THE DODD-FRANK EXTRATERRITORIAL JURISDICTION PROVISION: WAS IT EFFECTIVE, NEEDED OR SUFFICIENT?

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In Morrison v. National Australia Bank, the U.S. Supreme Court ruled in June 2010 that securities fraud suits could not be brought under Section 10(b) of the Exchange Act against foreign defendants by foreign plaintiffs who bought their securities outside the United States (so called "f-cubed" securities litigation). The Court held that Section 10(b) reaches only 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." Congress responded to Morrison with Section 929P of the Dodd-Frank Act, which gives federal courts jurisdiction over some similar cases if they are brought by the SEC or the Department of Justice (DOJ).

This Article discusses alternative explanations for why Congress used extraterritorial jurisdiction language in Section 929P instead of directly addressing the reach of Section 10(b) on the merits, and whether as a result Section 929P does nothing more than confer jurisdiction on federal courts that the Morrison opinion already recognized courts have over all Section 10(b) cases. This Article also discusses whether Section 929P reinstates for SEC and DOJ suits some of the case law in the courts of appeals that was overturned by Morrison, and if so, how that case law is to be applied. This Article discusses whether Section 929P is retroactive, and how Section 929P likely will be used by the SEC and DOJ in insider trading and other cases. Finally, this Article discusses whether Section 929P was necessary given the SEC's already expansive enforcement authority under Section 10(b) and whether Congress should have taken the opportunity to address other more pressing post-Morrison issues in Dodd Frank. These issues include the status under Morrison of securities listed both in the United States and outside the United States, and the status of off-exchange traded security-based swap agreements, as well as other private transactions where identifying a transaction location is not as easy as it is for exchange traded securities.

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Buried in the thousands of pages of legislative text in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[1] is a provision a few paragraphs long responding to a United States Supreme Court opinion handed down only weeks before the bill was signed into law by the President. This provision was almost an afterthought, and was awkwardly drafted, but it covered a topic of crucial importance—the extraterritorial reach of United States securities laws. With the increasing interdependence of securities markets around the globe, as illustrated by the potential merger of the New York Stock Exchange and the Deutsche Boerse, extraterritoriality will be a crucial issue in financial services regulation. Because that issue is only briefly touched upon in Dodd-Frank, it may have to be revisited by Congress in the near future.

In *Morrison v. National Australia Bank*,[2] the U.S. Supreme Court ruled in June 2010 that securities fraud suits could not be brought under Section 10(b) of the Securities Exchange Act of 1934 against foreign defendants by foreign plaintiffs who bought their securities outside the United States (so called "f-cubed" securities litigation). The plaintiffs, who purchased shares of National Australia Bank ("NAB") on the Australia stock exchange, claimed they had been deceived in Australia by statements of NAB about the finances of a U.S. subsidiary and they sued NAB under Section 10(b). The Court held that the alleged fraudulent conduct in the U.S. subsidiary was not a ground to apply Section 10(b) extraterritorially to transactions in NAB stock on the Australian stock exchange.

The Court held that Section 10(b) did not apply because "the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States."[3] The Court concluded that Section 10(b) reaches only 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."[4]

Congress responded to *Morrison* with a provision in Dodd-Frank that gives federal courts jurisdiction in some situations over similar cases brought by the Securities Exchange Commission ("SEC") and the Department of Justice ("DOJ").

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
[2] 130 S. Ct. 2869 (2010).
[3] *Id.* at 2884.
[4] *Id.* at 2888.

Part I of this Article briefly discusses the holding in *Morrison*. Part II discusses the extraterritorial jurisdiction provision in Dodd-Frank and various explanations for why Congress chose to use the statutory language that it did. Part III discusses complications that arise in interpreting this provision of Dodd-Frank. First, does the statute do anything other than confer jurisdiction on federal courts that the *Morrison* opinion already recognized they have over all Section 10(b) cases? Does the provision do anything to change the substance of the holding in *Morrison*? Second, if the provision makes any substantive changes to the law, does it reinstate the conduct and effects tests that were used in many circuit courts before *Morrison* was decided, and if so, which version of these tests? Third, is this provision of Dodd-Frank retroactive so that the SEC and DOJ can use it against perpetrators of frauds that may have caused the 2008 financial crisis or is it prospective only? Fourth, was the extraterritoriality provision of Dodd-Frank necessary, given that the SEC and DOJ already have broad enforcement powers under Section 10(b), and is there a risk that in those few cases in which this provision does broaden the SEC's and DOJ's powers, these powers will be used unwisely? Of particular concern is the extraterritorial enforcement of United States insider trading laws. Finally, Part IV of this Article discusses whether Dodd-Frank missed an opportunity to clarify important issues that remain open after *Morrison*. One issue Congress should have addressed is the status of securities that are listed in, as well as outside the United States, but that are mostly traded outside the United States. Another issue is the status of security-based swap agreements in the United States that reference foreign traded securities as well as security-based swap agreements in foreign countries that reference U.S. traded securities. Congress could have addressed these issues in Dodd-Frank but did not do so.

I. The *Morrison* Holding

The first part of the *Morrison* opinion sorts out confusion in the courts of appeals about whether the reach of Section 10(b) is a question of subject-matter jurisdiction or instead a question of the merits.

The Second Circuit had approached the issue in *Morrison* as one of subject-matter jurisdiction. By the time the case reached the Supreme Court, however, the briefs in *Morrison* were already considering this issue as going to the merits of Section 10(b) rather than to jurisdiction.[5] The Supreme Court in late 2009 had decided *Union Pacific R.R. Co. v. Locomotive Engineers*,[6]

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[5] *See* Supp. Brief for Respondents at 2–5, *Morrison*, 130 S. Ct. 2869 (No. 08-1191) (discussing and citing cases and noting that this concept goes back to Arbaugh v. Y&H Corp., 546 U.S. 500 (2006), Steel Co. v. Citizens for a Better Env't, 523 U.S. 83 (1998), Romero v. Int'l Terminal Operating Co., 358 U.S. 354 (1959), and Bell v. Hood, 327 U.S. 678 (1946)).

[6] *See* Union Pac. R.R. Co. v. Bhd. of Locomotive Eng'rs, 130 S. Ct. 584 (2009).

holding—or rather, reiterating the Court's prior holdings—that Congress determines the jurisdictional reach of a statute, that jurisdiction often exists regardless of the merits of a case, and that courts cannot refuse to exercise jurisdiction because they do not believe a claim exists on the merits.

Although *Union Pacific* was not a case brought under Section 10(b), the Court's reasoning in *Union Pacific* as well as in prior Supreme Court cases cited in *Union Pacific* indicated that the scope of Section 10(b) was a merits question, and not a question of subject-matter jurisdiction. The federal courts have jurisdiction over all cases brought under Section 10(b); the question on the merits is whether there is a cause of action under Section 10(b) in f-cubed cases. The Second Circuit thus should have decided the case on the merits. Justice Scalia states in Part II of *Morrison*:

> [T]o ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question. Subject-matter jurisdiction, by contrast, "refers to a tribunal's 'power to hear a case.' *Union Pacific R. Co. v. Locomotive Engineers and Trainmen Gen. Comm. of Adjustment*, *Central Region*, 558 U.S. ___, ___, 130 S. Ct. 584, 596, 175 L.Ed.2d 428 (2009) (quoting *Arbaugh v. Y & H Corp.,* 546 U. S. 500, 514 (2006), in turn quoting *United States v. Cotton*, 535 U.S. 625, 630 (2002)) [alternate citations omitted]. It presents an issue quite separate from the question whether the allegations the plaintiff makes entitle him to relief. *See Bell v. Hood*, 327 U. S. 678, 682 (1946) [alternate citations omitted]. The District Court here had jurisdiction under 15 U.S.C. § 78aa to adjudicate the question whether § 10(b) applies to National's conduct.[7]

The next part of Justice Scalia's opinion is the crux of the *Morrison* holding. In it, the Court held that, even though the federal courts had subject-matter jurisdiction, there was no cause of action on the merits where the securities were not purchased in the United States (as explained below, there is confusion about whether the *Morrison* opinion supports applying Section 10(b) to securities purchased outside the United States when such securities are listed on a U.S. securities exchange). The Court refused to recognize the "conduct and effects" tests that had been used in the courts of appeals to allow some of these cases to proceed if conduct inside the United States was a substantial factor in causing fraud in a securities transaction outside the United States. In cases falling outside the reach of Section 10(b), as defined in *Morrison*, a plaintiff's complaint was to be dismissed on the merits under Rule 12(b)(6). The Court did just that in *Morrison*. The *Morrison* Court did not directly address suits brought by the SEC or DOJ, but presumably the scope of Section 10(b) would be the same in those cases also, because—absent an express directive from Congress—the statute would not have a broader

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[7] *Morrison*, 130 S. Ct. at 2877.

scope in one context than another simply because of the identity of the plaintiff.

II. The Dodd-Frank Extraterritoriality Provision

As discussed below, Dodd-Frank appears to include a directive from Congress that Section 10(b) should have extraterritorial reach in cases brought by the SEC and DOJ. Extraterritoriality, however, was not the principal focus of Dodd-Frank. Instead, Dodd-Frank was the multifaceted legislative response to the financial failures, mostly occurring in the United States, that led to the crisis of 2008–09. Dodd-Frank did many things to regulate business practices, corporate governance, and disclosure, mostly in the financial services sector. It also addressed the market in security-based swap agreements and other derivative instruments. Extraterritoriality, for Dodd-Frank, appears to have been an afterthought.

The Dodd-Frank Act included a provision responding to *Morrison*, but the provision was inserted into the Act at the last minute because *Morrison* was decided only weeks before the Act became law. Given the very different approaches to extraterritorial securities litigation in the courts of appeals prior to Dodd-Frank, it was difficult to predict what, if anything, the Supreme Court would do to change the law in *Morrison*. When the Court did make a major change in the law, Congress had very little time to react. As explained below, Congress was not careful in the language it used.

Congress responded to *Morrison* with statutory language directed at cases brought by the SEC and DOJ and also ordered an SEC study of whether extraterritorial private rights of action should be reinstated.[8] Section 929P of the Dodd-Frank Act is under the heading "Extraterritorial Jurisdiction of the Antifraud Provisions of the Federal Securities Laws" and states:

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[8] Section 929Y of the Dodd-Frank Act provides that the SEC shall solicit public comment and then conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Exchange Act should be extended to cover the same conduct with respect to which actions brought by the SEC and the United States are authorized under Section 929P of the Act. The study:

> shall consider and analyze, among other things—
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> (1) the scope of such a private right of action, including whether it should extend to all private actors or whether it should be more limited to extend just to institutional investors or otherwise;
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> (2) what implications such a private right of action would have on international comity;
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> (3) the economic costs and benefits of extending a private right of action for transnational securities frauds; and
>
> (4) whether a narrower extraterritorial standard should be adopted.

The provision requires that a report of the study be submitted and recommendations made to the Senate Committee on Banking, Housing, and Urban Affairs of and the House Committee on Financial Services within eighteen months. Dodd-Frank Act § 929Y.

> Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) is amended—
> . . . .
> by adding at the end the following new subsection:
> (b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of the antifraud provisions of this title involving—
> (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
> (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.[9]

The Act contains similar provisions with respect to Section 22 of the Securities Act and Section 214 of the Investment Advisors Act.

This provision expressly confers jurisdiction on federal courts in the cases described in the provision. In this respect, however, the provision merely reaffirms what the Court had said in Part II of *Morrison*,[10] that federal courts have subject-matter jurisdiction over all cases brought under Section 10(b).

As discussed in Part III of this Article, there is disagreement about what else Section 929P of Dodd-Frank does. Does this provision also reach the merits of a Section 10(b) suit brought by the SEC or DOJ and overturn the holding in *Morrison* by applying Section 10(b) to some securities transactions outside the United States? Does this provision of Dodd-Frank reinstate the conduct and effects test that the Second Circuit and many other circuits had used prior to *Morrison* and, if so, how? All that is certain is that the statutory language expressly affirms, as does Part II of the *Morrison* opinion, that federal courts have jurisdiction over Section 10(b) cases brought in connection with the purchase or sale of securities outside the United States. The focus of Part II of the *Morrison* opinion and the focus of Section 929P of Dodd-Frank is the same: jurisdiction. The focus of the rest of the *Morrison* opinion is the substantive reach of Section 10(b) outside the United States. This aspect of extraterritoriality is not expressly addressed in Section 929P even though Congress probably intended to do so.

There are at least four explanations for what Congress intended in this provision of Dodd-Frank.

The first explanation is that Congress made a mistake in using the jurisdictional language, because Congress intended to address the merits of Sec-

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[9] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 929P(b)(2), § 27(b), 124 Stat. 1376, 1862 (2010).

[10] *See Morrison*, 130 S. Ct. at 2876–77.

tion 10(b). Congress thus intended to define the scope of Section 10(b) to include transactions outside the United States that are affected by the conduct inside the United States that is described in the statute. The statute was drafted incorrectly, but this was for an explainable reason, because the courts of appeals had for so long addressed the extraterritorial reach of Section 10(b) as a jurisdictional question. Presumably the drafters did not focus on the fact that once this question reached the Supreme Court in *Morrison* it was addressed in the parties' briefs—including the Solicitor General's brief drafted by the SEC[11]—as a question of the merits rather than jurisdiction. Nobody bothered to change the statutory language. Thus Congress, and the SEC on which Congress relied for drafting advice, simply got it wrong.

Some of the legislative history supports this explanation of what happened. The language on extraterritoriality that was ultimately adopted in Dodd-Frank is based on earlier bills that had been proposed before *Morrison* was decided. Some members of Congress wanted to preserve f-cubed securities cases in at least some circumstances if the Court were to bar such suits in *Morrison*.

An earlier version of what became the Dodd-Frank Act was the Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173. Section 7216 of H.R. 4173[12] proposed to provide for extraterritorial jurisdiction with respect to antifraud provisions in the federal securities laws if there is "conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors." The bill covered the Securities

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[11] *See* Brief for the United States as *Amicus Curiae*, on Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit at 9, Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869 (2010) (No. 08-1191) ("Thus, under the plain terms of Section 78aa, the geography of an alleged fraudulent scheme—*i.e.*, whether it was conceived and executed in whole or in part outside the United States—is irrelevant to the district court's subject-matter jurisdiction.").

[12] § 7216. EXTRATERRITORIAL JURISDICTION OF THE ANTIFRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS.

> (a) Under the Securities Act of 1933- Section 22 of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended by adding at the end the following new subsection:
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> (c) Extraterritorial Jurisdiction- The jurisdiction of the district courts of the United States and the United States courts of any Territory described under subsection (a) includes violations of section 17(a), and all suits in equity and actions at law under that section, involving—
>
> > (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
> >
> > (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

Identical language from (c) was added to Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) and Section 214 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-14). Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. §§ 7216(a)–(c) (as introduced in House, Dec. 2, 2009).

Act of 1933, Section 22;[13] the Securities Exchange Act of 1934, Section 27;[14] and the Investment Advisers Act of 1940, Section 214.[15]

The language that ultimately made it into Dodd-Frank was apparently drafted by the SEC and was substantially similar to the earlier language for H.R. 4173, except that coverage was limited to actions brought by the SEC or DOJ.

In all of these versions of the bill, the legislative language addressed subject-matter jurisdiction. The language was not changed even though the SEC and the Solicitor General acknowledged the previous fall that this wasn't a question of jurisdiction.[16]

Thus, the first explanation for what happened is that the SEC and Congress simply made a mistake. The Dodd-Frank provision had intended to address the merits of Section 10(b) but did not.

A second explanation is that there was such a drafting mistake but that some Members of Congress also were aware of this mistake and decided not to redraft the statute. A reason for not redrafting could have been the pressing time constraints and the fact that redrafting the provision would require substantive changes to Section 10(b) of the Exchange Act as well as to the Securities Act and the Investment Advisors Act provisions mentioned in the provision. Some Members of Congress would have supported these changes, but others might have refused to vote for a bill that went beyond jurisdictional questions to make substantive changes to these key provisions of federal securities laws. The ensuing debate might have held up the entire Dodd-Frank Act at a time when opponents of the bill's other provisions were seeking delay and the President wanted the bill on his desk to sign. Fixing the Dodd-Frank extraterritoriality provision would have been more technically proficient, but was politically too risky.

The SEC and the bill's sponsors, according to this explanation, thus decided to retain the jurisdictional language as it was written and take their chances. Courts, they hoped, would recognize that Congress had intended substantive changes to Section 10(b) as well as jurisdictional ones. Otherwise the statute would be meaningless, and courts were unlikely to hold an act of Congress to be meaningless.

A third explanation is that Congress—or at least some Members of Congress—intended to confer jurisdiction and nothing more. These Members presumably would not have voted for substantive changes to the extraterritorial reach of Section 10(b) in SEC and DOJ actions. Although the Supreme Court had ruled in *Morrison* that federal courts have subject-matter jurisdiction in all Section 10(b) cases, these Members may have wanted to codify this jurisdiction for the SEC and DOJ cases described in the statute.

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[13] *See* 15 U.S.C. 77v(a).
[14] *See* 15 U.S.C. 78aa.
[15] *See* 15 U.S.C. 80b-14.
[16] *See* Brief for the United States *supra* note 11, at 9.

Congress thus ratified the jurisdiction federal courts have over these cases—albeit jurisdiction that courts already recognized they had—but Congress also left it up to the courts to decide what to do with this jurisdiction in interpreting Section 10(b) on the merits. Congress had voted for a provision that sounded tough but did not change the law. The Dodd-Frank provision under this explanation is much noise signifying nothing.

If pressed, a Member of Congress who supported the provision on these grounds could point to something it accomplished, although not very much. The provision presumably would prevent SEC and DOJ suits in the future from being dismissed on jurisdictional grounds if for any reason the Court were to change its mind about its approach to jurisdiction in *Union Pacific* and Part II of *Morrison*. Courts, under Section 929P, would have to accept jurisdiction over SEC and DOJ suits, although they would dismiss these suits on the merits under *Morrison* if there was no securities transaction inside the United States connected with the conduct in question. Congress could later decide whether courts' application of *Morrison* in SEC and DOJ suits was reasonable and whether to respond with substantive changes to Section 10(b).

Members of Congress who supported jurisdiction and nothing more could point to the fact that many SEC and DOJ lawsuits would survive *Morrison* even without any substantive change to the extraterritorial reach of Section 10(b). The SEC or DOJ could, for example, sue defendants similarly situated to NAB because NAB had American Depositor Receipts (ADRs) trading in the United States. Nothing in *Morrison's* interpretation of Section 10(b) on the merits would have stood in the way of such a suit. Furthermore, courts might use their jurisdiction to narrowly or expansively construe *Morrison* in suits brought by the SEC and DOJ. There was considerable ambiguity in *Morrison* on several issues, including how to determine when a transaction occurs in or outside of the United States,[17] and it might be premature for Congress to address the merits of extraterritorial suits by the SEC or DOJ before the courts of appeals had resolved these issues. For the time being, Congress would only lock in the jurisdiction that the Supreme Court had already said federal courts have and then wait to see what courts did with this jurisdiction in SEC and DOJ cases, a context that was very different from the private suit in *Morrison*.

A fourth explanation is that Congress intended something very different: to address the extraterritorial application of federal securities laws as a question of jurisdiction—as courts of appeals had done before *Morrison*—and to address the merits of Section 10(b) by saying that federal courts have jurisdiction over certain SEC and DOJ actions.[18] Under this explanation, the

[17] *See infra* Part IV, discussing how Congress should have clarified some of these issues in Dodd-Frank.

[18] This explanation of congressional intent, apparently favored by the SEC, was discussed shortly after enactment of Dodd-Frank in Richard W. Painter, Douglas Dunham, & Ellen Quackenbos, *When Courts and Congress Don't Say What They Mean: Initial Reactions to*

holding in both parts of the *Morrison* opinion was legislatively overruled in SEC and DOJ suits. When Congress chose to overrule *Morrison* in this respect, Congress explicitly intended to reinstate the approach of the circuit courts of appeals in SEC and DOJ suits, including their approach to this issue as a question of subject-matter jurisdiction.

Congress can do this because it has the final say on what is a question of subject-matter jurisdiction. As the Court recognized in *Arbaugh v. Y.H. Corp.*,[19] Congress makes an issue one of subject-matter jurisdiction by affirmatively including the issue in subject-matter jurisdiction provisions. The Dodd-Frank language, under this explanation, was not a drafting error but instead was intended to codify the courts of appeals' approach to extraterritoriality. The statutory language thus turns the extraterritorial issue into a question of jurisdiction rather than of the merits and says that certain SEC and DOJ suits can proceed because there is jurisdiction.

Under this explanation, Congress intended to reinstate the case law that had existed in courts of appeals before *Morrison* was decided. The courts of appeals had approached extraterritoriality as a jurisdictional issue, despite the Supreme Court's contrary approach to jurisdiction even prior to *Morrison* and *Union Pacific*.[20] The courts of appeals had differed in their articulation of the "conduct and effects" tests—the Second,[21] as well as the Third, Eighth, and Ninth Circuits[22] each articulating slightly different versions of

Morrison v. National Australia Bank and to the Extraterritorial Jurisdiction Provisions of the Dodd-Frank Act, 20 MINN. J. INT'L L. 1, 6 n.21 (2010) (reporting that the SEC staff had told the authors that the SEC staff was substantially involved in providing technical assistance to members of Congress that included, among other things, explaining the Dodd-Frank provision's intended effect of codifying the courts of appeals' approach to extraterritoriality in SEC and DOJ enforcement actions). Subsequently the SEC has asserted in briefs submitted in *SEC v. Tourre* that Congress intended to reinstate the approach to the conduct and effects tests embraced by the Second Circuit prior to *Morrison*. *See infra* note 30. The Second Circuit's approach in *Morrison* and prior cases included treating extraterritoriality as a jurisdictional question rather than a question of the merits.

[19] 546 U.S. 500 (2006).

[20] The federal courts have been less than clear in explaining that extraterritoriality is not a question of subject matter jurisdiction. For example, in *Arbaugh*, 546 U.S. at 511–13, the Supreme Court pointed to one of its own decisions, E.E.O.C. v. Arabian Am. Oil Co., 499 U.S. 244 (1991), in which it had characterized the extraterritorial effect of Title VII as jurisdictional, as an example of a decision in which it had been "less than meticulous" in distinguishing between subject matter jurisdiction and an ingredient of a claim for relief. *See, e.g.*, Litecubes, LLC v. North. Light Prods., Inc., 523 F.3d 1353, 1368 (Fed. Cir. 2008) ("There is no indication that Congress intended the extraterritorial limitations on the scope of the Copyright Act to limit the subject matter jurisdiction of the federal courts. Accordingly, we hold that the issue is properly treated as an element of the claim which must be proven before relief can be granted, not a question of subject matter jurisdiction . . . ."). Congress's approach to extraterritoriality as a jurisdictional question is thus in part due to confusion created by the courts themselves.

[21] Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir. 1983); Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *overruled on other grounds*, 405 F.2d 215 (2d Cir. 1968); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 989 (2d Cir. 1975).

[22] *See, e.g.*, SEC v. Kasser, 548 F.2d 109, 114 (3d Cir. 1977); Cont'l Grain (Austrl.) Pty., Ltd. v. Pac. Oilseeds, Inc., 592 F.2d 409, 421 (8th Cir. 1979); Butte Mining PLC v. Smith, 76 F.3d 287, 290–91 (9th Cir. 1996). It is not clear which of these versions of the conduct and

those tests—but they had all approached the issue as one of subject-matter jurisdiction. Although the legislative history does not specifically say that Congress wanted to address extraterritoriality as a jurisdictional issue instead of an issue of the merits, or to combine the merits with the question of subject-matter jurisdiction, Congress did know generally that the courts of appeals had approached extraterritorial application of Section 10(b) one way and the Supreme Court had approached it another way. Evidently, for SEC and DOJ suits, some Members of Congress preferred the approach of the courts of appeals.

None of these four explanations has clear support in the legislative history for the extraterritoriality provision of Dodd-Frank because there is little legislative history other than a few isolated statements of Members and prior drafts of the extraterritoriality provision from before *Morrison* was decided.

III. Interpreting and Applying the Dodd-Frank Extraterritoriality Provision

A. *Does Dodd-Frank do anything other than confer jurisdiction?*

Courts interpreting the extraterritoriality provision of Dodd-Frank will have to decide whether it does anything with respect to the merits of Section 10(b), and if so, what it does. As discussed above, all the provision expressly does is confer jurisdiction, which is the same jurisdiction that Justice Scalia says in Part II of *Morrison* that the federal courts already have. There are at least four explanations for what Congress intended, some more plausible than others, but probably no single explanation that is demonstrably more plausible than the rest.

George Conway, counsel for NAB in the *Morrison* case, pointed out this problem in a memorandum on July 21, 2010, the day Dodd-Frank was signed by the President.[23] Dodd-Frank, he pointed out, said nothing about the issues addressed in the *Morrison* opinion other than in Part II. Dodd-Frank said nothing about whether Section 10(b) on the merits reaches transactions outside the United States. The *Morrison* opinion thus stood unchanged, even in actions brought by the SEC and DOJ.

The SEC has responded by emphatically saying that the Dodd-Frank extraterritoriality provision reinstates the "conduct and effects" tests of the courts of appeals in actions brought by the SEC and DOJ.[24]

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effects tests Congress intended to reinstate in SEC and DOJ actions. *See infra*, Part III.B of this Article.

[23] *See* Wachtell, Lipton, Rosen, & Katz, *Extraterritoriality of the Federal Securities Laws After Dodd-Frank: Partly Because of a Drafting Error, the Status Quo Should Remain Unchanged*, June 21, 2010 (authored by George T. Conway III), *available at* www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.17763.10.pdf.

[24] *See* SEC's Memorandum of Law in Opposition to Defendant Tourre's Motion for Judgment on the Pleadings at 7 n.1, SEC v. Goldman Sachs & Co. (*SEC v. Tourre*), 10 Civ. 3229 (S.D.N.Y. Oct. 13, 2010), 2010 WL 4530690, at n.1.

Only the third out of the four explanations above assumes that Congress intended to address only jurisdiction. This explanation assumes that Congress intended to enact a provision that accomplishes little if anything at all. The SEC will argue, probably convincingly, that this is unlikely. Of the remaining explanations of congressional intent, the SEC will likely prefer the fourth because it is the only explanation other than legislative drafting error—at the SEC—that explains why the provision was written the way it was. Regardless of the explanation of what Congress intended, the SEC will probably be able to convince most courts construing the Dodd-Frank provision that Congress intended to change the law.

The SEC could point out that confusion on this issue is the courts' own fault. Up until *Union Pacific* in late 2009, courts of appeals had approached extraterritoriality as a question of subject-matter jurisdiction. Congress in Dodd-Frank used the framework that these courts had used to address the extraterritorial application of Section 10(b). The courts of appeals had been wrong in the view of longstanding Supreme Court precedent, but the courts should not compound the problem by refusing to recognize a congressional mandate because of drafting deficiencies in language modeled on the courts' own case law.[25]

On the other hand, congressional intent is not what statutes are made of. In this instance, reconstructing what Congress intended involves construing substantive provisions of three complex statutes—the Securities Act, the Exchange Act, and the Investment Company Act—as having been amended to incorporate the conduct and effects tests used in the courts of appeals prior to *Morrison* whenever an action is brought by the SEC or DOJ. Some judges may refuse to do this; others may try to do this but create confusion by doing so in different ways (*see* Part III.B, *infra*, discussing the different iterations of the conduct and effects tests supposedly embodied in Section 929P of Dodd-Frank).

Finally, the SEC could argue that because the *Morrison* Court ruled on the scope of Section 10(b) of the Exchange Act but not Section 17(a) of the Securities Act, Section 17(a), as originally enacted, applies extraterritorially in SEC and DOJ actions. The SEC would urge that Dodd-Frank Section 929P be considered in interpreting Section 17(a) whether or not Section 929P in fact does anything other than confer jurisdiction. The problem with this argument is that the *Morrison* opinion relies extensively on congressional intent in the Securities Act as well as the Exchange Act. *Morrison*

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[25] Another argument the SEC could make is that courts should interpret Section 10(b) differently in SEC and DOJ suits in view of Dodd-Frank even though Congress did not amend Section 10(b). In Dodd-Frank, Congress arguably gave affirmative indication that Section 10(b) should apply extraterritorially. *See* United States v. Fausto, 484 U.S. 439, 453 (1988) (statutory construction presumption against repeal by implication does not apply as strongly where the "repeal" simply involves a judicial construction of a statute). This argument would involve using a 2010 statute for judicial construction of a 1934 statute and some courts may not be willing to do this.

also clearly states that the presumption against extraterritoriality applies to both statutes, and indeed to other statutes as well. Courts are already using *Morrison* to deny extraterritoriality in contexts well beyond the federal securities laws,[26] so it is unlikely that courts would interpret Section 17(a) differently than the Court interpreted Section 10(b). To the extent Dodd-Frank is relevant, the analysis circles back to the question of whether or not Dodd-Frank changed the substantive reach of Section 17(a) and Section 10(b). Section 929P uses virtually identical language in the jurisdiction provision for both statutes, making it difficult to argue that Section 929P affected one differently than it did the other.

In sum, Congress has created a difficult problem by enacting extraterritoriality provisions in Dodd-Frank that only expressly provide for jurisdiction after the Supreme Court had said there already was jurisdiction, that jurisdiction was not the issue, and that there was no case on the merits. Congress did not change or explain the jurisdictional language it chose despite months of notice that extraterritoriality was seen by the Supreme Court as a question of the merits rather than of jurisdiction.

It is uncertain how courts will respond. For the SEC, one ominous sign is the Supreme Court's holding in *Sosa v. Alvarex-Machain*, interpreting a much older statute, the Alien Tort Claims Act:

> Alvarez says that the ATS was intended not simply as a jurisdictional grant, but as authority for the creation of a new cause of action for torts in violation of international law. We think that reading is implausible. As enacted in 1789, the ATS gave the district courts "cognizance" of certain causes of action, and the term bespoke a grant of jurisdiction, not power to mold substantive law. *See*, *e. g.*, The Federalist No. 81, pp. 447, 451 (J. Cooke ed. 1961) (A. Hamilton) (using "jurisdiction" interchangeably with "cognizance"). The fact that the ATS was placed in § 9 of the Judiciary Act, a statute otherwise exclusively concerned with federal-court jurisdiction, is itself support for its strictly jurisdictional nature. Nor would the distinction between jurisdiction and cause of action have been elided by the drafters of the Act or those who voted on it. As Fisher Ames put it, "there is a substantial difference between the jurisdiction of the courts and the rules of decision." 1 Annals of Cong. 807 (Gales ed. 1834). It is unsurprising, then, that an authority on the historical origins of the ATS has written that "section 1350 clearly does not create a statutory cause of action," and that the contrary suggestion is "simply frivolous." Casto, The Federal Courts' Protective Jurisdiction over Torts Committed in Vi-

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[26] *See* Norex Petroleum Ltd. v. Access Indus., Inc., 631 F.3d 29 (2d Cir. 2010) (applying the presumption against extraterritoriality in *Morrison* and dismissing extraterritorial claims under RICO).

> olation of the Law of Nations, 18 Conn. L. Rev. 467, 479, 480 (1986). . . .[27]

Still, the Court is uncomfortable with the notion that Congress, when enacting a statute with a jurisdictional provision, was not at least aware of a substantive cause of action for which the jurisdiction could be used. For the Alien Tort Claims Act, the Court could look to the common law that existed at the time of the Act and hold that Congress envisioned the grant of jurisdiction being used for something even if Congress was not creating a new substantive cause of action:

> But holding the ATS jurisdictional raises a new question, this one about the interaction between the ATS at the time of its enactment and the ambient law of the era. *Sosa* would have it that the ATS was stillborn because there could be no claim for relief without a further statute expressly authorizing adoption of causes of action. *Amici* professors of federal jurisdiction and legal history take a different tack, that federal courts could entertain claims once the jurisdictional grant was on the books, because torts in violation of the law of nations would have been recognized within the common law of the time. Brief for Vikram Amar et al. as *Amici Curiae*. We think history and practice give the edge to this latter position.[28]

The problem with Dodd-Frank Section 929P is that *Morrison* predated the statute, and under *Morrison* there is no substantive cause of action under Section 10(b) unless there is a securities transaction inside the United States. A court applying reasoning similar to that of the Court in *Sosa* would be forced to find that Section 929P was "stillborn" in that it conferred jurisdiction that could not be used for anything substantive—in cases without a U.S. securities transaction—until a further statute were enacted. Whether a federal court will so hold, despite the very likely congressional intent to the contrary, remains to be seen.

Congress would help the SEC and DOJ, as well as the courts, avoid litigation over this problem if it were to enact a new provision that clearly states that it addresses the extraterritorial reach of these provisions of the securities laws as well as jurisdiction.[29]

B. Does Dodd-Frank reinstate the "conduct and effects" tests? If so, how?

If the Dodd-Frank extraterritoriality provision does anything substantive in addition to conferring jurisdiction, it probably reinstates the conduct

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[27] Sosa v. Alvarex-Machain, 542 U.S. 692, 713 (2004).

[28] *Id.* at 714.

[29] *See* Comment Letter of Richard W. Painter to the SEC (Feb. 17, 2011) (on file with author), *available at* http://www.sec.gov/comments/4-617/4617-7.pdf.

and effects tests with all of their ambiguities. But which versions of these tests and how shall they be applied?[30]

For conduct that has no demonstrable effect in the United States, but that does have an effect on investors abroad, the controlling factor will be the conduct test in subsection (b)(1) of the Dodd-Frank provision. In interpreting this provision courts will likely look back to the pre-*Morrison* conduct test which focused "on the nature of [the] conduct within the United States as it relates to carrying out the alleged fraudulent scheme . . ."[31]

Prior to *Morrison*, the Second, Fifth, and Seventh Circuits required that more than mere "preparatory" conduct to the fraud occur in the United States.[32] The distinction between "preparatory" conduct and "substantial" conduct, however, is an illustration of how confusing this version of the conduct test was in practice. The Second Circuit had applied this test in the *Morrison* case itself and was probably correct in finding that NAB's alleged conduct in the United States was at most "preparatory" to the alleged securities fraud and that a "substantial" component of the alleged fraud itself took place in Australia and not in the U.S. However, what constitutes "preparatory" conduct and "substantial" conduct under the facts of any particular case is necessarily determined by a court on an *ad hoc* basis, and therefore litigants face great "difficulty in predicting the application of the conduct test."[33] As Professors Choi and Silberman conclude, the "amount and importantly the qualitative type of conduct that must occur in the United States to trigger the conduct test is uncertain."[34]

The Third, Eighth, and Ninth Circuits had adopted a more relaxed approach, looking to whether the U.S. conduct has significantly contributed to the fraudulent scheme.[35] There was also confusion with this "significant contribution" approach as it is not clear how significant the U.S. contribution to the fraudulent scheme must be for Section 10(b) to apply.

The Dodd-Frank language refers to "conduct within the United States that constitutes significant steps in furtherance of the violation." The use of the word "significant" hints at the more relaxed approach of the Third,

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[30] The SEC's view is that Congress did adopt the conduct and effects tests in this provision of Dodd-Frank, and the SEC points to the Second Circuit test in particular. *See* SEC's Memorandum of Law in Opposition to Defendant Tourre's Motion for Judgment on the Pleadings at 7 n.1, *supra* note 24, at n. 1, stating: "In legislation recently enacted, Congress effectively overruled *Morrison* by codifying the Second Circuit's long-standing conduct and effects test (which *Morrison* had repudiated) for civil enforcement actions brought by the SEC. Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub. L. No.111-203, § 929P, 124 Stat. 1376 (July 21, 2010)." The SEC did not, however, claim that this provision was retroactive and thus contended that the transactions at issue in the *Tourre* case had taken place within the United States and thus could proceed under *Morrison*.

[31] Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir. 1983).

[32] *See, e.g.*, *id.* at 1046.

[33] *See* Stephen J. Choi & Linda J. Silberman, *Transnational Litigation and Global Securities Class Action Lawsuits*, 2009 Wis. L. Rev. 465, 492.

[34] *Id.*

[35] *See, e.g.,* SEC v. Kasser, 548 F.2d 109, 114 (3d Cir. 1977), *cert. denied*, 431 U.S. 938 (1977).

Eighth, and Ninth Circuit, but the Dodd-Frank provision focuses also on "steps in furtherance of the violation" which may—or may not—be more than a "contribution" to the violation.

For transactions where the premise of the SEC or DOJ suit is a "foreseeable substantial effect" in the United States, as set forth in subsection (b)(2) of the Dodd-Frank provision, the courts will probably return to the pre-*Morrison* effects test. Here also there is ambiguity. Courts sought to define how much and what type of an effect conduct has to have in the United States for Section 10(b) to apply extraterritorially. Courts generally required that the effect of the fraudulent conduct abroad be on U.S. investors or U.S. markets. For example, a transaction outside the United States might have an effect on the trading price of a security inside the United States sufficient to justify application of Section 10(b).[36] The effect, however, cannot be too general. The Second Circuit in *Bersch v. Drexel Firestone* thus held that "an adverse effect on this country's general economic interests or on American security prices" did not generate sufficient effect to result in the extraterritorial application of Rule 10b-5.[37]

The Dodd-Frank provision in subsection (b)(2) now says that the effect has to be "foreseeable and substantial" but does not mention that the effect has to be on U.S. markets or investors or on securities transactions taking place in the United States. The statute only provides that the effect has to be "within the United States."

For SEC and DOJ suits premised on conduct outside the United States that has an effect on securities transactions in the United States, Section 10(b) probably applies even without this Dodd-Frank provision. Presumably under *Morrison* a single securities transaction in the United States is enough for Section 10(b) to apply to any fraud "in connection with" that transaction, whether or not the effect on U.S. investors is "substantial." The provision in subsection (b)(2) of Dodd-Frank thus is superfluous whenever a connection can be shown between a fraud anywhere and a securities transaction within

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[36] *See* Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *overruled on other grounds*, 405 F.2d 215 (2d Cir. 1968). In *Schoenbaum*, a U.S. shareholder of Banff Oil Ltd., a Canadian corporation, alleged a violation of Section 10(b) claiming that controlling shareholders had arranged to purchase stock from the corporation in Canada for an artificially low price and that the sale of undervalued stock in Canada would negatively affect the price of Banff stock trading in the United States. The Second Circuit held that this negative effect on price was an effect in the United States sufficient to justify the extension of U.S. jurisdiction. This is one of many "effects" cases that, after *Morrison*, and even without Dodd-Frank Section 929P, might still be pursued by the SEC under Section 10(b) provided there are identifiable U.S. securities transactions in connection with the alleged fraudulent conduct outside the United States. This is because *Morrison* makes it quite clear that the determining factor for deciding whether Section 10(b) applies is whether there was a securities transaction inside the United States. *See* Morrison v. Nat'l Austral. Bank, 130 S. Ct. at 2884–85. Section 929P also covers another set of cases where there is a "foreseeable substantial effect" within the United States, broad language that probably covers some situations even where there is no identifiable U.S. securities transaction connected to the alleged fraud.

[37] Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 989 (2d Cir. 1975).

the United States. Indeed, the Dodd-Frank provision requires that the effect within the United States be "substantial," a requirement that in some cases makes the Dodd-Frank extraterritorial enforcement authority narrower than the authority that the SEC already had.

The effects test in subsection (b)(2) of the Dodd-Frank provision only broadens the SEC's authority in situations where the SEC uses it to pursue conduct outside the United States that has an effect inside the United States, but where the fraud is not "in connection" with a securities transaction in the United States. If the effect is still on a securities transaction taking place in the United States, this set of cases would be very small because courts interpret the "in connection with" language in Section 10(b) so broadly[38] that any fraud that has an effect on a U.S. securities transaction is also likely to be "in connection" with that transaction. Alternatively, the courts could interpret the "effects test" language in subsection (b)(2) of the Dodd-Frank provision more broadly and allow some SEC and DOJ enforcement actions where there is only a more general effect on U.S. securities prices, although not on specifically identifiable transactions, provided the effect is foreseeable, substantial, and predictable. Finally, courts could opt for the broadest possible interpretation and jettison entirely the requirement that there be an effect on U.S. securities markets. Under this interpretation, the provision would allow SEC and DOJ actions against a fraud outside the United States that causes U.S. investors to lose money in securities transactions outside the United States. Interpreted this way, the provision is extremely open-ended, giving the SEC apparent authority to pursue fraud on the London Stock Exchange that causes foreseeable and substantial harm to U.S. investors (given the large number of U.S. institutions that invest in London Stock Exchange stocks, such a showing might be easy for the SEC to make). Thus, depending upon how it is interpreted, subsection (b)(2) of the Dodd-Frank provision (i) is superfluous in that it covers very few instances in which the SEC or DOJ could not have pursued an action anyway for fraud outside the United States in connection with a securities transaction inside the United States, or (ii) allows the SEC or DOJ to pursue fraudulent conduct abroad that has a substantial and foreseeable effect in the United States, but not necessarily on easily identifiable securities transactions in the United States, or (iii) allows the SEC or DOJ to pursue fraudulent conduct abroad that causes U.S. investors to suffer foreseeable and substantial losses in foreign markets.

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[38] In Merrill Lynch v. Dabit, 547 U.S. 71 (2006), the Court held that "holder" class actions brought under state law by persons who did not buy or sell the securities they owned are still "in connection with the purchase or sale" of a security and therefore are preempted by this "in connection with" language in the Securities Litigation Uniform Standards Act of 1998. This is the case even though there is only a limited federal cause of action under 10(b), because the Court had ruled previously that a plaintiff must be a purchaser or seller of the securities in question in order to sue under Section 10(b). *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

Given the lack of clarity in the statutory text, a sensible approach might be for courts interpreting Section 929P to return to some version of the "effects" test in the courts of appeals, which generally required some specific effect on investors or markets inside the United States. There might be a small subset of transactions in which the SEC could find this enforcement authority useful, but the SEC is unlikely to gain an advantage by using the Dodd-Frank provision when it could also use a conventional method—either a lawsuit under the *Morrison* construction of Section 10(b) for fraud in connection with a U.S. securities transaction or a proceeding under Section 30 of the Exchange Act (discussed in Part III.D below).

As several courts and commentators pointed out before *Morrison*, no "cohesive doctrine" has arisen from the "conduct and effects" tests.[39] The Dodd-Frank provision is a "mish mash" of language taken from pre-*Morrison* opinions in the courts of appeals. In the conduct test in subsection (b)(1), Congress missed a chance to define what conduct constitutes "significant steps" in furtherance of a violation or how significant the conduct must be—marginally significant, critically significant, "but for" significant or some other type of significance. In the "effects" test in subsection (b)(2) Congress missed an opportunity to specify what types of effects within the U.S. are covered by the statute. Most of the pre-*Morrison* confusion in this area of the law thus remains intact for SEC and DOJ suits brought under the Dodd-Frank extraterritoriality provision. The only way to avoid this confusion is for Congress to amend the statute to be clearer about what it intends, or for courts to refuse to recognize that the statute does anything more than confer jurisdiction that *Morrison* recognizes the courts already have.

C. *Is the Dodd-Frank provision retroactive?*

A final interpretive issue is whether the extraterritorial provision of Dodd-Frank is retroactive or prospective only. Can the SEC or DOJ use Section 929P to pursue fraudulent conduct in connection with securities transactions outside the United States before the effective date of Dodd-Frank? Probably not.

Statutes that change the definition of prohibited conduct are presumed not to be retroactive. As the Supreme Court stated in *Landgraf v. USI Film Products*:

> [T]he presumption against retroactive legislation is deeply rooted in our jurisprudence . . . . Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and confirm their conduct accordingly . . . .

[39] *See* In re Alstom Sec. Litig., 406 F. Supp. 2d 346, 375 (S.D.N.Y. 2005); *see also* Choi & Silberman, *supra* note 33.

> [T]he antiretroactivity principle finds expression in several provisions of our Constitution. The *Ex Post Facto* Clause flatly prohibits application of penal legislation.[40]

Unless Congress specifies otherwise, statutes are thus deemed to be prospective only. "[W]hile the constitutional impediments to retroactive civil legislation are now modest, prospectivity remains the appropriate default rule."[41] The fact that Section 929P addresses Section 10(b) of the Exchange Act and Section 17(a) of the Securities Act—violations of which can be prosecuted criminally—makes the case against retroactivity that much more compelling.

Although the courts of appeals had been applying various iterations of the conducts and effects tests for decades prior to *Morrison*,[42] the law in this area was hardly predictable before *Morrison*, and in any event *Morrison* held that these appellate opinions were incorrect and that Section 10(b) did not apply to securities transactions outside the United States.[43] If Congress changed the scope of Section 10(b) in SEC and DOJ actions in Section 929P, it would have had to have done so prospectively or at least to have clearly stated that the provision was retroactive. Congress did not do so.

If the statutory language were only procedural, for example defining the jurisdiction of federal courts to hear these cases or defining some other procedural aspect of a Section 10(b) case having nothing to do with the prohibited conduct, this presumption against retroactivity probably would not apply. For the SEC to argue in favor of retroactivity on these grounds, however, the SEC would have to acknowledge that Section 929P of Dodd-Frank did nothing more than confer jurisdiction in SEC and DOJ suits. Such an acknowledgment would imply that the provision had no substantive impact on the extraterritorial scope of Section 10(b) itself. The SEC would then be left with the *Morrison* holding that federal courts have jurisdiction over all Section 10(b) cases, but no cause of action exists on the merits when the securities transaction occurs outside the United States.

An important case where the question of retroactivity would be relevant is the SEC enforcement action against Fabrice Tourre, a former Goldman Sachs banker who allegedly orchestrated deceptive sales of synthetic mortgage-backed securities and security-based swap agreements by Goldman Sachs to foreign banks. In *SEC v. Tourre* the SEC alleged that Tourre violated Section 10(b) and Rule 10b-5 by making false and misleading statements in connection with these transactions as well as aided and abetted violations by Goldman Sachs.[44] The SEC refers to the Dodd-Frank extraterri-

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[40] Landgraf v. USI Film Products, 511 U.S. 244, 265–66 (1994).
[41] *Id.* at 272.
[42] *See supra* notes 21–22 and accompanying text.
[43] *See supra* note 7 and accompanying text.
[44] Complaint, SEC v. Goldman Sachs & Co. (SEC v. Tourre), No. 10 Civ. 3229, 2010 WL 1508202 (S.D.N.Y. Apr. 16, 2010).

toriality provision in a footnote to a brief in this case, but does not argue that the provision is retroactive.[45] The SEC instead argues that the security-based swap agreements sold by Tourre and Goldman Sachs were transactions in the United States under *Morrison*.[46] It appears from this case that the SEC will not try to argue that the Dodd-Frank extraterritoriality provision can be used retroactively to pursue the transactions that took place at the time of the 2008 financial crisis. In the present round of enforcement proceedings, the SEC will have to make the best case it can that the transactions in question occurred inside the United States.

D. How much new enforcement authority for the SEC and DOJ does the Dodd-Frank extraterritoriality provision provide? How will it be used?

The SEC and DOJ did not need a provision that expanded the scope of Section 10(b) extraterritorially to pursue most cases that relate to their core mission of protecting U.S. investors and U.S. markets from securities fraud. Furthermore, the extraterritoriality provision of Dodd-Frank may not have provided the SEC and DOJ with much enforcement authority with respect to securities fraud outside the United States that they did not already have, even after *Morrison*.

Section 10(b) already applies whenever a single U.S. securities transaction is affected by the alleged fraud. National Australia Bank, for example, had ADRs listed in New York and could have been sued by the SEC for the fraud alleged in *Morrison*. Section 10(b), as construed in *Morrison*, also gives the SEC or DOJ authority to pursue fraudulent conduct that affects the price of just about any securities transaction inside the United States. Foreign companies lying to their investors while their securities—underlying common securities or ADRs—are trading in the United States is one example. Foreign traders who make public statements or use transactions on non-U.S. exchanges to manipulate the price of securities traded in the United States is another example. So long as there is a "connection"[47] between the fraudulent conduct anywhere and a U.S. securities transaction, the SEC or DOJ would have a good chance of succeeding with a conventional Section 10(b) enforcement action brought against the perpetrator regardless of where the conduct occurred.

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[45] SEC's Memorandum of Law in Opposition to Defendant Tourre's Motion for Judgment on the Pleadings at 7 n.1, SEC v. Tourre, No. 10 Civ. 3229, 2010 WL 4530690 at n.1, (S.D.N.Y. Oct. 13, 2010).

[46] *Id.* at 6–10. *See infra* Part IV. The circumstances in which securities-based swaps and other private transactions are transactions in the United States for purposes of *Morrison* is another topic that Congress failed to address in Dodd-Frank.

[47] Section 10(b) prohibits manipulative devices or contrivances "in connection with" the purchase or sale of a security. 15 U.S.C. § 78j(b) (2006).

Section 30 of the Exchange Act[48] gives the SEC yet more enforcement authority when fraudulent conduct in foreign markets is used by broker-dealers to circumvent U.S. securities laws. The *Morrison* opinion observed that in Section 30 Congress specifically addressed those situations where the SEC needs to protect investors in the United States against violations of the Exchange Act in foreign trading markets. The Supreme Court explained that Section 30(b) "seems to us to be directed at actions abroad that might conceal a domestic violation, or might cause what would otherwise be a domestic violation to escape on a technicality."[49]

Thus, while *Morrison* and other f-cubed cases were important to the size of the plaintiff class in private suits—an issue relevant to the compensation of plaintiffs' lawyers—f-cubed cases were in most situations irrelevant to the SEC's enforcement authority. The SEC could sue under Section 10(b) in any situation where U.S. securities transactions were also connected to the alleged fraud. The SEC, furthermore, is not likely to have a good reason to bring an enforcement action alleging fraud in securities transactions outside the United States if there are no U.S. transactions that are also connected to the alleged fraud. There may be a few cases where investors in the United States are defrauded only through transactions abroad, but Section 30 already gives the SEC additional enforcement power in cases where a broker-dealer is involved in foreign transactions and there is an attempt to evade U.S. securities laws. Because the SEC already has this authority to pursue fraudulent conduct in connection with any U.S. securities transactions and to pursue broker-dealer conduct abroad that evades U.S. securities laws, the SEC probably did not need the extraterritoriality provision of Dodd-Frank to carry out its core mission of protecting investors who are harmed in the United States.

The Dodd-Frank extraterritoriality provision, assuming it does anything other than confer jurisdiction, is open-ended compared with this targeted authority that the SEC and DOJ have under Section 10(b) and Section 30.

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[48] Section 30 provides:

> (a) It shall be unlawful for any broker or dealer, directly or indirectly, to make use of the mails or of any means or instrumentality of interstate commerce for the purpose of effecting on an exchange not within or subject to the jurisdiction of the United States, any transaction in any security the issuer of which is a resident of, or is organized under the laws of, or has its principal place of business in, a place within or subject to the jurisdiction of the United States, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors or to prevent the evasion of this chapter.
>
> (b) The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.

15 U.S.C. § 78dd (2006).

[49] Morrison v. Nat'l Austl. Bank, 130 S. Ct. 286, 2882–83 (2010).

Given that the SEC and DOJ can pursue most cases that impact U.S. markets and U.S. investors without the extraterritorial authority in Dodd-Frank, what will the SEC and DOJ do with this new provision?

One thing the SEC and DOJ may do with their Dodd-Frank extraterritorial enforcement authority is pursue cases involving security-based swap agreements and other similar transactions in circumstances where it is not clear whether the transactions took place inside or outside the United States for purposes of *Morrison*. The *SEC v. Tourre* case is one example, and indeed the SEC cited the Dodd-Frank extraterritoriality provision in its brief, suggesting that it will probably use this new authority in cases where the alleged conduct took place after Dodd-Frank was enacted.[50] As explained more fully in Part IV below, however, the SEC or Congress will sooner or later, for the benefit of private litigants as well as the SEC and DOJ, need to devise a workable test for discerning when a security-based swap agreement takes place inside the United States for purposes of *Morrison*.[51] The Dodd-Frank extraterritorial enforcement provision is a blunt instrument that the SEC and DOJ can use to avoid this issue until it is resolved. An enforcement approach that does not take into consideration the location of the swap agreement, however, risks the SEC and DOJ using the Dodd-Frank extraterritoriality provision to prosecute cases in which the United States has no genuine interest.

A second objective the SEC and DOJ might pursue with 929P is disgorgement of profits and other penalties in connection with securities transactions outside the U.S. when the same fraud also affected transactions inside the U.S. In some cases, expanding the scope of monetary recovery would expand the deterrent effect of SEC and DOJ endorsement actions.

A third objective the SEC and DOJ might pursue with the Dodd-Frank extraterritoriality provision is enforcement of U.S. insider trading laws abroad. The increasing number of foreign issuers doing business in the United States creates opportunities for corporate executives, investment bankers, consultants, and other fiduciaries to misappropriate information in the United States and then use it to trade in foreign markets. Because the SEC is more vigilant in enforcing insider trading laws than most foreign securities regulators, and criminal penalties for insider trading in the United States are harsher, such persons may attempt to evade enforcement by trading on inside information outside the United States. In response, the SEC and DOJ could turn to the extraterritoriality provisions of Dodd-Frank. Indeed, even before Dodd-Frank, the SEC has pursued cases involving insider trading in securities listed in the United States and abroad.[52] Prior to *Morrison*, the SEC could, theoretically at least, have used the conduct and effects

[50] *See supra* note 45 and accompanying text.

[51] *See infra* note 67 and accompanying text, discussing ambiguities about the status of securities-based swap agreements under *Morrison* and the need for this issue to be resolved.

[52] *See, e.g.*, Complaint, SEC v. MacDonald, No. 09 Civ. 5352, 2009 WL 1683785 (S.D.N.Y. June 9, 2009) (alleging insider trading in the United States and Canada).

tests to go after foreign transactions. The extraterritoriality provision may now allow the SEC to go after some of the foreign transactions despite *Morrison*.

Whether this is a good idea is another question. The SEC and DOJ could use Section 929P to impose United States law on trading in foreign securities markets whenever the alleged fraudulent conduct—here misappropriation of material nonpublic information—occurred in the United States. The SEC's and DOJ's Section 929P authority would be in addition to the authority they already have under Section 30 of the Exchange Act to pursue conduct by broker-dealers in foreign markets that evades U.S. securities laws, and presumably insider trading in foreign markets on the basis of information misappropriated in the United States is the type of conduct covered by Section 30. Does the SEC really need the authority to pursue persons other than broker-dealers who trade on such information exclusively in non-U.S. markets or is this a question best left to foreign regulators, perhaps working in conjunction with the SEC?

The difficulty with unilateral SEC enforcement of insider trading law in foreign markets is that traders who misappropriate information in the United States would be subject to one enforcement regime, whereas those who misappropriate information outside the United States would be subject to another enforcement regime or perhaps to no enforcement at all. Different market participants would play by different rules depending on where they received the information that was the basis for their trades. It is one thing to expect worldwide compliance with U.S. insider trading law by broker-dealers already regulated by the SEC because of their operations inside the United States, an end for which Section 30 was presumably designed. Is it necessary or even desirable, however, to impose U.S. insider trading law on other participants in foreign markets simply because they obtained some of their information inside the United States? The governments and nongovernmental organizations charged with regulating non-U.S. securities markets might not find U.S. insider trading law easy to implement. Investors in non-U.S. markets might also be troubled by the fact that their exposure to SEC or DOJ investigation and prosecution turns on the location of the source of information they use to trade, and whether or not the information was misappropriated inside or outside the United States, facts that might not even be known to an investor at the time of the trade. Foreign issuers that do not want their insiders exposed to U.S. insider trading law might respond to this uncertainty by keeping important nonpublic information out of the United States, which could mean a loss of business for U.S. investment bankers, management consultants, and lawyers, as well as lost business opportunities for U.S. companies.

Another set of problems arises because U.S. insider trading law is unique in its reliance on case law without a statutory definition of illegal insider trading.[53] Along with prohibiting corporate insiders from trading on nonpublic information absent disclosure, Section 10(b) has been held to prohibit trading by corporate outsiders on the basis of information that has been misappropriated in breach of a relationship of trust and confidence with the source of the information.[54] SEC rules attempt to define those fiduciary relationships in which the parties have an agreement or pattern of sharing confidences sufficient to give rise to insider trading liability under the misappropriation theory.[55] Persons who give tips with misappropriated information, as well as persons who trade on such tips, may be criminally and civilly liable.[56] The SEC enforces this insider trading prohibition civilly and refers appropriate cases to the DOJ for criminal prosecution.

Enforcement, however, can be impeded by the difficulty of detection and problems of proof. Information may be passed by a "tipper" to a "tippee" who then disguises trading by simultaneously making a large number of other trades or by using complex derivatives instruments. If inside information is passed through several sources before trading, detection is even more difficult. Furthermore, under *Dirks* the tipper or someone else must receive an identifiable benefit in return for the tip to create liability.[57] Prosecution of the tipper is difficult unless it can be shown that the tipper knew that the tippee was likely to trade on the information in securities markets.[58] These requirements make it difficult for the SEC and DOJ to investigate and prove insider trading cases even when all or most of the relevant conduct took place in the United States. The SEC and DOJ will confront further obstacles when they take this enforcement regime into foreign countries where traders, tippers, and tippees have allegedly engaged in conduct that violates Section 10(b).

Effective enforcement will require the SEC and DOJ to have access to trading data, electronic communications, and other information from foreign

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[53] *See generally* Richard W. Painter, Kimberly D. Krawiec & Cynthia A. Williams, *Don't Ask, Just Tell: Insider Trading after* United States v. O'Hagan, 84 VA. L. REV. 153 (1998) (discussing ambiguities in U.S. insider trading case law).

[54] United States v. O'Hagan, 521 U.S. 642 (1997) (lawyer violated Section 10(b) of the 1934 Securities Exchange Act and SEC Rule 10b-5 by trading in a company's securities based on information he learned about an imminent tender offer for that company by a client of his firm).

[55] The SEC has sought to clarify when a duty of trust or confidence exists in Rule 10b5-2. 17 C.F.R. § 240.10b5-2 (2010). The rule provides that such a duty exists when a person agrees to maintain the information in confidence, when there is "a history, pattern or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality," or when the information was learned from a close family member. *Id.*

[56] *See* Dirks v. SEC, 463 U.S. 646 (1983) (holding that to establish an insider trading violation, tipper must be breaching a duty of trust and confidence with the source of the information and the tipper must receive some personal benefit in return for the breach).

[57] *Id.* at 662–65.

[58] *See id.* at 659; SEC v. Switzer, 590 F. Supp. 756, 766 (W.D. Okla. 1984) (ruling that Rule 10b-5 does not apply to trading after overhearing a conversation containing material nonpublic information at a sporting event).

countries. This evidence may not be easily obtainable if foreign financial regulators and other law enforcement authorities do not cooperate. Cooperation will likely not be forthcoming if it appears that the SEC and DOJ are pursuing not only persons who misappropriate information inside the United States, but also other participants—tippees, tippers, traders, and accomplices—whose conduct occurred outside the United States. SEC and DOJ enforcement actions will be particularly controversial if these same non-U.S. persons would not be prosecuted under local law for trading on information misappropriated from somewhere other than the United States.

Some of these insider trading cases could probably be pursued by the SEC or DOJ through conventional means—in other words, without the Dodd-Frank extraterritoriality provision—even when the trader does not engage in a U.S. securities transaction. These cases would involve a trader who stands in a fiduciary relationship with shareholders trading in an issuer's shares inside the United States—for example, an officer or director of a company with shares trading in the United States. The trading fiduciary probably breaches a duty to disclose to his company's shareholders the material nonpublic information once he has decided to use that information for his personal gain. It should not matter where the fiduciary trades on the information or where his tippees trade. If the information is material to the U.S. investors' trading decisions and the fiduciary has an obligation to disclose the information to them, the fiduciary has violated Section 10(b) in a manner similar to any other corporate officer who lies to shareholders or conceals from shareholders material information the officer is obligated to disclose. These types of cases would pose practical difficulties if the SEC and DOJ tried to prosecute not only the fiduciary of the U.S. issuer but also the fiduciary's tippees and accomplices abroad. The SEC and DOJ, however, at least should not need the extraterritorial authority of Dodd-Frank 929P to pursue the fiduciary because the securities transactions connected to the failure to disclose the information—and adversely affected by the failure to disclose—would be in the United States.

However, the SEC and DOJ might need to use the extraterritorial reach of Section 10(b) in Dodd-Frank section 929P where the trader who uses the material nonpublic information does not have a fiduciary relationship with persons who are trading in the same or similar securities in the United States, but does have a fiduciary relationship with the source of the information. In these cases—often called "misappropriation theory" cases in U.S. insider trading jurisprudence[59]—the trader or his tipper breach a fiduciary duty by misappropriating information from one entity for trading in the securities of another entity with which they do not have a fiduciary relationship. The breach of a duty to the first entity, the source of nonpublic

[59] *See O'Hagan*, 521 U.S. at 652; Painter, Krewiec & Williams, *supra* note 53 (discussing problems with the misappropriation theory and contrasting it to the approach in other countries).

information, is the premise for the Section 10(b) violation, and there is no presupposed duty to the second entity or by extension to any traders in that entity's shares. In these cases, U.S. insider trading law protects sources of material nonpublic information rather than U.S. securities markets.

This unique application of U.S. insider trading law may be justifiable when misappropriated information is used in U.S. securities markets, as trading on misappropriated nonpublic information is believed to undermine the integrity of securities markets. However, if only the misappropriation occurs in the United States, and there is no U.S. trading in the relevant securities, the U.S. interest in an insider trading enforcement proceeding is more attenuated. Foreign market participants, market regulators and governments may even be hostile to the enforcement effort, particularly if the SEC or DOJ use their authority under Dodd-Frank to go further than prosecuting persons who misappropriated information in the United States. It is one thing for the SEC or DOJ to prosecute a person who misappropriates nonpublic information inside the United States and uses it for trading abroad or for tipping off someone who trades, but it would be considerably more controversial for U.S. enforcement authorities to pursue non-U.S. tippees trading on the information outside the United States. Foreign issuers would probably find the misappropriation theory in U.S. insider trading law to be unfamiliar and unpredictable, and they might respond by keeping their important executives and important business deals outside of the United States.

The United States thus probably should not try to unilaterally impose its system of insider trading regulation on securities markets outside the United States. It may be better for the SEC and Congress to recognize that other laws would be more effective instruments for prohibiting misappropriation of information inside the United States. Using the mail fraud or wire fraud statutes to prosecute persons who misappropriate confidential information inside the United States and sell it anywhere, or enacting a new statutory provision to prohibit unauthorized disclosure of confidential information obtained inside the United States for purposes of securities trading anywhere, are both viable options. Financial markets law is a particularly awkward instrument to accomplish this objective when a legitimate claim cannot be made that the purpose of enforcement is protection of U.S. markets. The SEC and DOJ furthermore might get further in combating global insider trading by encouraging foreign regulators to be more vigilant in pursuing insider trading while recognizing that different markets operate under different rules that define what types of insider trading are illegal and why. It makes little sense for the United States to create a regime in which traders in securities markets all over the world are subject to different rules depending on where they get their information rather than where they trade.

More generally, the extraterritoriality provision of Dodd-Frank could provoke adverse reaction abroad if the SEC pursues cases—whether insider trading cases or any other cases—unilaterally. Coordinated enforcement with foreign regulators would be more effective. The SEC and DOJ should not be perceived as attempting to set the enforcement agenda and perhaps even the private litigation agenda in other countries.

IV. Did Congress Miss an Opportunity to Address Open Issues on Extraterritoriality?

Dodd-Frank arguably missed an opportunity to clarify some important issues that remain open after *Morrison*. These include the status of dually-listed securities, an issue that ought to be clear but is still being contested by plaintiffs' lawyers, criteria for determining whether private transactions take place within the United States, the status of parties to derivative securities transactions in the United States that are based on foreign-traded securities, and the status of a transaction on a foreign exchange that is placed by a U.S. customer through a U.S. broker-dealer. Congress could have dealt with all of these issues but did not. Instead, Congress passed a provision that may not do anything at all, and if it does something, it reinstates in SEC and DOJ enforcement actions the confusion that existed under the conduct and effects tests before *Morrison* was decided.

First, there is the status of dually-listed securities, those securities listed both in the United States and in another country. Many Canadian companies have common stock that trades on both the Toronto Stock Exchange and the New York Stock Exchange. With the potential merger of the New York Stock Exchange and the Deutsche Boerse, there may be more securities listed both in New York and in Europe. Does Section 10(b) apply to trades in these securities made outside the United States?

The logic of the *Morrison* opinion suggests that Section 10(b) should apply only to transactions made in the United States. However, plaintiffs' lawyers have seized upon a sentence Justice Scalia used to summarize the *Morrison* opinion: "[a]nd it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies."[60] At the end of the opinion, Justice Scalia uses similar language: "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."[61] These two sentences, if read in isolation, suggest that a security listed on a U.S. exchange is covered by Section 10(b), even if that security is purchased outside the United States. Under this theory, Section 10(b) would apply to a purchase of securities in Germany on the Deutsche Boerse by a German citizen, simply because the shares are of a class that is also listed in New York. Plaintiffs' lawyers have

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[60] 130 S. Ct. 2869, 2884 (2010).

[61] *Id.* at 2888. Justice Scalia probably draws this language from the language in Section 10(b) itself: "the purchase or sale of any security registered on a national securities exchange or any security not so registered." 15 U.S.C. § 78j(b) (2006).

claimed that as long as any shares are listed on a U.S. exchange, transactions of the same class of shares on foreign exchanges are also covered by Section 10(b).[62] So far most of these cases have been brought in the Southern District of New York where judges have rejected this dual-listing argument and refused to recognize a cause of action for plaintiffs who purchased securities outside the United States simply because the issuer lists securities of the same class inside the United States.[63]

This is an important issue not just in private lawsuits but in SEC enforcement actions, at least those involving conduct that occurred before the Dodd-Frank extraterritoriality provision was enacted. The SEC, in a recent insider trading enforcement case involving transactions in Toronto, suggested that the trades "that took place on Canadian exchanges also fall within the scope of Section 10(b), because as the Supreme Court recently held, those transactions were of 'a security listed on an American stock exchange.' "[64]

The dual-listing theory undermines the holding in *Morrison*, which focuses on the location of the transaction and clearly states that Section 10(b) does not apply extraterritorially.[65] Furthermore, allowing Section 10(b) suits over dually-listed securities traded outside the United States is inconsistent with an important policy rationale for the holding in *Morrison*: applying

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[62] *See, e.g.*, Plaintiffs' Supplemental Memorandum Concerning the Impact of *Morrison v. National Australian Bank* at 10-16, *In re* Vivendi Universal, S.A. Sec. Litig., No. 02 Civ. 5571 (S.D.N.Y. July 16, 2010).

[63] *See In re* Vivendi Universal, S.A. Sec. Litig., No. 02 Civ. 5571, 2011 WL 590915 (S.D.N.Y. Feb. 17, 2011); *In re* Royal Bank of Scotland Group PLC Sec. Litig., No. 09 Civ. 300, 2011 WL 167749, at *6–7 (S.D.N.Y. Jan. 11, 2011); *In re* Alstom SA Sec. Litig., No. 03 Civ. 6595, 2010 WL 3718863, at *2–3 (S.D.N.Y. Sept. 14, 2010) ("[T]he most natural and elementary reading of Morrison" is "[t]hat the transactions themselves must occur on a domestic exchange to trigger application of § 10(b)."); Sgalambo v. McKenzie, No. 09 Civ. 10087, 2010 WL 3119349, at *17 (S.D.N.Y. Aug. 6, 2010) (*Morrison* foreclosed claims of plaintiffs who purchased Canadian Superior common stock on a non-U.S. exchange); Anwar v. Fairfield Greenwich Ltd., 728 F. Supp. 2d 372, 404–05 (S.D.N.Y. 2010) (deferring ruling on whether *Morrison* applied subject to further discovery regarding whether the transaction occurred within the United States); Terra Sec. ASA Konkursbo v. Citiqroup, Inc., No. 09 Civ. 7058, 2010 WL 3291579, at *7 (S.D.N.Y. Aug. 16, 2010) (dismissing claims for financial instruments sold on foreign exchanges and outside of the United States); Cornwell v. Credit Suisse Group, 729 F. Supp. 2d 620 (S.D.N.Y. 2010).

[64] *See* Plaintiffs' Memorandum of Law in Support of Motion for Summary Judgment (September 24, 2010) in *SEC v. MacDonald*, *supra* note 52, at 11, n.2, quoting *Morrison*. Perhaps wisely the SEC only sought disgorgement of profits from trades in the United States and did not seek disgorgement of profits from trades in Toronto. *See id.* at 11. It is thus unlikely that a court will rule on this issue in that case.

[65] Furthermore, NAB had ADRs listed in New York (traders in the ADRs were not parties to the case in *Morrison*, and presumably could sue under Section 10(b)). *Morrison*, 130 S. Ct. 2869 (No. 08-1191) app. at 56. NAB's registration statement for the ADR's under the Exchange Act pertained to the "ordinary shares" because in order for a foreign issuer to list ADRs for trading in the United States it must register the underlying shares with the SEC. The Form 20-F included in the *Morrison* Appendix says NAB's ordinary shares were "registered" on the "NYSE". *Morrison*, 130 S. Ct. 2869 (No. 08-1191) app. at 58. *Morrison* held, however, that Section 10(b) did not apply to trades in NAB's ordinary shares in Australia.

U.S. law to transactions on foreign exchanges would interfere with the laws of other countries.[66]

Congress should have clarified this point by providing that the mere listing of a security in the United States does not mean that all of the issuer's securities will be treated as if they were traded in the United States for purposes of Section 10(b). If courts were to reach a contrary conclusion, non-U.S. issuers would be encouraged to delist their securities in the United States to avoid worldwide exposure to Section 10(b). This is one of several post-*Morrison* issues that Congress could have considered in Dodd-Frank but did not.

Another post-*Morrison* issue that Congress could have addressed in Dodd-Frank is the status of security-based swap agreements and other derivative securities traded inside the United States that reference securities traded outside the United States. *Elliott Associates, L.P. v. Porsche Automobil Holding SE*[67] raises this issue. In *Porsche*, the plaintiffs were international hedge funds who bet that the value of Volkswagen AG shares would decline by taking short positions in equities-based swap agreements that referenced the common stock of Volkswagen AG, which traded in Germany but not in the United States.[68] The plaintiffs alleged the swap agreements were entered into inside the United States, although they did not identify the location of their counter parties.[69] They sued Porsche alleging that Porsche increased its share ownership in VW through October 2008,[70] while denying its intent to take over VW. When, as a result of Porsche's allegedly deceptive conduct the price of VW shares rose, plaintiffs suffered losses from their short positions in VW.[71] Plaintiffs sued Porsche under Section 10(b) even though almost all of the alleged conduct occurred outside the United States.[72] Judge Baer dismissed the complaint and found based on the totality of the circumstances that the transactions had not been entered into in the United States and were thus barred under *Morrison*. Judge Baer found that "[t]he economic reality is that Plaintiffs' swap agreements are essentially 'transactions conducted upon foreign exchanges and markets,' and not 'domestic transactions' that merit the protection of § 10(b)."[73]

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[66] The application of *Morrison* to dually-listed securities is explored further in Painter, Dunham & Quackenbos, *supra* note 18.

[67] No. 10 Civ. 0532, 2010 WL 5463846 (S.D.N.Y. Dec. 30, 2010). For more extensive analysis of the *Porsche* decision, see Wulf A. Kaal & Richard W. Painter, *The Aftermath of* Morrison v. National Australia Bank *and* Elliott Associates v. Porsche, 14 EUR. COM. & FIN. L. REV. (Mar. 2011). For a general discussion of concerns in Europe about f-cubed securities litigation before *Morrison* was decided, see Wulf A. Kaal & Richard W. Painter, *Extraterritorial Application of US Securities Laws*, 7 EUR. COM. L. 90 (2010).

[68] *Porsche* at *1–2.

[69] *Id.* at *2.

[70] *Id.* at *3.

[71] *Id.*

[72] *Id.* at *1–3.

[73] *Id.* at *6.

The court reached a logical result—U.S. plaintiffs placing side bets in swap agreements in the United States over the performance of foreign stocks should not be permitted to use U.S. law to sue the foreign issuers of the reference securities or other parties trading in the reference securities outside the United States. However, the court did not articulate a workable test for discerning which security-based swap agreements should be deemed to take place inside the United States and which security-based swap agreements should be deemed to take place outside the United States. Which of the following factors should determine the location of the swap agreement transaction: (i) the trading market for the reference security, (ii) the location of one or both parties to the swap agreement, (iii) the currency in which the swap agreement is settled, (iv) the place of settlement for the swap agreement, or (v) some other factor or combinations of the above factors? Is it relevant where the alleged fraudulent conduct took place, or does emphasis on that factor circle back to the conduct test rejected by *Morrison*?

Although the facts of the *Porsche* decision gave significant weight to the trading market for the reference security, it is not at all clear that Section 10(b) should always apply simply because the reference security is traded inside the United States. Consider a swap agreement between two German counterparties referencing a NYSE-traded stock. In order to sue under Section 10(b) should not the German swap parties have to establish that their specific transaction took place in the United States? Is trading of the reference security in the United States sufficient ground to locate the swap transaction here as well, particularly if there is only a weak connection between the alleged fraud and the reference security? What if, for example, the German swap parties sue the issuer of the NYSE traded stock for misrepresentations to investors, but the issuer did not even know that the German swap existed when it made the alleged misrepresentation? What if the German swap parties sue each other under Section 10(b) over the swap agreement (for example, if one of them allegedly lied to the other about its creditworthiness)? Is the mere fact that the reference security is traded in the United States enough to give them a cause of action here instead of in Germany? Applying Section 10(b) to many of these scenarios is counterintuitive and does not comport with the overall reasoning in *Morrison*, which is that Section 10(b) protects investors who buy and sell securities in the Untied States.

On the other hand, a stronger case for applying Section 10(b) could be made if an executive of the NYSE traded company were to misappropriate material nonpublic information from the company in the United States and then enter into a swap agreement in Germany referencing the NYSE traded stock. This conduct—someone entering into a swap agreement in Germany using nonpublic information misappropriated outside of Germany—would still be a concern principally of German securities laws but it is also a legitimate concern of the securities laws in the country where the information was misappropriated, particularly if the reference security for the swap is traded in that same country and the swap agreement is entered into abroad in order to evade domestic securities laws.[74] Most insider trading cases, however, are pursued by the government, not by private plaintiffs, and as pointed out in Part III.D above, the SEC's and DOJ's extraterritorial enforcement authority in Section 929P of Dodd-Frank—if held by the courts to have the substantive effect that Congress probably intended—would allow such an insider trading case to proceed without the difficulty in analyzing the foreign swap transaction under *Morrison*.

Finally, returning to the swap agreement in *Porsche*, what if the U.S. parties to the swap agreement, instead of suing Porsche or Volkswagen, had sued their counterparties over misrepresentations made by them inside the United States about the terms of the swap agreement, the legality of the swap agreement under U.S. law or about their own creditworthiness? A U.S. court should not dismiss such a case under *Morrison* simply because the reference security was traded in Germany. In that instance, the swap participants seeking protection under Section 10(b) would have invested their money and lost it in the United States because of an alleged misrepresentation made to them in the United States. The underlying reasoning in *Morrison* does not foreclose such a claim.

Congress's failure to address extraterritorial application of Section 10(b) to security-based swaps is curious given the attention paid to security-based swaps in Dodd-Frank, which introduced a new definition of a "swap"[75] and a new definition of a "security-based swap agreement"[76] and

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[74] As pointed out in Part III.D of this Article, Section 10(b) could be held to apply to the executive's conduct regardless of where the swap occurred if there were also U.S. transactions in the company's stock and the executive had a fiduciary duty to disclose his foreign swap agreement to the U.S. shareholders but did not do so. Furthermore, if an investment bank or other broker-dealer is involved in the fraudulent conduct—for example in setting up the swap for the NYSE company executive to facilitate insider trading abroad—the extraterritorial reach of Section 30 of the Exchange Act would also apply.

[75] Section 721(a) of the Dodd-Frank Act amends Section 1(a) of the Commodity Exchange Act by adding paragraph (47) to define a "swap" as:

> any agreement, contract, or transaction– (i) that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind; (ii) that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence; (iii) that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level . . . including any agreement, contract, or transaction commonly known as– (I) an interest rate swap; (II) a rate floor; (III) a rate cap; (IV) a rate collar; (V) a cross-currency rate swap; (VI) a basis swap; (VII) a currency swap; (VIII) a foreign exchange swap; (IX) a total return swap; (X) an equity index swap;

which brought security-based swap agreements squarely under the federal securities laws and the jurisdiction of the SEC, whereas they had before only been subject to the antifraud provisions such as Section 10(b).[77] For example, Section 9 of the Exchange Act prohibiting market manipulation has been amended by Dodd-Frank to prohibit a broad range of fraudulent, deceptive, or manipulative conduct in connection with security-based swap agreements,[78] and the SEC has already promulgated Proposed Rule 9j-1[79] to

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> (XI) an equity swap; (XII) a debt index swap; (XIII) a debt swap; (XIV) a credit spread; (XV) a credit default swap; (XVI) a credit swap; . . . (iv) that is an agreement, contract, or transaction that is, or in the future becomes commonly known to the trade as a swap; . . . or (vi) that is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of clauses (i) through (v).

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 721(a)(21), § 1a(47), 124 Stat. 1376, 1666-67 (2010).

[76] Section 761(a) of the Dodd-Frank Act creates Section 3(a)(68) of the Exchange Act, which defines a "security-based swap" as, subject to certain exceptions:

> any agreement, contract, or transaction that–
> (i) is a swap, as that term is defined under section 1a of the Commodity Exchange Act (without regard to paragraph (47)(B)(x) of such section); and
> (ii) is based on–
> (I) an index that is a narrow-based security index, including any interest therein or on the value thereof;
> (II) a single security or loan, including any interest therein or on the value thereof; or
> (III) the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 761(a)(6), § 78c, 124 Stat. 1376, 1756 (2010).

[77] Both Section 10(b) of the Exchange Act and Section 17(a) of the Securities Act prohibited fraudulent conduct in connection with security-based swap agreements prior to Dodd-Frank. *See* 15 U.S.C. § 78j(b) (2006); 15 U.S.C. § 77g(a) (2006).

[78] Section 763(g) of the Dodd-Frank Act adds new subparagraph (j) to Section 9 of the Exchange Act making it unlawful for:

> any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange, to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security-based swap, in connection with which such person engages in any fraudulent, deceptive, or manipulative act or practice, makes any fictitious quotation, or engages in any transaction, practice, or course of business which operates as a fraud or deceit upon any person.

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 763(g), § 9(j), 124 Stat. 1376, 1777-78 (2010).
Section 9(j) of the Act also states that the Commission shall "by rules and regulations define, and prescribe means reasonably designed to prevent, such transactions, acts, practices, and courses of business as are fraudulent, deceptive, or manipulative, and such quotations as are fictitious." *Id.*

[79] As the SEC recognized in its proposing Release, "[b]ecause such payments or deliveries occur after the purchase of a security-based swap but before the sale or termination of the security-based swap" these payments and deliveries presumably should be addressed pursuant to Section 9 of the Exchange Act rather than Section 10(b) which requires a purchase or sale of a security or a security-based swap. Prohibition Against Fraud, Manipulation, and Deception in

prohibit certain fraudulent conduct that occurs in connection with ongoing payments or deliveries between the parties throughout the life of a security-based swap.

Given the enormous increase in the amount of regulation imposed on swap agreements and other derivatives in the United States under Dodd-Frank, the issue of when a swap agreement is deemed to occur inside the United States for purposes of Section 10(b) should have also been addressed in the Act. This question should not have been left up to courts applying *Morrison*, a case which did not involve swaps but rather conventional transactions in a foreign stock on a foreign exchange.

An additional complication arises from the fact that the Dodd-Frank Act requires some derivative securities to be traded on organized exchanges in the United States.[80] This makes it even more difficult to claim that a swap transaction is outside the United States for purposes of *Morrison* simply because the reference security is traded outside the United States. The Dodd-Frank Act should have explicitly stated whether Section 10(b) applies when swap agreements referencing non-U.S. securities are traded on U.S. securities exchanges, and whether Section 10(b) applies not only to defendants involved in the U.S. swap agreements but also to defendants issuing or trading in the reference securities outside the United States (e.g. *Porsche*). Congress should have addressed these issues in Dodd-Frank but did not do so.

For example, Congress could have provided that for purposes of Section 10(b) a swap agreement entered into inside the United States that references securities traded outside the United States would be deemed to be a transaction inside the United States only where the conduct alleged to have violated Section 10(b) was in connection with the swap itself rather than in connection with the reference security; otherwise, the swap agreement would be deemed to be a transaction outside the United States. Congress

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Connection with Security-Based Swaps, 75 Fed. Reg. 68560, 68561 (proposed Nov. 8, 2010) (to be codified at 17 C.F.R. pt. 240). Proposed Rule 9j-1, thus provides:

> It shall be unlawful for any person, directly or indirectly, in connection with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance,
>
> (a) To employ any device, scheme, or artifice to defraud or manipulate;
>
> (b) To knowingly or recklessly make any untrue statement of a material fact, or to knowingly or recklessly omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;
>
> (c) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
>
> (d) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Id. at 68568.

[80] *See, e.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, secs. 171(b)(7)(B)(i), 610, 124 Stat. 1376, 1438, 1611–12 (2010).

could have also provided that for purposes of Section 10(b) a swap agreement entered into outside the United States that references securities traded inside the United States would be deemed to be a transaction inside the United States only where the conduct alleged to have violated Section 10(b) is both (i) directly in connection with the non-U.S. swap agreement and (ii) conduct that would also violate Section 10(b) if the transaction had instead been in the underlying securities. Congress could then specify that to meet the first criterion, the defendant would have to know about the specific terms of the swap agreement and intend for his conduct to affect the swap transaction; mere knowledge that foreign counter parties are entering into swap agreements referencing a U.S. traded security would not be sufficient.

Whatever Congress decides to do about the status of swap agreements under *Morrison*, Congress is likely to do a better job at drawing lines more precisely and more quickly than courts struggling to apply *Morrison* to a context having little to do with the facts of *Morrison*.

If Congress does not act, the SEC should, through rulemaking, better define when a swap agreement is deemed to occur inside the United States for purposes of Section 10(b) and Rule 10b-5. Courts could conceivably hold that such an SEC rule was inconsistent with their own interpretation of the reach of Section 10(b)—the SEC could not, for example, by rule-making alone overrule the *Morrison* court's construction of Section 10(b). Nonetheless, a reasonable rule that applied *Morrison* to swap agreements would probably receive considerable deference from the courts and would provide some certainty to the markets.

Yet another post-*Morrison* issue that should have been addressed in Dodd-Frank is a general rule for determining when a private transaction takes place inside the United States in suits where one party is alleged to have defrauded the other. This issue is at the heart of litigation between the SEC and Fabrice Tourre, the Goldman Sachs executive whose conduct precipitated a separate SEC lawsuit against Goldman that has since settled.[81] Tourre contends that the transactions—sales by Goldman to European banks of synthetic collateralized debt obligations tied to subprime mortgages and similar security-based swap agreements—took place outside the United States because, among other factors, they were sold through Goldman's London affiliate pursuant to Regulation S, a Securities Act rule exempting securities sold outside the United States from registration.[82] The SEC contends that the Regulation S exemption is for registration purposes only, and does not apply to antifraud statutes, and that the transactions took place inside the United States because they were conceived, structured, and marketed by Tourre and others from Goldman's office in New York.[83] A decision from the United States District Court for the Southern District of New York

[81] *See* SEC v. Tourre, *supra* note 44.
[82] *See id.* at 8–9.
[83] *Id.* at 9–10.

is imminent, and will then probably be appealed. Section 929P of Dodd-Frank, assuming it is more than just a jurisdictional statute, would allow the SEC to bypass this issue in litigation over future conduct, but private plaintiffs' suits will still be subject to *Morrison*. The Dodd-Frank Act should have anticipated this problem and provided clear rules defining when a private transaction takes place inside the United States. The place where a private transaction is settled—regardless of the currency in which it is settled—should probably be the predominant factor for locating the transaction inside or outside the United States, although perhaps the parties should be permitted to contractually agree otherwise. Regardless of the rule that is chosen, the rule would be more predictable if chosen by Congress rather than by courts. If Congress does not address this issue, the next best option is for the SEC to promulgate rules setting forth a reasonable interpretation of *Morrison* for private transactions and then to urge the courts to adopt it.

Conclusion

Congress passed a poorly drafted provision that may not do anything other than confer jurisdiction that courts already have, although Congress probably intended for it to do more. If this provision does do something substantive, it reinstates much of the confusion that existed before *Morrison* under the conduct and effects tests and it misses an opportunity for a clearer articulation of those tests. The provision is in many situations not needed given the SEC's and DOJ's already broad enforcement powers under Section 10(b) whenever fraudulent conduct anywhere in the world is in connection with a single U.S. securities transaction, and also given the additional authority under Section 30 of the Exchange Act to pursue broker-dealers who use transactions on foreign exchanges to evade U.S. securities laws. The principal effect of the provision will be to increase the monetary penalties that the SEC and DOJ can recover by allowing enforcement action to reach outside the United States. Another area where the SEC and DOJ might use the Dodd-Frank extraterritorial enforcement provision is to combat insider trading, but these efforts could be problematic if the United States goes too far in imposing its insider trading laws on foreign markets. Finally, Dodd-Frank missed an opportunity to address some critically important issues that have arisen in the wake of *Morrison*, including the status of dually-listed securities under Section 10(b) and the status of swap agreements entered into either inside or outside the United States that reference securities traded either inside or outside the United States. In the few months since *Morrison*, there has already been considerable litigation surrounding these issues, and Congress may find itself addressing them sooner rather than later.