

January 2014

Global Expansion of National Securities Laws: Extraterritoriality and Jurisdictional Conflicts

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Junsun Park, *Global Expansion of National Securities Laws: Extraterritoriality and Jurisdictional Conflicts*, 12 U.N.H. L. REV. 69 (2014), available at http://scholars.unh.edu/unh_lr/vol12/iss1/5

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Global Expansion of National Securities Laws: Extraterritoriality and Jurisdictional Conflicts

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INTRODUCTION

As securities fraud has grown increasingly transnational,¹ it has become necessary to expand the reach of anti-fraud provisions to persons and entities participating in global securities markets.² So far, however, no single antifraud provision exists to govern the entire global marketplace.³ Although each country strives to combat international securities fraud by using its own regulatory regime, problems can develop when extraterritorial application of

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1. See Felice B. Friedman et al., *Taking Stock of Information Sharing in Securities Enforcement Matters*, 10 J. FIN. CRIME 37, 37 (2002) (pointing out the globalization of fraud).

2. See Kun Young Chang, *Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject-Matter Jurisdiction*, 9 FORDHAM J. CORP. & FIN. L. 89, 90 (2003) (discussing regulatory issues arising from the globalization of securities fraud).

3. See *id.*

national securities laws leads to regulatory overlapping or conflicts.⁴ In light of these problems, it is necessary to set forth clear guidelines for determining whether national securities laws can apply extraterritorially and, if so, how far they can extend.⁵ The U.S., in particular, has longstanding and extensive experience in seeking extraterritorial application of national securities laws.⁶ In doing so, the U.S. has developed several tests to justify extraterritoriality,⁷ and has bolstered a statutory basis for extraterritorial application of anti-fraud prohibitions in actions brought by the U.S. Securities and Exchange Commission (SEC) or the U.S. Department of Justice (DOJ).⁸

I. EXTRATERRITORIALITY TESTS PRIOR TO THE DODD-FRANK ACT

A. Extraterritoriality Tests Before *Morrison*: Effects and Conduct Tests

Until abrogated by the U.S. Supreme Court's decision in *Morrison v. National Australia Bank Ltd.* on June 24, 2010, the Second Circuit Court of Appeals had led the way in extraterritorial application of anti-fraud prohibitions by using two methods: the effects test and the conduct test.⁹ Under the effects test, subject matter jurisdiction lay in a U.S. court when "the wrongful conduct had a substantial effect in the United States or upon United States citizens."¹⁰ In *Schoenbaum v. Firstbrook*, the Second Circuit introduced the effects test¹¹ by holding that

the district court has subject matter jurisdiction over violations of the Securities Exchange Act although the transactions which are alleged to violate the Act take place outside the United States, at least when the transactions

4. *Id.* at 90–92; see also INT'L BAR ASS'N, REPORT OF THE TASK FORCE ON EXTRATERRITORIAL JURISDICTION 6 (2009), available at <http://www.ibanet.org/Document/Default.aspx?DocumentUid=ECF39839-A217-4B3D-8106-DAB716B34F1E> [hereinafter REPORT ON EXTRATERRITORIAL JURISDICTION].

5. See Chang, *supra* note 2, at 94.

6. See, e.g., *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), abrogated by *Morrison v. Nat'l Austl. Bank Ltd.*, 130 S. Ct. 2869 (2010); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972), abrogated by *Morrison*, 130 S. Ct. 2869; Dodd-Frank Wall Street & Consumer Protection Act, H.R. 4173, 111th Cong. §§ 929P(b), 929Y (2010) (enacted) [hereinafter Dodd-Frank Act].

7. See SEC v. *Berger*, 322 F.3d 187, 192–93 (2d Cir. 2003), abrogated by *Morrison*, 130 S. Ct. 2869.

8. Dodd-Frank Act § 929P(b).

9. See Chang, *supra* note 2, at 95; see also *Schoenbaum*, 405 F.2d at 206; *Leasco*, 468 F.2d at 1334.

10. *Berger*, 322 F.3d at 192–93; *Morrison*, 130 S. Ct. at 2879.

11. J. WILLIAM HICKS, INTERNATIONAL DIMENSIONS OF U.S. SECURITIES LAW § 11:29 (2012).

involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors.¹²

In later cases, this court stipulated that the “effects” for the purpose of the effects test must be strong enough to generate “foreseeable and substantial harm to interests in the United States,”¹³ and also declared that mere adverse effects were insufficient to meet the requirements of the effects test.¹⁴

Under the conduct test, by contrast, subject matter jurisdiction lay in a U.S. court so long as “the wrongful conduct occurred in the United States.”¹⁵ Beginning with *Leasco Data Processing Equipment Corp. v. Maxwell*,¹⁶ the conduct test was used to close the loopholes of the effects test.¹⁷ Whereas the effects test focused on harm to U.S. investors or markets, the conduct test allowed a federal court to address where the fraudulent conduct occurred.¹⁸ Accordingly, a U.S. court could obtain jurisdiction over foreign-related transactions that involved domestic misconduct even though the frauds did not harm U.S. investors or markets.¹⁹ To prevent the U.S. from being “used as a base for manufacturing fraudulent security devices for export, even when these [were] peddled only to foreigners,”²⁰ the Second Circuit employed the conduct test, requiring that subject matter jurisdiction in the U.S. would depend on whether “substantial acts in furtherance of the fraud”²¹ occurred on U.S. soil.²² The court then held that this conduct test would be satisfied when “(1) the defendant’s activities in the United States were more than ‘merely preparatory’ to a securities fraud conducted elsewhere, and (2) these activities or culpable failures to act within the United States ‘directly caused’ the claimed losses.”²³ These two requirements had to be satisfied

12. *Schoenbaum*, 405 F.2d at 208.

13. *Tamari v. Bache & Co. S.A.L.*, 730 F.2d 1103, 1108 (7th Cir. 1984).

14. *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 989 (2d Cir. 1975); see also Stephen Choi & Linda Silberman, *Transnational Litigation and Global Securities Class-Action Lawsuits*, 2009 WIS. L. REV. 465, 475–76 (2009).

15. *Berger*, 322 F.3d at 192–93; *Morrison*, 130 S. Ct. at 2879.

16. *Leasco*, 468 F.2d 1326.

17. HICKS, *supra* note 11, § 11:30.

18. Christine Jarmer, Comment, *International Internet Securities Fraud and SEC Enforcement Efforts: An Update*, 73 TUL. L. REV. 2121, 2132 (1999); see also Chang, *supra* note 2, at 95–96.

19. Chang, *supra* note 2, at 96.

20. *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975).

21. *Psimenos v. E.F. Hutton & Co., Inc.*, 722 F.2d 1041, 1045 (2d Cir. 1983) (citing *IIT*, 519 F.2d at 1018); *Berger*, 322 F.3d at 193.

22. *Psimenos*, 722 F.2d at 1045; *Berger*, 322 F.3d at 193.

23. *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 122 (2d Cir. 1995) (citing *Alfadda v. Fenn*, 935 F.2d 475, 478 (2d Cir. 1991)), *abrogated by Morrison*, 130 S. Ct. 2869.

even when the SEC, as a plaintiff, filed an action under the conduct test.²⁴

Although these two tests were independently developed, the court thought that they could be combined with each other.²⁵ Indeed, the Second Circuit had used both tests “in a combined form.”²⁶ The benefits of this form were demonstrated in *Bersch v. Drexel Firestone, Inc.*²⁷

Following these tests set by the Second Circuit, other circuit courts adopted similar extraterritoriality tests.²⁸ The specific form of the tests, however, differed depending on the court in question.²⁹ In particular, the D.C. Circuit used the strictest form of the conduct test, requiring that “the American-based conduct at issue had to itself constitute a securities law violation.”³⁰ The Fifth and Seventh Circuits used a less strict form of the conduct test,³¹ requiring that the conduct on U.S. soil “directly [cause] the plaintiff’s alleged loss in that the conduct forms a substantial part of the alleged fraud and is material to its success.”³² The Third, Eighth, and Ninth Circuits, by contrast, used the most lenient form of the conduct test,³³ “requir[ing] only some activity designed to further a fraudulent scheme to occur in this country.”³⁴ Under this last form, therefore, mere preparation may be sufficient to meet the requirements of the conduct test.³⁵ Given the inconsistency among the courts in defining the required degree of domestic conduct, the conduct test could not function as a bright line in individual cases.³⁶ Foreign market participants could not understand exactly what

24. See HICKS, *supra* note 11, § 11:41 (examining previous cases to see whether the two requirements of the conduct test should be met even when the SEC, as a plaintiff, brings a lawsuit). In *Berger*, however, the Second Circuit acknowledged that, “in cases where the SEC [brought] suit prophylactically, it [would] be necessary to modify the conduct test to account for the fact that no harm or loss [had] occurred.” *Berger*, 322 F.3d at 193, n.2.

25. HICKS, *supra* note 11, § 11:42.

26. *Id.*

27. 519 F.2d 974.

28. *Morrison*, 130 S. Ct. at 2880.

29. See THOMAS HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION, § 17.4[1] (2010), available at 1995 WL 1759427; see also Stephen Choi & Andrew Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT’L L. & BUS. 207, 217 (2009); HICKS, *supra* note 11, § 11:39.

30. HICKS, *supra* note 11, § 11:39 (citing *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987)).

31. *Id.*

32. *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 667 (7th Cir. 1998), *abrogated by Morrison*, 130 S. Ct. 2869; HICKS, *supra* note 11, § 11:39.

33. HICKS, *supra* note 11, § 11:39.

34. *Id.*; *SEC v. Kasser*, 548 F.2d 109, 114 (3d Cir. 1977), *abrogated by Morrison*, 130 S. Ct. 2869; Choi & Guzman, *supra* note 29, at 217; HAZEN, *supra* note 29, § 17.4[1]. These courts addressed “whether the domestic conduct caused the plaintiff’s loss.” HICKS, *supra* note 11, § 11:39.

35. Choi & Guzman, *supra* note 29, at 217.

36. See *id.* at 217–18; see also Chang, *supra* note 2, at 109.

circumstances put them under the jurisdiction of U.S. securities regulation.³⁷

Similar to the conduct test, the effects test also suffered from certain problems.³⁸ In particular, it was vague as to what degree of “effects” must be made on the U.S. in order to meet the requirements of the effects test.³⁹ Thus, the specific extent of extraterritoriality under this test was left unsettled and unpredictable.⁴⁰ Also, as internet networks had seen drastic improvement, overseas activities could unexpectedly impact U.S. markets or investors.⁴¹ Given these circumstances, the effects test risked expanding the scope of U.S. securities laws too far.⁴² Such unsettled and excessive expansion of national laws could infringe upon the sovereignty of other countries, and thus harm international relations.⁴³

B. Extraterritoriality Tests Under *Morrison*: Transactional Test

Recognizing the concerns about the effects and conduct tests,⁴⁴ in 2010 the Supreme Court overruled the two tests set forth in *Morrison v. National Australia Bank Ltd.*⁴⁵ The decision observed correctly that no explicit statutory basis existed for extraterritorial application.⁴⁶ Yet, the Supreme Court went on to address the defects of the effects and conduct tests,⁴⁷ and introduced a new test, the transactional test, as the primary standard to be used to determine the reach of Section 10(b) of the Exchange Act.⁴⁸ Specifically, focusing on the text of Section 10(b), the Court held that this provision applied to cases where fraudulent actions in question accompanied

37. See Choi & Guzman, *supra* note 29, at 217–18.

38. John Kelly, Note, *Let There Be Fraud (Abroad): A Proposal for a New U.S. Jurisprudence with Regard to the Extraterritorial Application of the Anti-Fraud Provisions of the 1933 and 1934 Securities Acts*, 28 LAW & POL’Y INT’L BUS. 477, 493 (1997).

39. *Id.*; Chang, *supra* note 2, at 110.

40. See Louise Corso, Note, *Section 10(b) and Transnational Securities Fraud: A Legislative Proposal to Establish a Standard for Extraterritorial Subject Matter Jurisdiction*, 23 GEO. WASH. J. INT’L L. & ECON. 573, 576 (1989); see also Chang, *supra* note 2, at 109–10.

41. George Nnona, *International Insider Trading: Reassessing the Propriety and Feasibility of the U.S. Regulatory Approach*, 27 N.C. J. INT’L L. & COM. REG. 185, 198 (2001); Chang, *supra* note 2, at 109–10 & n.99.

42. See Chang, *supra* note 2, at 109–10.

43. See *id.* at 117–18; see also REPORT ON EXTRATERRITORIAL JURISDICTION, *supra* note 4, at 5 (stating that a sovereign state can enact legislation to regulate activities arising on its own soil).

44. See *Morrison*, 130 S. Ct. at 2879–81.

45. *Morrison*, 130 S. Ct. 2869; see also Letter from Hannah L. Buxbaum, Comments on Study on Extraterritorial Private Rights of Action Release No. 34-63174, File No. 4-617, 1 (Feb. 18, 2011), available at <http://www.sec.gov/comments/4-617/4617-14.pdf> [hereinafter Comments by Buxbaum].

46. *Morrison*, 130 S. Ct. at 2883.

47. *Id.* at 2879–81.

48. *Id.* at 2884.

“the purchase or sale of any security registered on a national securities exchange or any security not so registered.”⁴⁹ Through this decision, the Court sought to remove ambiguity and provide clarity in determining the reach of Section 10(b).⁵⁰

In *Morrison*, Australian shareholders who had purchased stock on an Australian exchange filed a class action lawsuit against an Australian bank for violating sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5.⁵¹ The plaintiffs contended that the defendant made material misstatements regarding a mortgage servicing company it intended to acquire.⁵² In response, the district court dismissed this case for absence of subject matter jurisdiction, a decision the appellate court affirmed.⁵³ Finally, the Supreme Court agreed with the lower courts’ dismissals,⁵⁴ but rejected their underlying reasoning, specifically disputing their basis for deciding whether to grant extraterritorial applicability to U.S. securities laws.⁵⁵

Various foreign factors played a part in the *Morrison* case. Most importantly, the parties involved were Australian—both the individual plaintiffs⁵⁶ and the National Australia Bank Limited as defendant.⁵⁷ The plaintiffs, in fact, had bought “ordinary shares”⁵⁸ in this bank, and this stock was listed on foreign stock exchanges including the Australian Stock Exchange Limited.⁵⁹ The case also displayed any number of domestic dimensions, including the conduct of a subsidiary in Florida and the listing of American Depositary Receipts (ADRs) on a U.S. exchange.⁶⁰ In its reasoning, however, the Court held that the foreign dimensions of the case were those that were fundamental to it.⁶¹

In deciding this case, the Supreme Court introduced significant changes in interpreting whether U.S. securities laws can apply extraterritorially.⁶² First, the Court clarified the question of whether section 10(b) could apply extraterritorially, overturning the lower courts’ treatment of this question as

49. 15 U.S.C. § 78j(b) (2011); *Morrison*, 130 S. Ct. at 2884.

50. See Richard Painter, et al., *When Courts and Congress Don’t Say What They Mean: Initial Reactions to Morrison v. National Australia Bank and to the Extraterritorial Jurisdiction Provisions of the Dodd-Frank Act*, 20 MINN. J. INT’L L. 1, 6 (2011).

51. *Morrison*, 130 S. Ct. at 2873.

52. *Id.* at 2876.

53. *Id.*

54. *Id.* at 2888.

55. *Id.* at 2876–83, 2888.

56. *Id.* at 2876.

57. *Morrison*, 130 S. Ct. at 2875.

58. *Id.* at 2876.

59. *Id.* at 2875.

60. *Id.* at 2875, 2883–84.

61. *Id.* at 2884.

62. *Id.* at 2869.

an issue of subject matter jurisdiction.⁶³ Upon deliberation, the Court declared that the extraterritoriality of section 10(b) was to be considered a matter of merits or prescriptive jurisdiction (i.e., whether the conduct fell within the scope of the statute), rather than one of subject matter jurisdiction.⁶⁴ The Court's decision left no doubt that U.S. federal courts have subject matter jurisdiction over Exchange Act claims regardless of an extraterritorial dimension.⁶⁵ While examining the extraterritoriality of section 10(b), therefore, the federal courts had to determine whether that provision extended to the fraud that allegedly occurred (a matter of prescriptive jurisdiction) and not just whether the courts had authority to hear the case (a matter of subject matter jurisdiction).⁶⁶

Given this clarification, the Supreme Court's substantive analysis of section 10(b) revealed that this provision did not extend beyond U.S. territory⁶⁷ because of the text of the statute:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe⁶⁸

The Court then noted that it could not find any explicit provision allowing section 10(b) to apply extraterritorially.⁶⁹ The Court thus concluded that section 10(b) did not extend extraterritorially.⁷⁰

In its reasoning, the Court indicated that the effects test and conduct test, as well as a combination of these two, were problematic because they did not rest on any firm ground, making it impossible to anticipate when U.S. antifraud provisions applied to a transaction.⁷¹ The Court then introduced the transactional test, which allows section 10(b) to apply to the case where the

63. *Morrison*, 130 S. Ct. at 2876–77.

64. *Id.*

65. *Id.* at 2877; *see also* Comments by Buxbaum, *supra* note 45, at 3–4; Painter, *supra* note 50, at 3.

66. *Morrison*, 130 S. Ct. at 2877; *see also* Comments by Buxbaum, *supra* note 45, at 3–4; Painter, *supra* note 50, at 3.

67. *Morrison*, 130 S. Ct. at 2883.

68. 15 U.S.C. 78j (2011); *Morrison*, 130 S. Ct. at 2881–82.

69. *Morrison*, 130 S. Ct. at 2883.

70. *Id.*

71. *Id.* at 2879–81.

fraudulent actions in question involve “transactions in securities listed on domestic exchanges, and domestic transactions in other securities.”⁷² Through this test, the Court sought to provide clarity in deciding whether section 10(b) applies to overseas transactions.⁷³

Due to the language written in *Morrison*, however, the transactional test could be perceived as vague and confusing.⁷⁴ The most significant problems with the transactional test arise from this specific wording: “transactions in securities listed on domestic exchanges, and domestic transactions in other securities.”⁷⁵ Some people have interpreted this wording to mean that the location of a transaction is of no concern so long as the security is listed on a U.S. stock exchange.⁷⁶ The Court, however, may not have intended such an interpretation, as the overall analysis in *Morrison* seemingly did not result in protecting foreign transactions;⁷⁷ rather, the Court attempted to strictly limit extraterritorial application of section 10(b) unless an explicit statute providing extraterritoriality existed.⁷⁸ Given this understanding, the literal interpretation of the transactional test may deviate from the plain intention of Justice Scalia and the majority.⁷⁹ The appropriate interpretation, therefore, is that in *Morrison* the Supreme Court limited the applicability of section 10(b) to specific securities transactions that occur within the U.S.⁸⁰

Morrison's transactional test would have imposed serious limitations on the SEC and the DOJ, in addition to private plaintiffs such as those suing in *Morrison* itself.⁸¹ For example, if a person steals insider information from an employer within the U.S. and then uses that information to trade securities outside the U.S., this person would not violate section 10(b) under the transactional test.⁸² In *SEC v. Liang*, a chemist obtained confidential

72. *Id.* at 2884. In a post-*Morrison* case, the Second Circuit held that *Morrison*'s second prong, a “domestic transaction in other securities,” would be satisfied when “irrevocable liability was incurred or title was transferred within the United States.” *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 68 (2d Cir. 2012).

73. *See Morrison*, 130 S. Ct. at 2886; *see also Painter*, *supra* note 50, at 6.

74. *See Painter*, *supra* note 50, at 6–7.

75. *Morrison*, 130 S. Ct. at 2884; *see also Painter*, *supra* note 50, at 8.

76. *See* Comments by Buxbaum, *supra* note 45, at 1 (pointing out concerns about the potential arguments that might be made based on the language of *Morrison*).

77. *Id.* at 1–2 (quoting *Morrison*, 130 S. Ct. at 2882); *see also Painter*, *supra* note 50, at 9–10; Comments by Forty-Two Law Professors, Comments on Study on Extraterritorial Private Rights of Action Release No. 34-63174, File No. 4-617, at 13 (Feb. 18, 2011), *available at* <http://www.sec.gov/comments/4-617/4617-28.pdf> [hereinafter Comments by Forty-Two Law Professors].

78. *See Morrison*, 130 S. Ct. at 2883; Comments by Buxbaum, *supra* note 45, at 1.

79. *Painter*, *supra* note 50, at 9–10.

80. Comments by Buxbaum, *supra* note 45, at 1; Comments by Forty-Two Law Professors, *supra* note 77, at 13.

81. In his concurrence, Justice Stevens pointed out the defects of the transactional test. *See Morrison*, 130 S. Ct. at 2895 (Stevens, J., concurring).

82. Under the transactional test, “[s]ection 10(b) reaches the use of a manipulative or

information from the U.S. Food and Drug Administration (FDA), and, based on that information, then traded stocks by using the accounts of Chinese residents.⁸³ Fortunately for the U.S. government prosecutors, despite using foreign residents' accounts, the chemist in this case performed his trading on the NASDAQ and NYSE Amex.⁸⁴ If, however, this chemist were to have traded the stocks on a Chinese exchange, the transactional test would allow him to avoid liability for violating section 10(b). A person or hedge fund manager who violates U.S. securities laws but is shrewd enough to execute his trading outside the U.S. is able to escape liability. Such loopholes in the transactional test interfere with the government's ability to prosecute actions that undermine market integrity and reduce investor confidence in the fairness of securities markets. In order to partially close these loopholes, Congress enacted the Dodd-Frank Act and restored the effects and conduct tests in actions brought by the SEC and the DOJ.⁸⁵

II. EXTRATERRITORIALITY TESTS UNDER THE DODD-FRANK ACT

A. Extraterritoriality Provision of the Dodd-Frank Act

In response to *Morrison*, Congress added a new provision in the Dodd-Frank Act that had been pending in Congress for many months.⁸⁶ In actions brought by the SEC and the DOJ, this provision establishes a statutory basis for extraterritorial application of the Exchange Act's and Securities Act's anti-fraud provisions.⁸⁷ In particular, Section 929P of the Act allows the SEC and the DOJ to rely on the effects and conduct tests, stipulating that:

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

deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States.” *Morrison*, 130 S. Ct. at 2888.

83. SEC v. Liang, Compl. 1–2, 8:11 CV 00819-RWT (Jun. 2, 2011), available at <http://www.sec.gov/litigation/complaints/2011/comp21987.pdf> [hereinafter Liang Complaint]; see also Liang, Litigation Release No. 22171 (Nov. 30, 2011), <http://www.sec.gov/litigation/litreleases/2011/lr22171.htm>.

84. See Liang Complaint, *supra* note 83, at 5–9.

85. See Dodd-Frank Act § 929P(b); see also HICKS, *supra* note 11, § 11:50.

86. See Richard Painter, *The Dodd-Frank Extraterritorial Jurisdiction Provision: Was It Effective, Needed or Sufficient?*, 1 HARV. BUS. L. REV. 196, 199 (2011).

87. See Dodd-Frank Act § 929P(b).

- (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
- (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.⁸⁸

Congress enacted this extraterritoriality provision for the purpose of guaranteeing the robust police power of the SEC and the DOJ against offshore securities frauds.⁸⁹ Regardless of *Morrison*, therefore, the SEC and the DOJ are once again able to rely on the effects and conduct tests in establishing extraterritorial securities fraud in violation of Rule 10b-5.⁹⁰ In other words, they can file a lawsuit against perpetrators of multinational securities fraud on the ground of violating anti-fraud provisions so long as the effects or conduct test is met under Section 929P of the Dodd-Frank Act.⁹¹

B. The Effects, Conduct, and Transactional Tests After the Dodd-Frank Enactment

From the *Morrison* decision and Dodd-Frank enactment, it is clear that the SEC is equipped with several statutory grounds for extraterritorial application of U.S. anti-fraud provisions.⁹² One basis is the anti-fraud provisions themselves; in *Morrison*, the Supreme Court declared that the transactional test could be inferred directly from one of the anti-fraud provisions.⁹³ Based on these provisions, then, the SEC can bring extraterritorial enforcement actions against a securities fraud that occurs in connection with U.S. securities transactions, even though the fraudulent scheme concerns overseas activities.⁹⁴

A second basis is Section 30 of the Exchange Act.⁹⁵ This provision is designed to combat instances where a broker-dealer commits securities fraud on offshore markets in order to avoid U.S. securities regulation.⁹⁶ Under this provision, the SEC can apply the Exchange Act to those who pursue their fraudulent scheme by committing “actions abroad that might conceal a domestic violation, or might cause what would otherwise be a domestic

88. *Id.*

89. See HICKS, *supra* note 11, § 11:50.

90. *See id.*

91. *See* Dodd-Frank Act § 929P(b).

92. *See* Painter, *supra* note 86, at 214–15.

93. *See id.*

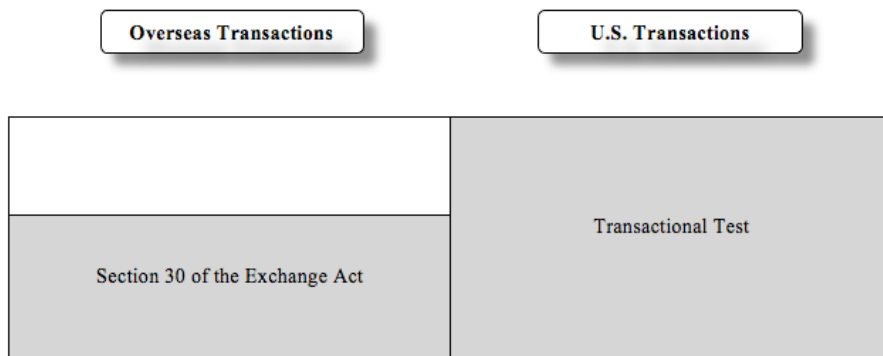
94. *See id.*

95. 15 U.S.C. § 78dd (2006 & Supp. 2011); *see also* Painter, *supra* note 86, at 215.

96. Painter, *supra* note 86, at 215.

violation to escape on a technicality.”⁹⁷ In order to use Section 30, however, the SEC would have to promulgate rules pursuant to this provision.⁹⁸ With these in place, the SEC would be able to apply the Exchange Act’s antifraud provisions to certain overseas transactions, such as where a U.S. citizen uses a Canadian brokerage firm to buy stock listed only on a Canadian exchange and there are only nominal contacts between the brokerage firm and the U.S.⁹⁹

Figure 1.
Extraterritoriality in SEC Enforcement Actions Under *Morrison*



A third and final basis for extraterritorial application is Section 929P of the Dodd-Frank Act.¹⁰⁰ Even if the facts of a foreign-related fraud do not meet the transactional test inferred from the antifraud provision, the SEC can bring enforcement actions against the perpetrator by using the effects or conduct test restored by the Dodd-Frank Act.¹⁰¹ In other words, the Dodd-Frank Act allows the SEC’s enforcement powers to reach securities fraud that involves “conduct within the United States that constitutes significant steps in furtherance of the violation”¹⁰² or “conduct occurring outside the

97. *Morrison*, 130 S. Ct. at 2882–83; see also Painter, *supra* note 86, at 215.

98. See *Morrison*, 130 S. Ct. at 2885; see also Genevieve Beyea, *Morrison v. National Australia Bank and the Future of Extraterritorial Application of the U.S. Securities Laws*, 72 OHIO ST. L.J. 537, 572 (2011).

99. Beyea, *supra* note 98, at 572 (citing *Kook v. Crang*, 182 F. Supp. 388, 389 (S.D.N.Y. 1960); see also Martin E. Goldman & Joseph L. Magrino, Jr., *Some Foreign Aspects of Securities Regulation: Towards a Reevaluation of Section 30(b) of the Securities Exchange Act of 1934*, 55 VA. L. REV. 1015, 1027 (1969).

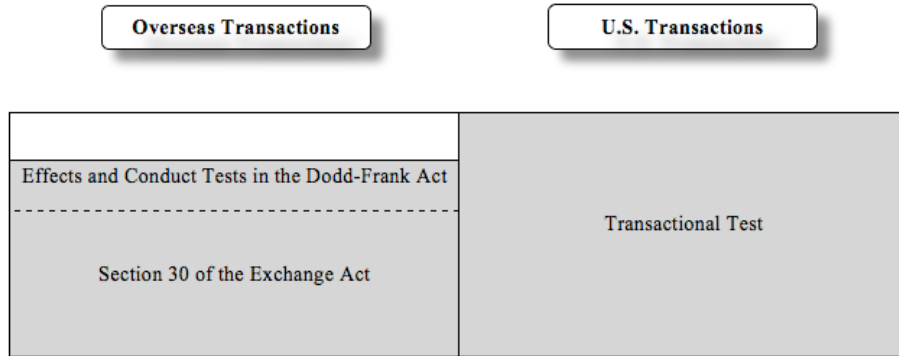
100. Dodd-Frank Act § 929P(b).

101. See *id.*; see also HICKS, *supra* note 11, § 11:50.

102. Dodd-Frank Act § 929P(b).

United States that has a foreseeable substantial effect within the United States.”¹⁰³

Figure 2.
Extraterritoriality in SEC Enforcement Actions Under
Morrison and the Dodd-Frank Act



Though the Dodd-Frank Act allows the SEC to keep using the effects and conduct tests, it is doubtful that the extraterritoriality provision of this Act can remove the ambiguity that existed before *Morrison*.¹⁰⁴ This is primarily because Section 929P mirrors words used by appellate courts before *Morrison*.¹⁰⁵ In particular, the meaning of the phrases “significant steps in furtherance of the violation”¹⁰⁶ and “a foreseeable substantial effect”¹⁰⁷ in Section 929P is unclear, and still left in the hands of courts.¹⁰⁸ Such ambiguity in the extraterritoriality provision can cause controversy in prospective cases, as it did before *Morrison*.¹⁰⁹ It can also mislead the SEC to initiate enforcement actions in a case that displays only feeble U.S. interest,¹¹⁰ destroying international relations accordingly.¹¹¹ The effects and conduct tests restored by the Dodd-Frank Act result in claims that overlap with those of other countries’ transactional tests, which remain more fundamental. In Figure 2, the region designated “Overseas Transactions” demonstrates this risk.

103. *Id.*

104. Painter, *supra* note 86, at 212.

105. *Id.*

106. Dodd-Frank Act § 929P(b).

107. *Id.*

108. *See* Painter, *supra* note 86, at 212.

109. *Id.*

110. *See id.* at 216.

111. *See* Chang, *supra* note 2, at 117–18.

III. HARMONIZING THE OVERLAPPING APPLICATIONS OF NATIONAL SECURITIES LAW

When interpreting the effects and conduct tests under the Dodd-Frank Act, the SEC, the DOJ, and the federal courts may consult pre-*Morrison* decisions made by the courts of appeals.¹¹² Before *Morrison*, the precise definitions of the effects and conduct tests were left unsettled.¹¹³ As a result, it was unclear exactly what circumstances put foreign market participants under the jurisdiction of U.S. securities regulation.¹¹⁴ Addressing this concern about the effects and conduct tests, in *Morrison* the Supreme Court overruled the Second Circuit's use of these two tests.¹¹⁵ Congress, however, enacted a provision in the Dodd-Frank Act that allows the SEC and the DOJ to keep using these two tests for purposes of their own prosecutions.¹¹⁶ For this reason, even after *Morrison* and the Dodd-Frank enactment, the courts may examine how the Second Circuit interpreted the effects and conduct tests with respect to actions initiated by the SEC and the DOJ.¹¹⁷

Even if courts apply the aforementioned interpretations to a post-*Morrison* case, it still remains difficult to determine exactly when the effects and conduct tests should be applied.¹¹⁸ This is primarily because determining whether conduct occurs in the U.S. or when misconduct affects the U.S. depends on specific facts in a particular case.¹¹⁹ Such ambiguity in the extraterritoriality provision of the Dodd-Frank Act can sway the SEC and the DOJ to initiate enforcement actions in cases that prompt only negligible U.S. interest.¹²⁰

The SEC and the DOJ also face instances where the effects and conduct tests restored by the Dodd-Frank Act result in claims that overlap with the claims of other countries' transactional tests, which remain more

112. See Painter, *supra* note 86, at 209–10, 212.

113. It was unclear what degree of “effects” must be executed in the U.S. in order to satisfy the requirements of the effects test. See Kelly, *supra* note 38, at 493; see also Chang, *supra* note 2, at 110. Each circuit also defined the form of the conduct test in different ways. See HAZEN, *supra* note 29, § 17.4[1]; Choi & Guzman, *supra* note 29, at 217; HICKS, *supra* note 11, § 11:39.

114. Choi & Guzman, *supra* note 29, at 218; Kelly, *supra* note 38, at 493; Chang, *supra* note 2, at 110.

115. *Morrison*, 130 S. Ct. at 2869; see also Comments by Buxbaum, *supra* note 45, at 1.

116. See HICKS, *supra* note 11, § 11:50.

117. Painter, *supra* note 86, at 209–10, 212 (stating that in order to interpret Section 929P of the Dodd-Frank Act, the courts may refer to some form of the effects and conduct tests created by the courts of appeals before *Morrison*).

118. *Id.* at 212.

119. See *id.*; see also Choi & Guzman, *supra* note 29, at 215–16.

120. See Painter, *supra* note 86, at 216.

fundamental.¹²¹ For example, in *SEC v. McClellan*,¹²² misappropriation of non-public information occurred within the U.S., but transactions of securities based on that information occurred outside the U.S.¹²³ Arnold McClellan obtained non-public information while working at Deloitte Tax LLP and disclosed that information to his wife, Annabel McClellan, in the U.S.¹²⁴ His wife then tipped off her affiliates, James Sanders and Miranda Sanders, who resided in the U.K.¹²⁵ Since James Sanders traded derivatives based on the non-public information outside the U.S.,¹²⁶ he has been more appropriately prosecuted in the U.K.¹²⁷ Indeed, the SEC filed an enforcement action against only Arnold McClellan and Annabel McClellan,¹²⁸ while the U.K. FSA brought legal actions against others, including James Sanders and Miranda Sanders.¹²⁹ This sort of partitioning of enforcement helps prevent friction in the process, for if the SEC sought to prosecute not only U.S. insiders but also U.K. traders, jurisdictional conflicts might arise between the SEC and the FSA.¹³⁰

For this reason, the SEC and the DOJ should be careful in exercising their extraterritorial jurisdiction. That the SEC and the DOJ can legally assert extraterritorial jurisdiction does not mean that they should always assert it, particularly when other countries have equal or greater claims to enforcement. If the SEC and the DOJ aggressively, abusively, or unilaterally insist upon extraterritorial application of U.S. antifraud provisions under the Dodd-Frank Act, international relations can be significantly impaired.¹³¹ As a result, foreign authorities may become reluctant to provide cross-border cooperation, leading to frustration in investigating even multijurisdictional

121. See Genevieve Beyea, *Transnational Securities Fraud and the Extraterritorial Application of U.S. Securities Laws: Challenges and Opportunities*, 1 GLOBAL BUS. L. REV. 139, 159 (2011).

122. *SEC v. McClellan*, Compl. 1, CV-105412 (JCS) (N.D. Cal. Nov. 30, 2010), available at <http://www.sec.gov/litigation/complaints/2010/comp21758.pdf> [hereinafter *McClellan Complaint*].

123. *SEC v. McClellan*, Litigation Release No. 21758 (Nov. 30, 2010), available at <http://www.sec.gov/litigation/litreleases/2010/lr21758.htm> [hereinafter *McClellan Litigation Release*]; see also *McClellan Complaint*, *supra* note 122, at 8.

124. *McClellan Complaint*, *supra* note 122, at 1.

125. *Id.* at 1–2, 4.

126. *Id.* at 8.

127. See Painter, *supra* note 86, at 220.

128. *McClellan Litigation Release*, *supra* note 123; see also Press Release, *FSA, SEC and DOJ Investigation Leads to Two People Being Charged by the SEC with Insider Dealing in the U.S.*, FSA (Dec. 1, 2010), <http://www.fsa.gov.uk/pages/library/communication/pr/2010/169.shtml>.

129. Press Release, *Five Charged with Insider Dealing*, FSA (Nov. 25, 2010), <http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/166.shtml>.

130. See Painter, *supra* note 86, at 220.

131. Chang, *supra* note 2, at 117–18.

cases that are predominantly related to the U.S.¹³² Indeed, being too aggressive and unilateral in enforcing U.S. securities laws outside the U.S. may cause foreign countries to be hostile to the U.S.¹³³

When, therefore, securities transactions occur abroad, the SEC and the DOJ should multilaterally consult with foreign authorities related to the case before seeking to apply U.S. antifraud provisions extraterritorially.¹³⁴ Such a cooperative approach is necessary for countries to solve jurisdictional problems that arise when fighting international securities fraud.¹³⁵ By unilaterally being more conservative about their extraterritorial enforcement, the SEC and the DOJ can reduce criticisms from other countries, but they cannot ultimately eliminate jurisdictional conflicts.¹³⁶ This is mainly because other countries seeking extraterritorial enforcement can easily destroy jurisdictional stability that is unilaterally achieved.¹³⁷ Furthermore, excessive unilateral restrictions can create regulatory loopholes for transnational securities fraud.¹³⁸ For this reason, the SEC and the DOJ should bilaterally or multilaterally resolve the jurisdictional conflicts that arise in international securities enforcement.¹³⁹

In order to make this practice more common, the International Organization of Securities Commissions (IOSCO) should require each member regulator to consult with each other when faced with an extraterritoriality issue. Furthermore, the IOSCO should promulgate a guideline showing how to cooperatively deal with jurisdictional overlapping. As shown in the International Bar Association's report on extraterritorial jurisdiction, such a guideline should outline how to designate a lead regulator from among those of different countries, and then charge the lead regulator with conducting an investigation.¹⁴⁰

Through this cooperative approach, each country's regulators can resolve the jurisdictional overlapping before it becomes controversial, and so the extraterritorial application of each country's securities laws can be well harmonized.¹⁴¹ The regulators can also obtain assistance from other countries in an early stage of investigation, and thereby "avoid duplication of

132. *See id.*

133. *See Painter, supra* note 86, at 220; *see also Beyea, supra* note 121, at 165.

134. *See* REPORT ON EXTRATERRITORIAL JURISDICTION, *supra* note 4, at 26 (addressing a cooperative approach).

135. *See id.* In global financial markets, securities regulators need to secure assistance from foreign authorities. HICKS, *supra* note 11, § 11:53.

136. Beyea, *supra* note 121, at 159; *see also* Joshua G. Urquhart, Comment, *Transnational Securities Fraud Regulation: Problems and Solutions*, 1 CHI. J. INT'L L. 471, 478 (2000).

137. Beyea, *supra* note 121, at 159; *see also* Urquhart, *supra* note 136, at 478.

138. Beyea, *supra* note 121, at 154.

139. *See* REPORT ON EXTRATERRITORIAL JURISDICTION, *supra* note 4, at 26.

140. *Id.* at 300.

141. *Id.* at 26.

information requests and interviews.”¹⁴² Finally, the regulators can effectively combat transnational securities fraud without allowing any regulatory loophole.¹⁴³

142. *Id.* at 300.

143. *See* Beyea, *supra* note 121, at 154.