive from justice.\textsuperscript{74}

Until very recently, the courts were clear on the type of conduct that satisfied the first prong of the conduct test, and \textit{Berger} represented a self-contained exception to the rule based on its distinguishing circumstances. In 2008, however, the holding in \textit{Berger} was discussed by the Second Circuit in the \textit{Morrison} case in a manner that suggested that the preparation of alleged misrepresentations was sufficient U.S. conduct to satisfy the conduct test.\textsuperscript{75} Subsequently, the \textit{Berger} decision was relied upon by the Eleventh Circuit in \textit{In re CP Ships} to assert subject matter jurisdiction over claims alleging U.S. conduct that clearly was preparatory.\textsuperscript{76}

\section{B. The "Directly Caused" Requirement of the Conduct Test}

While there have been diverging opinions on the type of conduct sufficient to trigger the jurisdiction of U.S. courts over foreign claims, there has been an utter absence of any direct guidance on whether, and to what extent, a plaintiff must establish a causal link between the U.S. fraud and the foreign loss. Despite the fact that all the circuits have required that the U.S. conduct "directly cause" the claimed losses, there have only been indirect suggestions by circuit courts as to what this requirement means. A number of district courts have adopted the view that the "directly cause" prong of the conduct test requires some showing of reliance by the foreign claimant on the U.S. fraudulent conduct, and one Second Circuit decision can be interpreted as endorsing this view. But there is far from a consensus on this point and, in fact, as described infra, a recent decision has cast doubt on the continued viability of the "directly caused" requirement.

\textsuperscript{74} Id. at 189-91.
\textsuperscript{75} Morrison v. Nat'l Austl. Bank Ltd., 547 F.3d 167, 174 (2d Cir. 2008).
\textsuperscript{76} In re CP Ships Ltd. Sec. Litig., 578 F.3d 1306, 1313 (11th Cir. 2009).
1. Reliance as a Necessary Element of the "Directly Caused" Requirement

One reading of the "directly caused" requirement, and the reading adopted by several district courts, is that a plaintiff would need to allege "transaction causation" in order to satisfy the conduct test. "Transaction causation is akin to reliance, and requires only an allegation that 'but for the claimed misrepresentations or omissions, the plaintiff would not have entered into the detrimental securities transaction.'" In other words, if the plaintiff relied on the U.S. fraudulent conduct in making the decision to enter into the transaction that eventually led to the losses, the plaintiff will have carried his or her burden under the conduct test. As the Supreme Court noted in its decision in Basic Inc. v. Levinson, "[r]eliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." In at least seven cases, district courts have refused to assert subject matter jurisdiction over claims of foreign members of a purported class action because the plaintiffs did not allege reliance by those class members on the U.S. fraud. Rather than

77. Lentell v. Merrill Lynch & Co., 396 F.3d 161, 172 (2d Cir. 2005) (quoting Emergent Cap. Inv. Mgmt., LLC v. Stonepath Group, Inc., 348 F.3d 189, 197 (2d Cir. 2003)); see also Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 171 (2008) ("Transaction causation, in turn, is often defined as requiring an allegation that but for the deceptive act, the plaintiff would not have entered into the securities transaction."); In re Mercer, 246 F.3d 391, 419 (5th Cir. 2001) ("[A]ctual reliance is the equivalent of causation-in-fact.") (citations omitted).
79. See Marland v. Heysel, 578 F. Supp. 2d 552, 554 (S.D.N.Y. 2008) (holding that the court did not have subject matter jurisdiction over the foreign plaintiff's claims because, inter alia, the plaintiff did "not claim to have relied on any" of defendant's U.S. filings or releases); In re China Life Sec. Litig., No. 04 Civ. 2112, 2008 U.S. Dist. LEXIS 67077, at *27-28 (S.D.N.Y. Sept. 3, 2008) ("[Plaintiffs] do not show that any of this activity in the United States 'directly caused' losses to foreigners who purchased their stock on the HKSE."); In re AstraZeneca Sec. Litig., 559 F. Supp. 2d 453, 465-66 (S.D.N.Y. 2008) ("[I]n order to demonstrate that the fraud 'directly caused' plaintiffs' losses, plaintiffs must in part have sufficiently alleged that the foreign purchasers relied on the United States-based conduct when deciding to acquire the stock."); In re Bayer AG Sec. Litig., No. 03 Civ. 1546, 2004 U.S. Dist. LEXIS 15959, at *54 (S.D.N.Y. Sept. 30, 2004) (*[T]he Complaint's allegations that defendants filed misleading forms with the SEC are insufficient because of the absence of any allegation that those filings were a
establishing that the U.S. misrepresentations caused the foreign members of the class to purchase stock at an inflated price, the plaintiffs instead relied on the fraud-on-the-market theory to satisfy the "directly caused" requirement. The fraud-on-the-market theory "is based on the hypothesis 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. Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements." Given that "most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action."

The fraud-on-the-market presumption, however, was adopted to address the insurmountable obstacle presented by the reliance requirement of Rule 10b-5 in the context of Rule 23 class certification. As the Court stated in Basic, "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones." The presumption was not adopted for the purpose of establishing a causal link between alleged U.S. fraud and a foreign plaintiff's alleged losses for purposes of subject matter jurisdiction, nor would such an application be logical. If the foreign plaintiff is required under the conduct test to establish (1) U.S. conduct that is more than merely preparatory, and (2) a connection between the U.S. conduct and his or her loss,
it makes little sense to presume there is a connection merely because there was U.S. conduct. The first prong of the conduct test would obviate the need for the second.

It is for this reason that the courts that have been confronted with an attempt by plaintiffs to employ the fraud-on-the-market theory to satisfy the "directly caused" requirement have held that this "would extend the reach of the 1934 Act too far. It would allow a foreign plaintiff to sue a foreign defendant based on an extraterritorial transaction whenever that foreign defendant had filed a fraudulently misleading document with the SEC."84

Although courts at the circuit level have not directly addressed the issue, the Second Circuit has implied that the conduct test does require reliance by the plaintiff on the alleged U.S. misrepresentation.85 The Second Circuit's decision in Itoba Ltd. v. LEP Group PLC is most recognized for its holding that the conduct and effects tests should not be considered independently, but rather that an admixture of the two tests should be used when determining subject matter jurisdiction under the antifraud provisions of the securities laws.86 Yet Itoba also provided support for the proposition that reliance is a component of the conduct test. The case involved the acquisition of a U.S. company, a subsidiary of the defendant LEP Group PLC ("LEP"), by the plaintiff Itoba Ltd. and its parent company A.D.T. Limited ("ADT"). ADT's decision to acquire LEP was based on a report compiled by its investment bank, S.G. Warburg, which premised its analysis on LEP's alleged fraudulent regulatory filings. The Second Circuit, reversing the district court's decision, held that the court did have jurisdiction because the plaintiff "not only relied on the discussion of the SEC filing as contained in the Warburg report, he also used his own copy of the 1988 Form 20-F to formulate his purchase recommendations" and "the decision to acquire

85. See Itoba Ltd. v. LEP Group PLC, 54 F.3d 118, 122 (2d Cir. 1995) (holding that plaintiff's derivative reliance on the alleged misrepresentations, through its investment bank, was sufficient to satisfy the conduct test).
86. Id.
[LEP] was based upon these recommendations." According to the court, the fact that the plaintiff derivatively relied on the purported misrepresentations, through the report of its investment bank, did not diminish the significance: "A party need not personally have read a misleading financial report to establish reliance; derivative reliance is a well-established basis for liability in a Rule 10b-5 action." Although not explicitly stating that there is a reliance requirement, the court undertook its analysis as though there was one.

At first glance, the Itoba court’s approval of derivative reliance to satisfy the conduct test could be seen as an implicit approval of the fraud-on-the-market theory as a means to satisfy the conduct test, since the fraud-on-the-market theory is a form of derivative reliance—the efficient market acts as the third-person upon whom the plaintiff relies. While this is certainly a possible, albeit broader, interpretation of derivative reliance, it is unlikely that this is what the Second Circuit had in mind in Itoba. When the court condoned the use of derivative reliance to satisfy the conduct test, it cited six cases that involved reliance on identifiable third persons; it did not cite any cases for the proposition that the market can act as the intermediary. In fact, one of the cases cited by the court, Garfinkel v. Memory Metals, Inc., discusses the fraud-on-the-market theory in a different portion of the opinion than the portion cited by the Itoba court to support its point. Had the Second Circuit meant to include the fraud-on-the-market theory as a basis for satisfying the conduct test, it likely would have either stated so directly, or provided citations to support such a position. Instead, the court seemed to require actual reliance and distinguished a case cited by the defendant as invol-

87. Id.
88. Id. (citations omitted).
ing "fraud on the market class issues" rather than the "direct individual fraud" involved in *Itoba*.

Whether or not the court intended to include the fraud-on-the-market theory in its discussion of derivative reliance, by no means did the court present a complete or clear picture of the "directly caused" requirement and what is necessary to satisfy it. To this day, no circuit court has expressly rejected or accepted reliance as an element of the "directly caused" prong of the conduct test, and not one circuit court has directly addressed the fraud-on-the-market theory as an acceptable means of satisfying the "directly caused" prong of the conduct test.

2. *Loss Causation as a Means of Satisfying the "Directly Caused" Requirement*

Another reading of the "directly caused" requirement, and one that has yet to be adopted by a court, is that the plaintiff must establish "loss causation" (i.e., a causal connection between the U.S. material misrepresentation and the loss).

In *Dura Pharmaceuticals, Inc. v. Broudo*, the Supreme Court held that in order to plead loss causation adequately, a plaintiff must establish not only that the price was inflated on the date of purchase, but also that the misrepresentations proximately caused an economic loss. According to the Court, while an inflated purchase price might "touch upon" a later economic loss, "[t]o 'touch upon' a loss is not to cause a loss, and it is the latter that the law requires." Therefore, in order to adequately plead loss causation, the Court held that a plaintiff must claim that the defendant's stock price fell after, and as a result of, the truth being revealed.

Such a principle could be extended to the subject matter jurisdiction context. The problem with permitting a plaintiff to satisfy the "directly caused" requirement by alleging loss causation in this fashion, however, is that a causal connection

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91. *Itoba*, 54 F.3d at 123 (internal quotes omitted).
93. Id. at 345-46 ("[T]he statute expressly imposes on plaintiffs 'the burden of proving' that the defendant's misrepresentations 'caused the loss for which the plaintiff seeks to recover.'") (citing 15 U.S.C. § 78u-4(b)(4)).
94. Id. at 343 (citing § 78u-4(b)(4)).
95. Id. at 346-47.
between the revelation of the truth and the economic loss does not indicate which particular statements played a role in that loss. Instead, the plaintiff would need to establish that it was the U.S. misrepresentation that caused the artificial inflation of the stock price in the first instance as opposed to a foreign misrepresentation. 96 This could be accomplished by pointing to a stock price increase following on the heels of one of the U.S. misrepresentations. However, the absence of a stock price increase following a U.S. press release would not necessarily negate the causal link between the release and the artificial inflation of the stock price. As the Fifth Circuit recognized in Nathenson v. Zomagen Inc., 97 there are instances in which a false statement may affect the market price of a stock "even though the stock's market price does not soon thereafter change. For example, if the market believes the company will earn $1.00 per share and this belief is reflected in the share price, then the share price may well not change when the company reports that it has indeed earned $1.00 a share even though the report is false in that the company has actually lost money (presumably when that loss is disclosed the share price will fall)." 98 Indeed, even a "gradual price decline is not inconsistent with the theory that the price was artificially inflated, since the misrepresentations may well have buoyed a price that would otherwise have sunk much faster, thus raising the price at which plaintiffs purchased the stock." 99 This is particularly true where the plaintiff alleges that there were material omissions, as opposed to misrepresentations, which led to the artificial inflation.

96. C.f. Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co., No. 3:02-CV-1152-M, 2008 WL 4791492, at *2 (N.D. Tex. Nov. 4, 2008) (noting that one of two ways in which a plaintiff can demonstrate that an alleged misrepresentation moved the market is by "demonstrating an increase in the stock price after the release of false positive news"); Home Solutions of Am. Investor Group v. Fradella, No. 3:06-CV-1096-N, 2008 WL 1744588, at *10 (N.D. Tex. Mar. 24, 2008) ("Theoretically, there should be both an increase [in stock price following a misrepresentation] and a decrease [in stock price following the disclosure of the truth], but, because it is accepted that either may be difficult to accurately detect, courts permit evidence of one to serve as surrogate for the other.").

97. 267 F.3d 400 (5th Cir. 2001).

98. Id. at 419.

Therefore, employing a theory of loss causation to demonstrate that it was the U.S. misrepresentation that proximately caused the plaintiff's economic loss is not a perfect fit for the "directly caused" requirement. The question remains: what is? The decision in Bersch, in which Judge Friendly established the "directly cause" requirement, looms large today. Without an adequate explanation of the causal link necessary to confer jurisdiction over foreign claims, there will continue to be practical problems with applying the conduct test, and serious policy concerns if and when jurisdiction is asserted over foreign claims. Never are these concerns more evident than in the class action context, and particularly in the foreign-cubed class action context, where a causation requirement could make the difference between a considerable class of foreign purchasers and a much smaller class limited to U.S. purchasers.

C. The Problems Presented by Class Actions

The current state of the jurisdictional boundaries of the U.S. securities laws is most certainly a product of a continued broadening of previous principles. When Judge Friendly first propounded the conduct and effects tests, he did so by broadly interpreting the intent of the Congress that passed the securities laws, asserting that even though the Congress did not then express an intent for the antifraud provisions to be applied to foreign transactions, it would have done so if it were faced with the circumstances present in 1975. Likely not out of a sense of irony, later courts interpreted Judge Friendly's conduct and effects tests to grant jurisdiction in cases for which he specifically stated he did not intend them to apply—namely, class actions.

As discussed supra, there is the doctrinal question of how the "directly caused" requirement could ever be satisfied by a class of unnamed foreign members of a purported class action because the class representative could not purport to know the "direct cause" of each unnamed class member's loss. In addition, however, there also are several policy concerns implicated by the assertion of subject matter jurisdiction over the claims of a class of unnamed foreign plaintiffs.

When Judge Friendly first announced the conduct test in Bersch and IIT, he made sure to limit its application to the individual context: “We are indeed holding in IIT v. Vencap, Ltd., decided this day, that Congress did not mean the United States to be used as a base for fraudulent securities schemes even when the victims are foreigners, at least in the context of suits by the SEC or by named foreign plaintiffs.” Underlying the Bersch court’s concern was “the serious problem here presented of the dubious binding effect of a defendants’ judgment (or a possibly inadequate plaintiff’s judgment) on absent foreign plaintiffs or the propriety of purporting to bind such plaintiffs by a settlement.” According to the court, this concern is not implicated “when the SEC seeks to enjoin activity...or when the action is by named plaintiffs...” Judge Friendly reiterated his reluctance to expand the jurisdictional reach to foreign members of a class action in IIT, where the court disclaimed: “Class actions may stand differently [from individual ones], for reasons developed in Bersch—primarily the likelihood that a very small tail may be wagging an elephant and that there is doubt that a judgment of an American court would protect the defendants elsewhere.”

Judge Friendly’s concern was that a dissatisfied foreign plaintiff could collaterally attack the U.S. decision or settlement in his or her home country and, aside from the nonbinding principle of comity, there was nothing to protect that decision or settlement, and correspondingly the defendants and other plaintiffs who wished to be bound by it. This is only one side of the coin, however.

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100. Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir. 1975) (emphasis added) (internal citation omitted).
101. Id. at 986.
102. Id. at 986 n.26 (citations omitted).
103. IIT v. Vencap, Ltd., 519 F.2d 1001, 1018 n.31 (2d Cir. 1975).
104. See Taveras v. Taveraz, 477 F.3d 767, 783 (6th Cir. 2007) (“‘Comity’ is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other.”) (citing Hilton v. Guyot, 159 U.S. 113, 163-64 (1895)).

While it would be problematic if a foreign plaintiff brought a related claim against the same defendant in a foreign jurisdiction that does not recognize the U.S. decision, it would be equally troubling if the outcome is recognized by the foreign jurisdiction to bind a foreign plaintiff who never intended to be bound by the U.S. jurisdiction in the first place. This would be the flip side of the “serious problem” addressed by *Bersch*,\(^\text{105}\) and is particularly troublesome when the foreign jurisdiction employs a different standard for choosing whether to become a member of a purported class action.

Rule 23 of the Federal Rules of Civil Procedure provides that, in connection with a class action for money damages, a “court will exclude from the class any member who requests exclusion.”\(^\text{106}\) Inaction constitutes acquiescence, whereby a potential class member who does not proactively opt-out of the class becomes a member of it. This class action opt-out right, a fundamental component of the American judicial system, has not been adopted so vigorously abroad.\(^\text{107}\) In fact, for “most European Member states (with \[ \] very rare exceptions... which do not emulate the U.S. class action in any event), the concept [of an opt-out right] is an anathema.”\(^\text{108}\)

Given the unfamiliarity by foreign nations with the opt-out class action, it seems inevitable that at least some, if not many, foreign purchasers would be swept up into a U.S. class action without any intention, and perhaps no desire, to be a part of one. If such a foreign plaintiff is unable to proceed

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105. *Bersch*, 519 F.2d. at 986.

106. Fed. R. Civ. P. 23(c)(2)(B)(v). Although Rule 23 does not expressly grant opt-out rights for class actions under Rule 23(b)(1) and (b)(2), a number of courts do grant opt-out rights for such actions. See Steven T. O. Cottrreu, *The Due Process Right to Opt Out of Class Actions*, 73 N.Y.U. L. Rev. 480, 484-85 (1998) (“The reality of opt out rights, however, is a bit more complicated than Rule 23 suggests. First, some courts do grant opt out rights in (b)(1) and (b)(2) actions. Second, some state court class action rules do not automatically provide opt out rights in (b)(3) actions. Third, courts possess a fair amount of discretion in choosing the rule under which to certify a class action.”) (internal citations omitted).


108. Id.
with a separate action in a foreign jurisdiction, that purchaser
would be deprived of a day in court under the regime of his or
her choosing simply due to the lack of familiarity with the class
action procedures in the United States. In such circum-
stances, the U.S. court would not simply be binding the unin-
formed foreign purchasers to a decision under the U.S. securi-
ties laws, it would also be binding them to the United States’
decision to adhere to an opt-out class action system.

3. Treatment of Class Actions by the Courts

Although the decisions in Bersch and IIT were the first to
express reluctance about extending the conduct test to class
actions, the disfavor for asserting subject matter jurisdiction
over claims of foreign members of a class action continued
throughout the progression of the conduct test. In Itoba Ltd.
v. LEP Group PLC, the Second Circuit panel held that the dis-
trict court improperly refused to assert subject matter jurisdic-
tion over the plaintiff’s claims, but in so doing, distinguished
the facts of the case, involving “a single plaintiff asserting di-
rect individual fraud,” from those involving “‘fraud on the
market’ class issues.” In concluding its decision, the Itoba
court stated that, “[u]nlike some securities actions brought to
recover questionable damages on behalf of optimistically de-
scribed classes, we are met here with a single plaintiff which
suffered direct substantial losses.” While this language by
no means prohibited the application of the conduct and ef-
facts tests in the class action context, it did suggest that the
court might have reached a different conclusion if it had been
confronted with such a case.

Eight years later, in SEC v. Berger, the Second Circuit again
provided support for the proposition that class actions stand
differently than a case brought by the SEC or an individual
named plaintiff. The Berger court echoed the holding in
Bersch, and distinguished an action brought by the SEC from
“class action lawsuits on behalf of unnamed foreigners: We ex-
pressly noted in Bersch that ‘Congress did not mean the United
States to be used as a base for fraudulent securities schemes

109. Itoba Ltd. v. LEP Group PLC, 54 F.3d 118, 123 (2d Cir. 1995).
110. Id. at 125.
even when the victims are foreigners, *at least in the context of suits by the SEC or by named foreign plaintiffs*.”

Yet for the thirty-three years in which courts applied some version of the conduct and effects test propounded in *Bersch* and *IIIT*, no circuit has addressed head-on the standard to be applied in class actions. And while a number of district courts have noted a difference between class actions and individual ones, they have not proposed a different standard to be applied in such cases. In fact, a number of district courts have been willing to assert jurisdiction over a predominantly foreign class action.

IV.

THE SECOND CIRCUIT'S DECISION IN *MORRISON* AND ITS IMPLICATIONS ON THE CONDUCT TEST

The questions presented by the conduct test now find themselves on the Supreme Court's radar, and perhaps on the verge of resolution, thanks to the Second Circuit's decision in *Morrison v. National Australia Bank Ltd.* in 2008, which addressed all three questions for the first time in the history of the conduct test. The *Morrison* court, however, did little to clarify the answers to these questions, and instead vastly broadened the scope of jurisdiction and the areas of ambiguity along with it. The court cast doubt on the long-accepted interpretation of the "more than merely preparatory" requirement, expanded the "directly cause" requirement by seemingly eliminating the requirement that a plaintiff plead a causal link between the U.S. conduct and the foreign claim.

112. See, e.g., Blechner v. Daimler-Benz AG, 410 F. Supp. 2d 366, 373 (D. Del. 2006) ("Class actions may require different treatment from cases in which there are individual plaintiffs."); In re Yukos Oil Co. Sec. Litig., No. 04 Civ. 5243, 2006 WL 3026024, at *9 (S.D.N.Y. Oct. 25, 2006) ("These concerns are particularly acute in the context of a class action.").
114. 547 F.3d 167 (2d Cir. 2008).
115. Id. at 170-77.
116. Id. at 172 n.6.
117. Id. at 167.
and liberated the court from thirty-years of admonitions regarding the dangers of class actions.\textsuperscript{118}

\section{A. The Facts in Morrison}

The claims in \textit{Morrison} arose out of the accounting practices of a subsidiary of the defendant National Australia Bank ("NAB"), headquartered in Melbourne and incorporated under Australian law.\textsuperscript{119} The subsidiary, HomeSide Lending Inc. ("HomeSide"), an American mortgage service provider headquartered in Florida, allegedly was using faulty assumptions in its valuation of the fees it would generate in future years, which resulted in a gross overstatement of its servicing rights.\textsuperscript{120} When the truth was revealed by NAB in July and September 2001, NAB's ordinary shares, which were traded on stock exchanges in Australia, New Zealand, London and Tokyo, fell 5\% in July and 13\% in September, while its American Depository Receipts, traded on the New York Stock Exchange, fell 5\% in July and 11.5\% in September.\textsuperscript{121} Four individuals filed suit in the Southern District of New York against NAB, HomeSide and various officers and directors, alleging violations of §§ 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5.\textsuperscript{122} Three of the plaintiffs sought to represent a class of foreign purchasers of NAB ordinary shares on foreign exchanges under the conduct test,\textsuperscript{123} while the fourth sought to represent a class of American purchasers.\textsuperscript{124}

Plaintiffs alleged that "HomeSide knowingly used unreasonably optimistic valuation assumptions or methodologies" and that various of the Defendants made materially false and misleading statements in SEC filings, annual reports and press releases regarding HomeSide's profitability, economic health, and its contribution to NAB.\textsuperscript{125} Although plaintiffs claimed that HomeSide falsified the numbers in Florida, those num-

\begin{itemize}
\item \textsuperscript{118} Id. at 172.
\item \textsuperscript{119} Id. at 168.
\item \textsuperscript{120} Id. at 169.
\item \textsuperscript{121} Id.
\item \textsuperscript{122} Id.
\item \textsuperscript{123} Id. The foreign plaintiffs did not attempt to satisfy the effects test, and rested their jurisdiction arguments instead solely on the conduct test. See id. at 176.
\item \textsuperscript{124} Id. at 169.
\item \textsuperscript{125} Id.
\end{itemize}
bers were then sent to NAB in Australia, where NAB personnel disseminated the false information via public filings and public statements.\textsuperscript{126} The district court dismissed the claims of the U.S. plaintiff for failure to state a claim, and dismissed the claims of the non-American plaintiffs for lack of subject matter jurisdiction.\textsuperscript{127} The plaintiffs appealed, challenging only the dismissal of the foreign plaintiffs' claims for lack of jurisdiction.\textsuperscript{128}

\section*{B. The Morrison Court's Holding}

The Second Circuit, after noting that the Exchange Act "omitted any discussion of its application to transactions taking place outside of the United States," returned to the familiar analysis of evaluating "the underlying purpose of the anti-fraud provisions" and, in particular, "whether Congress would have wished the precious resources of the United States courts and law enforcement agencies to be devoted to such transactions."\textsuperscript{129} The court reiterated that jurisdiction under the conduct test 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."\textsuperscript{130} The court, however, gave this test a novel interpretation.

The court first dealt with, and rejected, the defendants-appellees' contention that the conduct test should not apply to foreign members of a purported class action. The defendants-appellees had argued that, due mainly to the general presumption against extraterritorial application of American laws, "showing domestic conduct should never be enough and subject matter jurisdiction cannot be established where the conduct in question has no effect in the United States or on American investors."\textsuperscript{131} According to their argument, if the Second Circuit did apply the conduct test to such claims, it would "undermine the competitive and effective operation of American securities markets, discourage cross-border economic activity, [ ] cause duplicative litigation," and "bring our securities laws

\begin{itemize}
  \item \textsuperscript{126} \textit{Id.}
  \item \textsuperscript{127} \textit{Id.} at 170.
  \item \textsuperscript{128} \textit{Id.} at 170 n.3.
  \item \textsuperscript{129} \textit{Id.} at 170 (internal quotes and citations omitted).
  \item \textsuperscript{130} \textit{Id.} at 171.
  \item \textsuperscript{131} \textit{Id.} at 174.
\end{itemize}
into conflict with those of other jurisdictions."\textsuperscript{132} The panel acknowledged these concerns as serious, but held that they did not "require the jettisoning of our conduct and effects tests for 'foreign-cubed' securities fraud actions and their replacement with the bright-line ban advocated by Appellees," especially in the context of anti-fraud laws, which are "broadly similar" among nations.\textsuperscript{135} Further prompting the court's decision was its leeriness of the bright-line rule propounded by the defendants because, as the court stated, "we cannot anticipate all the circumstances in which the ingenuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction."\textsuperscript{134}

This represented the first time a circuit court had addressed head-on the question of whether a different version of the conduct test should be applied in class action cases. The court's answer was a resounding "no."

The court next attempted to provide, for the first time, clarification of the "directly cause" component of the conduct test. According to the court, the "determination of whether American activities 'directly' caused losses to foreigners depends on what and how much was done in the United States and on what and how much was done abroad."\textsuperscript{135} To the court, this simply involved determining "what conduct comprises the heart of the alleged fraud."\textsuperscript{136} Using Bersch, \textit{II}T and Berger as illustrations, the court concluded that when the "heart" of the allegedly fraudulent conduct takes place in the United States, subject matter jurisdiction attaches.\textsuperscript{137}

Applying those principles to the case at hand, the court determined that the allegedly fraudulent conduct for purposes of the conduct test was not the generation of the false numbers by HomeSide in Florida, but rather was NAB's dissemination of that false information in its public statements. "The actions taken and the actions not taken by NAB in Australia were, in our view, significantly more central to the fraud and more directly responsible for the harm to investors than the

\begin{subequations}
\begin{align*}
  132. & \textit{Id.} \\
  133. & \textit{Id.} \textit{at} 175. \\
  134. & \textit{Id.} \\
  135. & \textit{Id.} \textit{at} 171. \\
  136. & \textit{Id.} \textit{at} 175. \\
  137. & \textit{See id.} \textit{at} 173-76.
\end{align*}
\end{subequations}
manipulation of the numbers in Florida.\textsuperscript{138} Because this conduct occurred abroad, jurisdiction did not exist. Further buttressing its conclusion was the complete lack of any U.S. effects resulting from the alleged fraud,\textsuperscript{159} and the "lengthy chain of causation" between HomeSide's actions and the harm to investors.\textsuperscript{140}

C. The Consequence of the Morrison Court's Holding

Although the actual holding in \textit{Morrison} was a straightforward affirmance of the district court's refusal to grant jurisdiction, embedded in the decision was much more. The Second Circuit, for the first time in the life of the conduct and effects tests, addressed the treatment of class actions and how the "directly caused" requirement should be interpreted, and the result was a drastic expansion of the jurisdictional boundaries of the antifraud provisions of the U.S. securities laws. This expansion occurred on several levels.

1. \textit{Casting Doubt on How to Satisfy the "Merely Preparatory" Requirement}

Although the \textit{Morrison} court appeared to endorse the view that the issuance of the public statements from abroad constituted the relevant conduct under the conduct test,\textsuperscript{141} a concept that \textit{Bersch} established long ago,\textsuperscript{142} the \textit{Morrison} court also discussed with approval the decision in \textit{Berger}, which, as discussed supra, reasoned that the preparation of the false materials, and not the dissemination, constituted the relevant "conduct" for purposes of the conduct test.\textsuperscript{143} Notably, the \textit{Morrison} court did not stress the distinguishing circumstances of the

\begin{flushleft}
\textsuperscript{138} Id. at 176.
\textsuperscript{139} Id.
\textsuperscript{140} Id. at 177.
\textsuperscript{141} See id. at 176 ("Appellants' claims arise under Rule 10b-5(b), which focuses on the accuracy of statements to the public and to potential investors.") (internal citation omitted); see also id. at 175 ("A much stronger case would exist, for example, for the exercise of subject matter jurisdiction in a case where the American subsidiary of a foreign corporation issued fraudulent statements or pronouncements from the United States impacting the value of securities trading on foreign exchanges.").
\textsuperscript{142} Id. at 173 (citing Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir. 1975)).
\textsuperscript{143} Morrison, 547 F.3d at 173-74.
\end{flushleft}
Berger decision, and instead stated that "[t]he critical factor" in Berger, and "the conduct that directly caused loss to investors" was "the creation of the fraudulent statements," and not their dissemination.\textsuperscript{144}

At first glance, the Morrison court's reliance on Berger seems somewhat gratuitous since the court did not need further support than that found in Bersch, and since the discussion of Berger only raises the question of whether courts should focus on the issuance of the public statement or its creation and preparation for purposes of the conduct test. Yet the court may have intended to raise this very question and leave it unanswered. Just as the court was "leery" of adopting a brightline rule with respect to class actions,\textsuperscript{145} it may also have been leery of adopting the Bersch or Berger approach at the expense of the other for the very same reason—that it is impossible to "anticipate all the circumstances in which the ingenuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction."\textsuperscript{146} If the court held that only the filing of the public statement constituted the fraud, a company could evade the securities laws by releasing the statement from abroad, despite every other piece of the fraud having been carried out within U.S. boundaries. Adopting the opposite approach would provide safe haven to those who concocted and drafted the fraudulent statements abroad, but disseminated the public statements from within the United States. Whatever its rationale, the result was to obscure the definition of the conduct necessary to trigger the jurisdiction of U.S. courts in such cases.

In fact, this result is evidenced by the Eleventh Circuit's very recent decision in \textit{In re CP Ships Ltd. Securities Litigation}, where the court applied the Second Circuit's version of the conduct test to a set of facts parallel to those in Morrison, and yet reached a different outcome.\textsuperscript{147} \textit{In re CP Ships} involved Rule 10b-5 claims, brought on behalf of both foreign and domestic purchasers of CP Ships stock who alleged that they were misled by the company about its fraudulent accounting prac-

\textsuperscript{144} \textit{Id.} at 174 (emphasis added).
\textsuperscript{145} \textit{Id.} at 175.
\textsuperscript{146} \textit{Id.}
\textsuperscript{147} \textit{In re CP Ships Ltd. Sec. Litig.}, 578 F.3d 1306, 1313-17 (11th Cir. 2009).
tices. The complaint alleged that the fraudulent accounting practices occurred in one of the company's offices in Tampa, Florida, which "then transmitted this false data to the Company's foreign offices, where it was incorporated into allegedly false and misleading financial statements that were disseminated from abroad." 148 Despite the fact that CP Ships itself is a foreign company—organized under the laws of Canada and headquartered in England—and despite the fact that all of the misleading statements were issued from abroad, the Eleventh Circuit held that there was subject matter jurisdiction over the claims of foreign purchasers because the conduct underlying the false statements took place in Tampa and because individuals who were responsible for preparing many of the false statements were located in Tampa. 149 Like the Morrison court, the Eleventh Circuit relied on the Second Circuit's decision in Berger for support. 150 Unlike the Morrison court's decision, however, the Eleventh Circuit's decision reflects a sharp deviation from the position that it is the issuance of the public statements, and not the activities underlying them or the preparation of them, that represents the fraudulent conduct for purposes of the conduct test.

In their petition for a writ of certiorari, the Morrison plaintiffs cited the district court opinion in CP Ships (the Eleventh Circuit had not yet ruled) for the proposition that "courts in different circuits are reaching different results on essentially identical facts." 151 What is most astounding, however, is not that two different circuit panels reached a different outcome on essentially identical facts, but rather that they did so while professing to apply an identical version of the conduct test.

2. The Relevance of Causation Under the "Heart of the Fraud" Test

The Morrison court's adoption of the "heart of the fraud" test raises a number of questions for the future of the "directly caused" requirement. Under the Second Circuit's new test, it appears that there is no longer any requirement that the al-

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148. Id. at 1314.
149. Id. at 1310, 1315-17.
150. Id. at 1314.
leged U.S. fraud be connected in any way to the plaintiffs' losses abroad. For example, if ten fraudulent public statements were prepared and released from within the United States, and only one was prepared and released abroad, it would seem that the "heart" of the fraud occurred in the United States, thereby conferring to the court jurisdiction over plaintiffs' claims. But what if the foreign plaintiffs never saw any of the ten U.S. releases, and read and relied on only the one foreign release? Similarly, what if six fraudulent public statements were prepared and released in the United States, and six were prepared and released abroad? Can a fraud have two hearts? If so, wouldn't it be more likely that a foreign plaintiff was relying on the foreign "heart" in making the decision to enter into the transaction? The Morrison court did not answer these questions, but it appears that the analysis under the "directly caused" requirement now focuses on how much conduct occurred in the United States compared to abroad, as opposed to whether the conduct that occurred in the United States actually and directly caused the plaintiffs' losses.

In sum, the Morrison court may have been trying to define the "directly caused" prong more clearly, but in so doing it appears to have removed any semblance of a causation requirement.

3. The Failure to Address the Fraud-on-the-Market Theory As a Means of Satisfying the "Directly Caused" Requirement

Although the Morrison court held that jurisdiction did not exist in that case, the court failed to reject outright the use of the fraud-on-the-market theory to satisfy the "directly caused" requirement, thereby implicitly approving of such an approach. In fact, the court suggested that it would have jurisdiction over the claims of foreign members of a class action regardless of whether they relied on the U.S. conduct when it stated, in dicta, that "[a] much stronger case would exist, for example, for the exercise of subject matter jurisdiction in a case where the American subsidiary of a foreign corporation issued fraudulent statements or pronouncements from the United States impacting the value of securities trading on foreign exchanges."152

152. Morrison, 547 F.3d at 175.
This is consistent with the court's dilution, or perhaps elimination, of a causation requirement (and any reliance requirement that could be read into it). If the court has altered the conduct test to focus only on the number and location of public statements made, rather than on the causal link between those statements and the foreign plaintiffs' losses, the fraud-on-the-market theory becomes obsolete. While the definition of the "directly caused" requirement adopted by the court is not nearly as restrictive as would be a definition that required the plaintiff to plead a causal link, there is no question that the "heart of the fraud" test is not nearly as expansive as would have been the sanctioning of the fraud-on-the-market theory as a means of satisfying the conduct test. Employing the fraud-on-the-market theory to satisfy the "directly caused" requirement would confer jurisdiction over claims of foreign plaintiffs based on only one U.S. public statement, even if twenty public statements were released abroad. The "heart of the fraud" in such a case would be abroad, and therefore a U.S. court would not have jurisdiction.

Therefore, even though the *Morrison* court did expand U.S. courts' subject matter jurisdiction over 10b-5 claims of foreign purchasers, it did not turn American courts into "the world's court."153

4. **Jettisoning Class Action Caveats**

Finally, with respect to the application of the conduct test to class actions, the *Morrison* court not only rejected the bright-line rule proposed by defendants, it also abandoned the class action caveats expressed by the Second Circuit for thirty years, beginning with *Bersch* in 1975154 and reiterated by *Berger* as recently as 2004.155 The court "decline[d] to place any special limits beyond the 'conduct test' on 'foreign-cubed' securities fraud actions."156 Despite Judge Friendly's warning that he

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153. *Id.*


155. *SEC v. Berger*, 322 F.3d 187, 195 (2d Cir. 2003); see also *Blechner v. Daimler-Benz AG*, 410 F. Supp. 2d 366, 373 ("Class actions may require different treatment from cases in which there are individual plaintiffs."); *In re Yukos Oil Co. Sec. Litig.*, No. 04 Civ. 5243, 2006 WL 3026024, at *9 (S.D.N.Y. Oct. 25, 2006) ("These concerns are particularly acute in the context of a class action.").

156. *Morrison*, 547 F.3d at 175.
did not construct the conduct test with class actions in mind.\textsuperscript{157} The \textit{Morrison} court expressed the view that the conduct test, as currently constructed, strikes the appropriate balance between the policy arguments for and against extending jurisdiction over such claims.\textsuperscript{158} The court did not convey any interest in restricting the conduct test in any way to account for the policy considerations implicated by "foreign-cubed" class actions. As with the other holdings in \textit{Morrison} described above, this particular holding provides an answer to a longstanding question, and the answer results in expanded jurisdiction.

In sum, despite the outcome in \textit{Morrison}, which affirmed the district court's ruling that it did not have subject matter jurisdiction over the claims of foreign plaintiffs, the court nonetheless managed to expand the reach of the antifraud provisions of the U.S. securities laws in a way that no Second Circuit court previously had done. When addressing each critical issue with which it was confronted, the court came down on the side of broader jurisdictional boundaries. It is not clear whether the \textit{Morrison} court intended to align the Second Circuit's version of the conduct test more closely with the less restrictive tests of the Third, Eighth and Ninth Circuits, whether it was attempting to respond to the financial crisis and the type of fraud that caused it, or whether it was envisioning something entirely different. Regardless of the court's intent, the impact of the decision in \textit{Morrison} will be played out in the district courts unless, and until, the Supreme Court or Congress decides otherwise.

V. RESOLVING THE CIRCUIT SPLIT BY RESTRICTING THE JURISDICTIONAL REACH OF THE ANTIFRAUD PROVISIONS OF THE SECURITIES LAWS UNDER THE CONDUCT TEST

It has now been more than forty years since the decisions in \textit{Schoenbaum} and \textit{Leasco} first applied the conduct and effects tests to determine the jurisdictional reach of the antifraud provisions; forty years of courts divining whether Congress would have intended the securities laws to apply to a particular trans-

\begin{itemize}
\item \textsuperscript{157} See Bersch, 519 F.2d at 997.
\item \textsuperscript{158} Morrison, 547 F.3d at 175.
\end{itemize}
action; forty years of circuit interpretations of the appropriate version of the conduct test; and forty years of ambiguity regarding the definition of the "directly caused" requirement. Even the 
Morrison court, which continued, and in fact expanded, the application of the conduct test, "respectfully urge[d] that [the Exchange Act's silence as to its extraterritorial application] receive the appropriate attention of Congress and the Securities and Exchange Commission." 

As a result of the recent financial crisis, the 
Morrison court's request appears to have been answered. While there is no question that a perfect storm of variables contributed to the financial crisis, there is also no question that massive frauds on an international scale played a leading role. The importance of policing, preventing and deterring securities fraud is as evident today as it ever has been. Consequently, it is not surprising that the Supreme Court granted 
certiorari in the 
Morrison case, nor is it surprising that Congress has proposed amending the antifraud provisions to address their extraterritorial application. The main question each will face is how drastically to alter the jurisdictional tests currently in place.

A. Arguments for Eliminating the Conduct Test

In the absence of Congressional revision of the antifraud provisions to address their extraterritoriality, there are compelling arguments to abandon the conduct test altogether. When interpreting a statute that is silent as to its extraterritorial application, the courts begin with the presumption that federal statutes apply only within the territorial jurisdiction of the United States, absent clear Congressional intent to the contrary. That presumption is grounded in the notion that Congress legislates with domestic concerns in mind, and therefore the presumption "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord." 

159. Id. at 170 n.4.


162. Id.
In three recent decisions, the Supreme Court has restricted the subject matter jurisdiction of U.S. courts by relying on this presumption.\textsuperscript{163} In \textit{F. Hoffmann-La Roche Ltd. v. Empagran S.A.},\textsuperscript{164} for example, the Court addressed the subject matter jurisdiction over a Sherman Act claim brought by a foreign plaintiff arising out of a foreign harm. The Court concluded that while "Congress might have hoped that America's antitrust laws, so fundamental a component of our own economic system, would commend themselves to other nations as well," this is insufficient to extend U.S. subject matter jurisdiction over such claims.\textsuperscript{165} To the contrary, "if America's antitrust policies could not win their own way in the international marketplace for such ideas, Congress, we must assume, would not have tried to impose them, in an act of legal imperialism, through legislative fiat."\textsuperscript{166} It is noteworthy that in the antitrust context, jurisdiction over foreign claims lies where there is foreign conduct that has an adverse effect in the United States, but not where U.S. conduct has an adverse effect abroad.\textsuperscript{167}

163. See Small v. United States, 544 U.S. 385, 388-91, 393-94 (2005) (holding that "Congress generally legislates with domestic concerns in mind", and that "[t]his notion has led the Court to adopt the legal presumption that Congress ordinarily intends its statutes to have domestic, not extraterritorial, application"); Sosa v. Alvarez-Machain, 542 U.S. 692, 727-28 (2004) (expressing a policy of judicial restraint whenever the courts delve into foreign law without explicit authorization from Congress); F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 169-70 (2004) (concluding that "if America's ... policies could not win their own way in the international marketplace ... Congress, we must assume, would not have tried to impose them, in an act of legal imperialism, through legislative fiat"); \textit{cf.} Microsoft Corp. v. AT&T Corp., 550 U.S. 437, 454-55 (2007) ("The presumption that United States law governs domestically but does not rule the world applies with particular force in patent law.").

165. \textit{Id.} at 169.
166. \textit{Id.}

167. \textit{See id.} at 158-59 (noting that the "Foreign Trade Antitrust Improvements Act of 1982 (FTAIA) excludes from the Sherman Act's reach much anticompetitive conduct that causes only foreign injury" but makes an exception for conduct that "has a 'direct, substantial, and reasonably foreseeable effect' on domestic commerce" that gives rise to a Sherman Act claim) (citing Foreign Trade Antitrust Improvements Act, 15 U.S.C. §§ 6a(1)(A), (2) (1982)). Although the Second Circuit has noted that the jurisdictional analysis in the antitrust context is very similar to the jurisdictional analysis in the securities fraud context, only with "more emphasis on the effects of the rele-
Although not addressing head-on the Supreme Court's decision in Empagran, the Second Circuit panel's decision in Morrison made clear that it does not view the presumption against extraterritoriality, or the desire to avoid conflicts of laws and dubious binding effects of U.S. judgments, as an excuse to "jettison[ ]" the conduct test. Rather, it stated that the current version of the conduct test strikes the appropriate balance of the policy arguments on both sides. It would not be at all surprising if the Supreme Court diverges from the Morrison court's rejection of the presumption against extraterritoriality. In fact, in 2007, the Court rejected a holding by the Federal Circuit that employed reasoning similar to that provided by the Morrison court. As discussed supra, the Morrison court refused to apply the presumption against extraterritoriality because, inter alia, the adoption of a bright-line rule, and the "jettisoning" of the conduct test in foreign-cubed class action cases, would provide perpetrators of fraud a loophole to evade the U.S. securities laws. As the Morrison court noted, "we cannot anticipate all the circumstances in which the inge-
nuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction." 171

In Microsoft Corp. v. AT&T Corp., 172 the Supreme Court rejected similar reasoning employed by the Federal Circuit in deciding to apply U.S. patent law, 35 U.S.C. § 271(f), to the exportation of software abroad. The Federal Circuit had held that 35 U.S.C. § 271(f) should extend beyond the jurisdictional boundaries of the United States because failing to so hold would "create[ ] a 'loophole' for software makers," whereby "[l]iability for infringing a United States patent could be avoided... by an easily arranged circumvention: Instead of making installation copies of software in the United States, the copies can be made abroad, swiftly and at small cost, by generating them from a master supplied from the United States." 173 The Court concluded that "[w]hile the majority's concern is understandable, we are not persuaded that dynamic judicial interpretation of § 271(f) is in order. The 'loophole,' in our judgment, is properly left for Congress to consider, and to close if it finds such action warranted." 174

Given its recent decisions, and the inability of the circuits to consistently apply the conduct test to determine jurisdiction over the claims of foreign investors, the Supreme Court may decide to eliminate the conduct test altogether, and find that, like the patent laws involved in Microsoft, if the securities laws are to be amended to address foreign fraud, "the alteration should be made after focused legislative consideration, and not by the Judiciary forecasting Congress' likely disposition." 175

Further fueling this argument is the fact that Congress has revised the securities laws in the past, 176 is proposing to do so

171. Id.
173. Id. at 456-57.
174. Id. at 457.
175. Id. at 459.
again, and can revise them again in the future whenever it so chooses. It is not for the courts to interpret what the legislative branch would have done seventy-five years ago if it were confronted with the specific issue now facing the courts. This argument led the Zoelsch court to question whether Judge Friendly should ever have wandered into the jurisdictional morass of the U.S. securities laws in the first place:

Were it not for the Second Circuit's preeminence in the field of securities law, and our desire to avoid a multiplicity of jurisdictional tests, we might be inclined to doubt that an American court should ever assert jurisdiction over domestic conduct that causes loss to foreign investors. It is somewhat odd to say, as Bersch and some other opinions do, that courts must determine their jurisdiction by divining what "Congress would have wished" if it had addressed the problem. A more natural inquiry might be what jurisdiction Congress in fact thought about and conferred. Congress did not think about conduct here that contributes to losses abroad in enacting the Securities Exchange Act of 1934; it could easily provide such jurisdiction if that seemed desirable today.

Finally, and not insignificantly, U.S. courts do not have unlimited resources and, as the Zoelsch court expressed, "[i]t is far from clear that these resources would be well spent on all the potential disputes in which domestic conduct makes a relatively small contribution to securities fraud that occurs elsewhere." Where a foreign plaintiff purchases the stock of a foreign company on a foreign exchange, a federal court in the United States certainly would not be the only arbiter with jurisdiction over claims arising out of that transaction, and may not be the most appropriate one either. Even where a misleading statement was prepared in, and released from, the United States, jurisdiction also would lie in the country in which the transaction was consummated, the country in which the defendant is domiciled, and the country in which the plaintiff is domiciled (which very likely is the country in which the plain-

179. Id.
tiff read the fraudulent statement and was misled into purchasing the stock). Thus, the United States would simply be offering a wider range of forums from which to shop, at the expense of an already overworked judiciary. As the Morrison court artfully stated: "[W]e are an American court, not the world's court, and we cannot and should not expend our resources resolving cases that do not affect Americans or involve fraud emanating from America."180

During oral argument in the Morrison case, the Supreme Court voiced a number of these concerns, and focused particularly on the conflict of laws issues that arise in a case, like Morrison, where the plaintiffs are foreign, the defendant is foreign, the stock was purchased on a foreign exchange, and the misrepresentation was made in a foreign country. As Justice Breyer noted, Australia might not like class actions, punitive damages and opt-out requirements, and does not want its companies subject to the American court system when the action involves shares purchased or sold on an Australian exchange. Based on the line of questioning at oral argument, there appears to be little doubt that the Court will affirm the outcome below. The question is whether it will maintain the conduct and effects tests (or some variation of them) or eliminate these tests altogether and replace them with a simple "exchange test"—as advocated by defense counsel—by which jurisdiction lies whereever the shares at issue were purchased or sold.

B. Striking the Balance With a Reliance Requirement

Eliminating the conduct test altogether, however, would ignore America's strong interest in preventing our nation from becoming a breeding-ground for financial fraud, a concern that appears to have been realized with the financial crisis. As the Third Circuit aptly stated more than thirty years ago, "to deny such jurisdiction may embolden those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations. . . . We are reluctant to conclude that Congress intended to allow the United States to

180. Morrison v. Nat'l Austl. Bank, Ltd., 547 F.3d 167, 175 (2d Cir. 2008); see also Butte Mining PLC v. Smith, 76 F.3d 287, 291 (9th Cir. 1996) ("We are not to be a haven for scoundrels; nor should we be a host for the world's victims of securities fraud.").
become a 'Barbary Coast,' as it were, harboring international securities 'pirates.'”  

The Second Circuit echoed this sentiment in *Morrison*, stating that “the United States should not be seen as a safe haven for securities cheaters; those who operate from American soil should not be given greater protection from American securities laws because they carry a foreign passport or victimize foreign shareholders.”

A more measured approach, and the approach endorsed by this article, would be to restrict the current conduct test so that only those losses caused by a U.S. fraud are permitted to proceed in U.S. courts. This could be achieved by interpreting the “directly caused” element of the conduct test as requiring the plaintiff to plead that he or she relied on the U.S. fraud, and by not permitting the plaintiff to employ the fraud-on-the-market theory to satisfy that requirement.

By restricting, but not eliminating, the conduct test, the Court could strike a balance between the policy arguments on

182. *Morrison*, 547 F.3d at 175.
183. The Solicitor General, in its amicus brief in the *Morrison* case, similarly advocates for a causal connection requirement in cases brought by private parties, but does not address the interplay between that requirement and the fraud-on-the-market-theory. See Brief for the United States as Amicus Curiae at 15, *Morrison*, No. 08-1191, 2009 WL 3460235 (Oct. 27, 2009) (“Requiring a direct causal connection between the foreign plaintiff's injury and the United States component of a transactional scheme alleviates [the danger of diverting U.S. judicial resources to redress harms having only an attenuated connection to this country].”). In addition, however, the Solicitor General argues that such a causal nexus between the U.S. conduct and foreign loss would not be necessary to confer jurisdiction in actions brought by the SEC. See id. (“The [SEC], by contrast, . . . can be expected to take account of national interests (including the national interest in ensuring that this country does not become a safe haven for wrongdoers) when it determines whether particular enforcement suits represent sound uses of its own resources and those of the federal courts. . . . This was a distinction previously rejected by the Second Circuit. See SEC v. Berger, 322 F.3d 187, 193-4 (2d Cir. 2003) (“[T]he SEC first contends that, where securities fraud litigation is brought by the SEC rather than by private plaintiffs, there need not be a direct causal connection between the actions in the United States and the claimed losses resulting from the fraud in order for jurisdiction to exist. . . . But we do not think that the SEC's ability to bring a securities fraud action before the fraudulent conduct has caused any harm overrides the generally applicable principles of subject matter jurisdiction. . . . We must therefore apply the traditional conduct test and determine whether Berger's conduct in the United States directly caused these losses.”).
both sides of the issue. On the one hand, there would still be a U.S. forum for cases in which a fraud was perpetrated from within the United States that causes effects abroad. On the other hand, insisting that plaintiffs allege actual reliance, and not permitting them to rest on the fraud-on-the-market presumption to do so, would restrict jurisdiction and account for several serious policy considerations, mainly involving foreign-cubed class actions.

It is difficult to envision a named plaintiff ever being able to make a showing on behalf of a class of unidentified foreign class members that a U.S. misrepresentation led to their losses. An individual plaintiff simply would not know what, if anything, led to the purported class members’ losses. This would, in practice, eliminate the claims of foreign members of a purported class action who purchased foreign stock on a foreign exchange. As a result, applying this standard would sidestep the potential conflict between a U.S. court’s decision and the legal regimes of foreign nations, and along with it the serious doubt that such a judgment would be recognized by the foreign nation. The “dubious binding effect” of a U.S. judgment in a foreign country motivated Judge Friendly in Bersch to expressly refuse to extend the conduct test to foreign members of a class action.184 Thirty-four years later, In re CP Ships Ltd. Securities Litigation185 demonstrated that Judge Friendly’s concern is still prevalent today. In that case, the district court granted the defendant’s motion to dismiss the plaintiffs’ purported class action lawsuit, which was filed on behalf of a class of unnamed foreign purchasers of CP Ships stock. While the plaintiffs’ appeal was pending, the parties agreed to a settlement in the amount of $1.3 million. After the settlement was reached, however, Allen Germain, a Canadian citizen who was a member of the class, objected to the settlement on the grounds that the U.S. court did not have subject matter jurisdiction over the claims of foreign purchasers, that notice of the settlement was inadequate, and that the settlement itself was not fair or reasonable.186 Germain, as it turns out, preferred to be bound by the outcome in a related class action in

184. See Bersch v. Drexel Firestone, 519 F.2d 974, 986-87 (2d Cir. 1975).
185. In re CP Ships Ltd. Sec. Litig., 578 F.3d 1306 (11th Cir. 2009).
186. Id. at 1310-11.
Canada, where CP Ships is organized. The Eleventh Circuit rejected Germain’s arguments, and affirmed the ratification of the settlement. It is not yet clear what impact the Eleventh Circuit’s ruling will have on Germain’s attempts to remain part of the Canadian class action, but CP Ships highlights the collateral attacks Judge Friendly cautioned about in Bersch.

This concern remains problematic whether or not the foreign jurisdiction recognizes the U.S. judgment. If the foreign jurisdiction does not recognize the judgment, then the defendant finds itself subject to exposure for the same claim by the same plaintiff in two or more different jurisdictions, thus violating the axiomatic principle that “courts can and should preclude double recovery by an individual.” On the other hand, if the foreign jurisdiction does recognize the U.S. judgment, then a foreign plaintiff who was not even identified for most of the U.S. proceeding would be bound by the U.S. judgment and unable to proceed with the claim he or she truly wished to bring. This is particularly problematic where the procedure for joining or not joining the class action is different than the procedure employed in the United States. For example, in July 2009, the Italian Parliament approved a law that went into effect January 1, 2010, which permits a collective remedy to protect group interests. Italy’s new “class action,” however, requires that an individual opt in to the action, rather than opting out, like in the United States. Therefore, an individual in Italy can only be a member of a class if he or she proactively decides to join it, and binding such an individual to a U.S. judgment would not only be subjecting that individual to the securities laws of the United States, but also its procedural standards.

In fact, there is evidence to suggest that some foreign “class members” of a U.S. class action are not even aware that

187. Id.
188. Id. at 1318.
190. See supra Part IV.B.
they are members of the class or that they have received a damage or settlement award. A 2007 report by the National Association of Pension Funds ("NAPF") estimated that although "$18.3 billion was paid out by US companies under class action settlements" in 2006, "some $2.4 billion remains unclaimed by UK and European investors." In this sense, awarding damages against a defendant for claims of foreign purchasers in a foreign-cubed class action is evocative of a punitive damage award. There is no connection to U.S. conduct specifically, or to the United States generally. The justification for the assertion of jurisdiction over such claims would appear to be the United States' "legitimate interests in punishing unlawful conduct and deterring its repetition." Yet in the punitive damages context, the Supreme Court has held that it is not for one State to "impose its own policy choice on neighboring States. . . . [O]ne State's power to impose burdens on the interstate market. . . . is. . . constrained by the need to respect the interests of other States." As a result, "a State may not impose economic sanctions on violators of its laws with the intent of changing the tortfeasors' lawful conduct in other States." Similarly, the United States should not be permitted to punish a defendant for foreign conduct that may be lawful in a foreign country, and did not have any effect on the United States or its residents—a risk that is raised when a U.S. court asserts subject matter jurisdiction over foreign claims that relate, not to the U.S. fraudulent conduct, but to its for-


194. BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 568 (1996); see also Exxon Shipping Co. v. Baker, 128 S. Ct. 2605, 2634 n.28 (2008) (noting the similar function served by class actions and punitive damages, in that both encourage litigation when the compensatory damage amount would be an insufficient motivation).

195. BMW of N. Am., 517 U.S. at 571. For this reason, among others, the Supreme Court has refused to permit punitive damages to be based on injury to individuals who are not before the court. In Philip Morris USA v. Williams, the Court concluded that "the Constitution's Due Process Clause forbids a State to use a punitive damages award to punish a defendant for injury that it inflicts upon nonparties or those whom they directly represent, i.e., injury that it inflicts upon those who are, essentially, strangers to the litigation." 549 U.S. 346, 353 (2007).

196. BMW of N. Am., 517 U.S. at 572.
eign counterpart. As the Supreme Court noted in the antitrust context:

[W]hy is it reasonable to apply [the antitrust] laws to foreign conduct insofar as that conduct causes independent foreign harm and that foreign harm alone gives rise to the plaintiff's claim? . . . Why should American law supplant, for example, Canada's or Great Britain's or Japan's own determination about how best to protect Canadian or British or Japanese customers from anticompetitive conduct engaged in significant part by Canadian or British or Japanese or other foreign companies? 197

Instituting a reliance requirement as part of the conduct test would prevent U.S. courts from asserting jurisdiction over foreign claims that have no causal connection to the United States. However, a reliance requirement would not preclude the claims of foreign purchasers who could allege reliance on the fraudulent U.S. conduct, nor would it preclude the claims of U.S. purchasers of stock (regardless of the exchange on which they purchased the stock) or the claims of foreign purchasers who purchased stock on a U.S. exchange, because the effects test would be satisfied in such circumstances. If the Supreme Court concluded that this was not sufficient to protect the interests that the United States has in asserting jurisdiction over fraudulent conduct carried out from within U.S. borders, there could be an exception to the reliance requirement where all of the alleged fraudulent conduct took place in the United States. If all of the alleged fraud took place in the United States, and if plaintiffs otherwise satisfy the PSLRA pleading requirements—including adequately alleging loss causation—it would be safe to assume that the plaintiffs' losses were caused by defendant's U.S. conduct, and the policy considerations discussed above would not be implicated. This would provide an outlet for class actions in cases where the United States seems the most appropriate forum for the dis-

197. F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 165 (2004). In Empagran, the Supreme Court held that the Sherman Act does not apply where "[t]he price-fixing conduct significantly and adversely affects both customers outside the United States and customers within the United States, but the adverse foreign effect is independent of any adverse domestic effect." Id. at 164.
pute (i.e., the forum in which the fraudulent conduct took place).\footnote{198}

Of course, even this "safety valve" would not result in a perfect solution. While courts would be able to assert jurisdiction over foreign-cubed class actions in which all the fraudulent conduct occurred in the United States, this would still preclude class actions where a majority, or even a large portion, of the fraudulent conduct occurred in the United States. Foreign purchasers who truly did wish to bring their claims in a U.S. court could do so individually, but this would decrease the financial incentive to bring such claims, and could result in duplicative litigation that would tax the U.S. judiciary's limited resources, thereby undermining two of the objectives that Rule 23 was specifically enacted to achieve.\footnote{199} On the other hand, foreign purchasers who do wish to bring a class action lawsuit in connection with a partially-American fraud could bring the action in the United States if they were able to plead reliance on the fraudulent conduct that occurred in the U.S. The reliance requirement would only prevent them from purporting to represent other unidentified foreign purchasers who may not wish to bring such a claim in the United States. In this way, such a requirement would turn foreign-cubed class actions into opt-in actions, rather than opt-out ones.

\footnote{198. At first glance, such an exception would seem to create a curious and undesirable incentive for defendants to commit as wide and pervasive a fraud as possible, crossing numerous national borders, because doing so it would preclude a large class action from being filed in the United States. Yet the defendant would still be subject to U.S. jurisdiction over the claims of American purchasers and claims of foreign purchasers of stock on U.S. exchanges. In addition, nothing would prevent foreign purchasers from pursuing claims in foreign jurisdictions if they so chose.}

\footnote{199. See American Pipe & Const. Co. v. Utah, 414 U.S. 538, 553-54 (1974) (noting that "efficiency and economy of litigation" was "a principal purpose" of the Rule 23 class action procedure); Walters v. Reno, 145 F.3d 1032, 1047 (9th Cir. 1998) ("[C]lass certification in this case is entirely proper in light of the general purposes of Rule 23, avoiding duplicative litigation."); see also 1 Laurence H. Tribe, American Constitutional Law 454 (3d ed. 2000) (stating that states are permitted bring \textit{pares patriarch} suits "on behalf of citizen consumers as a statewide 'class' of sorts—a group whose members may lack a sufficient economic stake to justify bringing suit as individuals or who may have insufficient incentive, or may otherwise be unable to meet the criteria, to sue as a Rule 23 class") (citing Maryland v. Louisiana, 451 U.S. 725, 737-39 (1981)).}
Although the burden to establish subject matter jurisdiction is not meant to be a heavy one, it is still the plaintiff's burden to carry. The burden would be turned on its head if an individual plaintiff, who knew nothing about the claims of hundreds or thousands of unnamed foreign purchasers, nonetheless could trigger U.S. jurisdiction over them. The notion that a plaintiff could succeed in establishing U.S. jurisdiction over a massive class action law suit—involving a foreign defendant, foreign plaintiff and foreign transaction—merely by alleging that a fraudulent statement emanated from the United States, without even alleging that the statement was connected to the foreign plaintiff's decision to enter into the transaction, pushes the jurisdictional envelope too far.

VI. CONCLUSION

It has reached the point that, regardless of where a public statement originates, it quickly winds its way through international waters. A company need only place a press release on its website for it to be accessible worldwide. Every foreign fraud seemingly has some connection to the United States, and every fraud perpetrated from within the United States finds its prey, at least in part, in the pool of foreign investors. The recent financial crisis proves the point. As one report notes, "[t]he crisis affecting 2008 is a global issue and is not specific to a certain company's shareholders, but rather has negatively impacted the share price of almost every listed entity around the world." The frauds emanating from within the United States reverberated throughout the world, affecting investors from across the globe.

As a result of the continued and unending globalization of the world's financial markets, there is no longer such a thing as a solely domestic fraud. But until there is a uniform

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200. See, e.g., Morrison v. Nat'l Austl. Bank Ltd., 547 F.3d 167, 170 (2d Cir. 2008) ("A plaintiff asserting subject matter jurisdiction has the burden of proving by a preponderance of the evidence that it exists. . . . [j]urisdiction must be shown affirmatively, and that showing is not made by drawing from the pleadings inferences favorable to the party asserting it.") (internal quotes and citations omitted).

system of laws to regulate the financial markets. Financial globalization is just as much, if not more, of a justification for restricting jurisdiction than it is for expanding it. Foreign shareholders have already begun to turn to U.S. courts to provide recovery where their own country’s systems do not. As a report by PricewaterhouseCoopers notes, “[d]ue to limited shareholder rights and protections currently available outside the US, foreign investors and pension funds continue to seek recovery of losses from US courts by filing claims and participating in US class actions.” It seems that the Morrison court’s proclamation that “we are not the world’s court” has done little to decelerate the trend toward that result.

This is not to suggest that the U.S. courts should remove themselves from adjudicating all U.S. conduct that has its effects overseas. Instead, their approach should recognize the regulatory systems that foreign jurisdictions chose to establish. The policing of financial fraud is an effort joined by foreign nations that, like the United States, have instituted regulations that they believe strike the appropriate balance to accomplish the task. Until there is a global regulatory body to enforce securities fraud in multi-national markets, or until Congress legislates otherwise, the United States will need to depend on, and to trust, those choices and the resulting regulatory regimes. The U.S. courts should not accept cases involving a predominantly foreign class of purchasers merely because there was some conduct that occurred within U.S. borders. Where a foreign jurisdiction is more appropriately positioned to handle the case, U.S. courts should not, to borrow a baseball analogy, swing at a pitch outside the strike zone merely because it can reach it.

The key, of course, is to appropriately define the “strike zone.” The Morrison court felt that the “heart of the fraud” test adequately balanced the competing policy concerns raised by the extraterritoriality of the securities laws, and only time will tell if the court is right. If the past forty years is any indication, the “heart of the fraud” will need to be defined much more clearly for courts to have any idea what they should and should not swing at. A reliance requirement would accomplish this goal. By forcing the plaintiff to plead a causal connection between the foreign claim and the fraudulent U.S. conduct, it

202. Id. at 55.
would ensure that "the precious resources of United States courts and law enforcement agencies"\textsuperscript{203} are devoted to the appropriate claims.

\textbf{Epilogue}

On June 24, 2010, the Supreme Court handed down its decision in \textit{Morrison v. National Australia Bank Ltd.}\textsuperscript{204} The Court, relying on the presumption against extraterritoriality, eliminated the conduct and effect tests altogether and established an "exchange test," whereby a claim only may be brought under Section 10(b) when it involves securities that were purchased or sold on an American exchange. According to Justice Scalia's opinion for the Court, "[w]hen a statute gives no clear indication of an extraterritorial application, it has none."\textsuperscript{205} Justice Scalia noted that the presumption against extraterritoriality encompasses both a deference to the legislature\textsuperscript{206} as well as a deference to the legal regimes put in place by foreign countries.\textsuperscript{207} According to the Court, the circuit courts' disregard of this presumption "has produced a collection of tests for divining what Congress would have wanted, complex in formulation and unpredictable in application."\textsuperscript{208} Rather than sharing the Second Circuit's concern that a bright line rule would too easily enable fraudsters to evade it, the Supreme Court extolled a predictable standard that courts and potential plaintiffs and defendants alike could comprehend.\textsuperscript{209} In deciding to eliminate the "conduct" and effect

\begin{itemize}
  \item \textsuperscript{203} Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 985 (2d Cir. 1975).
  \item \textsuperscript{204} 130 S. Ct. 2869 (2010).
  \item \textsuperscript{205} \textit{Id.} at 2878; see \textit{supra} pp. 405-06.
  \item \textsuperscript{206} 130 S. Ct. at 2886 ("It is [the Court's] function to give the statute the effect its language suggests, however modes that may be; not to extend it to admirable purposes it might be used to achieve."); see \textit{supra} pp. 408-09.
  \item \textsuperscript{207} 130 S. Ct. at 2885 ("Like the United States, foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction. And the regulation of other countries often differs from ours as to what constitutes fraud, what disclosures must be made, what damages are recoverable, what discovery is available in litigation, what individual actions may be joined in a single suit, what attorney's fees are recoverable, and many other matters."); see \textit{supra} p. 410.
  \item \textsuperscript{208} 130 S. Ct. at 2878.
  \item \textsuperscript{209} \textit{Id.} at 2879 ("There is no more damning indictment of the 'conduct' and 'effects' tests than the Second Circuit's own declaration that 'the presence or absence of any single factor which was considered significant in

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tests, the Supreme Court reaffirmed its recent line of cases restricting extraterritorial application of U.S. statutes and adopted a straightforward standard that is both easy for courts to administer and comforting to companies that do not list their ordinary shares or ADRs on a U.S. exchange but nonetheless conduct business in America. Justice Stevens, with whom Justice Ginsburg joined, concurred in the majority's outcome but not in its reasoning. While Justice Stevens agreed that Section 10(b) does not apply to wholly foreign frauds, and that the facts of this case present too attenuated a connection to the U.S. to warrant adjudication by a U.S. court, he wrote that "the real question in this case is how much, and what kinds of, domestic contacts are sufficient to trigger application of [Section] 10(b). In developing its conduct-and-effects tests, the Second Circuit endeavored to derive a solution from the Exchange Act's test, structure, history, and purpose." Justice Stevens noted that the majority's opinion departed from a long history of Supreme Court decisions embracing "judge-made rules" in the 10b-5 context, and that as a result, "it pays short shrift to the United States' interest in remedying frauds that transpire on American soil or harm American citizens, as well as to the accumulated wisdom and experience of the lower courts."