INDIANA UNIVERSITY

MAURER SCHOOL OF LAW
Bloomington

February 18, 2011

Via e-mail to rule-comments@sec.gov

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number 4-617 – Dodd-Frank Act Section 929Y

Ladies and Gentlemen:

I submit this letter in response to the Commission's request for comments on whether, and to what extent, private rights of action under the antifraud provisions of the Exchange Act should be extended to cover cases of transnational securities fraud. The following comments focus on issues relating to international comity, and are based on my research on jurisdiction and procedure in cross-border securities litigation.[1]

Morrison and the Role of International Comity. In *Morrison v. National Australia Bank*,[2] addressing the extraterritorial reach of Exchange Act Section 10(b), the Supreme Court rejected the long-standing "conduct" and "effects" tests in favor of a single transaction-based test. Concluding that "the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States,"[3] it held that Section 10(b) applies to fraud only in connection with "transactions in securities listed on domestic exchanges, and domestic transactions in other securities."[4] While it might be argued that this test permits the application of U.S. law in connection with foreign transactions as long as the securities in question are *also* listed on U.S. exchanges, in my view the Court's intention was to limit the reach of Section 10(b) to claims of purchasers whose particular investment transactions had taken place within the United States. The Court emphasizes this intention elsewhere in its opinion: "Nothing suggests that [the United States'] *national* public interest pertains to

[1] *See* Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 COLUM. J. TRANSNAT'L L. 14 (2007); Hannah L. Buxbaum, *Transnational Regulatory Litigation*, 46 VA. J. INT'L L. 251 (2006).
[2] 130 S.Ct. 2869 (2010).
[3] *Id.* at 2884.
[4] *Id.*

Office of the Dean 211 S. Indiana Avenue Bloomington, IN 47405-7001 (812) 855-8885 fax (812) 855-7057

transactions conducted upon *foreign* exchanges and markets."[5]

The Court's decision to restrict the application of Section 10(b) to investment transactions occurring within the United States rested in part on considerations of international comity. As the Court recognized, foreign countries regulate their own securities exchanges – and often make regulatory choices different from ours. Moreover, the procedural frameworks within which remedies are made available to defrauded investors differ significantly from country to country. When a U.S. court applies U.S. antifraud law to claims arising out of a foreign investment transaction, it brings our substantive and procedural law into conflict with that of the country in which that transaction took place. Foreign governments have expressed particular concern about two aspects of U.S. securities fraud litigation: first, the use of opt-out class actions (which, along with contingency fees, are viewed as contrary to public policy in many countries); second, the availability of the fraud-on-the-market theory (which eliminates the requirement, insisted on by most countries, that investors establish actual reliance).[6]

Unless the scope of Section 10(b) were to be restricted to claims involving no foreign elements whatsoever, some amount of jurisdictional conflict arising from securities fraud litigation is inevitable. Where the regulatory interest of the United States is particularly strong – as in cases where transactions taking place on U.S. exchanges have been affected by fraud – this risk of conflict should not preclude the application of U.S. law. However, where the regulatory interest of the United States is weaker, and that of a foreign country is strong, the application of U.S. law risks greater insult to principles of international comity. These risks were highlighted by the spate of "foreign-cubed" securities claims brought prior to *Morrison,* in which U.S. law was sometimes applied to claims brought against foreign defendants by foreign investors who had purchased their securities on foreign exchanges. In such cases, the application of U.S. law served not the core regulatory interest of protecting U.S. markets and investors, but the substantially weaker interest of preventing the United States from becoming a "launching pad" for fraud directed elsewhere. To the countries whose core regulatory interests *were* implicated – those in whose markets the transactions had taken place – that relatively weak interest seemed an insufficient basis for overriding their remedial and procedural schemes as to their own investors.

In view of these considerations of international comity, private rights of action based on U.S. effects raise fewer concerns than private rights of action based on conduct within the United States.

Extending the effects test to private actions. Section 929P of the Dodd-Frank legislation reinstated the effects test with respect to actions brought by the Commission or by the United States. In my view, it should be reinstated with respect to private actions as well. Recognizing effects as a basis for the application of U.S. law is consistent with *Morrison*'s holding that U.S.

[5] *Id.* at 2882 (emphasis in original). In addition, this reading is consistent with the Court's holding in F. Hoffmann-La Roche, Ltd. v. Empagran, S.A., 542 U.S. 155 (2004), a case considering the extraterritorial reach of U.S. antitrust law. In its decision, the Court held that U.S. antitrust law sought to forbid conduct only to the extent that it caused harm to purchasers engaged in U.S. transactions, not to the extent that it also caused independent harm to purchasers engaged in foreign transactions.

[6] *See* Buxbaum, *Multinational Class Actions, supra* note 1, at 61-64.

law may be applied to fraud that affects a transaction taking place within the United States.[7] Moreover, effects-based cases implicate the central regulatory interest of the United States: protecting U.S. markets and those who transact on them. They are therefore relatively unproblematic with respect to international comity.

Should Congress restore the effects test for private actions, it should clarify the status of claims brought by investors in U.S.-traded ADSs. At least one case decided subsequent to *Morrison*, *In re Societe Generale Sec. Litig.*,[8] has dismissed the claims of such investors on the theory that because an ADS represents the right to receive a certain number of the issuer's foreign shares, a transaction in ADSs does not qualify as a U.S.-based transaction.[9] But surely the United States' regulatory interest in protecting its markets is triggered by fraud relating to *any* securities trading in those markets; and surely an investor who purchases ADSs on a U.S. securities exchange, or in the over-the-counter market in the United States, is entitled to the protection of U.S. antifraud law just as it would be had it purchased different securities in those markets.

Extending the conduct test to private actions. In light of the principle of international comity, the application of U.S. law to claims arising out of foreign investment transactions – on the basis of fraudulent conduct occurring within the United States – is more problematic. As early decisions recognized, the United States does have a significant regulatory interest in some such claims: those that involve the foreign transactions of U.S. investors. Indeed, the first decision articulating the conduct test, *Leasco v. Maxwell*, involved allegations that the defendant had engaged in fraudulent conduct within the United States in order to induce a U.S. investor's purchase of securities abroad.[10] Over time, however, U.S.-based conduct has been used to justify the application of U.S. law to the claims of foreign investors as well, on the basis that Congress would not wish the United States to become a haven for unlawful practices wherever directed.[11] In such cases, the U.S. regulatory interest is more attenuated, and comity concerns accordingly more substantial.

If Congress chooses to reinstate the conduct test for private actions, it should limit the reach of U.S. antifraud law on that basis to claims brought by U.S. investors.

Subject-matter jurisdiction vs. prescriptive jurisdiction. Early decisions addressing the extraterritorial reach of U.S. securities law cast the issue as one of "subject-matter jurisdiction." Following that lead, later cases, as well as scholarly commentary on the topic, simply continued to use that label in analyzing the law's scope. In *Morrison*, the Supreme Court corrected this mistake in terminology. As it pointed out, the federal courts plainly do have subject-matter

[7] Cases decided under the effects doctrine have consistently held that general or diffuse effects within the United States are insufficient to support the application of U.S. law; rather, the effects had to be in the form of "specific harms suffered" by investors. Interbrew S.A. v. Edperbrascan Corp., 23 F.Supp.2d 425, 430 (S.D.N.Y. 1998). With this focus on specific harms suffered in particular transactions, the effects basis for regulation is consistent with the transaction-based test articulated in *Morrison.*

[8] 2010 WL 3910286.

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

[10] Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1331 (2d Cir. 1972).

[11] *See* Buxbaum, *Multinational Class Actions, supra* note 1, at 23-25 (discussing the expansion of the conduct test to cover cases that did not involve direct U.S. interests).

jurisdiction over Section 10(b) claims with foreign elements;[12] the issue is one of *prescriptive* jurisdiction – that is, whether or not Section 10(b) actually prohibits certain conduct. Section 929P of the Dodd-Frank Act, which was initially drafted prior to the decision in *Morrison*, reverts to the terminology of subject-matter jurisdiction by referring to the jurisdiction of the courts. Although the intent of Section 929P is clearly to delineate the substantive reach of U.S. antifraud provisions, should the Act be amended, Congress should take the opportunity to clarify that intent by rewording the provision and eliminating references to subject-matter jurisdiction.

Thank you for the opportunity to submit these comments.

Very truly yours,

Hannah L. Buxbaum
John E. Schiller Chair in Legal Ethics

[12] 130 S.Ct. at 2877 (quoting Section 78aa of the Exchange Act, granting the district courts jurisdiction of violations under the statute).