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BY EMAIL

William K. Shirey, Esq.
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Re: Study on Extraterritorial Private Rights of Action
(Release No. 34-63174; File No. 4-617)

Dear Mr. Shirey:

It was a pleasure to see you again and to meet your colleagues on May 3 at the American Law Institute's Conference on the Extraterritorial Application of Federal Securities Law. After the conference, you inquired whether I would be willing to submit, as a comment on the Commission's Study on Extraterritorial Private Rights of Action, the hypothetical amendment to Section 10(b) of the Securities Exchange Act of 1934 that I described at the conference. Attached is a slightly revised version of the hypothetical amendment, and below is an explanation of the reasoning behind it. The hypothetical amendment does not reflect the views of my Firm or any of its clients, but is rather merely the product of an effort to foster discussion at the conference. It is an attempt to illustrate how the competing concerns of protecting American investors and markets, and of respecting the differing approaches of foreign nations to protecting their investors and markets, could be reconciled and balanced.

Although Morrison v. National Australia Bank Ltd., 130 S. Ct. 2869 (2010), which I argued for the respondents, was correctly reasoned and decided under Section 10(b) of Securities Exchange Act of 1934 as it currently reads, a narrowly crafted revision of that provision could reasonably promote the interests of the United States in investor protection in a manner that does not offend international comity. In particular, for reasons already well expressed in Morrison, in the briefs in Morrison, and in many of the comments already made to the Commission, the principal practical difficulties with the old "conduct" and "effects" tests were the tests' lack of determinacy and their application in fraud-on-the-market class actions involving transactions on foreign exchanges. Any proposal to amend Section 10(b) to provide for extraterritorial application should minimize or avoid these difficulties. And balancing the domestic and foreign interests that would be implicated by such a proposal requires that different types of Section 10(b) litigation be treated differently.

In particular, as I argued at the ALI conference, Section 10(b) litigation should be divided into at least three categories, each of which raises differing comity concerns:

1. The first category consists of enforcement proceedings brought the Commission and criminal cases brought by the Department of Justice. Even under the now-abrogated conduct and effects tests, such litigation had never been thought to pose a significant threat to international comity. One reason is that, as Judge Bork once put it, "a responsible governmental agency" such as the Commission "will surely take into account in framing its enforcement actions any foreign policy concerns communicated to it by the Department of State," Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 33 n.3 (D.C. Cir. 1987); another is that the Commission works closely with securities regulators around the world, communicates directly with them, and relies upon their goodwill, see Brief for the United Kingdom of Great Britain and Northern Ireland as Amicus Curiae in Support of Respondents 38-39, Morrison ("U.K. Br.") ("dialogue and cooperation" between the Commission and foreign regulators "limit[s] the risks of conflict with regulation by another state and of duplicative foreign litigation"). The reported cases confirm these points: the Commission and the Department of Justice have sought to apply Section 10(b) to extraterritorial events only in a small number of circumstances, where the interests of the United States are most compelling. As a result, it probably makes sense, and would not offend international comity, to permit relatively broad extraterritoriality for enforcement and criminal proceedings.

Accordingly, the hypothetical amendment would incorporate a version of the conduct and effects tests into Section 10(b). Only the Justice Department and the Commission would be able to take full advantage of the extension of authority contemplated in the hypothetical amendment, however, because the amendment, as explained below, would establish significant comity-promoting limitations on claims brought by private parties. The hypothetical amendment's explicit geographic ex-

tension of the substantive scope of Section 10(b) would eliminate any question about the practical effectiveness of the Dodd-Frank Act's revision of Section 27 of the Exchange Act, which, by its terms, defines only the "jurisdiction" of the "district courts of the United States," 15 U.S.C. § 78aa, and, as a result, addresses only "a tribunal's power to hear a case" and not the substantive "merits question" of "what conduct § 10(b) reaches [and] prohibits," Morrison, 130 S. Ct. at 2877 (citation and internal quotation marks omitted).[1]

2. The second category of Section 10(b) litigation consists of individual cases brought by private plaintiffs who allege and prove that they actually relied upon deceptive or manipulative conduct of a defendant. These cases present a greater threat to international comity than do enforcement and criminal actions because "[a] private individual need not and often will not" consider comity concerns in deciding whether to bring suit. Zoelsch, 824 F.2d at 33 n.3. At the same time, however, individual private cases involving actual reliance on deceptive conduct do not pose the same threat to comity as do class actions involving plaintiffs who claim to have "relied" on the "integrity of the market price[s]" on foreign exchanges under the fraud-on-the-market presumption recognized in Basic Inc. v. Levinson, 485 U.S. 224, 241-49 (1988). See pp. 4-5, below.

As a result, in such actual-reliance cases, some extraterritorial application should be permitted, but should be carefully circumscribed—and specifically restricted to circumstances in which the United States' interest in redressing fraudulent conduct is the strongest. To that end, the hypothetical amendment would provide, in subparagraphs (i) and (ii) of the amendment's proviso, that private plaintiffs may invoke Section 10(b) to seek redress for extraterritorial transactions only when either the plaintiff's actual reliance, or the manipulative or deceptive conduct upon which the plaintiff actually relied, occurs in the United States. Tying extraterritorial applicability to these elements of the claim, rather than to the more nebulous concepts of "'substantial acts in furtherance of the fraud,'" Morrison, 130 S. Ct. at 2893 (Stevens, J., concurring in judgment; citation omitted), or of "significant steps in furtherance of the violation," 15 U.S.C. § 78aa(b)(1), or other similar formu-

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[1] See, e.g., Richard W. Painter, The Dodd-Frank Act's Extraterritorial Jurisdiction Provision: Was It Effective, Needed or Sufficient?, 1 HARV. BUS. L. REV. 401, 414 (2011) (courts may be "forced to find that Section 929P[(b)] [of Dodd-Frank] was 'stillborn' in that it conferred jurisdiction that could not be used for anything substantive"; Congress should "enact a new provision that clearly states that it addresses the extraterritorial reach" of Section 10(b) and other substantive antifraud provisions); Adam C. Pritchard, Securities Law in the Roberts Court: Agenda or Indifference? 49-50 (Univ. of Mich. Law School, Empirical Legal Studies Center, Working Paper No. 10-026, Draft No. 10, 2011) ("Unfortunately, Congress enacted language ensuring only that the courts would have jurisdiction to hear cases with extraterritorial application, not that § 10(b) would have extraterritorial application"; emphasis in original), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1691683; Genevieve Beyea, Morrison v. National Australia Bank and the Extraterritorial Application of the U.S. Securities Laws, 72 OHIO ST. L.J. 537, 570-71 (2011) (effect of Dodd-Frank provision will "depend[] on the willingness of courts to overlook the plain language of the statute").

lations of the conduct test, would avoid the "counterproductive" effects of making the exercise of legislative "jurisdiction turn on a welter of specific facts," which, as the history of the conduct test illustrates, produces standards that "are difficult to apply and are inherently unpredictable," and "thus present powerful incentives for increased litigation," Zoelsch, 824 F.2d at 32 n.2; see also Morrison, 130 S. Ct. at 2879, 2886 (conduct and effects tests "were not easy to administer" and produced "adverse consequence[]" of excessive private litigation).

The hypothetical amendment also would require a plaintiff to prove that the defendant solicited the transaction or directed manipulative or deceptive conduct specifically at the plaintiff. This requirement would preclude, for example, a so-called "f-squared" individual action in which American investor decided to make an unsolicited purchase of a foreign issuer's stock on a foreign exchange in actual reliance upon foreign disclosures that the investor found and read, on his or her own, on the foreign issuer's website. In such circumstances, where the issuer did not specifically solicit or direct its conduct specifically at the American purchaser, it would be unfair, and would threaten international comity, to give American purchasers remedies that foreign purchasers do not have, and to impose American substantive law and procedures on the foreign issuer. Both sets of purchasers should be relegated to the remedies allowed by the country in which they chose to transact and in which the issuer chose to list its shares for trading. In addition, requiring proof of solicitation or fraudulent conduct directed at the plaintiff would eliminate the threat to comity posed by claims brought by purchasers of derivative securities against foreign issuers of foreign securities upon which the derivatives are based. Cf., e.g., Letter from Dr. Oliver Schnakenberg, Acting Consul General of the Federal Republic of Germany, to Hon. Harold Baer, Jr., Elliot Assocs., L.P. v. Porsche Automobil Holding SE, No. 10 Civ. 0532 (S.D.N.Y. Aug. 20, 2010). But the hypothetical amendment would permit investors like some of those posited in Justice Stevens's concurrence in Morrison—who are "convinced [to buy a foreign traded stock] on the basis of material misrepresentations" made by "executives [who] go knocking on doors in Manhattan," and were thus solicited in the United States—to sue under Section 10(b). 130 S. Ct. at 2895 (Stevens, J., concurring in judgment).

3. The third and last category of Section 10(b) litigation involves private claims invoking the fraud-on-the-market presumption of reliance recognized in Basic v. Levinson. That powerful presumption greatly alleviates a plaintiff's burden of proof, and more importantly, is the doctrinal innovation that has permitted private securities cases to be brought as class actions. Without the fraud-on-the-market presumption, "'individual issues' would 'overwhelm[] the common ones'" and would foreclose class treatment under Fed. R. Civ. P. 23(b)(3). Erica P. John Fund, Inc. v. Halliburton Co., No. 09-1403, slip op. at 5 (U.S. June 6, 2011) (quoting Basic, 485 U.S. at 242). The rest of the world does not recognize the doctrine; "'the United States is unusual in recognizing presumed reliance based on the fraud on the market theory, rather than requiring investors to prove actual reliance on misleading

information.'" Brief for the Republic of France as Amicus Curiae in Support of Respondents 23 n.16, Morrison ("France Br.") (quoting Hannah L. Buxbaum, Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict, 46 COLUM. J. TRANSNAT'L L. 14, 61 (2007)). Other nations, in fact, "deliberately rejected it after careful consideration and reflection." Brief of Amici Curiae Professors and Students of the Yale Law School Capital Markets and Financial Instruments Clinic in Support of Respondents 9, Morrison ("Yale Br.").

Of all the types of transnational securities litigation that have been brought under Section 10(b), cases seeking to apply the fraud-on-the-market presumption to foreign securities markets presented the greatest threat to international comity. After all, it was precisely this species of class action litigation, epitomized by Morrison, that prompted other nations to object forcefully to the extraterritorial application of Section 10(b). See generally France Br. 17-33; U.K. Br. 29-37; Embassy of Switzerland in the United States of America, Diplomatic Note to the United States Department of State, Note No. 17/2010 (Feb. 23, 2010), reprinted in Brief of the Int'l Chamber of Comm. et al. as Amici Curiae in Support of Respondents 1a-4a, Morrison. Even Australia, which itself generously allows opt-out securities class action litigation in its own courts, objected to the application of Section 10(b) in cases like Morrison—in no small part because "in Australia," "there is no doctrine of 'fraud on the market,'" and "[e]ach shareholder plaintiff must be able to demonstrate a link between the conduct complained of, and the loss suffered, before a right to compensation will arise." Brief of the Commonwealth of Australia as Amicus Curiae in Support of Respondents 19, Morrison.

Given the strong objections that fraud-on-the-foreign-market class litigation has drawn from other nations, application of the Basic presumption to private securities claims involving extraterritorial transactions would categorically contravene international comity. See Yale Br. 9-13. Put another way, investors who claim that they relied on the integrity of foreign securities markets should have their claims decided under the law of the sovereigns that regulate those markets. That is why the hypothetical amendment would require all plaintiffs who seek recovery for losses on such transactions to establish actual reliance.

Sincerely,

George T. Conway III

Attachment

To be inserted at the end of 15 U.S.C. § 78j:

Subsection (b) of this section, and rules promulgated under subsection (b) of this section, shall apply to domestic or extraterritorial conduct involving manipulative or deceptive devices or contrivances in connection with any extraterritorial purchase or sale of any security, where either

> (1) conduct within the United States that constitutes substantial acts in furtherance of a manipulative or deceptive device or contrivance, or
>
> (2) conduct outside the United States that has a substantial and reasonably foreseeable effect within the United States,

has occurred in connection with the purchase or sale; provided, however, that, in any private action arising under subsection (b) of this section, where the plaintiff seeks recovery of losses arising from any extraterritorial purchase or sale, the plaintiff shall be required to prove that the defendant solicited the purchase or sale or engaged in manipulative or deceptive conduct directed specifically at the plaintiff, and that either

> (i) the plaintiff, while within the United States, actually relied upon manipulative or deceptive conduct of the defendant, or
>
> (ii) the plaintiff, while outside the United States, actually relied upon manipulative or deceptive conduct of the defendant occurring inside the United States.