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**U.S. Chamber of Commerce**
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February 18, 2011

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

Re: **Study Under Section 929Y of the Dodd-Frank Wall Street Reform and Consumer Protection Act to Determine the Extent to Which Private Rights of Action Under the Antifraud Provisions of the Securities Exchange Act of 1934 Should Be Extended to Cover Transnational Securities Fraud [Release No. 34-631374; File No. 4-617]**

Dear Ms. Murphy:

These comments are submitted by the U.S. Chamber of Commerce Center for Capital Markets Competitiveness ("CCMC") and the U.S. Chamber Institute for Legal Reform ("ILR"). The U.S. Chamber of Commerce (the "Chamber") is the world's largest business federation, representing the interests of more than three million companies of every size, sector, and region. The Chamber created CCMC to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. ILR is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, fairer and faster for all participants.

We appreciate the opportunity to express our views regarding the study to be undertaken by the Securities and Exchange Commission ("SEC" or the "Commission") pursuant to Section 929Y of the Dodd-Frank Wall Street Reform and Consumer Protection Act addressing whether the rule announced by the Supreme Court in *Morrison v. National Australia Bank, Ltd.* should remain in place, or instead be overridden to authorize private suits for fraud in connection with purchases and sales of securities outside the United States.[1] As you know, the Supreme Court concluded in *Morrison* that private liability under section 10(b) of the Securities Exchange Act of

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[1] 130 S. Ct. 2869 (2010).

1934 ("Exchange Act") was limited to alleged fraud "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."[2]

For the following reasons, we strongly oppose creation by the United States of a new, extraterritorial private cause of action:

***First***, such a new cause of action is unnecessary to protect investors here or abroad, or to preserve the reputation of the United States for effectively policing securities fraud. Our country has the toughest administrative enforcement of securities laws in the world, and the Commission and the Department of Justice ("DOJ") received new, express extraterritorial enforcement authority in section 929P of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[3] These public enforcement mechanisms are far-reaching and potent. Moreover, although foreign regulators rely to a somewhat greater extent than U.S. authorities on informal enforcement mechanisms, they also police securities fraud effectively and keep their securities markets safe and sound.

***Second***, there are no grounds for the United States to take the extraordinary step of overriding the policy choices of other nations by creating new private liability for fraud in connection with foreign securities transactions. The vast majority of other nations—many of them our closest allies—have declined to adopt the U.S. model of private securities litigation, and in particular our country's authorization of "opt-out" securities class actions. These sovereign decisions to reject the U.S. approach do not suggest any lesser concern with detecting and punishing securities fraud. Rather, they reflect sound policy determinations by each individual nation—based on its own underlying values and preferences—regarding the best means for achieving a common end.

Significantly, the doubts that other nations have expressed about the wisdom of the U.S.'s litigation system are consistent with a growing body of empirical evidence about the inefficacy of that system as applied in our country—and its harmful consequences. A consensus has emerged that U.S. securities class actions (i) do not meaningfully further the primary goals of securities regulation—*i.e.*, deterring fraud

[2] *Id.* at 2888.
[3] Dodd-Frank Act, Pub. L. 111-203, § 929P(b), 124 Stat. 1376, 1381 (2010).

and compensating defrauded investors—and (ii) impose significant unjustified costs on U.S. businesses, investors, and the economy. Indeed, recent research shows that public enforcement is more of a deterrent to securities fraud than private litigation and that it also more effectively compensates injured investors. The Commission need not endorse these doubts about the effectiveness of the U.S. litigation model to recognize that, at a minimum, the legitimate debate about the issue renders it particularly incumbent upon the United States not to take action that would override the essentially universal decision by foreign nations to reject the U.S. approach.

Moreover, all of the particular justifications that have been advanced in support of creation of a new U.S. private cause of action for foreign securities transactions fail to withstand scrutiny. There is no evidence that the United States is becoming a "Barbary Coast" for securities fraud, and the United States has no interest in creating a compensatory remedy for the citizens of the foreign country in which the securities transactions occurred, or for other non-Americans who purchased or sold securities in that country. Further, our country's interest in creating a remedy for any U.S. investors who transact securities in foreign countries is weak or nonexistent. In addition to the legitimate doubts that have been raised about the compensatory value of securities class actions, it also is the case that those U.S. investors who trade directly in foreign securities are almost exclusively highly sophisticated market participants—generally institutions or wealthy individuals. These sophisticated investors can be expected to understand that, as the Commission has observed in a related context, "[a]s investors choose their markets, they choose the laws and regulations applicable in such markets."[4]

***Third***, extraterritorial expansion of private liability would disrupt relationships with other countries and their regulators. The Commission relies heavily on the cooperation of other nations' regulatory authorities in investigating and prosecuting securities fraud. If the United States decides to entertain private fraud suits in connection with overseas securities transactions, other countries might well come to resent the United States for acting in the role of a global policeman—and therefore to view it as a bad neighbor. Private suits pose a more acute concern than public enforcement in this regard because, as the Commission itself has recognized, the U.S. government lacks the power to control the circumstances in which a private remedy is

[4] Offshore Offers and Sales, Securities Act Release No. 6863, Exchange Act Release No. 27,942, 55 Fed. Reg. 18,306, 18,308 (May 2, 1990).

invoked. The ill-will resulting from expanded private litigation might also lead foreign regulators to be less willing to share information or cooperate in evidence gathering and enforcement efforts. And foreign countries might assert a right to enforce their own securities laws extraterritorially, or retaliate in other issue areas by seeking to regulate the activities of U.S. parties that impact their countries.

***Fourth***, extraterritorial expansion of private liability for securities fraud would discourage foreign direct investment ("FDI") in the United States and foreign listing on U.S. capital markets. *Morrison*'s bright-line rule allows non-U.S. individuals and businesses to focus solely on economic considerations in deciding whether to invest or do business here (assuming they do not list here). And foreign companies that list on U.S. capital markets can calibrate their level of litigation exposure by adjusting the number of their U.S. shares outstanding. By contrast, a standard for extraterritorial liability akin to the pre-*Morrison* "conduct and effects" test would force foreign companies and investors to factor into their cost-benefit calculus the possibility of unpredictable and potentially catastrophic litigation exposure. Fear of litigation likely would have a significant (and, over time, worsening) negative impact on how those in other nations view the desirability of investing and listing in the United States. And particularly in light of recent adverse trends in the United States' economic and financial competitiveness—for example, falling FDI and a declining share of global Initial Public Offerings ("IPOs")—our country can ill-afford to take actions that make its economy and capital markets less attractive.

***Fifth***, there is no need for legislation to correct the lower courts' application of *Morrison*. The courts have had little difficulty applying the bright-line transactional test to new factual settings, and they have done so in a manner consistent with the letter and spirit of the Supreme Court's ruling and the dictates of sound policy.

***Finally***, we respectfully suggest that the Commission take the following steps in conducting its study of this important issue. First, the Commission should identify the questions that must be addressed in order to conduct a useful study, which should include an assessment of the strength of the criticisms of the U.S. securities litigation model. Recent empirical work calls for a fresh evaluation of this important issue by the Commission. Second, the Commission should determine what information it needs in order to address the questions it identifies thoroughly and fairly. In particular, we suggest that the Commission conduct its own field research—or

commission one or more outside parties to conduct such research—in order to gain a comprehensive and accurate picture of the empirical landscape. The Commission also should consider consulting with leading academics who have studied the U.S. securities class action system and its extraterritorial application. We recommend possible candidates below.[5] Finally, the Commission should obtain the views of key stakeholders—including foreign financial services regulators (and foreign governments generally) and domestic and foreign businesses and investors—regarding the effects of exterritorial private securities lawsuits.

## I. Legislation Overturning *Morrison* Is Unnecessary to Protect Investors Here or Abroad

### *A. U.S. public enforcement authorities are fully capable of addressing transnational securities fraud that injures U.S. investors*

"The United States has the toughest administrative enforcement of securities laws in the world,"[6] and the Commission and the Department of Justice received new, express extraterritorial enforcement authority in the Dodd-Frank Act.[7] These public enforcement mechanisms are far-reaching, and constitute the real deterrent to transnational securities fraud.

**1. SEC authority.** As you know, the Commission employs a broad range of statutory and administrative tools to deter fraud. It may issue administrative orders barring or suspending individuals from serving as officers or directors of reporting companies, require the disgorgement of any ill-gotten gains, and impose large civil penalties.[8] It also may initiate suit in federal court to seek an even broader array of remedies, including injunctions.[9] The Dodd-Frank Act expanded the Commission's substantive enforcement authority in a number of ways, including by enhancing its ability to obtain civil penalties by making them available in administrative actions, thus relieving the Commission of the need to go to court.[10]

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[5] *See infra* page 34.
[6] Committee on Capital Markets Regulation, *Interim Report* 71 (Nov. 2006), http://tinyurl.com/35gayn.
[7] *See* Dodd-Frank Act, § 929P.
[8] *See* 5 Bromberg & Lowenfels on Securities Fraud § 12:56 (2d ed.).
[9] *Id.* §§ 12:55-12:84.
[10] Dodd-Frank Act, § 929P.

Particularly in recent years, the Commission has shown that it is "aggressively bringing significant enforcement cases in a broad range of areas."[11] In FY 2010, the SEC brought 681 enforcement actions, and sought orders barring 71 defendants and respondents from serving as officers or directors of public companies and 57 orders to freeze assets.[12] The Commission also ordered $2.8 billion in disgorgement and penalties in that fiscal year, representing almost three times the amount collected in FY 2008.[13] Although most of the SEC's enforcement activities naturally have targeted domestic issuers, the Commission also has vigorously pursued wrongdoing by foreign issuers. NERA reports that of the 197 total settlements reached with company defendants in misstatement cases between the enactment of the Sarbanes-Oxley Act of 2002 ("SOX") and the end of 2008, 18 (or 9.1%) involved foreign issuers.[14] And in 2008, the SEC issued eight new accounting-related litigation releases charging foreign issuers or their employers.[15]

Furthermore, since the enactment of SOX, the Commission has had a robust mechanism for compensating those harmed by securities fraud, namely, the creation of "Fair Funds" to distribute disgorgements and penalties to defrauded investors. As of April 2010, the Commission had created a total of 128 Fair Funds, and returned $6.9 billion to injured investors.[16] The Dodd-Frank Act has further expanded the SEC's capacity in this area by granting the Commission broader authority to impose money penalties, and by requiring the designation of such penalties for Fair Funds.[17]

**2. DOJ authority.** Securities fraud is a criminal violation punishable by fines and imprisonment—"a strong deterrent."[18] The Department of Justice ("DOJ")

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[11] *Mortgage Fraud, Securities Fraud, and the Financial Meltdown: Prosecuting Those Responsible: Hearing Before the S. Comm. on the Judiciary*, 111th Cong. (Dec. 9, 2009) (statement of Robert Kuzami, Director, SEC Division of Enforcement), http://tinyurl.com/4ou8xtp.

[12] SEC, *FY 2010 Performance and Accountability Report* 11 (Nov. 15, 2010), http://tinyurl.com/4r2739k (hereinafter "*2010 Performance Report*"); SEC, *Select SEC and Market Data, FY 2010*, at 2, http://tinyurl.com/4v4k7mx.

[13] *See* SEC, *2010 Performance Report*, *supra* note 12, at 11; SEC, *2008 Performance and Accountability Report* 12 (Nov. 14, 2008), http://tinyurl.com/4l2g5w8.

[14] Jan Larsen et al., NERA Econ. Consulting, *SEC Settlements: A New Era Post-SOX* 13 (Nov. 10, 2008), http://tinyurl.com/4c4xqqw.

[15] PriceWaterhouseCoopers LLP ("PwC"), *2008 Securities Litigation Study* 53 (Apr. 1, 2009), http://tinyurl.com/cwxrv9.

[16] GAO, *SEC Fair Fund Collections and Distributions*, GAO-10-448R, at 31 (Apr. 22, 2010).

[17] Dodd-Frank Act, § 929B.

[18] *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 166 (2008); *see also* 15 U.S.C. § 78ff.

aggressively and "systematically" enforces the criminal laws against securities violators.[19] Lanny Breuer, Assistant Attorney General for the Criminal Division, has stressed that "pursuing financial fraud is one of the Department's top priorities."[20] According to congressional testimony that Assistant Attorney General Breuer gave in 2010, since 2002 the Department has obtained approximately 1,300 corporate fraud convictions, including convictions of more than 200 corporate chief executives or presidents, more than 120 vice presidents, and more than 50 chief financial officers.[21] The FBI reports that there are currently more than 2,200 pending corporate and securities fraud investigations across the country.[22] In FY 2009 alone, efforts to hold accountable the most egregious corporate and securities fraud offenders resulted in 473 convictions.[23] Moreover, at the end of 2010, DOJ reported the results of Operation Broken Trust, a law enforcement effort organized by DOJ's Financial Fraud Enforcement Task Force to target investment fraud. Operation Broken Trust resulted in the initiation of enforcement actions against 343 criminal defendants and 189 civil defendants, for schemes that involved more than $10 billion of estimated losses to victims.[24]

Although *Morrison* raised some question about whether public authorities could pursue securities fraud in connection with overseas transactions, Congress clarified the existence of this authority in the Dodd-Frank Act. The Act grants the federal courts "jurisdiction" over actions brought by the SEC, DOJ, and other federal government agencies alleging violations of section 10(b) of the Exchange Act (as well as the remaining anti-fraud provisions of the Exchange Act, section 17(a) of the Securities Act of 1933 ("Securities Act"), and section 206 of the Investment Advisers Act of 1940) involving "conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside

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[19] John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. Pa. L. Rev. 229, 245 (2007) (hereinafter "*Law and the Market*").
[20] Lanny A. Breuer, Assistant Attorney General for the Criminal Division, U.S. Dep't of Justice, *Remarks at the American Bar Association National Institute on White Collar Crime* (Mar. 1, 2010), http://tinyurl.com/6kfdnp2.
[21] *Wall Street Fraud and Fiduciary Duties: Can Jail Time Serve as an Adequate Deterrent for Willful Violations?: Hearing Before the Subcomm. on Crime and Drugs of the S. Comm. on the Judiciary*, at 10, 111th Cong. (2010) (statement of Lanny A. Breuer, Assistant Attorney General Criminal Division, U.S. Dep't of Justice), http://tinyurl.com/5weuhg6.
[22] *Id.* at 16.
[23] *Id.*
[24] Press Release, U.S. Dep't of Justice, *Financial Fraud Enforcement Task Force Announces Results of Largest-Ever Nationwide Operation Targeting Investment Fraud* (Dec. 6, 2010), http://tinyurl.com/69qltgd.

the United States and involves only foreign investors," or "conduct occurring outside the United States that has a foreseeable substantial effect within the United States."[25] The SEC has taken the position that this provision "effectively overruled *Morrison* by codifying the Second Circuit's long-standing conduct and effects test . . . for civil enforcement actions brought by the SEC."[26] At least as applied to antifraud actions brought by the SEC and other public authorities under the Exchange Act,[27] this reading appears to be correct,[28] and makes clear that public authorities can bring their full arsenal of antifraud weapons to bear against wrongdoing that meets the standard.

*B. Foreign countries also regulate securities fraud effectively.*

"Like the United States, foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction."[29] Indeed, the governments of important overseas securities markets have put in place comprehensive regimes for maintaining the safety and transparency of those markets and detecting and punishing wrongful conduct by any market participant. "[A]ll major stock markets are subject to regulations that, among other things, specify required information disclosure by firms, define restrictions on insider trading, and impose constraints on corporate governance choices."[30] And "[s]ecurities regulations

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[25] Dodd-Frank Act, § 929P(b).

[26] *See* SEC's Memorandum of Law in Opposition to Defendant Tourre's Motion to Dismiss the Amended Complaint, at 10 n.1 (filed Dec. 21, 2010), *SEC v. Tourre*, Civ. No. 10-3229 (S.D.N.Y.).

[27] We express no view on whether the Dodd-Frank Act also granted the SEC extraterritorial authority to enforce "all similar provisions of the federal securities laws," even those not expressly mentioned in section 929P, as appears to be the Commission's position. *See* Yin Wilczek, *Reform Act Restores SEC Enforcement Reach Beyond Antifraud Rule, General Counsel Says*, BNA (Feb. 8, 2011). Regardless, the enforcement authority expressly mentioned in section 929P certainly encompasses the Commission's broad authority to take action against securities fraud.

[28] Section 929P speaks to the district courts' "jurisdiction" over government enforcement actions, and the Supreme Court was clear in *Morrison* that the question of the extraterritorial reach of section 10(b) of the Exchange Act goes to the "merits," not the courts' "jurisdiction." *Morrison*, 130 S. Ct. at 2877. Nonetheless, we think it reasonable to read section 929P as speaking sufficiently clearly to accomplish Congress's apparent intent to expand the government's authority to bring suit to extraterritorially enforce at least section 10(b) and the other referenced provisions. It is true that a literal reading of the term "jurisdiction" might render section 929P(b) without that effect; but since the Supreme Court was clear in *Morrison* that the federal courts already have jurisdiction over suits to enforce section 10(b) extraterritorially, *see id.*, we believe that the courts are unlikely to conclude that Congress intended to enact what would be, if read in that way, effectively a null statute. *See Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 216 (1995) (interpretation that would leave a statute "utterly without effect" is "a result to be avoided if possible").

[29] *Morrison*, 130 S. Ct. at 2885.

[30] *See* Glenn Boyle & Richard Meade, *Intra-Country Regulation of Share Markets: Does One Size Fit All?*, 25 Eur. J. Law & Econ. 151, 153 (2008).

in the EU and United States have a similar emphasis on investor protection, fair and orderly markets, and price transparency."[31]

In the countries with the most developed and liquid securities markets, moreover, powerful and well-resourced public regulators ensure compliance with applicable rules and pursue violators.[32] Examples of such regulators include France's Authorité des Marchés Financiers ("AMF"),[33] Switzerland's Financial Market Supervisory Authority ("FINMA"),[34] the UK's Financial Services Authority ("FSA"),[35] Germany's Federal Financial Supervisory Authority ("BaFin"),[36] and Australia's Securities and Investments Commission ("ASIC").[37] These regulators are active and

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[31] Tanja Boskovic et al., *Comparing European and U.S. Securities Regulations*, World Bank Working Paper No. 184, at 14 (2010), http://tinyurl.com/4cm8xxa.

[32] *See* Howell E. Jackson, *The Impact of Enforcement: A Reflection*, 156 U. Pa. L. Rev. PENNumbra 400, 404 (2008) (hereinafter "*Impact of Enforcement*"), http://tinyurl.com/4tgo663 ("all of the major financial centers of the world—the United States, the United Kingdom, Hong Kong, Luxembourg, Singapore, and Amsterdam—do report above-average levels of regulatory staffing and budgets").

[33] IMF, *France: Financial Sector Assessment Program*, IMF Country Report No. 05/186, at 157 (2005) (hereinafter "*IMF, French Report*"), http://tinyurl.com/4m8n6re (noting that the AMF "can seek administrative fines against authorized and unauthorized persons, suspend authorization to do business, require cessation of violations (which can take effect immediately on a provisional basis), seek and seize records and freeze assets (regardless of who is holding them) through court order, and refer misconduct for criminal prosecution").

[34] FINMA has broad authority to supervise stock exchanges, securities dealers, collective investment schemes, and others involved in the securities markets. This authority includes investigatory powers and an enforcement arsenal consisting of the imposition of administrative sanctions—including the ordering of injunctive relief, prohibition of individuals from practicing their profession, suspension and revocation of licenses, and the confiscation of illegal gains—and referral of appropriate cases for prosecution. *See* Swiss Diplomatic Note No. 17/2010, at 2a-3a, Brief of the International Chamber of Commerce et al. as Amici Curiae in Support of Respondents (appendix), *Morrison*, 130 S. Ct. at 2869, 2010 WL 719334; *see also* FINMA, Enforcement/Market Supervision, http://tinyurl.com/yhztkny (last visited Feb. 10, 2011).

[35] *See* Financial Services and Markets Act ("FSMA"), 2000, c. 8, Pt. VI, § 91; Pt. VIII; Pt. XXVII, § 397; Pt. XIV; Pt. XXV, §§ 380-384 (Eng.) (as amended 2006), http://tinyurl.com/39mmv5f (setting forth FSA's powers to impose fines and penalties for rule violations and market abuse, bring criminal proceedings for specified misleading statements and practices, fine and censure authorized firms, apply for injunctions, and order restitution). The British also "maintain several other regulatory bodies"—such as the British Financial Reporting Council and the Panel of Takeovers and Mergers—"that fulfill functions comparable to those of the U.S. SEC." Jackson, *Impact of Enforcement*, *supra* note 32, at 402-03.

[36] *See* BaFin, Act Establishing the Federal Financial Supervisory Authority (2002, as amended), http://tinyurl.com/4hwte2m; *German Securities Trading Act* (1998, as amended), http://tinyurl.com/dlrvs7; *see also* BaFin, Annual Report 2009, at 174-81 (Jan. 25, 2011), http://tinyurl.com/4jthqvz (describing recent BaFin prosecutions for insider trading and market manipulation).

[37] *See* Brief of the Government of the Commonwealth of Australia as Amicus Curiae in Support of the Defendants-Appellees, at 5-9, *Morrison*, 130 S. Ct. 2869, 2010 WL 723006 (describing ASIC's "broad and diverse" "remedial powers").

effective.[38] The intensity of their enforcement efforts also has been accelerating in recent years. For example, BaFin initiated 150 new investigations of market manipulation in 2009, twice the number in 2008.[39] And in 2008, the FSA imposed the highest number of fines since receiving the authority to do so in 2001.[40]

To be sure, the SEC (and DOJ) employs *ex post* enforcement mechanisms—including the imposition of financial penalties—to an extent unmatched by most other securities regulators.[41] But "[t]he relative scarcity of enforcement actions in . . . other jurisdictions does not necessarily imply greater noncompliance [with the securities laws] or economic drag."[42] Rather, "[t]he means by which regulators enforce legal requirements may well differ materially around the world."[43] In particular, many foreign regulatory bodies—for example, the FSA, FINMA, and Japan's Financial Services Agency—are inclined "to resolve enforcement actions informally and without public disclosure," and some regulators rely more heavily than the SEC on private parties to assist enforcement efforts.[44] As Professor Howell E. Jackson of Harvard Law School has observed, "alternative mechanisms of social control are plausible substitutes for the formal enforcement actions that characterize the regulatory activity in the United States and a few other jurisdictions."[45]

## II. There Is No Justification for the United States to Override the Policy Choices of Other Nations by Creating New Private Liability for Securities Fraud in Connection with Foreign Transactions

One of the critical attributes of national sovereignty is, of course, the power to determine the legal regime most appropriate for regulating activities within a nation's

[38] The IMF has noted, for example, that securities regulation is effective in both France and Germany. *See* IMF, *French Report*, at 193; IMF, *Germany: Financial System Stability Assessment*, IMF Country Report No. 03/343, at 41 (2003) (hereinafter "*Germany Assessment*"). *See also* Coffee, *Law and the Market*, supra note 19, at 281 (stating that Australia through ASIC "does appear to rival and perhaps outdo the SEC at enforcement").
[39] IMF, *Germany Assessment*, *supra* note 38, at 177.
[40] PwC, *2008 Study*, *supra* note 15, at 54.
[41] *See* Coffee, *Law and the Market*, *supra* note 19, at 244.
[42] *See* Jackson, *Impact of Enforcement*, *supra* note 32, at 407.
[43] *Id.*
[44] *Id.*; *see also id.* at 404, 408; Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, Harvard Law School John M. Olin Center for Law Economics and Business Discussion Paper Series, Paper No. 638, at 29 (Apr. 2009) (published in the Journal of Financial Economics, vol. 93 (2009)), http://tinyurl.com/49qlvxt.
[45] Jackson, *Impact of Enforcement*, *supra* note 32, at 407.

territorial boundaries. In an increasingly globalized economy, every country must seek sufficient protection for its own citizens, while also according the policy choices of other nations the same level of respect that it expects from them for its own choices.

Extraterritorial application of U.S. law, and in particular the extraterritorial reach of U.S. private litigation, has in the past been a particular international flash point because of the stark differences between the rules applied in the United States and those of just about every other developed nation.[46] As the Supreme Court explained in *Morrison*, "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."[47] Moreover, the Commission has no control over private litigants, and thus cannot calibrate the intensity of private enforcement to take account of regulatory considerations or foreign policy concerns.[48] The Commission therefore should tread especially carefully before endorsing creation of a new private cause of action with broad extraterritorial reach.

At minimum, the Commission must consider (a) the policy choices made by other nations; (b) the strength of the reasons for those choices; and (c) the extent to which the United States has legitimate national interests that might justify the extraordinary step of overriding those different policy choices. When that analysis is conducted, it becomes clear that there is no conceivable justification for creating this new private cause of action. And that conclusion is bolstered by the adverse consequences that would result from such a course, which we discuss in sections III and IV, below.

### *A. Other countries' private remedies differ significantly from the U.S. model of private securities litigation*

The legal systems of many countries—including Canada, Australia, the United Kingdom, Sweden, Switzerland, Germany, and the Netherlands—do afford substantial private judicial remedies to investors injured by securities fraud. And there

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[46] *See infra* page 25.
[47] 130 S. Ct. at 2885.
[48] *See infra* page 23-24.

are aspects of foreign law that are *more* favorable to private civil plaintiffs than the corresponding U.S. approach. For example, some countries permit investors injured by misconduct to recover based on a showing of mere negligence.[49]

But in most respects, the substantive and procedural rules governing securities fraud litigation are more advantageous to private plaintiffs in the U.S. than in other nations. As Professor John C. Coffee of Columbia Law School has observed, the United States is exceptional in the extent to which "public enforcement of [the securities laws] is supplemented by a vigorous, arguably even hyperactive, system of private enforcement."[50] Therefore, as the Supreme Court noted in *Morrison*, "[t]he probability of incompatibility" between extraterritorial application of private liability under the securities laws and the "applicable laws of other countries is . . . obvious."[51] For example, "[o]nly a few other nations have adopted the class action device even to a limited extent,"[52] and few of the countries that permit such suits have structured them "in a manner similar to the U.S. class action."[53]

To be sure, a number of countries other than this one have mechanisms of some kind for group securities litigation. For example, under Germany's Capital Investors' Model Proceeding Law, enacted in 2005, courts may designate a "model case" in shareholder actions for false, misleading, or omitted public capital-markets information, and for specific performance under the Securities Acquisition and Takeover Act. The court rules on the common questions presented in the model case, and all individual cases are decided on the basis of the decision on the common questions. But decisions on common questions in a German "model case" do not

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[49] *See, e.g.*, French Civil Code Art. 1383 (imposing liability for negligence), http://tinyurl.com/4zlwwjz; *Spector Photo Group NV v. CBFA*, ¶¶ 37-38, 62 (European Court of Justice, Dec. 23, 2009), http://tinyurl.com/48t894z (intent is presumed where an individual knowingly in possession of inside information purchases or sells a security, unless it is shown that the inside information did not influence his actions); Swiss Code of Obligations Art. 752 (establishing negligence liability standard for issuer that publishes a misleading prospectus in connection with an IPO).

[50] Coffee, *Law and the Market*, *supra* note 19, at 245.

[51] 130 S. Ct. at 2885.

[52] Thomas D. Rowe, Jr., *Debates Over Group Litigation in Comparative Perspective: What Can We Learn From Each Other?*, 11 Duke J. Comp. & Int'l L. 157, 157-58 (2001); *see also* Coffee, *Law and the Market*, *supra* note 19, at 266 ("Class actions remain rare to unknown in Europe[.]").

[53] Ilana T. Buschkin, *The Viability of Class Action Lawsuits in a Globalized Economy—Permitting Foreign Claimants to be Members of Class Action Lawsuits in the U.S. Federal Courts*, 90 Cornell L. Rev. 1563, 1597 (2005).

bind absent persons, and individual litigation is required for each unique issue, including individualized damages.[54]

England implemented a similar "opt in" mechanism in 2000, "enabling a court to issue a Group Litigation Order . . . for claims arising out of related issues of fact or law."[55] France permits victims of securities fraud to bring collective civil actions, but only through appointment of a common agent or under the auspices of a certified association representing investor interests.[56] A Swedish law went into effect in 2003 that allows "individual class-action lawsuits by a plaintiff class member for both injunctive and monetary relief," but again only on an "opt in" basis.[57] And Swiss law authorizes several types of group litigation devices, including a provision for certain judgments in shareholder litigation involving mergers and acquisitions to bind all, or an extended group of, shareholders—"a very limited class action."[58]

Only four countries other than the U.S. (Canada, Australia, South Korea, and the Netherlands) permit securities class actions on an "opt-out" basis.[59] Nine securities class actions were filed in Australia in 2009, and eight were filed in Canada in 2010.[60] The Netherlands is the only European country that recognizes the "opt out" mechanism in this type of litigation, and it permits the certification of a class for settlement purposes only.[61]

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[54] *See* Stephen J. Choi & Linda J. Silberman, *Transnational Litigation and Global Securities Class Action Lawsuits*, 2009 Wis. L. Rev. 465, 486-87 (2009).

[55] *See id.* at 487.

[56] *See* French Monetary and Financial Code, Art. L. 452-2, http://tinyurl.com/4r2s4xn. In 2007, France concluded a long-simmering debate about whether to enact an "opt in" securities class action mechanism without taking any legislative action based on concerns regarding the negative economic impact of such suits and the view that public enforcement was sufficient. *See* Leslie Schulman, *France Parliament Puts Off Class Actions Legislation Debate*, Jurist, Feb. 1, 2007, http://tinyurl.com/4c5gw6d.

[57] Choi & Silberman, *supra* note 54, at 487.

[58] Samuel P. Baumgartner, *Class Actions & Group Litigation in Switzerland*, 27 Nw. J. Int'l L. & Bus. 301, 303, 336-37 (2007) .

[59] *See* Luke Green, *Multi-National Securities Class Actions Go Global*, RiskMetrics Group (posted Jan. 11, 2011), http://tinyurl.com/4vsn3kb; Choi & Silberman, *supra* note 54, at 488.

[60] *See* John Haut & Christopher Noe, *Recent Trends in Australian Securities Class Actions*, Charles River Associates (Dec. 2009), http://tinyurl.com/4oy2g9w; Mark L. Berenblut et al., NERA Econ. Consulting, *Trends in Canadian Securities Class Actions: 2010 Update* 1 (Jan. 2011), http://tinyurl.com/4htqwzq.

[61] *See* Xandra Kramer, *Report on Dutch Collective Settlements Act,* Conflict of Laws.net (Dec. 9, 2010), http://tinyurl.com/4d6a48b.

Thus, when a case filed in the U.S. District Court for the Southern District of New York ("SDNY") was dismissed (*see Copeland v. Fortis*, 685 F. Supp. 2d 498, 500 (S.D.N.Y. 2010) (dismissing complaint under conducts

Other differences between the United States and foreign countries in terms of the procedural rules governing private securities litigation also are significant. "[T]he 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."[62] Moreover, few countries subscribe to the U.S. model of relatively unlimited, party-controlled discovery,[63] and "[t]he 'English rule' [loser pays] is the predominant rule" in Europe, with only one EU member state, Luxembourg, reject[ing] that rule in favor of the American approach."[64] Most countries also forbid or significantly limit the use of contingency fees.[65]

These differences do not reflect a lesser commitment on the part of foreign sovereigns to fighting securities fraud. Rather, they are the product of considered policy choices—often rooted in the different cultural perspectives, and economic and legal orientations, of other nations.[66] Many countries have a fundamental preference for "public proceedings over private litigation as the primary enforcement mechanism,"[67] perhaps due to the perception that the settlement of private disputes through the courts is undesirable. It also is well-known that "Europe has had little

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and effects test)), members of the class refiled their claims against the former Fortis Bank, certain officers and directors, and the lead underwriter in the Netherlands. A special foundation formed under Dutch law and backed by two U.S. plaintiffs' firms—Grant & Eisenhofer and Barroway Topaz Kessler Meltzer & Check—is now pursuing those claims on behalf of more than 140 institutional investors, including many of the largest pension funds in Europe, and 2,000 individual shareholders from Europe, Asia, and the United States. *See* David Bario, *Dutch Treat? With Doors to U.S. Courts Closed by Morrison, Securities Class Action Lawyers Sue Fortis in Holland*, Am. Lawyer, Jan. 10, 2011; *see also Kevin LaCroix, Plaintiffs' Lawyers Pursue Non-U.S. Securities Litigation Alternatives After Morrison*, D&O Diary (posted Jan. 11, 2011), http://tinyurl.com/4gx4oss. According to one of the plaintiffs' attorneys involved in the proceeding, "[w]e believe this action could be a model for future investor claims outside the United States." LaCroix, supra.

[62] Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 Colum. J. Transnat'l L. 14, 61 (2007).

[63] *See* Denis Waelbroeck et al., Executive Summary, *Study on the Conditions of Claims for Damages in Case of Infringement of EC Competition Rules—Comparative Report*, at 61-64 (Ashurst, Aug. 31, 2004), http://tinyurl.com/yb3pfvu.

[64] Stefano M. Grace, *Strengthening Investor Confidence in Europe: U.S.-Style Securities Class Actions and the Acquis Communautaire*, 15 J. Transnat'l L. & Pol'y 281, 289 (2005).

[65] *See* Buxbaum, *supra* note 62, at 63; Coffee, *Law and the Market*, *supra* note 19, at 267 & n.101.

[66] *See* Buxbaum, *supra* note 62, at 61 (noting that "[a]lthough the central concerns addressed by anti-fraud rules may be the same across systems, many differences remain both in specific rules and in the broader cultural approaches that infuse the regulatory choices of other countries") (footnotes omitted).

[67] *Id.*

litigation compared to the United States,"[68] and that "U.S. entrepreneurial-style lawyering is viewed with hostility in many other countries."[69]

Foreign nations also may have different—but equally legitimate—views about the optimal approach to regulating securities markets. Such regulation involves inherent trade-offs, exchanging a possible, perhaps wholly speculative, reduction in the level of fraud for "substantial additional costs beyond those borne directly by regulated parties," including by "disrupt[ing] some number of transactions that would have been socially desirable but that regulation impeded either through its breadth or through misinterpretation by the private parties."[70] The ways in which U.S. law addresses issues such as the availability of class actions, the breadth of discovery, the presumption of reliance, and the distribution of attorneys' fees reflect in large part the choices that U.S. political and legal institutions have made in an effort to balance often-conflicting policy goals. Other countries have chosen to reconcile these conflicts differently.

Indeed, policymakers and the public in many foreign countries view the U.S. approach to private securities litigation as anathema. For example, European policymakers, even as they consider the possibility of adopting more robust forms of group litigation, have been quite clear that the U.S. class action model is not the right one for Europe. In just the latest statement to that effect, the European Commission recently announced that it "firmly opposes introducing 'class actions' along the US model into the EU legal order, or creating incentives for abusive litigation."[71] "At the heart of th[e] [outright] rejection of U.S.-style litigation" in Switzerland and the EU, one close observer has explained, "is a deep unease with the way in which the jury trial, a procedure steeped in equity, anti-formalism, entrepreneurial lawyering, the prospect of punitive damages, and the tendency toward the lawsuit as a business deal that these features support, results in a litigation system in the United States in which power (including judicial power), money (who has it and who does not), and tactics

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[68] Laurel J Harbour & Marc E. Shelley, *The Emerging European Class Action: Expanding Multi-Party Litigation to a Shrinking World*, at 1 (ABA Annual Meeting 2006), http://tinyurl.com/46kttwg.
[69] Buxbaum, *supra* note 62, at 63.
[70] Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 Yale J. Reg. 253, 261 (2007); *see also* Choi & Silberman, *supra* note 54, at 499 ("Not all regulatory protections are value-increasing for issuers and investors.").
[71] Press Release, European Commission, *Commission seeks opinions on the future for collective actions in Europe*, IP/11/132 (Feb. 4, 2011), http://tinyurl.com/6jr4oox.

seem to be more important in the outcome of litigation than a finding of who is right and who is wrong."[72]

*B. Foreign countries have sound reasons for rejecting the U.S. model of securities class action litigation*

Whatever the merits for this country of the U.S. approach to securities fraud litigation, there can be no doubt that the concerns underlying foreign countries' rejection of that approach are rational—and deserving of the United States' recognition and respect. Significantly, the foreign hostility to the U.S. model is consistent with a growing body of empirical evidence indicating that the U.S. securities class action system (i) does not effectively further the main goals of securities regulation and (ii) imposes significant unjustified costs on U.S. businesses, investors, and the economy.

In fact, based on a significant quantity of recent empirical work, the legal academy has reached a remarkable consensus on this issue. As Professors Howell Jackson and Mark Roe of Harvard Law School succinctly explain, "the conventional legal academic view . . . is that securities litigation, at least as practiced within the United States, is seriously compromised. Private securities lawsuits in the United States (1) often provide meager returns to wronged plaintiffs, (2) usually do not visit their costs on the wrongdoing actors inside public firms, because the wrongdoers can usually transfer the costs to others, and (3) often just transfer losses from one innocent group of shareholders to another innocent group, with large fees obtained by the lawyers for both sides."[73]

The following sections identify the individual elements of these criticisms and describe in some detail their empirical foundations. To be sure, there is continuing

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[72] Baumgartner, *supra* note 58, at 314-16 (footnotes omitted).

[73] Jackson & Roe, *supra* note 44, at 5; *see also* Coffee, *Law and the Market*, *supra* note 19, at 304 ("[I]t must be recognized that private enforcement of the securities laws in the United States is working imperfectly, achieving little, if any compensation and only limited deterrence because its costs fall largely on innocent shareholders rather than the culpable corporate officers actually responsible for 'cooking the books' and other misdeeds."); Honorable Joseph A. Grundfest, Stanford Law School, Address at the Meeting of the Advisory Committee on the Auditing Profession 4 (Feb. 4, 2008), http://tinyurl.com/45tesjl (observing that "[t]he class action securities fraud litigation system is broken. It fails efficiently to deter fraud and fails rationally to compensate those harmed by fraud. Its greatest proponents seem to be the class action counsel and others who profit as a consequence of the irrationally large damage exposures generated by the current regime")

controversy about some of these issues, and theoretical and empirical debate about the overall wisdom of the U.S. approach to private securities litigation is ongoing and vigorous. Two points, however, are clear.

First, the Commission need not endorse as correct the arguments challenging the U.S. approach to conclude that the questions raised about the effectiveness of that approach in compensating victims and deterring fraud have sufficient plausibility and force to provide a legitimate basis for foreign countries to reject significant aspects of it. And second, there is no reason to think that a country's rejection of the U.S. private securities litigation model compromises the efficacy of its regime for regulating securities markets.

> **1. Compensation.** There is widespread agreement that securities class action suits cannot reasonably be justified as providing "compensation" to "injured investors" on either an *ex ante* or an *ex post* basis.[74]

To begin with, such suits have been criticized as inherently illogical from a compensatory perspective. At a fundamental level, as Professor Coffee (among many others) has noted, "the familiar secondary market 'stop drop' case . . . essentially involves shareholders suing shareholders. Inevitably, the settlement cost imposed on the defendant corporation in a securities class action falls principally on its shareholders. This means that the plaintiff class recovers from the other shareholders, with the result that secondary market securities litigation largely generates pocket-shifting wealth transfers among largely diversified shareholders."[75] Based on the "circularity" issue alone, Professor Coffee has concluded that "the odds

[74] *See* Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors' and Officers' Insurance and Securities Settlements*, 157 U. Pa. L. Rev. 755, 831 (2009).

[75] Coffee, *Law and the Market*, *supra* note 19, at 304; *see also* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1556-61 (2006) (hereinafter "*Reforming the Securities Class Action*"); Donald C. Langevoort, *On Leaving Corporate Executives "Naked, Homeless and Without Wheels": Corporate Fraud, Equitable Remedies, and the Debate over Entity Versus Individual Liability*, 42 Wake Forest L. Rev. 627, 632 (2007) (hereinafter "*Without Wheels*"); Letter from Donald C. Langevoort et al. to the Honorable Christopher Cox, Chairman, SEC (Aug. 2, 2007), http://tinyurl.com/48evhc2 (signed by Professors Donald Langevoort, James D. Cox, Jill Fisch, Michael A. Perino, Adam C. Pritchard, and Hilary A. Sale); Comm. on Capital Mkts. Reg., *supra* note 6, at 79; Richard A. Booth, *Who Should Recover What in a Securities Fraud Class Action*? 7 n.10 (University of Md. Legal Studies, Research Paper No. 2005-32, 2005), http://tinyurl.com/4uvybnk; Merritt B. Fox, *Demystifying Causation in Fraud-on-the-Market Actions*, 60 Bus. Law. 507, 529 (2005).

are high that shareholders are made systematically worse off by securities class actions."[76]

A distinct problem is that, as Professor Janet Alexander of Stanford Law School first observed fifteen years ago, unlike "traditional tort plaintiffs, who cannot diversify against the risk of injury," "many investors may not really need compensation from litigation, because they have diversified against the risk of securities violations."[77] Diversification is a costless insurance strategy, and most stockholders are in fact well-diversified because they hold their shares through institutions that are well-diversified.[78] A diversified investor is equally likely to sell as to buy during the fraud period, meaning that she "will be fully compensated for [her] trading losses that are due to securities fraud by windfalls on other transactions. Such investors have no need for further compensation obtained through litigation."[79] And "even though a diversified stockholder might sometimes lose [from fraud], she would be opposed in principle to a rule that permits recovery because she is effectively insured against loss by virtue of being diversified. The cost of litigation is a deadweight loss."[80]

Moreover, recoveries from securities class action litigation mainly go to large institutional investors and hedge funds.[81] By contrast, "small undiversified investors"—the intended beneficiaries of the class action mechanism—"are seldom likely to receive a monetary benefit from [such suits]" because such investors generally "buy and hold" their shares, and are "more likely to have purchased . . . stock before the class period commenced."[82] Thus, "securities litigation systematically may transfer

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[76] *See* Coffee, *Law and the Market*, *supra* note 19, at 304.
[77] Janet C. Alexander, *Rethinking Damages in Securities Class Actions*, 48 Stan. L. Rev. 1487, 1502 (1996) (hereinafter "*Rethinking Damages*").
[78] *See* Richard A. Booth, *The Buzzard Was Their Friend—Hedge Funds and the Problem of Overvalued Equity*, 10 U. Pa. J. Bus. & Emp. L. 879, 889 (2008) (hereinafter "*Buzzard*") (observing that approximately 73 percent of all U.S. shares are held through such diversified institutions).
[79] Alexander, *Rethinking Damages*, *supra* note 77, at 1502; *see also* Booth, *Buzzard*, *supra* note 78, at 901.
[80] Richard A. Booth, *Direct and Derivative Claims in Securities Fraud Litigation*, 4 Vir. L. & Bus. Rev. 277, 298 (2009); *see also* Langevoort, *Without Wheels*, *supra* note 75, at 633-34; Coffee, *Reforming the Securities Class Action*, *supra* note 75, at 1558-59; Frank H. Easterbrook & Daniel R. Fischel, *The Economic Structure of Corporate Law* 339-41 (1991).
[81] Alexander, *Rethinking Damages*, *supra* note 77, at 1502; *see also* Booth, *Buzzard*, *supra* note 78, at 901.
[82] Coffee, *Reforming the Securities Class Action*, *supra* note 75, at 1559-60; Comm. on Capital Mkts. Reg., *supra* note 6, at 80.

wealth from [small] buy and hold investors" to larger investors and more active traders.[83] "This is illogical."[84]

In addition, any compensation that might be obtained by defrauded investors through securities class action suits is incredibly inefficient. As Professor Donald C. Langevoort of Georgetown Law has observed, "[w]ere this [system] sold as an insurance product, consumer-protection advocates might well seek to have it banned as abusive because the hidden costs are so large."[85]

Most significantly, the transaction costs—particularly attorneys' fees—that accompany such suits are extraordinarily high. Plaintiffs' counsel take approximately 25 to 33 percent right off the top of the average recovery, with attorneys' fees that approach 50 percent of the settlement value not infrequent.[86] In a particularly egregious—but by no means unique—example, Milberg LLP recently was awarded $21 million in a case in which each class member's recovery was only $20, along with "coupons" for $8.22.[87] In 2010, aggregate attorneys' fees totaled $1.353 billion.[88] And then there are the costs of defense lawyers, which may exceed the fees awarded plaintiffs' lawyers because of the need for separate lawyers for multiple defendants.

Small investors are again disfavored most of all by the inefficiencies in the current system. Many individual investors effectively hold their stock through large institutions, either because they own shares in mutual funds or have a future entitlement to their pensions. The evidence shows, however, that these institutions do a very poor job of ensuring that class action settlements actually benefit the individual investors who have sustained harm. In a 2005 study, for example,

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[83] Comm. on Capital Mkts. Reg., *supra* note 6, at 80; Coffee, *Reforming the Securities Class Action*, *supra* note 75, at 1560.

[84] Booth, *Buzzard*, *supra* note 78, at 901.

[85] Langevoort, *Without Wheels*, *supra* note 75, at 635; *see also* Merritt B. Fox, *Why Civil Liability for Disclosure Violations When Issuers Do Not Trade?*, 2009 Wis. L. Rev. 297, 307 (2009) (observing that "securities litigation is so costly, relative to the amount of loss spreading achieved, that it is unlikely to be worthwhile even if there were no alternative way of reducing the social disutility arising from the risks of issuer misstatements").

[86] *See* Langevoort, *Without Wheels*, *supra* note 75, at 628 n.2; Coffee, *Reforming the Securities Class Action*, *supra* note 75, 1545-46.

[87] *See* Editorial, *Lawyering Unto Peredition*, Wash. Times, Dec. 28, 2010; Daniel Fisher, *Lawyer Appeals Judge's Award Of $21 Million In Fees, $8 Coupons For Clients*, Forbes, Jan. 10, 2011.

[88] *See* Dr. Jordan Milev, Robert Patton, & Svetlana Starykh, NERA Econ. Consulting, *Trends 2010 Year-End Update: Securities Class Action Filings Accelerate in Second Half of 2010; Median Settlement Value at an All-Time High* 235 (Dec. 14, 2010), http://tinyurl.com/6jcjvje.

Professors James D. Cox (Duke Law School) and Randall S. Thomas (Vanderbilt University Law School) found that most institutional investors (70 percent of their sample) with provable losses in securities class action settlements never actually perfected their claims, and that not a single institutional investor (out of 23 surveyed) allocated money recovered from settlements to the accounts of those investors who had actually been defrauded.[89] As a result, "there is a mismatch between those investors who suffered losses and those who benefit from the recovery."[90] Based on their research, Professors Cox and Thomas express great "skeptic[ism] that class actions can be seen as purely or substantially compensatory."[91]

Simply put, then, for the vast majority of investors, the securities class action system functions merely as "a grotesquely inefficient"—and unnecessary—"form of insurance against large stock market losses."[92]

**2. Deterrence.** Serious and credible doubts also have been raised about the deterrent value of securities class actions.

Research over the last two decades shows that merits-related factors by and large do not drive either a plaintiff's decision to file such a suit or a defendant's decision to settle one. Filings are triggered by declines in stock price and the amount of the defendant's insurance coverage, not the existence of credible evidence of fraud.[93] Settlement decisions likewise are driven by non-merits-related factors.[94] The central concern that leads defendants to settle even meritless claims is that the massive amount of potential liability—a consequence in large part of the fraud-on-the-market theory—can put corporate survival at risk.[95] Exacerbating this problem is the

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[89] James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 Stan. L. Rev. 411, 449-50 (2005).
[90] *Id.* at 449.
[91] *Id.* at 451.
[92] Janet C. Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 501 (1991) (hereinafter "*Merits*").
[93] Patrick M. Garry et al., *The Irrationality of Shareholder Class Action Lawsuits: A Proposal for Reform*, 49 S.D. L. Rev. 275, 287 n.98 (2003-2004) (citing studies).
[94] *See, e.g., id.* (citing studies); Baker & Griffith, *supra* note 74, at 831; Alexander, *Merits*, *supra* note 92, at 528-34.
[95] *See Evaluating S. 1551: The Liability for Aiding and Abetting Securities Violations Act of 2009: Hearing Before the Subcomm. on Crime and Drugs of the S. Comm. on the Judiciary*, 111th Cong., at 3 (Sept. 17, 2009), http://tinyurl.com/4thqkpv (statement of Adam C. Pritchard, Professor, University of Michigan Law School) ("Given the trading volume in secondary markets," the upshot of application of the fraud-on-the-market theory is

difficulty of "[d]istinguishing fraud from mere business reversals."[96] And even today, after two rounds of legislative reform intended to address the problem, courts have few effective tools with which to dismiss "strike suits" predicated on insubstantial evidence.[97]

As a result, as the Supreme Court noted as recently as 2006, "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."[98] In particular, "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies."[99] These costly disruptions "representing an *in terrorem* increment of the settlement value" that gives even an insubstantial complaint "a settlement value to the plaintiff out of any proportion to its prospect of success at trial."[100]

The example of JDS Uniphase—one of the few companies to have litigated a securities class action to a jury verdict in the last decade—is instructive. Although the company was *exonerated* in 2008, the case lasted for five years and cost it $50 million in legal fees.[101] Faced with the prospect of such costs (or, even worse, a massive judgment imposed by an unpredictable jury), it is no surprise that companies—even those that have not violated the law—almost invariably decide to cut their losses and settle after denial of a motion to dismiss.[102] Indeed, only a small handful of securities class actions—twenty-two as of November 2010—have been tried to verdict in the

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that "the potential recoverable damages in securities class actions can be a substantial percentage of the corporation's total capitalization, easily reaching hundreds of millions of dollars, and sometimes billions.").

[96] *Id.*

[97] *Id.* In 1995 Congress enacted the Private Securities Litigation Reform Act to remedy "nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and 'manipulation by class action lawyers of the clients whom they purportedly represent.'" *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 80 (2006) (quoting H.R. Rep. 104-369, at 31 (1995) (Conf. Rep.), *as reprinted in* 1995 U.S.C.C.A.N. 730, 730). Notwithstanding the PSLRA's modest safeguards, such as a heightened pleading standard, securities class actions often survive motions to dismiss—and enter the protracted and expensive discovery phase—because courts must accept the factual allegations as true. In 1998, Congress enacted the Securities Litigation Uniform Standards Act "to protect the interests of shareholders and employees of public companies that are the target of meritless 'strike' suits." S. Rep. No. 105-803, at 13 (1998) (Conf. Rep.).

[98] *Dabit*, 547 U.S. at 80 (internal quotation marks omitted).

[99] *Stoneridge*, 552 U.S. at 163.

[100] *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740-41 (1975).

[101] *See* Ashby Jones, *JDS Wins Investor Lawsuit, Bucking a Trend*, Wall St. J., June 2, 2008.

[102] Milev et al, *supra* note 88, at 13 (finding that approximately 60 percent of federal securities class actions resolved since January of 1996 have settled, while nearly all the rest have been dismissed at the motion-to-dismiss stage).

past decade (with only seven of those verdicts resulting in a decision in favor of the plaintiffs).[103]

"[I]f the merits of claims" are "irrelevant to their initiation or settlement values," "the deterrent effect [of class actions] is weak."[104] And when all cases that survive a motion to dismiss are settled, litigation and settlement amounts become a cost of doing business, not a sign of wrongdoing. Further vitiating any deterrent effect is that penalties fall not on individual wrongdoers, but "on the corporation and its insurer, which means that they are ultimately borne by the shareholders."[105] The authors of one study conclude that "to a large extent, even culpable officers appear to be shielded from liability in securities class actions."[106]

Thus, particularly given the existence of robust government enforcement, it appears that "[p]rivate class actions move a lot of money around, but add little to deterrence at the margin."[107]

**3. Costs imposed on companies, investors, and the economy.** The U.S. securities class action system imposes massive, and growing, costs on the country's judicial system and businesses—costs which ultimately are borne by investors and consumers.

3,245 issuers have been named as defendants in federal class action securities fraud lawsuits since the enactment of the PSLRA in 1995.[108] And over the last

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[103] *Id.* at 15.
[104] Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 Duke L.J. 945, 952 (1993).
[105] Comm. on Capital Mkts. Regulation, *supra* note 6, at 78; *see also* Baker & Griffith, *supra* note 74, at 821 (observing that "settlements are funded largely, and often entirely, by D&O insurance"); Donald C. Langevoort, *U.S. Securities Regulation and Global Competition*, 3 Vir. L. & Bus. Rev. 191, 199 (2008) (hereinafter "*Global Competition*") ("By and large, the money paid in judgments, settlements, and legal fees comes out of either the corporate treasury or an insurance policy, and is thus funded by the company's shareholders, not the individual wrongdoers."); Donald C. Langevoort, *Capping Damages For Open-Market Securities Fraud*, 38 Ariz. L. Rev. 639, 648 & n.43 (1996); *see also* Alexander, *Rethinking Damages*, *supra* note 77, at 1499.
[106] Michael Klausner & Jason Hegland, *How Protective is D&O Insurance in Securities Class Actions*, 23 Professional Liability Underwriting Society 4 (Feb. 2010).
[107] Pritchard, *supra* note 95, at 5; *see also* Baker & Griffith, *supra* note 74, at 831-32 ("[P]rivate securities litigation, at least as the system is currently administered, is unlikely to deter bad corporate actors.").
[108] Stanford Law School Securities Class Action Clearinghouse Statistics (last updated Feb. 14, 2011), http://tinyurl.com/4qzbnhl.

decade, each year's newly filed suits have targeted an average of over 2% of all listed companies.[109]

For a variety of reasons, "securities class actions disproportionately claim judicial time and attention."[110] The relatively high administrative costs of these lawsuits are a deadweight loss that falls squarely on the shoulders of the American taxpayers.[111]

The "enormous size of settlement values" that result from the *in terrorem* nature of such suits also is well-known.[112] According to Cornerstone Research, the total value of securities class action settlements in 2009 was $3.83 billion—a 35-percent increase over the corresponding amount in 2008.[113] The ten largest securities class action settlements of all time have occurred in the past five years, and all ten have exceeded $1 billion.[114] Even more troublingly, NERA reports a significant growth trend in average settlement values over the past decade and a half,[115] with the average settlement reaching an all-time high of $109 million in 2010.[116] It is true that a company's insurance often covers the settlement and litigation costs. But shareholders of all public companies ultimately end up footing most of the bill because insurance premiums inevitably rise across the board to reflect the higher risk of liability. These spiraling expenditures in part explain why insurance costs for Fortune 500 companies are six times higher in the U.S. than they are in Europe.[117]

Securities class actions also destroy massive amounts of shareholder wealth. A

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[109] *See* Cornerstone Research, *Securities Class Action Filings: 2009: A Year in Review* 10 (2010).
[110] Coffee, *Reforming the Securities Class Action*, *supra* note 75, at 1540.
[111] *See id.*
[112] Comm. on Capital Mkts. Regulation, *supra* note 6, at 74.
[113] Laura E. Simmons & Ellen M. Ryan, Cornerstone Research, *Securities Class Action Settlements: 2009 Review and Analysis* 1 (2010), http://tinyurl.com/4h29v8h.
[114] The top ten ($MM) are: (1) Enron Corp. (2007): $7,242; (2) WorldCom, Inc. (2005): $6,158; (3) Cendant Corp. (2000): $3,561; (4) Tyco International, Ltd. (2007): $3,200; (5) AOL Time Warner Inc. (2006): $2,650; (6) Nortel Networks (I) (2006): $1,143; (7) Royal Ahold, NV (2006): $1,100; (8) Nortel Networks (II) (2006): $1,074; (9) McKesson HBOC Inc. (2008): $1,043; (10) American International Group, Inc. (2010): $1,010. *See* Milev et al., *supra* note 88, at 21.
[115] *Id.* at 17 (noting that average settlement amount increased more than two-and-a-half times between 1996-2001 and 2003-2010, from $16.6 million to $42.8 million).
[116] *Id.* at 17, 19. Excluding billion-dollar-plus settlements, the average settlement in 2010 was about the same as 2009's record total.
[117] Comm. on Capital Mkts. Reg., *supra* note 6, at 71.

study published in 2010 in the Financial Analysts Journal reported that securities class actions brought against companies "are highly disruptive," and on average have a negative effect on the share price of the target company even over the long-run.[118] Another 2010 study by scholars from Cincinnati, Duke, and Vanderbilt law schools reported that "[a]lthough uncertainty persists about the precise connection between settlements and financial distress, there is no uncertainty that firms involved in securities class action litigation experience statistically greater risks of financial distress than their cohort firms."[119] This study also noted that "the burdens of ongoing embroilment in securities class action contribute to the firm experiencing value-decreasing pressures."[120] The only systematic effort to quantify these costs—a study of almost 500 post-PSLRA suits between 1995 and 2005—found that "at least $24.7 billion in shareholder wealth was wiped out just due to litigation."[121]

Based on this evidence, other countries have a legitimate basis for concluding that the costs of implementing a U.S.-style private securities litigation model—including "opt out" class actions, extensive pre-trial discovery, contingency fees, rejection of loser pays, and fraud-on-the-market presumed reliance—outweigh any potential benefits. The U.S. should not override those considered decisions by imposing its private cause of action for securities fraud on the rest of the world.

**4. Public enforcement is more effective than private securities litigation.** The evidence shows that public enforcement is more effective than private litigation at deterring securities fraud and that it also more effectively compensates defrauded investors. As Professor Coffee has observed, the most recent empirical evidence shows that "'public enforcement [of the securities laws] typically dominates private enforcement.'"[122] He was referring in particular to a comprehensive study by Professor Jackson and Professor Mark Roe of Harvard Law School, who found that "[r]esource-based public enforcement is regularly associated

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[118] *See* Rob Bauer & Robin Braun, *Misdeeds Matter: Long-Term Stock Price Performance after the Filing of Class-Action Lawsuits*, 66 Fin. Analysts J. 74, 83, 91 (2010) (noting exceptions for suits alleging a breach of the duty of loyalty by insiders and suits based on allegations of accounting fraud).

[119] Lynn Bai, James D. Cox, & Randall S. Thomas, *Lying and Getting Caught: An Empirical Study of the Effect of Securities Class Action Settlements on Target Firms*, 158 U. Pa. L. Rev. 1877, 1913 (2010).

[120] *Id.*

[121] Anjan V. Thakor, U.S. Chamber of Commerce Institute for Legal Reform, *The Unintended Consequences of Securities Litigation* 14 (2005), http://tinyurl.com/ydxk4lz.

[122] Coffee, *Law and the Market*, *supra* note 19, at 302 (quoting Howell E. Jackson & Mark J. Roe, *Public Enforcement of Securities Laws: Preliminary Evidence* 37 (Aug. 8, 2007) (unpublished manuscript)).

with deeper securities markets,"[123] while liability in private lawsuits is often "negatively correlated with robust capital markets, at times significantly."[124] Indeed, their results show that "[a]llocating more resources to public enforcement"—as has been the trend in the United States in recent years—"is positively associated with robust capital markets, as measured by market capitalization, trading volume, the number of domestic firms, and the number of initial public offerings."[125]

This discrepancy between the effectiveness of public and private enforcement appears to hold true for the United States, and has a number of plausible explanations. In terms of deterrence, because the SEC and DOJ need not establish reliance, causation, or damage in order to discipline violators,[126] their actions are a much more precise and far-reaching tool for the punishment and prevention of misconduct than private claims. And because these public agencies are staffed by experts and charged with a public purpose, they are much more likely than private litigants to enforce the securities laws effectively, fairly, and responsibly. Similarly, the possibility of massive individual penalties, career-ending sanctions, and even jail time is a far greater deterrent to wrongful conduct than private enforcement through securities class actions. As discussed above, such suits "often do not penalize the relevant actors, can distort incentives, and can be inefficacious";[127] and they also virtually always settle for reasons unrelated to the merits and without any determination regarding the wrongfulness of the defendant's conduct.[128]

Moreover, there is no evidence whatsoever that private actions "uncover" frauds that government enforcement authorities would not find on their own. We have studied securities fraud class actions filed in 2009 and 2010 to investigate whether the plaintiffs based their claims on evidence of fraud that they (or their attorneys) discovered on their own.[129] We found that an extremely high percentage of initial complaints—almost 95 percent—were triggered by, and predominantly if not entirely based on, information that was already in the public domain at the time of suit—such as the announcement of a government investigation, an earnings

[123] Jackson & Roe, *supra* note 44, at 28.
[124] *Id.* at 31.
[125] *Id.* at 2.
[126] *See* Langevoort, *Without Wheels*, *supra* note 75, at 652.
[127] Jackson & Roe, *supra* note 44, at 2.
[128] Coffee, *Reforming the Securities Class Action*, *supra* note 75, at 1534.
[129] A copy of our results is attached as an appendix to this letter for your reference.

restatement, or the target company's own disclosure of other "bad news." This information is equally available to public enforcement authorities, which can (and do) take action if warranted. Indeed, in approximately one quarter of the suits, the private complaint referenced an already ongoing or completed government investigation.

*C. The U.S. has no legitimate national interest in creating this new private cause of action*

Even if the Commission were to conclude, contrary to this submission, that the different policy determinations of other countries on the merits of U.S.-style securities class actions are wholly unsupportable, those determinations remain entitled to substantial deference as those of sovereign nations. Accordingly, before recommending extraterritorial expansion of the U.S. private cause of action for securities fraud, the Commission would have to identify a legitimate interest of the United States that is sufficiently weighty to justify that extraordinary step. There is no such interest.

*First*, a private cause of action is not required to prevent the United States from "becom[ing] a 'Barbary Coast' . . . harboring international securities 'pirates.'"[130] As the Supreme Court observed in *Morrison*, there is no evidence that any such speculative danger has come to pass.[131] And if there are instances in which fraudsters use the U.S. as a platform to export their schemes overseas, U.S. regulators—acting in conjunction with their foreign counterparts—are well-positioned to direct their attention and resources to combat the problem.

*Second*, the United States has no interest in creating a compensatory remedy for the citizens of the foreign country in which the securities transaction occurred, or for other non-Americans who purchased or sold securities in that country. That is a policy question reserved for the home countries of those investors.

*Third*, the United States' interest in creating a remedy for any U.S. investors who purchase or sell securities in foreign countries is weak or nonexistent. In

[130] *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir. 1977); *see also ITT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975) (United States should not be "used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners").
[131] 130 S. Ct. at 2886.

addition to the legitimate doubts about the compensatory and deterrent value of securities class actions discussed above, it also is the case that those U.S. investors that trade directly in foreign securities are almost exclusively highly sophisticated market participants—generally institutions or wealthy individuals.[132]

Even if they are not familiar with the *Morrison* decision specifically, such sophisticated investors can be expected to operate under a baseline assumption that U.S. law does not apply to their trading activities in foreign markets.[133] "If an investor travels to Japan to purchase securities on the Tokyo Stock Exchange, the typical investor will expect that Japanese law applies to the transaction (much like Japanese law applies to other actions the investor may take in Japan, such as driving above the speed limit)."[134] As the Commission itself has recognized in excluding offshore offers and sales from the registration requirements under section 5 of the Securities Act, it stands to reason that "as investors choose their markets," so "they choose the laws and regulations applicable in such markets."[135] The *Morrison* rule also has the added benefit of preventing sophisticated litigation arbitrageurs from gaming the system by "purchas[ing] securities under one regime and then tak[ing] advantage of the more rigorous enforcement regime in the United States by obtaining compensation in private litigation."[136]

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[132] Warren Bailey et al., *Foreign Investments of U.S. Individual Investors: Causes and Consequences* 4 (working paper Apr. 2007) (version published in Management Science 54 (2008)), http://tinyurl.com/464txef ("[w]ealthier or more experienced investors, who are likely to enjoy an informational advantage, are more likely to use [foreign] securities"); *see also* Howell E. Jackson, *A System of Selective Substitute Compliance*, 48 Harv. Int'l L.J. 105, 108 (2007) (noting that "[i]ncreasingly, . . . major institutional investors have established offices overseas in key financial centers, like London and Tokyo, and prefer to trade their foreign securities in the home market of issuers, where there is likely to be greater liquidity and market depth"); Alan Ahearne et al., *Information Costs and Home Bias: An Analysis of U.S. Holdings of Foreign Equities*, Fed. Reserve Board, Int'l Fin. Discussion Paper No. 691, at 11 (May 2001), http://tinyurl.com/6b4kjee (observing that CalPERS and the New York State Common Retirement Fund both target a greater than 25 percent weighting of non-U.S. stocks in their equity portfolios).

[133] *See* Choi & Silberman, *supra* note 54, at 500; *see also* Buxbaum, *supra* note 62, at 56 n.170 ("It is . . . difficult to imagine that investors would expect U.S. regulatory law to follow them in their foreign trading, especially given the level of sophistication of investors involved in cross-border investment.").

[134] Choi & Silberman, *supra* note 54, at 500. Likewise, "foreign citizens have little reason to expect the protection of U.S. law, as opposed to the law of the site of the harmful effects." Donald C. Langevoort, *Schoenbaum Revisited: Limiting the Scope of Antifraud Protection in an Internationalized Securities Marketplace*, 55 Law & Contemporary Problems 241, 257 (1992).

[135] Offshore Offers and Sales, Securities Act Release No. 6863, Exchange Act Release No. 27,942, 55 Fed. Reg. 18,306, 18,308 (May 2, 1990).

[136] Buxbaum, *supra* note 62, at 69.

Significantly, the main intended beneficiaries of the U.S. securities class action system—less-diversified, relatively unsophisticated U.S. retail investors—are highly unlikely to invest directly in foreign markets (although they may invest with sophisticated institutions that invest in such markets on their behalf).[137] To begin with, most retail investors never even become aware of opportunities to invest overseas. SEC regulations establish significant hurdles to the marketing of foreign securities in the United States,[138] and for this and other reasons the "deadweight costs to learning about [foreign] securities deter investors below a certain level of wealth."[139] Moreover, although institutional investors have many ways to engage in foreign transactions, including through their overseas branches and offices, fewer such avenues are available to retail investors.[140] Thus, even if a relatively unsophisticated retail investor finds out about a foreign investment opportunity, that investor is unlikely to be able to execute the trade. Accordingly, small retail investors are "probably far less likely to over-invest in a foreign company than a domestic one."[141]

In implementing the Securities Act's registration requirements, the SEC has observed that "the reasonable expectations of participants in the global markets justify reliance on laws applicable in jurisdictions outside the United States to define requirements for transactions effected offshore."[142] Precisely the same rationale justifies leaving the *Morrison* rule in place.

## III. Extraterritorial Expansion of Private Liability Will Disrupt Relationships with Other Countries and Their Regulators

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[137] *See* V. Kyrychenko & P. Shum, *Who holds foreign stocks and bonds? Characteristics of active investors in foreign securities*, 18 Fin. Services Review 1, 6-8 (2009) (finding that the vast majority of stockholders—88 percent over the five-year period under study—directly held no non-U.S. equities at all, and that sophisticated investors—those defined as having a college-level education or higher, and investments in 20 to 50 individual stocks—were significantly more likely to hold such equities than other investors).

[138] S. Eric Wang, *Investing Abroad: Regulation S and U.S. Retail Investment in Foreign Securities*, 10 U. Miami Bus. L. Rev. 329 (2002).

[139] Bailey et al., *supra* note 132, at 54.

[140] Howell E. Jackson et al., *Foreign Trading Screens in the United States,* 1 Cap. Markets L.J. 54, 71 (2006); *see also* Jane J. Kim, *Fidelity Pumps Up Foreign Trading*, Wall St. J., Oct. 22, 2009 (reporting that retail brokerages that allow customers to trade foreign stocks directly generally offer the opportunity only to those who invest large amounts and engage in heavy trading).

[141] Langevoort, *Global Competition, supra* note 105, at 199.

[142] 55 Fed. Reg. at 18,308.

Over the last three decades, the evolution of cooperative relationships between international securities regulatory authorities "has led to clearer, more comprehensive regulation" of securities markets.[143] The Commission and other U.S. enforcement authorities in particular rely heavily on the assistance of foreign regulators in investigating and prosecuting fraud. In 2010, for example, the Commission made 605 requests to foreign authorities for information, and responded to 457 information requests from such authorities.[144] If the United States authorizes private securities fraud suits in connection with overseas transactions, and thus imposes its policy choices on the rest of the world, it will alienate other nations and significantly diminish such cooperation.

The Commission and other regulators routinely share information and evidence, help each other in document production and procuring witness testimony, and engage in joint enforcement efforts.[145] To facilitate these types of cooperation, the Commission has joined 71 other regulatory authorities (as of January 2011) in signing the International Organization of Securities Commissions ("IOSCO") Multilateral Memorandum of Understanding ("MMOU").[146] This MMOU "has significantly enhanced [the Commission's] enforcement program by increasing [its] ability to obtain bank, brokerage, and beneficial ownership information from a growing number of jurisdictions," and "has created incentives for jurisdictions that lack the legal ability to engage in effective information-sharing to enact legislation that will enable them to do so."[147] The Commission also has signed bilateral enforcement cooperation memoranda with 20 foreign regulatory authorities to facilitate assistance beyond that required under the IOSCO MMOU,[148] such as compelling testimony and gathering "Internet service provider, phone and records other than bank, broker, and beneficial owner information on behalf of the requesting authority."[149] And the

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[143] Michael D. Mann et al., *Developments in the Internationalization of Securities Enforcement*, 1743 PLI/Corp. 789, 793 (2009).

[144] SEC, *2010 Performance Report*, *supra* note 12, at 53.

[145] Mann, *supra* note 143, at 793-95; *see also SEC Speaks in 2010*, 1784 PLI/Corp. 519, 541-42 (2010) (hereinafter "*SEC Speaks*").

[146] *See* IOSCO, List of Signatories to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, http://tinyurl.com/4lx8x3c (last visited Feb. 17, 2011).

[147] *SEC Speaks*, *supra* note 145, at 541.

[148] *See* Office of International Affairs: Cooperative Arrangements with Foreign Regulators, http://tinyurl.com/4kekwak (last visited Feb. 17, 2011).

[149] *SEC Speaks*, *supra* note 145, at 541.

United States has entered into Mutual Legal Assistance Treaties that provide for cooperation in criminal securities fraud matters with a large number of countries.[150]

Extraterritorial application of the U.S. private liability model would threaten this critical cooperation. Other countries will come to resent the United States for acting in the role of global policeman. "[T]here is no reason to assume that such sophisticated markets as those of the United Kingdom, Japan, and Germany are unable to regulate themselves as they see fit, and indeed there is no indication that any other nation has requested that the United States prosecute fraudulent activity in lieu of exercising its own jurisdiction over the alleged defendants."[151] And as Professor Coffee has noted, "the United States' foreign neighbors must fear that a global class action in a U.S. court may threaten the solvency of even their largest companies and could have an adverse impact on the interests of local constituencies, including labor, creditors and local communities."[152] In that event, "other countries may not view the United States as a 'good neighbor.'"[153] Indeed, foreign countries repeatedly have voiced their strong objections to the United States' recognition of private liability for securities fraud in connection with transactions on their markets.[154]

The concern is particularly acute because, as the United States noted in the amicus brief it filed in *Morrison*, the U.S. government lacks the power to control the circumstances in which a private remedy is invoked. For example, a lawsuit can be filed by private parties in circumstances that the government deems inappropriate or unjustified (because, for example, the law of the foreign nation provides a sufficient

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[150] Mann, *supra* note 143, at 794.

[151] John D. Kelly, *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, 495 (1997).

[152] John C. Coffee, Jr., *Foreign Issuers Fear Global Class Actions,* Nat'l L. J., June 14, 2007 (hereinafter "*Global Class Actions*").

[153] John C. Coffee, Jr., *Securities Policeman to the World?: The Cost of Global Class Actions*, N.Y.L.J., Sept. 18, 2008 (hereinafter "*Securities Policeman*").

[154] *See, e.g.,* Brief of the Government of the Commonwealth of Australia as Amicus Curiae in Support of the Defendants-Appellees, at 22-23, *Morrison*, 130 S. Ct. 2869, 2010 WL 723006; Brief for the Republic of France as Amicus Curiae in Support of Respondents at 14, 2010 WL 723010, *Morrison*, 130 S. Ct. 2869; Brief of the United Kingdom of Great Britain and Northern Ireland as Amicus Curiae in Support of Respondents at 15-16, 19, *Morrison*, 130 S. Ct. 2869, 2010 WL 723009; Brief of the International Chamber of Commerce, The Swiss Bankers Association, Economiesuisse, The Federation of German Industries and The French Business Confederation as Amici Curiae in Support of Respondents, app. A (Swiss Diplomatic Note No. 17/2010), *Morrison*, 130 S. Ct. 2869, 2010 WL 719334.

remedy). "As a federal law-enforcement agency, the SEC can be expected to take account of national interests when it determines whether particular enforcement suits represent sound uses of its resources and the resources of the federal courts. The overarching concern of individual plaintiffs, in contrast, is redressing their own injuries," and "such plaintiffs have little incentive to consider whether resolution of their securities-related grievances represents a wise use of federal judicial resources."[155]

A recent case, *In re Vivendi Universal, S.A. Securities Litigation*, affords a vivid demonstration of the threat to U.S. relations with other countries—including our key allies. In that case, a class of foreign and U.S. investors in Vivendi stock, 75 percent of whom purchased their shares overseas,[156] sued the company based on its alleged dissemination of fraudulent statements and financial data.[157] In 2009, a jury found the company liable for damages that, according to plaintiffs' counsel, could exceed $9 billion (if the verdict withstands challenge under *Morrison*).[158] A legal regime that permits U.S. courts to impose such a staggering judgment on a flagship foreign company based on conduct primarily in connection with foreign securities transactions—and through a procedural mechanism (the "opt out" class action) that the vast majority of nations have squarely rejected—is bound to engender serious international conflict.

Moreover, the risk of further *Vivendi*-type judgments was steadily increasing in the run-up to *Morrison*, and likely would continue to increase were that decision overturned. Between 1996 and 2010, suits against foreign issuers increased dramatically as a percentage of total securities class actions, from 6 percent to 15.9 percent (according to Cornerstone).[159] And PriceWaterhouseCoopers LLP ("PWC") reports that the number of suits in which a foreign issuer was a defendant reached a high of 36 cases in 2008, well above the annual average of 20 such suits over the last ten years.[160] Although these statistics encompass all suits against foreign issuers,

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[155] Brief for the United States as Amicus Curiae, at 28, *Morrison*, 130 S. Ct. 2869, 2010 WL 719337.
[156] *See In re Vivendi Universal, SA Sec. Litig.*, 242 F.R.D. 76, 81 (S.D.N.Y. 2007).
[157] *See In re Vivendi Universal, S.A. Sec. Litig.*, 381 F. Supp. 2d 158 (S.D.N.Y. 2003); *see also In re Vivendi Universal, S.A. Sec. Litig.*, No. 02 Civ. 5571, 2004 WL 2375830 (S.D.N.Y. Oct. 22, 2004).
[158] *See Court Finds Vivendi Liable for Misleading Investors*, N.Y. Times, Jan. 29, 2010.
[159] Cornerstone Research, *Securities Class Action Filings: 2010 Year in Review* 13 (Jan. 20, 2011), http://tinyurl.com/4a293hb.
[160] *See* PwC, *2009 Securities Litigation Study* 34-35 (Apr. 2010), http://tinyurl.com/yaznmhs (hereinafter "*2009 Study*").

including those based on U.S. securities transactions, a 2007 study conducted by Professor Hannah Buxbaum of Indiana University Law School confirmed that the rate at which multinational class actions based on foreign transactions were being filed in U.S. court was increasing.[161] Foreign issuers also have paid substantial settlements, amounting to an average of $88.4 million per settlement over the past decade.[162] Indeed, foreign issuers have paid some of the largest U.S. class action settlements since the enactment of SOX.[163]

Among the consequences of the resulting ill will might well be unwillingness on the part of foreign regulators to share information or cooperate in evidence gathering and enforcement efforts. Indeed, other nations have in other contexts enacted retaliatory measures in response to U.S. efforts to enforce its laws extraterritorially. For example, "[m]any countries have objected to the extraterritorial application of U.S. antitrust (and other) laws, and several of these have enacted legislation"—including blocking and claw-back statutes—"designed to blunt the effect of these laws as applied to their own citizens or residents, including the following: Australia, Canada, France, South Africa, and the United Kingdom."[164] And reacting to the perceived excesses of the U.S. discovery model, a number of European countries have enacted blocking legislation that forbids their nationals from cooperating with American discovery requests or orders.[165] These laws increasingly are being enforced vigorously: a recent decision of the French Cour de Cassation—the French Supreme Court of Judicature—upheld a criminal fine imposed on a French lawyer who violated the French blocking statute when he tried to obtain information from a witness in France in connection with a litigation in California.[166] Foreign governments could implement similar measures that hamper regulatory cooperation in pursuing transnational securities fraud—perhaps out of a concern that information shared with U.S. regulators would eventually make its way to private litigants for use in litigation.

[161] Buxbaum, *supra* note 62, at 41.
[162] *Id.*
[163] *See* Milev et al., *supra* note 88, at 21.
[164] Derek Devgun, *Crossborder Joint Ventures: A Survey of International Antitrust Considerations*, 21 Wm. Mitchell L. Rev. 681, 702 (1996).
[165] *See* Restatement (Third) of Foreign Relations Law of the U.S., § 442, reporters' notes 1, 4; *see also Société Nationale Industrielle Aérospatiale v. U.S. Dist. Court*, 482 U.S. 522, 526 & n.6 (1987) (discussing French blocking statute).
[166] *See In re Avocat "Christopher X,"* Cass. Crim. (Dec. 12, 2007, Pourvoi no. 07-83.228, Bulletin Criminel 2007, no. 309).

The resentments generated by a return to the pre-*Morrison* standard might also lead foreign countries to assert a right to enforce their own securities laws extraterritorially. "Until the United States is ready to contemplate a system in which even the claims of U.S. investors, based on U.S. trading, are subject to the laws of another country, it is inappropriate to solve the problem of multiple proceedings by suggesting that they all take place in U.S. courts."[167] Foreign nations could also retaliate in other issue areas by "seeking to regulate activities of U.S. parties that impact their countries."[168]

In the past, the Commission has evinced an acute awareness of the dangers of intruding on foreign nations' enforcement jurisdiction. For example, the SEC did not seek penalties in its own enforcement action against the Dutch company Ahold, acceding to the request of Dutch authorities conducting a parallel investigation. The Commission recognized that "the need for continued cooperation between the SEC and regulatory authorities in other countries" counseled in favor of forbearance.[169] Similar considerations should lead the Commission to recommend restraint when it comes to the extraterritorial application of the U.S. private liability regime as well.

## IV. Extraterritorial Expansion of Private Liability Would Discourage Foreign Direct Investment and Foreign Listing on U.S. Capital Markets

### A. Foreign investment

Legislation overturning *Morrison* likely would drive away many foreign issuers considering engaging in foreign direct investment or other business activities in the United States. Securities class actions "disruptively expos[e] foreign corporations to a litigation environment in which plaintiffs arguably have undue leverage,"[170] and few foreign corporations have experience with such litigation from their home markets. *Morrison* establishes a clear line for such foreign issuers: if they wish to avoid the risk of a U.S. securities class action altogether, all they need do is avoid listing in the U.S. market. The "certainty" and "predictability" of this rule allows foreign issuers

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[167] Buxbaum, *supra* note 62, at 61.

[168] Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. Cal. L. Rev. 903, 914 (1998).

[169] *SEC Charges Royal Ahold and Three Former Top Executives with Fraud*, Accounting & Auditing Enforcement Release No. 2124, Litigation Release No. 18,929, 83 SEC Docket 2976 (Oct. 13, 2004), http://tinyurl.com/5t7nh43.

[170] Coffee, *Global Class Actions*, *supra* note 152.

considering an investment in the U.S.—or a joint venture with a U.S. company—to focus on economic considerations (rather than securities litigation concerns) in making their investment decisions.[171]

By contrast, a liability standard that resembled the pre-*Morrison* "conduct and effects" test would force a potential foreign investor to factor into its business calculus the risk that its U.S. conduct would expose it to uncertain and potentially catastrophic securities class action liability for its worldwide operations. The exposure might well be out of all proportion with the expected gain from the investment or venture. Indeed, because of the complexity, unpredictability, and likely inconsistent application of any conduct-based standard, the litigation risk would be even harder to quantify than that faced by domestic issuers.[172]

If Congress authorizes extraterritorial liability, the *Vivendi* case discussed above—resulting in a jury verdict that could amount to $9 billion—would provide a chilling example to foreign companies of the possible consequences of doing business here. More systematically, a number of studies conducted pre-*Morrison* found evidence that the U.S. litigation environment was having the predictable effect of depressing foreign willingness to invest in the United States.

For example, in a 2008 report, the U.S. Department of Commerce observed that "concerns with excessive litigation and navigating what is seen as an expensive U.S. legal system are among a small number of issues that are front and center whenever the U.S. climate for FDI is discussed," and "are among the more important concerns to those interested in investing in the United States."[173] Similarly, a study conducted by Eurochambers and the U.S. Chamber of Commerce in 2005 found that European companies doing business in the United States ranked "fear of legal action" among their top concerns.[174] And a survey prepared in 2008 for the Organization for International Investment found that class action lawsuits were ***the top concern*** about

[171] Choi & Silberman, *supra* note 54, at 502.
[172] *Morrison*, 130 S. Ct. at 2878, 2879 (observing that pre-*Morrison* tests were tests were "complex in formulation," "unpredictable [and inconsistent] in application," and "not easy to administer").
[173] *See* U.S. Dep't of Commerce, *The U.S. Litigation Environment and Foreign Direct Investment: Supporting U.S. Competitiveness by Reducing Legal Costs and Uncertainty* 2-5 (Oct. 2008) (hereinafter "*U.S. Litigation and FDI*"), http://tinyurl.com/yzbznt9.
[174] Eurochambres & U.S. Chamber of Commerce, *Obstacles to Transatlantic Trade and Investment* 10-12 (2005), http://tinyurl.com/4p69hp2.

the U.S. legal system expressed by high-level executives of major U.S. subsidiaries of foreign companies, and especially CEOs of large companies.[175] Finally, a study released in early 2007 by Senator Charles E. Schumer and Mayor Michael R. Bloomberg identified, based on surveys and interviews of global corporate executives and business leaders, "the increasing extraterritorial reach of US law" and "the unpredictable nature of the legal system" as "significant factors that caused" U.S. financial markets to lag in competiveness.[176] The study also reported an increasing perception that the U.S. legal system was the "predominant problem" affecting the U.S. "business environment," and that "rather than being just an incremental cost of doing business, the mere threat of legal action can seriously—and sometimes irrevocably—damage a company."[177] The Supreme Court also has noted, in considering a different aspect of the Rule 10b-5 private cause of action, the sensitivity of foreign companies considering business ventures in the United States to the costs imposed by U.S. securities class action litigation.[178]

As the Supreme Court observed in *Morrison*, "some fear that [the U.S.] has become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets."[179] According to Professor Buxbaum, this is in part a result of "efforts of the U.S. plaintiffs' bar to cultivate foreign investors."[180] For example, prominent U.S. plaintiffs' firms have opened offices in Europe and formed alliances with foreign firms to better serve European institutional investors interested in pursuing U.S. securities litigation.[181] There is every reason to believe that legislation overturning *Morrison* would lead to a resumption of these trends—and ever more frequent targeting of foreign companies by class action plaintiffs. Further penetration by U.S. trial lawyers into European and other markets would have the additional undesirable consequence of spreading to the rest of the

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[175] Neil Newhouse Public Opinion Strategies, *The Insourcing Survey: A CEO-Level Survey of U.S. Subsidiaries of Foreign Companies*, survey conducted for the Organization for International Investment (2008), http://tinyurl.com/4p3dnd7.

[176] Michael R. Bloomberg & Charles E. Schumer, *Sustaining New York's and the US' Global Financial Services Leadership* 73 (Dec. 2006), http://tinyurl.com/yf3uu6o.

[177] *Id.* at 75-76.

[178] *See Stoneridge,* 552 U.S. at 164 (noting that adoption of scheme liability theory could deter "[o]verseas firms with no other exposure to our securities laws" than contracting with U.S. companies "from doing business [in the United States]").

[179] *Morrison*, 130 S. Ct. at 2886.

[180] Buxbaum, *supra* note 62, at 62.

[181] *See id.*

world the culture of abuse—including the payment of kickbacks to repeat plaintiffs and the rise of a pay-to-play culture of corruption—that is increasingly pervading the U.S. securities class action system.[182]

Expanded private liability for securities fraud would of course be bad for foreign issuers (and their shareholders), incentivizing them to make suboptimal economic decisions by avoiding the U.S. market. More significantly, however, such an expansion also would harm U.S. businesses and consumers by depriving the economy of the substantial benefits that foreign investment brings—including increased economic activity, job growth, and higher wages. "Foreign direct investment plays a major role as a key driver of the U.S. economy and as an important source of innovation, exports, and jobs."[183] Moreover, more than 30 percent of jobs created directly through FDI are in manufacturing, and jobs at foreign-owned firms tend to be better paid than the U.S. private sector average.[184]

The conduct that subjected Vivendi to liability to foreign purchasers was its purchase of a U.S. company, its business contacts with the U.S. market, and the relocation of company officials to the United States.[185] Likewise, in *In re Alstom*, in deeming the conduct test satisfied, the SDNY highlighted Alstom's entry into a joint venture with a U.S. company, its sale of gas turbines in the United States, and its production of railway cars in the United States.[186] This country should be doing everything it can to attract, not drive away, this kind of substantial foreign investment in our media, manufacturing, and other leading sectors.

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[182] *See* Second Superseding Indictment, *United States v. Milberg Weiss LLP*, CR 05-587 (D)-JFW, ¶¶ 24, 27, 37 (C.D. Cal.) (Oct. 2006 Grand Jury), http://tinyurl.com/4vrrcpq (criminal prosecution of the former Milberg Weiss law firm, a number of its partners, and others for paying kickbacks to repeat plaintiffs); *see also* Peter Lattman, *Mr. Lerach Mulls Life Behind Bars, Guilty but Defiant, The Plaintiffs' Lawyer Kicks Back in La Jolla*, Wall St. J., Feb. 12, 2008 (payments by Millberg Weiss attorneys were "industry practice"); Edward R. Becker et al., *The Private Securities Law Reform Act: Is It Working?*, 71 Fordham L. Rev. 2363, 2369 (2003) (describing "pay to play" as follows: "[P]ublic pension funds are in many cases controlled by politicians, and politicians get campaign contributions. The question arises then as to whether the lead plaintiff, a huge public pension fund, will select lead counsel on the basis of political contributions made by law firms to the public officers who control the pension funds and who, therefore, have a lot of say in selecting who counsel is"); John C. Coffee, Jr., *'Pay-to-Play' Reform: What, How and Why?*, N.Y.L.J., May 21, 2009 (labeling pay-to-play "a necessary consequence of the PSLRA, which has left securities litigation highly profitable . . . but made public pension funds the principal distributor of this largess").

[183] U.S. Litigation and FDI, *supra* note 173, at 2.

[184] *See id.* at 2-3.

[185] *See supra* page 24.

[186] *See In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 346, 392-93 (S.D.N.Y. 2005).

It is now almost universally acknowledged that the United States must become more attractive to foreign investment if its economy is to thrive in increasingly competitive global markets. And even after the *Morrison* decision, a set of largely unrelated developments—for example, financial globalization and the rising quality and sophistication of rival financial centers—pose serious challenges to the relative standing of this country in the eyes of potential foreign investors and business partners. The U.S. economy continues to offer attractive investment opportunities, but the indications are unmistakable that the nation faces greatly increased competition as a premier investment destination. The United States' share of global FDI has fallen since the 1980s, and the trend has continued in recent years as the growth rate of investment into the country persistently has lagged behind that of many other economies.[187] Recent phenomena, such as the subprime meltdown and the global credit crunch, have exacerbated the problem by diminishing global financial assets and cross-border capital flows,[188] including a "plunge of flows between European countries and the United States."[189]

Of course, some of these challenges are unavoidable. But precisely for that reason, "[g]etting the regulatory balance right is . . . increasingly crucial."[190] And in areas where the country can exercise some control—such as in determining the extraterritorial application of its private securities liability system—the United States can ill-afford to take steps with potentially dramatic adverse consequences, at least absent a compelling policy justification. As described above, there is no such justification for a return to the pre-*Morrison* world.

Giving further reason for caution is that some of the markets that compete most fiercely with the United States for foreign investment dollars have a much more favorable litigation environment. For example, 63 percent of senior executives polled in connection with the Schumer-Bloomberg study expressed the view that the UK had a less litigious culture than the United States, while only 17 percent felt the

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[187] *See* U.S. Litigation and FDI, supra note 173, at 2-3; *Funding for Invest in America to Attract Investment, Create Jobs and Stimulate Growth Industries: Hearing Before the Subcomm. on Economic Policy of the S. Comm. On Banking, Housing, and Urban Affairs* 2-3 (submitted Dec. 18, 2009) (supplemental report to testimony of Rick L. Weddle), http://tinyurl.com/4lberlm.

[188] *See* McKinsey Global Institute, *Global Capital Markets: Entering a New Era* 8-9, 13-15 (Sept. 2009), http://tinyurl.com/4gbtym5 (describing decline in global financial assets and foreign direct investment).

[189] *Id.* at 15.

[190] Langevoort, *Global Competition*, *supra* note 105, at 196.

reverse.[191] And the Supreme People's Court of China does not even permit private actions based on claims of insider trading or market manipulation.[192] China also has "ruled out class action suits . . . as an acceptable form of action for civil compensation cases arising from securities-related false statements."[193] Of course, the United States does not need to—and should not—simply mimic the regulatory regimes of its main economic competitors; this country's regulatory environment is part of its comparative advantage in global markets. At the same time, the Commission and Congress should take account of the extent to which the burdens that the U.S. litigation system imposes on foreign investors are unique. And they should decline to expand that system in a way that cannot be justified persuasively and that will make the U.S. market a less desirable place in which to invest and do business.

### B. Discouragement of non-U.S. issuers

We also urge the Commission to consider the distinct threat that legislation overturning *Morrison* would discourage foreign issuers from listing on U.S. capital markets. Of course, under the *Morrison* test, foreign issuers that list in the United States are subject to suit for fraud in connection with transactions in their U.S. securities.[194] But the bright line established by *Morrison* means that even if foreign companies do choose to list in this country, they can calibrate their litigation exposure by regulating the amount of their securities traded on our markets.[195] Reinstatement of a "conduct" test for foreign transactions, by contrast, would subject companies with U.S.-listed securities—even if such securities are only a small share of their total outstanding—to private suit brought by investors who bought or sold their securities on overseas markets. The prospect of this expanded liability might well deter foreign issuers from listing in the United States in the first place (or drive those companies that are listed here at present to delist).

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[191] Bloomberg & Schumer, *supra* note 176, at 75.
[192] *See* Sanzhu Zhu, *Civil Litigation Arising From False Statements on China's Securities Market*, 31 N.C.J. Int'l L. & Com. Reg. 377, 381 (2005).
[193] *Id.* at 400.
[194] *See Morrison*, 130 S. Ct. at 2888 ("Section 10(b) reaches the use of a manipulative or 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.").
[195] *See* Choi & Silberman, *supra* note 54, at 501.

The creation of further disincentives to foreign listing would be disastrous to the health of U.S. capital markets. Recent trends have been dramatic. A 2007 study found that U.S. IPOs accounted for only 6 percent of the global total in 2005, down from 48 percent in the 1990s.[196] The Committee on Capital Markets Regulation, under the direction of Professor Hal Scott of Harvard Law School, reached a similar conclusion in its 2006 Interim Report on the competitiveness of U.S. capital markets, finding in particular that the decline in the country's share of global IPOs had been especially steep between 2000 and 2005.[197]

Moreover, this worrying downward decline has persisted—and perhaps even accelerated since these studies were conducted. PwC reports that between 2008 and 2009 the number of new private foreign issuers decreased 61 percent, with the dollar value of registered securities declining by $41 billion.[198] And an independent survey of 50 securities attorneys who advised on 75 percent of the IPOs listed on major U.S. exchanges in 2010 reported that 71 percent of those surveyed were of the view that the United States is continuing to lose its share of global IPOs.[199] Perhaps of greatest concern is that a large number of foreign companies have cut their ties with the U.S. capital markets since the Commission amended its rules in June 2007 to remove barriers to deregistration. By the end of 2008, 15 out of 27 French companies registered in the United States at the end of 2006 had deregistered, as had 19 of 44 U.K. companies, 7 of 20 German companies, 6 of 11 Italian companies, and 15 of 24 Australian companies.[200]

There is widespread agreement that fear of U.S. securities litigation is at least partially responsible for these developments.[201] As Professor Coffee has explained, "[f]or the foreign issuer who typically does not face any risk of a class action in its home jurisdiction, the U.S. litigation environment is a major disincentive and may best

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[196] Luigi Zingales, *Is the U.S. Capital Market Losing its Competitive Edge?*, ECGI Working Paper Series in Finance No. 192, at 2 (2007).
[197] Comm. on Capital Mkts. Reg., *supra* note 6, at 34.
[198] *See* PwC, *2009 Study*, *supra* note 160, at 43.
[199] Press Release, KCSA Strategic Commc'ns, *KCSA Strategic Communications Survey Finds Leading IPO Attorneys Unanimously Think China Will Be a Major Contributor to 2011 IPO* (Dec. 29, 2010), http://tinyurl.com/4jx6dyd.
[200] *See* SEC, International Registered and Reporting Companies (last visited Feb. 17 2011), http://tinyurl.com/4ko9267.
[201] Coffee, *Securities Policeman*, *supra* note 153.

explain the asserted declining competitiveness of the U.S. capital markets."[202] Numerous studies support this conclusion. According to the Committee on Capital Markets Regulation, "[f]oreign companies commonly cite the U.S. class action enforcement system as the most important reason why they do not want to list in the U.S. market."[203] The report concluded that "liability risks" were a major reason for the country's loss of its leading competitive position compared to foreign capital markets.[204] A survey conducted in 2007 by the Financial Services Forum, which polled 334 senior executives of companies based in the United States, the UK, Germany, France, India, China, and Japan, made similar findings. One out of three companies that considered going public in the United States rated litigation as an "extremely important factor in their decision," and "nine out of 10 companies who de-listed from a U.S. exchange" from 2003-2007 "said the litigation environment played some role in that decision."[205] Indeed, it is precisely companies from developed countries with "good governance standards"—*i.e.*, the companies that U.S. capital markets most need to attract—that are most likely to view listing on the U.S. market as not worth the potential litigation exposure.[206]

Under a liability standard akin to the "conduct and effects" test, foreign issuers considering raising capital in the United States would have to consider whether the benefits of doing so are worth the "prospect that, if its stock price falls suddenly, it will become potentially liable to a worldwide class of investors who could not otherwise feasibly sue it collectively."[207] Recent history suggests that such a risk would lead many foreign issuers to think twice about listing here.

## V. Lower Courts are Applying *Morrison* Properly

Lower courts have had little difficulty applying *Morrison*'s bright-line transactional test. Since the Supreme Court's ruling, district courts (mostly in the

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[202] *Id.*
[203] Comm. on Capital Mkts. Reg., *supra* note 6, at 11, 71.
[204] *Id.* at 10.
[205] Financial Services Forum, *2007 Global Capital Markets Survey* 6-8 (2007), http://tinyurl.com/4d3jaf8; *accord* Comm. on Cap. Mkts. Reg., *Committee on Capital Markets Regulation Completes Survey Regarding the Use By Foreign Issuers of the Private Rule 144A Equity Market* 3 (Feb. 2009), http://tinyurl.com/6grob2z.
[206] *Cf.* Zingales, *supra* note 196, at 12-14 (noting that "changes in the U.S. regulatory environment post SOX decreased the benefit of a U.S. cross-listing, particularly for countries that have good governance standards").
[207] Coffee, *Global Class Actions*, *supra* note 152.

SDNY) have applied the decision to dismiss private claims under the Securities Act,[208] as well as a number of private claims brought under the Exchange Act alleging fraud in connection with foreign securities transactions. The conclusion that the Securities Act does not apply extraterritorially to offers and sales outside the United States is faithful to *Morrison*'s reasoning,[209] and should present no problem for the Commission.[210] Nor do any of the lower courts' applications of *Morrison* to dismiss claims under the Exchange Act provide a reason for concern—or legislative intervention. These cases can be broken down into five basic categories.

***First***, courts uniformly have dismissed so-called "foreign-cubed" claims of the type at issue in *Morrison*, even those that—like the claims in *Morrison*[211]—involved allegations of conduct in the United States.[212] The *Morrison* Court noted that "it is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States," and made clear that the mere presence of "*some* domestic activity" does not necessarily render section 10(b) applicable.[213]

By contrast, courts have allowed more factual development where the domestic activity suggests the possibility that the transaction may actually have occurred in the United States. In *Anwar v. Fairfield Greenwich Limited*, for example, the SDNY deferred decision on whether *Morrison* barred claims based on the purchase of shares in certain foreign funds that fed investments into the Bernie Madoff ponzi scheme.[214] Plaintiffs

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[208] *See In re Royal Bank of Scotland Group PLC Sec. Litig.*, No. 09 Civ. 300, 2011 WL 167749 (S.D.N.Y. Jan. 11, 2011).

[209] *See Morrison*, 130 S. Ct. at 2885 (noting that "same focus on domestic transactions is evident in the Securities Act of 1933").

[210] *See* 17 CFR § 230.901; *see also Morrison*, 130 S. Ct. at 2885.

[211] The plaintiffs in *Morrison* alleged that the defendants had engaged in deceptive conduct, and made misleading public statements, in the U.S. *See Morrison*, 130 S. Ct. at 2883-84.

[212] *See, e.g., Terra Sec. Asa Konkursbo v. Citigroup. Inc.*, No. 09 Civ. 7058, 2010 WL 3291579, at *5 (S.D.N.Y. Aug. 16, 2010) (Marrero, J.) (dismissing claims by Norwegian municipalities that invested through Norwegian securities firm in Citigroup securities listed on European exchanges); *Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens Cvc Tur Limitada*, 732 F. Supp. 2d 1345, 1349, 1350 (S.D. Fla. 2010) (Huck, J.) (dismissing suit by a foreign plaintiff that purchased the shares of a foreign company from a foreign owner, and holding that the mere closing of the transaction in the U.S. was insufficient to distinguish the case from *Morrison*); *In re Banco Santander Securities-Optimal Litig.*, 732 F. Supp. 2d 1305, 1317, 1318 (S.D. Fla. 2010) (Huck, J.) (dismissing suit by foreign plaintiffs who purchased shares of a foreign investment fund traded on the Bahamian stock exchange notwithstanding allegations that purchases were for the ultimate purpose of investing with a fund that held U.S.-listed securities).

[213] 130 S. Ct. at 2884.

[214] 728 F. Supp. 2d 372, 405 (S.D.N.Y. 2010) (Marrero, J.).

in the case alleged that the securities transactions took place when their subscription agreements were accepted by the funds in New York, "where [one of the funds] had an office and where much of its executive staff was concentrated."[215] Because the case "allegedly does not involve securities purchases or sales executed on a foreign exchange," the court held that it "presents a novel and more complex application of *Morrison's* transactional test"[216]—*i.e.*, whether a purchase of the type alleged "is made in the United States."[217] This is precisely the role of the lower courts: determining how doctrine established by superior courts applies in new factual settings.

***Second***, adhering to the transaction test, courts properly have dismissed section 10(b) claims by investors located in the U.S. who transact foreign securities on foreign exchanges.[218] Such transactions do not satisfy that test because "[a] purchaser's citizenship or residency does not affect where a transaction occurs."[219] "[T]he purchaser or seller has figuratively traveled to that foreign exchange—presumably via a foreign broker—to complete the transaction."[220] The cases note that a contrary rule would undermine the much-needed clarity that the Supreme Court intended *Morrison* to bring to the question of section 10(b)'s extraterritorial reach.[221]

***Third***, at least two courts have rejected the argument that *Morrison* permits suits based on the purchase of shares on a foreign exchange merely because the same shares also are listed on a domestic exchange.[222] Apparently, the argument is

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[215] *Id.*
[216] *Id.*
[217] 130 S. Ct. at 2886.
[218] *Cornwell v. Credit Suisse Group*, 729 F. Supp. 2d 620, 624 (S.D.N.Y. 2010) (Marrero, J.) (dismissing claims by U.S.-based purchasers of Swiss-issued shares traded on the Swiss Stock Exchange, and noting that the plaintiffs' focus on the domestic purchasers' location was simply an attempt to revive the "conduct and effects" tests rejected in *Morrison*); *In re Royal Bank of Scotland*, 2011 WL 167749, at *18; *In re Celestica Inc. Sec. Litig.*, No. 07-cv-312, 2010 WL 4159587 (S.D.N.Y. Oct. 14, 2010) (Daniels, J.); *Plumbers Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, No. 08-cv-1958, 2010 WL 3860397, at *9 (S.D.N.Y. Oct. 4, 2010) (Koeltl, J.); *In re Alstom Sec. Litig.*, No. 03-cv-6595, 2010 WL 3718863 (S.D.N.Y. Sept. 14, 2010) (Marrero, J.).
[219] *Plumbers Union*, 2010 WL 3860397, at *9.
[220] *Stackhouse v. Toyota Motor Co.*, No. 10-cv-0922, 2010 WL 3377409, at *1 (C.D. Cal. July 16, 2010) (Fischer, J.) (noting that decision was not a final determination of the question); *see also Elliott Assocs. v. Porsche Automobil Holding SE*, No. 10-cv-0532, 2010 WL 5463846, at *6-*7 (S.D.N.Y. Dec. 30, 2010) (Baer, J.) (applying reasoning to securities-based swap agreements referencing foreign securities, and noting that "[p]laintiffs' swaps were the functional equivalent of trading the underlying [foreign] shares on a [foreign] exchange, . . . the economic reality is that [the] swap agreements are essentially 'transactions conducted upon foreign exchanges and markets'").
[221] *Cornwell*, 729 F. Supp. 2d at 624-27.
[222] *See In re Alstom SA*, 2010 WL 3718863, at *3.

premised on the theory that such foreign "transactions" literally were "in securities listed on domestic exchanges." The situation arises with some frequency because foreign issuers that sponsor ADRs must list the shares underlying the ADRs on a U.S. exchange, although not for trading purposes.[223] As the SDNY observed in rejecting this theory, "the most natural and elementary reading of *Morrison*" is that "the transactions themselves must occur on a domestic exchange to trigger application of § 10(b)."[224] Indeed, in *Morrison* itself, the Court did not suggest that defendant National's listing of ADRs on a U.S. exchange was relevant to the viability of the plaintiffs' claims based on overseas trading.[225] Adoption of this creative reading of *Morrison* would be particularly perverse because it would give section 10(b) a broader reach than ever before; many pre-*Morrison* suits that did not satisfy the "conduct and effects" test involved foreign transactions in securities also listed on a domestic exchange.

***Fourth***, in considering how *Morrison* applies to section 10(b) claims based on domestic purchases of ADRs,[226] district courts have reached a variety of results in different factual contexts. Most courts have distinguished ADR purchasers from purchasers of foreign shares, reserving judgment on whether the former's claims can go forward;[227] and the U.S. District Court for the Central District of California has held preliminarily that *Morrison* does not bar claims by ADR purchasers.[228] The SDNY reached a different result in *In re Societe Generale Securities Litigation*, holding that *Morrison* barred section 10(b) claims by purchasers of ADRs in the over-the-counter market.[229] In concluding that "[t]rade in ADRs is considered to be a predominantly foreign securities transaction," the court emphasized that the ADRs at issue were not

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[223] *See* 1 Edward F. Greene et al., *U.S. Regulation of the International Securities And Derivatives Markets* § 2.03[2][b][i], at 2-34 n.85 (9th ed. 2008) ("A company is also required to list the shares underlying listed ADRs, although the share listing is not for trading purposes").

[224] *In re Alstom SA*, 2010 WL 3718863, at *3; *see also In re Royal Bank of Scotland*, 2011 WL 167749, at *7 (observing that plaintiffs' reading "would be utterly inconsistent with the notion of avoiding the regulation of foreign exchanges").

[225] *See Morrison*, 130 S. Ct. at 2875.

[226] The Supreme Court did not reach this question; although the suit initially involved claims by a U.S. purchaser of National's ADRs, only the purchasers of National's foreign shares remained involved by the time the case reached the Supreme Court. *See id.* at 2876 n.1.

[227] *See, e.g.*, *In re Alstom*, 2010 WL 3718863, at *1; *Cornwell*, 729 F. Supp. 2d 620.

[228] *Stackhouse*, 2010 WL 3377409, at *2.

[229] *See In re Societe Generale Sec. Litig.*, No. 08-cv-2495, 2010 WL 3910286, at *6 (S.D.N.Y. Sept. 29, 2010) (Berman, J.).

traded "on an official American securities exchange," but rather "in a less formal market with lower exposure to U.S.-resident buyers."[230] Regardless whether this distinction between exchange-traded and over-the-counter ADRs has merit, the courts of appeals are well-situated to resolve the question, and legislation addressing it is wholly unnecessary.

***Fifth***, one district court has dismissed claims by foreign purchasers based on what the court described as foreign private transactions in the securities of SEC-registered companies that were not traded on a domestic exchange.[231] So characterized, the case appears to constitute a straightforward application of the Supreme Court's holding.

## VI. Suggestions for the Commission's Study Process

We respectfully suggest that the Commission take the following steps in conducting its study of this important issue. This initial solicitation of comments should provide the Commission with a good understanding of the key issues, and with preliminary input from some of the relevant stakeholders. The Commission should use this information to inform its construction of the process for conducting the study required by Congress.

First, we believe that the Commission should identify with care the issues that must be addressed in order to carry out a useful study.

Next, the SEC should determine what information it needs in order to address the issues it identifies. Some empirical information is already available—in particular about the costs and benefits of the U.S. securities class action model. But when it comes to many of the questions identified in the request for comments, the Commission will need to undertake its own research (or commission one or more research papers) in order to gain a comprehensive and accurate picture of the empirical landscape. The Commission also should consider consulting with leading academics who have studied the U.S. securities class action system—and the costs and benefits of applying it overseas. We suggest: Professor Adam C. Pritchett at the

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[230] *Id.* at *6 (quoting *Copeland*, 685 F. Supp. at 506).
[231] *Absolute Activist Value Master Fund Ltd. v. Homm*, No. 09-cv-08862, 2010 WL 5415885, at *5 (S.D.N.Y. Dec. 22, 2010) (Daniels, J.).

University of Michigan Law School, Professors John C. Coffee and Merritt B. Fox at Columbia Law School, Professor Hannah Buxbaum of Indiana University Law School, Professor Stephen J. Choi of New York University Law School, Professor Richard A. Booth of Villanova University Law School, Professors Janet C. Alexander and Joseph A. Grundfest of Stanford Law School, and Professor Howell Jackson of Harvard Law School.

Finally, the Commission should obtain the views of key stakeholders. That process should include soliciting the views of foreign financial services regulators (and of foreign governments generally) regarding the ability of those foreign regulators to detect and punish securities fraud and the effect of expansive U.S. private liability on other nations' regulatory systems and business environments, and their willingness to cooperate with the United States in joint investigation and enforcement efforts. That process also should include outreach to and interviews with other stakeholders—including foreign and domestic businesses, and investors—regarding the effects of exterritorial private lawsuits on their interests.

Sincerely,

David Hirschmann
President and Chief Executive Officer
Center for Capital Markets Competitiveness
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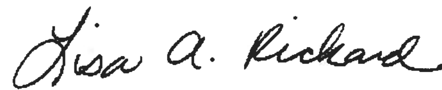

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