NOTE

FRAUD ABROAD: PROPOSING A WORKABLE MODEL OF EXTRATERRITORIAL SECURITIES FRAUD ENFORCEMENT

Chase J. Shelton[*]

ABSTRACT

In 2010, the Supreme Court disrupted decades of well-settled extraterritorial securities fraud jurisprudence when it decided Morrison v. National Australia Bank Ltd. *Throwing out the test that had long been used to determine whether a court had jurisdiction to entertain an extraterritorial securities fraud claim—the conduct-and-effects test—the Court devised a new transactional test to determine whether conduct is actionable under § 10(b) or Rule 10b-5. Less than one month later, Congress promulgated the Dodd-Frank Act, § 929P(b) of which grants federal courts subject-matter jurisdiction to hear public enforcement actions to enforce extraterritorial violations of § 10(b) of the Securities and Exchange Act or its accompanying SEC Rule 10b-5. Courts in every jurisdiction refused to address the apparent tension between* Morrison *and Dodd-Frank until the Tenth Circuit decided* SEC v. Scoville *in early 2019.*

This Note seeks to resolve the tension between Morrison *and Dodd-Frank and to offer a workable model of extraterritorial securities fraud enforcement. In doing so, it recognizes that although a novel overhaul of the current extraterritorial securities fraud enforcement regime may be ideal, it is certainly not practical to devise an entirely new system of enforcement to determine whether the enforcement is appropriate. Instead, this Note uses existing tools—including* Morrison*, Dodd-Frank,* Scoville*, and settled principles of statutory interpretation—to propose a theory of extraterritorial securities fraud enforcement. To develop the workable model of enforcement, this Note takes the primary goal of the federal securities laws to be deterrence and accordingly crafts a model that best deters extraterritorial fraudulent activity. In doing so, it concludes that Dodd-Frank overruled* Morrison *with respect to public enforcement actions, and thus a federal court's jurisdiction over a public*

[*] J.D. candidate, Boston University School of Law, 2021; B.A., English Literature, Philosophy, and Political Science, Miami University, 2018. I would like to thank Professor David Webber for piquing my interest in securities litigation; my family, Bella Seeberg, Dani Kunkel, and Kim Bishop for their endless support; and the editorial board and staff of the *Boston University Law Review* for their immeasurable time and efforts.

extraterritorial enforcement action is best judged by the conduct-and-effects test. However, it also maintains that Dodd-Frank did not overrule Morrison *with respect to private enforcement actions and that any benefit derived from private enforcement is not outweighed by the substantial negative effects of allowing private plaintiffs to bring these actions. By attending to the deterrence-focused regime proposed herein, the SEC can and should adopt a model of enforcement that, put simply, works.*

CONTENTS

INTRODUCTION

As with most else, equity markets are globalizing.[1] For American investors, market globalization has many positive effects. On a micro level, investors have, for example, more opportunities to mitigate risk through increased diversification and can easily invest in new technologies, regardless of where they develop in the world.[2] On a macro level, domestic markets generally demonstrate an increased capacity to exploit economies of scale and scope, and foreign companies' influence exerts pressure on domestic companies to increase productivity and efficiency.[3] But increased globalization also carries with it increased risks of varying sorts, including an increased risk that fraudulent activity causes investor losses.[4]

Section 10(b) of the Securities and Exchange Act of 1934[5] and its accompanying Rule 10b-5[6] are the primary tools used domestically by both private plaintiffs—often pursued as class actions—and the SEC to litigate against fraudulent activity related to the purchase or sale of securities.[7] For a long while, these were also the primary tools used to litigate extraterritorial fraud claims.[8] However, in the past several decades, the Supreme Court has substantially cabined the availability of § 10(b) and Rule 10b-5 in securities fraud actions.[9] This cabining has been especially prevalent regarding claims

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[1] *See* Christopher Osborne, *A Look at the Globalization of the Exchanges and Its Effects on the United States Market Through an Analysis of the NYSE and Euronext Merger*, 1 J. BUS. ENTREPRENEURSHIP & L. 447, 476-78 (2008) (discussing New York Stock Exchange's involvement in foreign markets, including those in London, India, and Japan). The precise definition of globalization and its effects are far from settled, *see* Philip M. Nichols, *The Neomercantalist Fallacy and the Contextual Reality of the Foreign Corrupt Practices Act*, 53 HARV. J. ON LEGIS. 203, 227-28 (2016), but it suffices for this Note's purposes that domestic investors regularly invest in foreign corporations and equity markets.

[2] *See* William C. Dudley, President & CEO, Fed. Reserve Bank of N.Y., Remarks at the Bombay Stock Exchange: Benefits and Challenges from Globalization (May 11, 2017), https://www.newyorkfed.org/newsevents/speeches/2017/dud170511 [https://perma.cc/EZ9H-AMAJ].

[3] *See id.*

[4] *See International Investing*, U.S. SEC. & EXCHANGE COMMISSION (last modified Dec. 8, 2016), https://www.sec.gov/reportspubs/investor-publications/investorpubsininvesthtm.html [https://perma.cc/YXR8-NWLM].

[5] 15 U.S.C. § 78j (2018).

[6] 17 C.F.R. § 240.10b-5 (2020).

[7] *See* CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2018 YEAR IN REVIEW 10 (2019), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review [https://perma.cc/78W3-L99F].

[8] *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 258-59 (2010).

[9] *See* David H. Webber, *Shareholder Litigation Without Class Actions*, 57 ARIZ. L. REV. 201, 204 (2015).

brought against foreign issuers "by foreign shareholders who bought their shares on a foreign exchange,"[10] otherwise known as "F-cubed" claims.[11]

Most importantly for this Note, in a 2010 F-cubed case, *Morrison v. National Australia Bank Ltd.*,[12] the Supreme Court held that, as a matter of statutory interpretation, § 10(b) and Rule 10b-5 do not provide for extraterritorial enforcement.[13] *Morrison* involved fraud claims from a class of Australian investors who purchased shares in National Australia Bank ("National"), an (as the name suggests) Australian bank.[14] National listed shares on an Australian stock exchange and other foreign stock exchanges, but it did not list its shares on any American stock exchange; however, it listed American Depository Receipts ("ADRs") on the New York Stock Exchange ("NYSE").[15] The ADRs gave the holder a right to receive shares in National after certain triggering events.[16] In holding that determining the extraterritorial reach of § 10(b) and Rule 10b-5 is a matter of statutory interpretation, the Court upended decades of well-settled precedent—precedent that instructed courts to apply the conduct-and-effects test to determine whether fraud that occurred extraterritorially was actionable under § 10(b) and Rule 10b-5—and created what it deemed a "transactional test" to determine whether conduct is actionable under § 10(b) or 10b-5.[17]

Less than a month after *Morrison*, Congress promulgated the Dodd-Frank Act, § 929P(b)[18] of which grants federal courts subject-matter jurisdiction to

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[10] Robert Bartlett et al., *The Myth of* Morrison*: Securities Fraud Litigation Against Foreign Issuers*, 74 BUS. LAW. 967, 976 (2019). F-cubed cases pose many interesting questions, one of the most poignant being: Why do foreign plaintiffs want to use American courts to litigate their claims against foreign issuers? Professor John C. Coffee, Jr. posits four reasons: (1) the United States is one of few countries that allows opt-out class actions, (2) the United States awards generous contingency fees, (3) the United States does not have "loser pays" rules that many other jurisdictions maintain, and (4) American law permits punitive damages. John C. Coffee, Jr., *Can* Morrison *Be Outflanked?: How Foreign Purchasers Are Suing in U.S. and Foreign Courts*, CLS BLUE SKY BLOG (Apr. 22, 2019), https://clsbluesky.law.columbia.edu/2019/04/22/can-morrison-be-outflanked-how-foreign-purchasers-are-suing-in-u-s-and-foreign-courts/ [https://perma.cc/S2K5-4RQJ].

[11] *See* Bartlett et al., *supra* note 10, at 976.

[12] 561 U.S. 247 (2010).

[13] *Id.* at 273.

[14] *Id.* at 251.

[15] *Id.* ADRs are ownership interests in a set amount of securities that the issuer deposits with a U.S. depository. *See* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 561 (Rachel E. Barkow et al. eds., 9th ed. 2019). Foreign issuers commonly use ADRs to list securities on domestic markets. *See id.*

[16] *Morrison*, 561 U.S. at 251.

[17] *Id.* at 269-70 (defining transactional test as inquiry into "whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange").

[18] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 929P(b), 124 Stat. 1376, 1864 (codified at 15 U.S.C. § 78aa (2018)).

hear public enforcement actions—i.e., actions brought by the SEC and the DOJ—to enforce extraterritorial violations of § 10(b) and Rule 10b-5.[19] Amidst the apparent tension between *Morrison* and Dodd-Frank, courts in every jurisdiction hesitated to answer the "complicated question" of whether *Morrison* or Dodd-Frank controlled in extraterritorial SEC enforcement actions[20] until the Tenth Circuit decided *SEC v. Scoville*[21] early last year.

While some viewed *Morrison*'s effect on the SEC's ability to enforce extraterritorial violations of § 10(b) and 10b-5 irrelevant after Congress passed Dodd-Frank,[22] the issue was—and still is—far from settled.[23] Namely, the *Morrison* decision explicitly rejected the view that the extraterritorial reach of the antifraud provisions is an issue of subject-matter jurisdiction, and instead it viewed it as a merits issue (that is, "to ask what conduct § 10(b) reaches is to ask

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[19] *See* Petition for a Writ of Certiorari at 6, Scoville v. SEC, No. 18-1566 (U.S. June 21, 2019).

[20] *See, e.g.*, SEC v. Sabrdaran, 252 F. Supp. 3d 866, 895 (N.D. Cal. 2017); SEC v. A Chi. Convention Ctr., LLC, 961 F. Supp. 2d 905, 908 (N.D. Ill. 2013).

[21] 913 F.3d 1204, 1209 (10th Cir.), *cert. denied*, 140 S. Ct. 483 (2019).

[22] *See, e.g.*, STAFF OF THE U.S. SEC. & EXCH. COMM'N, STUDY ON THE CROSS-BORDER SCOPE OF THE PRIVATE RIGHT OF ACTION UNDER SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934, at i (2012), https://www.sec.gov/news/studies/2012/929y-study-cross-border-private-rights.pdf [https://perma.cc/WU9X-M8CG] [hereinafter SEC STUDY] ("Congress promptly responded to the *Morrison* decision by adding Section 929P(b)(2) . . . ."); Joshua L. Boehm, Note, *Private Securities Fraud Litigation After* Morrison v. National Australia Bank*: Reconsidering a Reliance-Based Approach to Extraterritoriality*, 53 HARV. INT'L L.J. 249, 261 (2012); Email from Forty-Two Law Professors, to Elizabeth M. Murphy, Sec'y of the Sec. and Exch. Comm'n 5 (Feb. 18, 2011), https://www.sec.gov/comments/4-617/4617-28.pdf [https://perma.cc/J22N-WUF8].

[23] *See, e.g.*, PAUL VIZCARRONDO, JR., WACHTELL, LIPTON, ROSEN & KATZ, LIABILITIES UNDER THE FEDERAL SECURITIES LAWS 8 (2014), https://www.wlrk.com/docs/OutlineofSecuritiesLawLiabilities2014.pdf [https://perma.cc/9DHN-4V6W]; Daniel J. Morrissey, *The EU's Struggles with Collective Action for Securities Fraud: An American Perspective*, 7 TEX. A&M L. REV. 125, 136 (2019); George T. Conway III, *Extraterritoriality After Dodd-Frank*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 5, 2010), https://corpgov.law.harvard.edu/2010/08/05/extraterritoriality-after-dodd-frank/ [https://perma.cc/DHJ3-M2H6]. *See generally* Richard W. Painter, *The Dodd-Frank Extraterritorial Jurisdiction Provision: Was It Effective, Needed or Sufficient?*, 1 HARV. BUS. L. REV. 195 (2011) (querying whether Dodd-Frank did anything other "than confer jurisdiction on federal courts that the Morrison opinion already recognized courts have over all Section 10(b) cases"). The courts' frequent refusal to grapple with the issue further suggests that it is not settled. Finally, although some commentators argue that the *Scoville* decision settled the issue, *e.g.*, Kwon-Yong Jin, *Unclear Words, Clear Intent: Tenth Circuit Revives Extraterritorial Application of Federal Securities Laws*, YALE J. ON REG.: NOTICE & COMMENT BLOG (Feb. 25, 2019), https://www.yalejreg.com/nc/unclear-words-clear-intent-tenth-circuit-revives-extraterritorial-application-of-federal-securities-laws/ [https://perma.cc/FTU3-CALJ], the tension has not been settled nationwide, and thus it remains an open question.

what conduct § 10(b) prohibits, which is a merits question").[24] However, Dodd-Frank spoke only of a federal court's jurisdiction to entertain extraterritorial public enforcement actions.[25] Despite the disagreement regarding Dodd-Frank's effect on public enforcement, it seems well settled that Dodd-Frank had no impact on *Morrison*'s holding regarding private enforcement; the statute makes no mention of private enforcement actions, and thus there is no credible argument that the statute disrupts *Morrison*'s holding with respect to private enforcement.[26]

The central question animating this Note, then, is how to resolve the tension between Dodd-Frank and *Morrison* regarding SEC extraterritorial enforcement actions to determine a workable level of extraterritorial enforcement, with a specific eye to the *Scoville* decision's impact on the existing conversation. Importantly, this Note seeks a workable rather than an "optimal" or "perfect" level of enforcement; the aim of this Note is not to propose a novel overhaul of the status quo or a grand reimagining of the existing securities enforcement regime. Instead, this Note aims to use the extant tools—*Morrison*, Dodd-Frank, *Scoville*, and settled principles of statutory interpretation—to propose a theory of extraterritorial enforcement that still satisfies the SEC's primary goal of deterrence. While a novel overhaul may be theoretically ideal, it is neither pragmatic[27] nor necessary. In proposing an enforcement model, this Note claims that *Scoville*'s conclusion—which allows for extraterritorial SEC enforcement proceedings but does not allow such enforcement actions as private suits—best resolves the tension to arrive at the most workable level of enforcement.

This Note contributes to a well-established conversation regarding the relative value of public and private enforcement in securities litigation, including, amongst many others, arguments that a so-called multienforcer system is inefficiently redundant,[28] arguments that there is good reason to have both

[24] Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 254 (2010).

[25] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P(b), 124 Stat. 1376, 1864 (2010) (codified at 15 U.S.C. § 78aa (2018)) (granting federal district courts "jurisdiction of an action or proceeding brought or instituted by the Commission or the United States" alleging violations of § 10(b) and Rule 10b-5).

[26] *See* § 929P, 124 Stat. at 1862-65.

[27] *See* Alexander I. Platt, *"Gatekeeping" in the Dark: SEC Control over Private Securities Litigation Revisited*, 72 ADMIN. L. REV. 27, 43-44 (2020).

[28] *See, e.g.*, John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215, 224-26 (1983) (arguing that, despite potential benefits of private enforcement "piggybacking" on government enforcement efforts, "the private enforcer tends to accept inadequate settlements" that undercut any positive effect); Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2227-29 (2010) [hereinafter Rose, *Multienforcer Approach*] (advocating for exclusive SEC enforcement). *But see* Platt, *supra* note 27, at 54-55, 70-75 (showing that SEC does not consider positive effects of "piggyback" litigation on private enforcement and arguing that it should).

private and public enforcers in the securities law context,[29] arguments that private enforcement is preferable to public enforcement,[30] and arguments that private securities enforcement carries with it unnecessary social costs that public enforcement does not.[31] This Note contributes to the existing discussion by interrogating the relationship between *Morrison* and Dodd-Frank more carefully than previously done in this context to discern what the Court and Congress sought to do with public and private extraterritorial enforcement to arrive at a functional model of enforcement.

This task is taken up in three parts. Part I historicizes the development of extraterritorial enforcement actions, engaging specifically with the development of the conduct-and-effects test, *Morrison* and Dodd-Frank's respective impacts on the test, and Congress's passage of the Private Securities Litigation Reform Act ("PSLRA"). It also examines the resulting circuit-level confusion regarding extraterritorial enforcement actions after *Morrison* and Dodd-Frank and ends with a close analysis of the recent Tenth Circuit litigation. Part II frames this

[29] *See, e.g.*, Blackie v. Barrack, 524 F.2d 891, 907 (9th Cir. 1975); Eric C. Chaffee, *A Call for Legislative Reform: Expanding the Extraterritorial Application of the Private Rights of Action Under Federal Securities Laws While Limiting the Scope of Relief Available*, 22 STAN. J.L. BUS. & FIN. 1, 7-8 (2017) (proposing greater availability of private extraterritorial enforcement actions for plaintiffs seeking injunctive relief and greater availability of public extraterritorial enforcement actions regardless of remedy sought); Email from Forty-Two Law Professors, *supra* note 22, at 5; Elisse B. Walter, Comm'r, Sec. and Exch. Comm'n, Remarks Before the FINRA Institute at Wharton Certified Regulatory and Compliance Professional (CRCP) Program (Nov. 8, 2011), https://www.sec.gov/news/speech/2011/spch110811ebw.htm [https://perma.cc/4UHM-LB44].

[30] *See* Webber, *supra* note 9, at 259 (arguing that private class actions allow enforcement of negative-value claims because public enforcers do not pursue these claims). *But see* John C. Coffee, Jr., *Accountability and Competition in Securities Class Actions: Why "Exit" Works Better than "Voice,"* 30 CARDOZO L. REV. 407, 409-10 (2008) [hereinafter Coffee, *Accountability and Competition*] ("[E]ven meritorious securities class actions may simply transfer wealth among diversified shareholders, thus producing neither net compensation nor real deterrence.").

[31] *See, e.g.*, Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 514-19 (1991) (concluding that nonmeritorious private securities fraud claims often settle despite low likelihood that plaintiffs would prevail at trial); Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961, 969-70 (1994). In 1995, Congress passed the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.) ("PSLRA") in an effort to curb frivolous private securities class actions, which reflects Congress's concern with an overabundance of these actions. *See* Andrew S. Gold, *Experimenting with the Lead Plaintiff Selection Process in Securities Class Actions: A Suggestion for PSLRA Reform*, 57 DEPAUL L. REV. 447, 449 (2008). Judges also frequently express concern about private securities litigation. *E.g.*, Lentell v. Merrill Lynch & Co., 396 F.3d 161, 171 (2d Cir. 2005); Fort Worth Emp'rs' Ret. Fund v. Biovail Corp., 615 F. Supp. 2d 218, 220 (S.D.N.Y. 2009).

Note's proposal by providing a primer on theories of enforcement and by explaining the stakes of developing an enforcement model that avoids the social costs of under- and overdeterrence of securities fraud. Subsequently, it briefly surveys the work that other commentators have done in sketching models of securities enforcement. Part III proposes, given the existing state of the law, a workable model of extraterritorial securities fraud enforcement. Instead of treating *Morrison* as controlling, it proposes barring private litigants from bringing extraterritorial enforcement actions because the SEC can—and should—rely on § 929P(b) of Dodd-Frank as the source of its power to do so.

I. THE EVOLUTION OF EXTRATERRITORIAL SECURITIES FRAUD ENFORCEMENT

When the Supreme Court decided *Morrison*, it disrupted the test that inferior federal courts used for decades to determine the extraterritorial reach of American securities laws (the conduct-and-effects test).[32] As this Part explains, § 929P(b) of the Dodd-Frank Act then ostensibly sought to reinstate this test in the context of public enforcement actions.[33] To best contextualize the tension between *Morrison* and Dodd-Frank, it is essential to begin with some background on the test. This Part first explains the origins of the conduct-and-effects test and subsequently shows how *Morrison* overruled it. It then argues that the strongest interpretation of Dodd-Frank is that Congress sought to overrule *Morrison* in part and to reinstate the conduct-and-effects test for extraterritorial public securities fraud actions. It concludes that Congress was successful in achieving both goals.

A. *The Development of the Conduct-and-Effects Test*

The Second Circuit was largely responsible for developing the jurisprudence evaluating federal courts' jurisdictional power to entertain enforcement actions against extraterritorial securities law violations.[34] Generally, the presumption against extraterritoriality—which "instructs courts to construe geoambiguous statutes to apply only to the territory of the United States" and strips federal courts of jurisdiction to hear suits pursuing extraterritorial claims if the court interprets the statute to only apply domestically[35]—adheres to all federal statutes.[36]

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[32] Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 259 (2010).

[33] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P(b), 124 Stat. 1376, 1864 (2010) (codified at 15 U.S.C. § 78aa (2018)).

[34] *See generally* Roberta S. Karmel, *The Second Circuit's Role in Expanding the SEC's Jurisdiction Abroad*, 65 ST. JOHN'S L. REV. 743 (1991).

[35] Zachary D. Clopton, *Replacing the Presumption Against Extraterritoriality*, 94 B.U. L. REV. 1, 2 (2014).

[36] *See Morrison*, 561 U.S. at 255 ("When a statute gives no clear indication of an extraterritorial application, it has none."); Clopton, *supra* note 35, at 5-6.

However, under the test the Second Circuit developed, now commonly known as the conduct-and-effects test, when a foreign public corporation either engages in substantial fraudulent conduct in the United States or the fraudulent conduct has substantial deleterious effects on U.S. investors or markets, the presumption against extraterritoriality is overcome, and thus a federal district court has jurisdiction to entertain the case.[37] Two important elements of the conduct-and-effects test are clear at the outset: first, it is a jurisdictional matter; and second, lower courts applied it to both public and private enforcement actions under § 10(b) and Rule 10b-5.[38]

In its original conception developed in *Schoenbaum v. Firstbrook*,[39] the conduct-and-effects test was just the effects test.[40] In *Schoenbaum*, the Second Circuit considered a private enforcement action against Banff, a Canadian corporation that exclusively engaged in business in Canada and had shares listed on both American and Canadian stock exchanges (although the shareholder plaintiffs had purchased the shares at issue on a Canadian exchange).[41] Acquitaine, a Canadian subsidiary of a French corporation, had previously acquired a control bloc in Banff, and the parties began a joint venture exploring for oil. To finance the venture on its end, Banff sold 500,000 shares of treasury stock to Acquitaine for $1.35 per share and, later, 270,000 shares of treasury stock to Paribas, a Delaware-incorporated, wholly owned subsidiary of a French Bank, for $7.30 per share.[42] Both the Acquitaine and Paribas deals occurred in Canada.[43] The shareholder plaintiffs subsequently sued in the Southern District of New York, alleging that Banff's board failed to disclose information that would have substantially increased the share price, costing the shareholders an estimated $10 million and violating § 10(b) and Rule 10b-5.[44]

Although the corporate defendants contended that the district court lacked jurisdiction to hear the dispute because the claims alleged conduct that involved foreign parties dealing on foreign exchanges, the Second Circuit rejected this argument, finding that

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[37] *See* Margaret V. Sachs, *Unintended Consequences: The Link Between Judge Friendly's* Texas Gulf Sulphur *Concurrence and Recent Supreme Court Decisions Misconstruing Rule 10b-5*, 71 SMU L. REV. 947, 956 (2018).

[38] *See, e.g.*, SEC v. Berger, 322 F.3d 187, 192 (2d Cir. 2003); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 179-80 (2d. Cir. 1976); SEC STUDY, *supra* note 22, at ii.

[39] 405 F.2d 200 (2d Cir. 1968).

[40] *See id.* at 208 ("We hold that the district court has subject matter jurisdiction over violations of the Securities Exchange Act although the transactions which are alleged to violate the Act take place outside the United States, at least when the transactions involve stock registered and listed on a national security exchange, *and are detrimental to the interests of American investors*." (emphasis added)).

[41] *Id.* at 204-05.

[42] *Id.* at 205.

[43] *Id.*

[44] *Id.*

> neither the usual presumption against extraterritorial application of legislation nor the specific language of Section 30(b) show Congressional intent to preclude application of the Exchange Act to transactions regarding stocks traded in the United States which are effected outside the United States, when extraterritorial application of the Act is necessary to protect American investors.[45]

In explicitly rebutting the presumption against extraterritoriality, the Second Circuit significantly expanded the reach of the antifraud provisions and created the "effects" prong of the conduct-and-effects test.[46] However, *Schoenbaum* left open several questions, two of which are relevant here. First, the court seemed to make something of the fact that Banff had shares listed on an American exchange, although it did not explicitly condition its holding on that fact.[47] Second, it remained unclear what neutral principle would guide later courts in determining when extraterritorial application is "necessary" to protect domestic investors.

The Second Circuit subsequently created the "conduct" prong of the test in *Leasco Data Processing Equipment Corp. v. Maxwell*.[48] There, the plaintiff alleged that it was defrauded into purchasing stock in Pergamon Press, a British company controlled by Maxwell.[49] Several Leasco directors met with Maxwell in London, and he purportedly made several false or misleading statements about the financial health of Pergamon and directed them to meet with a director of an American Pergamon subsidiary—Pergamon Press, Inc.—which traded on an American exchange.[50] The Leasco directors met with the subsidiary's directors and began negotiations that occurred predominately in person in New York or over the phone with at least one party in America. These negotiations culminated in Leasco signing an agreement in New York in which it agreed to launch a tender offer for all of Pergamon's outstanding shares.[51] As part of the transaction, the parties agreed that the deal would comply with English tender offer regulations and that the closing would take place at an office in London.

Distinguishing *Schoenbaum*, Judge Friendly explained that the effects test was not applicable because the facts required the court to examine Congress's ability to regulate conduct occurring in America rather than the effects some

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45 *Id.* at 206.

46 Karmel, *supra* note 34, at 746.

47 *Schoenbaum*, 405 F.2d at 208 (noting that holding applies "at least when the transactions involve stock registered and listed on a national securities exchange").

48 468 F.2d 1326, 1334 (2d Cir. 1972).

49 *Id.* at 1330. Because the case was an appeal of two certified questions—whether the district court had personal jurisdiction and whether the district court had subject-matter jurisdiction to hear the case—the facts that the court accepted as true are the plaintiff's allegations. *See id.*

50 *Id.* at 1331.

51 *Id.* at 1332.

extraterritorial conduct had on American investors or markets.[52] Determining that Congress would have wished to protect that investor and finding that the defendants had engaged in significant fraudulent conduct in America, the court found that the conduct itself violated § 10(b).[53] While Judge Friendly doubted that the "impact on an American company and its shareholders would suffice to make [§ 10(b)] applicable if the misconduct had occurred solely in England, . . . it tips the scales in favor of applicability when substantial misrepresentations were made in the United States."[54] Thus, the conduct prong confers jurisdiction on federal courts to entertain § 10(b) claims where there is substantial fraudulent conduct in America even if exclusively foreign parties engaged in the conduct.[55]

Taken together, the conduct-and-effects test requires that plaintiffs satisfy one of the two prongs to establish whether a federal district court has subject-matter jurisdiction to hear the case: "(1) whether the wrongful conduct occurred in the United States, and (2) whether the wrongful conduct had a substantial effect in the United States or upon United States citizens."[56] Although the test had its critics,[57] it ruled the day for determining a federal court's jurisdiction to hear

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[52] *Id.* at 1334, 1337.

[53] *Id.* at 1334-35, 1337 ("[W]hen, as here, there has been significant conduct within the territory, a statute cannot properly be held inapplicable simply on the ground that, absent the clearest language, Congress will not be assumed to have meant to go beyond the limits recognized by foreign relations law.").

[54] *Id.* at 1337.

[55] The conduct prong was further specified in later cases, which distinguished conduct that was merely preparatory, *see, e.g.*, Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 992 (2d Cir. 1975), from conduct that directly caused the harm, *see, e.g.*, SEC v. Berger, 322 F.3d 187, 192 (2d Cir. 2003). Merely preparatory conduct is not sufficiently "significant" as required under *Leasco Data Processing* to overcome the presumption against extraterritoriality. *See Bersch*, 519 F.2d at 992. However, conduct that directly caused the harm complained of is sufficient to satisfy the test and thus overcome the presumption against extraterritoriality. *See Berger*, 322 F.3d at 192. A practical way of thinking about the distinction is that "conduct that is carried out to create the fraudulent statement is 'merely preparatory,' while the act of filing, mailing or releasing the false statement is more than merely preparatory." Daniel S. Kahn, *The Collapsing Jurisdictional Boundaries of the Antifraud Provisions of the U.S. Securities Laws: The Supreme Court and Congress Ready to Redress Forty Years of Ambiguity*, 6 N.Y.U. J.L. & BUS. 365, 382 (2010). *Bersch* may also be properly viewed as creating a "jurisprudential bookend," defining the outer limits of "significant" conduct. *See* Boehm, *supra* note 22, at 255. These cases are helpful to answer the questions left open by *Schoenbaum* noted above.

[56] *Berger*, 322 F.3d at 192.

[57] After *Morrison*, the SEC put out a request for public comment regarding the conduct-and-effects test and the *Morrison* transactional test. Twenty-three of the seventy-two comment letters submitted expressed a preference for the transactional test. SEC STUDY, *supra* note 22, at v; Ashby Jones, *The Whole World is Watching: 'F-Cubed' Case Moves to High Court*, WALL STREET J. (Mar. 29, 2010, 9:06 AM), https://www.wsj.com/articles/BL-

extraterritorial fraud claims until *Morrison*. Further, although *Schoenbaum* and *Leasco Data Processing* were both private enforcement actions, prior to *Morrison* and Dodd-Frank, courts applied the conduct-and-effects test in both private and public enforcement actions.[58]

B. *Changing Tides: The PSLRA*

After over twenty years of the conduct-and-effects test operating as the greatest limitation on private plaintiffs' ability to bring extraterritorial securities fraud actions, Congress dramatically interfered with the structure of securities litigation when it passed the PSLRA in 1995.[59] Relying on testimony from professors and corporate executives, Congress concluded that private securities litigation had evolved into a mechanism whereby "professional plaintiffs" would sue corporations quickly after any stock price drop.[60] These strike suits were frequently nonmeritorious claims that, despite having little to no likelihood of success on the merits, were filed to instill fear in the corporate defendants so that they would settle.[61] Beyond a concern with the fundamental unfairness of these suits, Congress expressed concern that these suits were frequently driven by plaintiffs' law firms rather than plaintiffs themselves, which led to perverse incentives for litigation and settlement behavior.[62] All in all, Congress's twin goals in drafting and passing the PSLRA were "to curb frivolous, lawyer-driven litigation, while preserving investors' ability to recover on meritorious claims."[63]

One need not take Congress at its word to understand that the PSLRA was passed to curb frivolous litigation; many of the substantive provisions of the statute demonstrate a clear intent to limit the viability of securities fraud class actions. For example, the statute places a mandatory stay on discovery until the plaintiffs' complaint survives a motion to dismiss.[64] While this stay on discovery would potentially not pose a large hurdle in a run-of-the-mill class action,

LB-26845 (explaining that foreign companies are less likely to list on domestic exchanges if they risk securities fraud liability in federal court).

58 *See, e.g.*, *Berger*, 322 F.3d at 192-93.

59 Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.). The PSLRA is certainly not the only place where Congress had a role in shaping securities litigation; for example, the SEC can bring enforcement actions against secondary violators—parties who aid and abet securities fraud—but private parties cannot. 15 U.S.C. § 78t(e) (2018). But the PSLRA is an excellent example of Congress exercising its influence on securities fraud enforcement schemes. For other examples, see Webber, *supra* note 9, at 204.

60 *See* H.R. REP. NO. 104-50, at 16 (1995) ("The leading plaintiffs' law firm reported that 69 percent of the cases it filed over a three year period were filled within 10 days of the event or disclosure that gave rise to the allegations of fraud.").

61 *Id.* at 16-17.

62 *Id.*

63 Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322 (2007).

64 *See* 15 U.S.C. § 78u-4(b)(3)(B) (2018).

plaintiffs pursuing securities fraud claims also face significantly heightened pleading standards compared to a plaintiff in a nonfraud suit. That is, plaintiffs filing complaints in most actions must only satisfy Rule 8(a)'s light pleading requirement of a short, plain statement that they are entitled to relief that is "supported by factual allegations."[65] These factual allegations are judged by a mere plausibility standard.[66] However, plaintiffs in a securities fraud suit must satisfy Rule 9(b)'s pleading requirement, which requires the plaintiff to "state with particularity the circumstances constituting fraud or mistake."[67] Securities fraud plaintiffs must also plead a strong inference of scienter, meaning a strong inference that the defendant had an intent "to deceive, manipulate, or defraud."[68] In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,[69] the Supreme Court interpreted the PSLRA's "strong inference" requirement to mean that the plaintiff must show an "inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."[70] Without access to discovery, this is an incredibly high burden for plaintiffs to overcome.[71]

Regardless of whether *Tellabs* actually placed a substantially higher burden on securities fraud plaintiffs in practice, the import of the PSLRA—its heightened pleading standard, mandatory stay on discovery, and legislative history—is that Congress evinced a desire to substantially cabin the availability and desirability of the class action vehicle for putative securities fraud classes. It is also worth noting that the PSLRA addressed securities class actions generally rather than only in the narrow context of extraterritorial enforcement, meaning the concerns raised by Congress may be more or less acute for purposes of this Note. This will be addressed in turn. But in many ways, the desire to cabin the availability of private securities fraud actions evinced by the PSLRA foreshadowed what was to come fifteen years later in *Morrison*.

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65 FED. R. CIV. P. 8(a).

66 Ashcroft v. Iqbal, 556 U.S. 662, 679 (2009).

67 FED. R. CIV. P. 9(b); *see also* 15 U.S.C. § 78u-4(b)(1)-(2) ("[T]he complaint shall, with respect to each act or omission alleged to violate this chapter, state *with particularity* facts giving rise to a *strong inference* that the defendant acted with [scienter]." (emphases added)).

68 Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 & n.12 (1976).

69 551 U.S. 308 (2007).

70 *Id.* at 324.

71 Geoffrey P. Miller, *Pleading After* Tellabs, 2009 WIS. L. REV. 507, 532 ("[T]he hydraulic pressures of the PSLRA's pleading rules have deformed the Rule 12(b)(6) motion in securities-fraud cases and converted it into . . . a sort of hybrid between the motion to dismiss and the motion for summary judgment."); Webber, *supra* note 9, at 204. *But see* Stephen J. Choi & A.C. Pritchard, *The Supreme Court's Impact on Securities Class Actions: An Empirical Assessment of* Tellabs, 28 J.L. ECON. & ORG. 850, 877-78 (2012) (concluding that *Tellabs* did not lead to higher rate of dismissal in securities fraud class actions); Roy Shapira, *Mandatory Arbitration and the Market for Reputation*, 99 B.U. L. REV. 873, 896-98 (2019) (claiming that securities fraud plaintiffs' lawyers improved investigatory abilities after PSLRA to craft "awesomely detailed" complaints (quoting Miller, *supra*, at 532)).

C. Morrison*'s Complete Removal of the Conduct-and-Effects Test*

After more than four decades of circuit-level activity applying the conduct-and-effects test, the Supreme Court granted certiorari to consider *Morrison* in 2010.[72] The case involved private Australian plaintiffs suing in federal district court, alleging that National (an Australian corporation), HomeSide (a Florida-based, wholly owned subsidiary of National), and several directors of both corporations violated § 10(b) and Rule 10b-5.[73] Specifically, the complaint alleged that National's public documents and statements from some HomeSide executives flaunted HomeSide's success, when in reality National planned to—and did—write down the value of HomeSide several times.[74] Predictably, writing down HomeSide's value caused a significant slump in share price, and Australian shareholders who bought HomeSide shares before the accounting maneuver sued to recover.[75]

As the plaintiffs were foreigners, they could not satisfy the effects prong of the conduct-and-effects test;[76] they thus sought to satisfy the conduct prong by showing National's and HomeSide's failure to disclose material information about the viability of HomeSide's business to investors on the American stock exchanges they traded ADRs on rose to the level of "sufficient" conduct to grant the court jurisdiction over their extraterritorial claim. The thrust of their argument was that, because National listed ADRs on the NYSE, it was legally obligated to keep up with SEC reporting requirements and, in these required disclosures, National defrauded the holders and purchasers of ADRs about the true value of the securities.

The Court rejected the plaintiffs' argument for jurisdiction, however, finding that lower courts had, since *Schoenbaum*, engaged in a "threshold error" by treating the issue of extraterritoriality as a subject-matter jurisdiction question rather than a merits question.[77] The proper inquiry, the Court held, was "what conduct § 10(b) prohibits" instead of a case-specific inquiry into whether there was sufficient deleterious conduct in the United States or effects on American investors to confer jurisdiction on a federal court.[78] In making that inquiry, the

[72] Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010); *see also* Kahn, *supra* note 55, at 404-05.

[73] *See Morrison*, 561 U.S. at 251-53.

[74] *Id.* at 251-52.

[75] *Id.* at 252-53.

[76] *See In re* Nat'l Austl. Bank Sec. Litig., No. 03-cv-06537, 2006 WL 3844465, at *4 (S.D.N.Y. Oct. 25, 2006), *aff'd sub nom.* Morrison v. Nat'l Austl. Bank Ltd., 547 F.3d 167 (2d Cir. 2008), *aff'd*, 561 U.S. 247 (2010).

[77] *Morrison*, 561 U.S. at 253-54. Interestingly, the Court could have reached the same decision using the conduct-and-effects test. This is the conclusion that Justice Stevens reached in his concurring opinion. *See id.* at 274 (Stevens, J., concurring in the judgment). However, Justice Scalia readily accepted that the parties had jurisdiction to entertain a § 10(b) dispute under § 929P(b).

[78] *Id.* at 254.

Court devised a new "transactional test," which asks "whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange."[79] The highly formulaic focus is thus on where the transaction occured rather than where the alleged fraudulent conduct or effects thereof occurred.

Plainly, eliminating the conduct-and-effects test was a controversial move;[80] however, it was not a totally unexpected one. The Court had several good reasons to be reticent to accept a robust extraterritorial enforcement scheme, especially with respect to private enforcement of F-cubed claims. For one, some commentators believed that the relatively extensive private enforcement regime that existed because of the conduct-and-effects test was causing foreign firms to pull out of domestic markets.[81] This fear was not merely theoretical—commentators have supported it with empirical evidence.[82] These reports also suggested that this problem could have become unique to domestic markets as foreign markets were not increasing the availability of private enforcement actions. Second, in the years leading up to *Morrison*, litigation against foreign issuers was steadily increasing, and F-cubed litigation in particular was becoming an increasingly pressing concern.[83] The rising number of private enforcement actions only served to exacerbate the real fear that domestic markets were suffering because of abusive private enforcement. Finally, as noted

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[79] *Id.* at 269-70. The Second Circuit considered adopting a transactional test in *Morrison*'s first appeal but declined to do so. Because it is impossible to "anticipate all the circumstances in which the ingenuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction." *Morrison*, 547 F.3d at 175.

[80] *See, e.g.*, SEC STUDY, *supra* note 22, at 42-49 (summarizing comment letters from various groups highlighting potential issues with transactional test); Marco Ventoruzzo, *Like Moths to a Flame? International Securities Litigation After* Morrison*: Correcting the Supreme Court's "Transactional Test*,*"* 52 VA. J. INT'L L. 405, 408 (2012).

[81] *See, e.g.*, Merritt B. Fox, *Securities Class Actions Against Foreign Issuers*, 64 STAN. L. REV. 1173, 1272-73 (2012) [hereinafter Fox, *Securities Class Actions*]; Robert J. Giuffra, Jr., *The Territorial Reach of U.S. Securities Laws After* Morrison v. National Australia Bank, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 13, 2011), https://corpgov.law.harvard.edu/2011/10/13/the-territorial-reach-of-u-s-securities-laws-after-morrison-v-national-australia-bank/ [https://perma.cc/574Z-B2B5].

[82] *See* Boehm, *supra* note 22, at 284 ("[E]xecutives from nine of ten foreign companies who delisted from the United States between 2003 and 2007 said that litigation risk was a factor in their delisting."); SULLIVAN & CROMWELL LLP, THE TERRITORIAL REACH OF U.S. SECURITIES LAWS AFTER *MORRISON V. NATIONAL AUSTRALIA BANK* 4 (2011), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_The_Territorial_Reach_of_US_Securities_Laws.pdf [https://perma.cc/UEZ3-PWKM] (noting that, between June 2007 and June 2009, "15 out of 27 French companies listed in the United States at the end of 2005 had de-listed, as had 19 of 44 United Kingdom companies, seven of 20 German companies, six of 11 Italian companies, and 15 of 24 Australian companies").

[83] *See, e.g.*, Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 COLUM. J. TRANSNAT'L L. 14, 17-18 (2007); Fox, *Securities Class Actions*, *supra* note 81, at 1177 n.4.

previously, in 1995, Congress expressed its discomfort with a robust private enforcement scheme by passing the PSLRA. Taking all this together, it is unsurprising that the Court sought to drastically limit extraterritorial securities enforcement actions in *Morrison*.

Several of the Justices considering *Morrison* predictably expressed concern at oral argument with the nature of the F-cubed claims, intimating that they sought to limit the extraterritorial applicability of § 10(b), especially in cases like F-cubed cases that carry with them the most far-fetched requests for extraterritorial reach.[84] The majority opinion was riddled with references to critiques of a robust private extraterritorial enforcement regime and concerns about class-action litigation driving foreign businesses out of domestic markets.[85] Justice Scalia, writing for the Court, also cited to a series of amicus briefs filed by other countries that all expressed concern with private extraterritorial suits.[86]

The Court's focus on the existing private enforcement scheme rather than the public enforcement scheme at oral argument and in the opinion may best be explained by the fact that *Morrison* was a private class action. Alternatively—and seemingly more accurately—it is possible that the majority intended to sweep broadly and eliminate private extraterritorial enforcement while having a limited impact on public enforcement.[87] Plainly, it is difficult to imagine that the Justices simply failed to consider their holding's impact on the SEC's ability to enforce extraterritorial enforcement actions. The Justices did not explicitly address the issue of public enforcement. Thus, if one believes the Justices considered SEC enforcement—a view this Note subscribes to—they are left to

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[84] For example, Justice Ginsburg and counsel for the petitioner disputed whether the case "has 'Australia' written all over it," meaning that it involved Australian plaintiffs suing an Australian bank about fraud that occurred in Australia, or whether "it has 'Florida' written all over it" because that was where much of the fraudulent activity occurred. Transcript of Oral Argument at 7-10, Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010) (No. 08-1191).

[85] *Morrison*, 561 U.S. at 270 (expressing concern that the United States "has become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets").

[86] *See id.* at 269-70. Australia's amicus brief went so far as to note that its argument only dealt with private suits and did not concern SEC enforcement. *See* Brief of the Government of the Commonwealth of Australia as *Amicus Curiae* in Support of the Defendants-Appellees at 5, Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010) (No. 08-1191).

[87] Subsequent cases reflecting a concern with expansive private securities litigation support this inference. *See* Janus Capital Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 141, 143-44 (2011) (explaining that narrowing liability in private securities fraud class actions to only parties who actually "make" material misstatements "accords with the narrow scope that we must give the implied private right of action"); *see also* Lorenzo v. SEC, 139 S. Ct. 1094, 1110 (2019) (Thomas, J., dissenting) ("[T]he majority does precisely what we declined to do in *Janus*: impose broad liability for fraudulent misstatements in a way that makes the category of aiders and abettors in these cases 'almost nonexistent.'" (quoting *Janus*, 564 U.S. at 143)).

assume what the Court's silence means. There are two ways to read the majority opinion.

One way to read the opinion is, despite some evidence to the contrary, to take it at face value and find that its holding applies to both private and public extraterritorial enforcement actions. This is the most conventional understanding of the holding and the most conventional way of reading Supreme Court opinions generally.[88] The other is to take Justice Stevens's view. Justice Stevens wrote a concurring opinion in *Morrison* and argued that the majority did not "foreclose the [SEC] from bringing enforcement actions in additional circumstances, as no issue concerning the [SEC]'s authority is presented by this case."[89] For now, however, it is not necessary to determine whether Justice Stevens's interpretation wins the day. Instead, it is sufficient to note that the Court's primary focus in *Morrison* was seemingly on private rather than public enforcement. The stakes of this will become clearer in Part III.

D. *Dodd-Frank's Attempt to Reinstate the Conduct-and-Effects Test for Public Extraterritorial Enforcement Actions*

Before the Supreme Court granted certiorari in *Morrison*, Congress was at work drafting the Dodd-Frank Act,[90] which reflected a general concern with increasing liability for securities fraud.[91] Less than a month after the Court released the *Morrison* decision, Congress successfully passed the Dodd-Frank Act, § 929P(b) of which seemingly codified the conduct-and-effects test by affirmatively granting subject-matter jurisdiction to federal district courts to entertain cases alleging extraterritorial securities fraud violations brought by the SEC or the United States when there is sufficient conduct in the United States

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[88] *See, e.g.*, Yuliya Guseva, *The SEC and Foreign Private Issuers: A Path to Optimal Public Enforcement*, 59 B.C. L. REV. 2055, 2111 (2018); Jennifer Wu, Note, Morrison *v. Dodd-Frank: Deciphering the Congressional Rebuttal to the Supreme Court's Ruling*, 14 U. PA. J. BUS. L. 317, 330 (2011) (claiming that *Morrison* "definitively discard[ed] the 'conduct and effects tests'").

[89] *Morrison*, 561 U.S. at 284 n.12 (Stevens, J., concurring in the judgment); *see also* Daniel E. Herz-Roiphe, Comment, *Innocent Abroad?* Morrison, Vilar, *and the Extraterritorial Application of the Exchange Act*, 123 YALE L.J. 1875, 1883-84 (2014) (explaining that Justice Stevens believed that "[b]arring extraterritorial public enforcement actions seriously hamstrings securities regulators in a world where close to forty percent of American investors hold some foreign assets. Such a categorical ban is not a reasonable response to concerns over f-cubed actions and frivolous shareholder suits" (footnote omitted)).

[90] *See* Brief for the Respondent in Opposition at 6-7, Scoville v. SEC, No. 18-1566 (petition for cert denied Nov. 4, 2019).

[91] *See* 156 CONG. REC. 12,418 (2010) (statement of Rep. Perlmutter) (claiming that Dodd-Frank "will reduce threats to our financial system, increase oversight and prevent future bailouts. The bill strikes a responsible balance, ending the 'wild west' era on Wall Street, while laying a new regulatory foundation for long-term growth which is stable and secure").

or sufficient negative effects on American shareholders or markets.[92] Congressional statements suggest that Congress's intent in promulgating § 929P(b) was to overrule *Morrison*,[93] but the determination of whether it did has long remained unresolved.

One can cogently view § 929P(b) as having no effect on the *Morrison* decision.[94] As shown, *Morrison* took no issue with the Court's subject-matter jurisdiction to hear the dispute—the issue that § 929P(b) ostensibly sought to cure—but instead dismissed the case on the merits. The plain text of § 929P(b) speaks only of subject-matter jurisdiction and makes no reference to the presumption against extraterritoriality or § 10(b). On a deeply textualist view, the Court and Congress agree: the SEC has subject-matter jurisdiction to enforce extraterritorial violations of securities laws in American federal courts. However, to interpret § 929P(b) as merely conferring jurisdiction on federal courts is to read out of the legislative history all indications of legislative intent[95] in contravention of well-accepted principles of statutory interpretation.[96] In fact,

[92] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P, 124 Stat. 1376, 18620-65 (2010) (codified at 15 U.S.C. § 78aa (2018)).

[93] *See, e.g.*, 156 CONG. REC. 12,432 (2010) (statement of Rep. Kanjorski) (claiming that § 929P(b)'s purpose was to "make clear that in actions and proceedings brought by the SEC or the Justice Department, [§ 10(b)] may have extraterritorial application" when plaintiff satisfies conduct-and-effects test). Representative Kanjorski had a significant role in the drafting and promulgation of Dodd-Frank.

[94] *See, e.g.*, Painter, *supra* note 23, at 229; Steve Thel, *Taking Section 10(b) Seriously: Criminal Enforcement of SEC Rules*, 2014 COLUM. BUS. L. REV. 1, 40 n.127.

[95] *See* 156 CONG. REC. 12,432 (2010) (statement of Rep. Kanjorski) (explaining that Congress intended to rebut presumption of extraterritoriality in drafting § 929P(b)).

[96] For a report explaining the most common canons of statutory and constitutional construction, see generally BRANDON J. MURRILL, CONG. RESEARCH SERV., R45129, MODES OF CONSTITUTIONAL INTERPRETATION (2018). There is a broad literature on canons of statutory construction, but for this Note, it is sufficient to accept that the goal of statutory construction is to glean legislative intent. *See, e.g.*, Philbrook v. Glodgett, 421 U.S. 707, 713 (1975); John F. Manning, *Textualism and Legislative Intent*, 91 VA. L. REV. 419, 424 (2005). A recent empirical study suggests that this assumption is a valid one as it is an oft-followed practice of federal appellate judges. *See* Abbe R. Gluck & Richard A. Posner, *Statutory Interpretation on the Bench: A Survey of Forty-Two Judges on the Federal Courts of Appeals*, 131 HARV. L. REV. 1298, 1302 (2018). Further, some commentators have noted that to determine whether a statute rebuts the presumption of extraterritoriality, a court must always consult legislative history. *See* William S. Dodge, *Understanding the Presumption Against Extraterritoriality*, 16 BERKELEY J. INT'L L. 85, 111-12 (1998). For a well-known argument that gleaning legislative intent is a fruitless task for judges, see Frank H. Easterbrook, *Text, History, and Structure in Statutory Interpretation*, 17 HARV. J.L. & PUB. POL'Y 61, 68 (1994) ("Intent is elusive for a natural person, fictive for a collective body. The different strands produce quite a playground—they give the judge discretion, but no 'meaning' that can be imputed to the legislature." (footnote omitted)). Although many so-called textualists claim that Congress legislates against a backdrop of canons of construction, *see, e.g.*, ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 61 (2012), data suggest

in a recent survey of forty-two federal appellate judges across the political spectrum, none "was willing to associate himself or herself with 'textualism' without qualification. All consult legislative history."[97]

Admittedly, the latter view, which this Note advocates in favor of, relies largely on legislative history rather than the plain text, which likely raises objections from textualists who argue that "[t]he text is the law, and it is the text that must be observed."[98] However, Dodd-Frank's legislative history is of particular importance because it allows courts interpreting the lengthy statute to determine what exactly Congress sought to do after *Morrison*. That is, because of the incredibly brief time lapse between the *Morrison* decision and Dodd-Frank's passage, it would have been functionally impossible for Congress to rewrite § 929P(b) to reflect its changed intent after *Morrison*. Further, because *Morrison* disrupted nearly fifty years of relatively well-settled jurisprudence, it would have similarly been functionally impossible for Congress to draft § 929P(b) in a way that preemptively responded to the Court's destruction of the conduct-and-effects test; this is because it could not, with any real certainty, foresee the move the Court would make.[99] Legislative history, which can help glean the express intent of the drafters of Dodd-Frank, is therefore a more useful tool than strict textualism for interpreting the effect of § 929P(b).

Section 929P(b) is thus best viewed as granting federal courts the power to entertain SEC and DOJ § 10(b) and Rule 10b-5 actions despite *Morrison* because it overrules the holding with respect to public actions. The legislative history—specifically Representative Kanjorski's statement during the hearings in the House of Representatives about Dodd-Frank—lends further credence to the argument that this was Congress's intent in promulgating § 929P(b) in light of *Morrison*.[100] Representative Kanjorski's statement was the only statement that explicitly referenced *Morrison*, and his statement is one of only two that

that this is not true. *See generally* Lisa Schultz Bressman & Abbe R. Gluck, *Statutory Interpretation from the Inside—An Empirical Study of Congressional Drafting, Delegation, and the Canons: Part II*, 66 STAN. L. REV. 725 (2014) (demonstrating that Congress often does not know what canons of statutory interpretation that courts use are); Abbe R. Gluck & Lisa Schultz Bressman, *Statutory Interpretation from the Inside—An Empirical Study of Congressional Drafting, Delegation, and the Canons: Part I*, 65 STAN. L. REV. 901 (2013) (same).

[97] Gluck & Posner, *supra* note 96, at 1302.

[98] ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 22 (1997); *see also* John F. Manning, *Without the Pretense of Legislative Intent*, 130 HARV. L. REV. 2397, 2405-12 (2017); William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. REV. 621, 623 (1990) ("Legislative history should not even be consulted to confirm the apparent meaning of a statutory text."). For a recent critique of textualism and Professor Manning's essay, see generally Mark Seidenfeld, *Textualism's Theoretical Bankruptcy and Its Implication for Statutory Interpretation*, 100 B.U. L. REV. 1815 (2020).

[99] *See* Painter, *supra* note 23, at 199.

[100] *See* 156 CONG. REC. 12,432 (2010) (statement of Rep. Kanjorski).

referenced the extraterritoriality provision at all.[101] The other statement that mentioned it—made by Senator Leahy—did not distinguish between whether a court has jurisdiction to hear an extraterritorial enforcement action and whether § 10(b) itself provided for extraterritorial enforcement, nor did he state whether he believed § 929P(b) overruled *Morrison*.[102] Instead, he simply noted his understanding of the provision was that it confirmed § 10(b) and Rule 10b-5 apply in SEC and DOJ enforcement actions if the facts satisfy the conduct-and-effects test.[103] While these two statements do not unequivocally demonstrate unanimous support of Representative Kanjorski's view of § 929P(b), no congressperson objected to these statements, nor did any congressperson offer an alternative view of the provision. One may draw a fair inference that at least those concerned with the SEC's power to enforce extraterritorial fraud agreed with the expressed intent of § 929P(b).

Despite this legislative history, the next Section demonstrates that the question of how to resolve the tension between § 929P(b) and *Morrison* has troubled—and still troubles—both federal courts and commentators since Congress promulgated Dodd-Frank. Because of the demonstrable tension between the statute's text and legislative history and courts' responses, it is important to resolve the tension in order to discern a workable model of enforcement against extraterritorial securities fraud.

E. *Recent Tenth Circuit Litigation and Its Impact on Extraterritorial Enforcement*

After Congress passed Dodd-Frank, courts in every circuit refused to resolve the dispute between *Morrison* and Dodd-Frank. Often, courts considering an extraterritorial enforcement action found that the facts satisfied both the subject-matter jurisdictional conduct-and-effects test as codified in Dodd-Frank and the merits-focused transactional test as created in *Morrison*.[104] Other courts appeared to believe that § 929P(b) overruled *Morrison*.[105] However, the latter

[101] *See id.* (statement of Rep. Kanjorski); 156 CONG. REC. 13,182 (2010) (statement of Sen. Leahy) (believing that extraterritorial language "clarifies that in actions brought by the SEC or the Department of Justice, specified provisions in the securities laws apply if the conduct within the United States is significant, or the external U.S. conduct has a foreseeable substantial effect within our country, whether or not the securities are traded on a domestic exchange or the transactions occur in the United States").

[102] 156 CONG. REC. 13,182 (2010).

[103] *Id.*

[104] *See, e.g.*, SEC v. Sabrdaran, 252 F. Supp. 3d 866, 895 (N.D. Cal. 2017).

[105] *See* SEC v. A Chicago Convention Ctr., LLC, 961 F. Supp. 2d 905, 910 n.1 (N.D. Ill. 2013); *id.* at 915-16 (noting that it had no responsibility to fix congressional drafting errors); Asadi v. G.E. Energy (USA), LLC, No. 4:12-cv-00345, 2012 WL 2522599, at *4 (S.D. Tex. June 28, 2012), *aff'd* 720 F.3d 620 (5th Cir. 2013).

statements were made as mere dicta and were often done with little to no analysis and thus are not conclusory holdings.[106]

The Southern District of New York's treatment of the tension between *Morrison* and § 929P(b) exemplifies the confusion from which district courts suffered after Dodd-Frank. In 2011, Judge Cote, writing the majority opinion in *SEC v. Compania Internacional Financiera S.A.*,[107] found that Dodd-Frank "may demonstrate the Congressional intent for the extraterritorial application of certain provisions of the federal securities laws that the *Morrison* court found lacking in prior versions of those laws."[108] Similarly, in 2012, Judge Scheindlin, in *In re Optimal U.S. Litigation*,[109] stated that she believed "Congress has attempted to remedy that problem by restoring the conducts and effects test for SEC enforcement actions."[110] However, a year later, Judge Forrest, in *SEC v. Tourre*,[111] wrote that she believed "the Dodd-Frank Act effectively reversed *Morrison* in the context of SEC enforcement actions."[112]

Despite federal courts' general hesitancy to address the tension between *Morrison* and § 929P(b) and the widespread confusion about which of the two controls, in early 2017, the District of Utah became the first federal court to affirmatively resolve the issue. It held that § 929P(b)—rather than *Morrison*—controls in determining the extraterritorial reach of § 10(b) and Rule 10b-5.[113] The court in *SEC v. Traffic Monsoon*[114] explicitly recognized that the plain language of the provision did not expressly evince an intent to overrule *Morrison* but determined that, because of Congress's demonstrated intent to allow extraterritorial SEC enforcement of securities law violations, § 929P(b) should control.[115]

In *Traffic Monsoon*, which was recaptioned *SEC v. Scoville*[116] on appeal, the District of Utah considered the behavior of a Utah LLC, the defendant, Traffic Monsoon.[117] Charles Scoville was the sole member, manager, and agent of Traffic Monsoon, and he operated the LLC, which existed only as a website, out of his apartment in Utah.[118] Traffic Monsoon outsourced much of its

[106] *See Chicago Convention Ctr.*, 961 F. Supp. 2d at 910; VIZCARRONDO, *supra* note 23, at 8.

[107] No. 11-cv-04904, 2011 WL 3251813 (S.D.N.Y. July 29, 2011).

[108] *Id.* at *6 n.2.

[109] 865 F. Supp. 2d 451 (S.D.N.Y. 2012).

[110] *Id.* at 456 n.28.

[111] No. 10-cv-03229, 2013 WL 2407172 (S.D.N.Y. June 4, 2013).

[112] *Id.* at *1 n.4.

[113] SEC v. Traffic Monsoon, LLC, 245 F. Supp. 3d 1275, 1293-94 (D. Utah 2017), *aff'd sub nom.* SEC v. Scoville, 913 F.3d 1204 (10th Cir. 2019), *cert. denied*, 140 S. Ct. 483 (2019).

[114] *Id.*

[115] *See id.* at 1290-94.

[116] 913 F.3d 1204 (10th Cir.), *cert. denied*, 140 S. Ct. 483 (2019).

[117] *Scoville*, 913 F.3d at 1209.

[118] *Id.*

programming and customer service functions to Russian programmers and call centers.[119] Its "product" was ostensibly an internet traffic exchange, meaning it would "sell visits to a purchaser's website in order to make that website look more popular than it really is."[120]

While purchasers could purchase a one-time, set amount of "clicks" on their advertisements or visits to their websites, they could also purchase an "Adpack," which gave the purchaser a set amount of clicks and visits and a chance to share in Monsoon's revenue for a twenty four–hour period, contingent on the purchaser clicking a given amount of times on other Monsoon customers' ads.[121] Thus, Adpacks essentially offered a share in Monsoon's revenue to customers who were willing to do some of the company's work. The purchase of one Adpack allowed the purchaser to share in the daily revenues perpetually so long as they performed their requisite daily clicks within each twenty four–hour period.[122] Adpack sales quickly ballooned, becoming most popular in foreign countries—Monsoon sold about ninety percent of its Adpacks to foreign countries—and attracting attention from the SEC. Specifically, the SEC believed that Monsoon was not paying out revenues in the manner promised, thus effectuating a Ponzi scheme.[123]

From the facts, it seems clear that *Scoville* is readily distinguishable from *Morrison*. Charles Scoville is an American citizen, and Monsoon is an American LLC. In that sense, *Scoville* has a much less far-fetched argument for jurisdiction than *Morrison* because it is not an F-cubed claim. However, because most of the purchases were made in foreign countries, the transactions would still arguably fail *Morrison*'s transactional test;[124] thus, the District of Utah and the Tenth

[119] *Id.* at 1209-10.

[120] *Id.* at 1209. The benefit of this service for consumers was that many search engines use algorithms to list the most frequently visited websites higher in search results, thereby generating more traffic to the purchaser's websites. *Id.*

[121] *Id.* at 1210.

[122] *Id.* at 1210-11.

[123] *Id.* at 1211.

[124] *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 269-70 (2010). It bears reminding that the transactional test requires that the transaction occur in the United States or that the security be one traded on a domestic exchange. Because the purchases of the Adpacks that gave the plaintiffs standing to sue occurred in foreign countries, this would seem to fail that test. Interestingly, the *Traffic Monsoon* court found that the facts satisfied the transactional test, *see* SEC v. Traffic Monsoon, LLC, 245 F. Supp. 3d 1275, 1295 (D. Utah 2017), *aff'd sub nom.* SEC v. Scoville, 913 F.3d 1204 (10th Cir. 2019), *cert. denied*, 140 S. Ct. 483 (2019), but it based this conclusion on a post-*Morrison* Second Circuit decision that purportedly clarified "what constitutes a domestic purchase or sale." *See id.* (quoting Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012)). Under *Absolute Activist*, a sale is domestic when either party to the sale incurs irrevocable liability within the United States to purchase or deliver a security. *Absolute Activist*, 677 F.3d at 68. The *Traffic Monsoon* court found that the facts satisfied the *Absolute Activist* test because Monsoon is a Utah LLC, so Monsoon incurred liability to deliver the Adpacks. *Traffic Monsoon*, 245 F.

Circuit both considered whether the SEC had the power to enforce this alleged extraterritorial securities fraud after Dodd-Frank. Both courts engaged in a lengthy discussion about whether Dodd-Frank or *Morrison* controlled, and both determined that § 929P(b) "affirmatively and unmistakably" overruled *Morrison* with respect to the SEC's power to enforce extraterritorial violations.[125] To that end, both courts determined that so long as the facts satisfied the conduct-and-effects test as codified in § 929P(b), the SEC could proceed with its enforcement action.[126]

1. The District Court Decision

In determining whether § 929P(b) sufficiently remedied the Court's issue with extraterritorial application of § 10(b) and Rule 10b-5, the District of Utah first explained its method of statutory interpretation.[127] The court rejected any clear-statement requirement and instead explained that "the context provided by related statutory provisions can be consulted to determine if the presumption should be applied."[128]

Based on that view, the court emphasized the "vital" importance of contextualizing Congress's work in drafting § 929P(b).[129] Congress began drafting Dodd-Frank well before the Court released the *Morrison* decision; however, because the conduct-and-effects test ruled the day for nearly fifty years before *Morrison*, the court explained, Congress was legislating against that legal landscape when drafting the provision.[130] Because the Court handed down the *Morrison* decision on the last day that the committee met to reconcile the House and Senate versions of Dodd-Frank and five days before Congress promulgated the final version of the bill,

> [i]t strains credulity to assume that legislators read *Morrison* on the last day that they met to negotiate the final version of a massive 850-page omnibus bill designed to overhaul large swaths of the United States financial regulations and consciously chose to enact Section [929P(b)] against the

Supp. 3d at 1295. However, focusing on the location of the transaction rather than the location of the fraudulent conduct or the fraudulent effects seems to elevate form over substance because "the person pays the same amount and takes on the same risk regardless of the transaction's form and location." Email from Forty-Two Law Professors, *supra* note 22, at 7.

[125] *Scoville*, 913 F.3d at 1215-18 (quoting RJR Nabisco, Inc. v. European Cmty., 136 S. Ct. 2090, 2100 (2016)); *Traffic Monsoon*, 245 F. Supp. 3d at 1286-94.

[126] *Scoville*, 913 F.3d at 1215; *Traffic Monsoon*, 245 F. Supp. 3d at 1292-94.

[127] *Traffic Monsoon*, 245 F. Supp. 3d at 1293-94 (relying on "the text of Section 929P(b), the legal context in which this amendment was drafted, legislative history, and the expressed purpose of the amendment" to glean legislative intent).

[128] *Id.* at 1287 (citing *Morrison*, 561 U.S. at 265); *see also* Dodge, *supra* note 96, at 110-12.

[129] *Traffic Monsoon*, 245 F. Supp. 3d at 1290-91.

[130] *Id.* at 1290.

background of the fundamental shift in securities law brought about by *Morrison*.[131]

The District of Utah therefore concluded that, given the circumstances surrounding the passage of § 929P(b), its legislative history, rather than the plain language, is the best indicator of legislative intent.[132] As Section I.C similarly concluded, the legislative history is clear: the drafters intended § 929P(b) to allow for extraterritorial SEC enforcement of § 10(b) and Rule 10b-5 where the facts satisfy the conduct-and-effects test.[133]

2. The Tenth Circuit Decision

Considering the same facts, the Tenth Circuit reached the same conclusion as the district court in largely the same fashion. After extensively cataloging the history of *Morrison* and § 929P(b), the court concluded that "Congress undoubtedly intended that the substantive antifraud provisions should apply extraterritorially when the statutory conduct-and-effects test is satisfied."[134]

In reaching this conclusion, Judge Ebel, writing for the majority, admitted that much of the plain text of § 929P(b) did not bolster his conclusion but explained that the circumstances surrounding the drafting and passage of Dodd-Frank demonstrate Congress's intent to codify the extraterritorial reach of *public* enforcement actions.[135] Despite his concession, Judge Ebel did rely in part on the text of the statute. His opinion specifically cited to § 929Y of the Act, which called for the SEC to conduct a study regarding whether extraterritorial enforcement of the antifraud provisions "should be *extended*" to private enforcement actions and to the title of this section of Dodd-Frank ("STRENGTHENING ENFORCEMENT BY THE COMMISSION").[136] That is, he posited that if Congress contemplated in § 929Y that the SEC should determine whether to "extend[]" extraterritorial enforcement actions to private enforcement, it clearly contemplated that § 929P(b) granted the SEC the power to bring these actions.[137] Judge Ebel further relied on Representative Kanjorski's statement before the House, which evinced a clear intent to expand the extraterritorial reach of the antifraud provisions for public enforcement actions.[138]

A critique of both decisions is not without merit. Without question, one can desire a version of § 929P(b) that is a more clearly drafted response to *Morrison*

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[131] *Id.* at 1291.

[132] *Id.* at 1294.

[133] *Id.* ("The court concludes that these clear indications that Congress intended Section[] 10(b) . . . to be applied to foreign transactions are sufficient to overcome the presumption against extraterritorial application.").

[134] SEC v. Scoville, 913 F.3d 1204, 1218 (10th Cir.), *cert. denied*, 140 S. Ct. 483 (2019).

[135] *Id.*

[136] *Id.* (emphasis added).

[137] *Id.*

[138] *Id.*

and that does not require that courts and commentators to quibble over the preferable canons of statutory construction and interpretation to determine its effect. Although this Note maintains that this critique is unfair given the timing of Dodd-Frank and *Morrison*, one may cogently argue that the best route at this point is to treat *Morrison* as controlling until Congress passes this desired, clearer version of § 929P(b).[139] Further, a fair critique of the decisions is that the legislative history is not altogether clear. It is clear that two congressmen—one in each chamber—believed that § 929P(b) had the effect of overruling *Morrison* in the context of SEC and DOJ extraterritorial enforcement actions and that no congressperson spoke out against that belief.[140] However, it is not clear that the vast majority of members of Congress actually believed, or even considered, the effect that § 929P(b) might have.

But, for this critique to have any real weight, courts would have to engage in a method of statutory interpretation that "would represent a significant change in the way the Court writes its statutory interpretation decisions."[141] That is, the traditional method of statutory interpretation is that, where legislative history strongly contradicts the plain language of the statute, a reviewing court should rely on the legislative history to discern congressional intent.[142] In the case of § 929P(b), the legislative history of the provision tells a very different story of congressional intent than the plain language of the provision. Because of the apparent contradiction between the statutory language and the legislative history, both the District of Utah and the Tenth Circuit properly consulted the legislative history of § 929P(b) to determine Congress's intended effect of the provision. Section 929P(b) is therefore best understood as reinstating the conduct-and-effects test for determining the SEC and DOJ's ability to enforce the substantive antifraud provisions extraterritorially.

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[139] Professor Painter does not subscribe to this view in his article but notes that "Congress would help the SEC and DOJ, as well as 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." Painter, *supra* note 23, at 208. Justice Scalia would likely believe that *Morrison* controls over Dodd-Frank because the plain language of § 929P(b) does not explicitly overrule the case, and thus Congress would need to redraft § 929P(b) if it desired a different effect. *See* Eskridge, *supra* note 98, at 623-24. Professor Eskridge himself takes a more moderate position, arguing that Justice Scalia is correct insofar as legislative history cannot always be relevant but believes throwing out legislative history altogether is similarly dubious. *See generally id.*

[140] 156 CONG. REC. 13,182 (2010) (statement of Sen. Leahy); 156 CONG. REC. 12,432 (2010) (statement of Rep. Kanjorski).

[141] Eskridge, *supra* note 98, at 624. This traditional method of statutory interpretation is easily contrasted from so-called "new textualism," a method of statutory interpretation of which Justice Scalia is well known as a strong proponent. *Id.* at 623-24. *But see* Jerry L. Mashaw, *Textualism, Constitutionalism, and the Interpretation of Federal Statutes*, 32 WM. & MARY L. REV. 827, 832 (1991) (claiming that textualism is "a major new direction in the approach to statutory interpretation").

[142] Eskridge, *supra* note 98, at 624.

II. A Primer on Theories of Enforcement

So far, this Note has traced the rise, fall, and resurrection of the conduct-and-effects test and arrived at the conclusion that, based on its legislative history, § 929P(b) of the Dodd-Frank Act overruled *Morrison*'s prohibition on using the conduct-and-effects test with respect to extraterritorial SEC and DOJ enforcement actions. Although that is hopefully now clear, it is not the end of this Note's project. This Part seeks to step back and examine several theories on ideal levels of enforcement in the securities fraud context. It takes a specific eye to comparing the value of public and private enforcement. In doing so, it first addresses the stakes of finding a workable securities enforcement regime and then discusses existing theories on enforcement. Part III will then combine the practical tools uncovered in Part I and theories of enforcement discussed in this Part to propose a workable model of extraterritorial enforcement.

At the outset, it is important to establish the goal of any enforcement regime. Because the SEC has explicitly noted that its principal goal is deterrence, this Note uses deterrence as the measure of the effectiveness of an enforcement regime.[143] Although commentators used to suggest that the securities laws had twin goals of deterrence and compensation—and some still take this position—the compensation justification is "weak and generally rejected by commentators" because private securities actions are generally unsuccessful at compensating injured shareholders.[144]

For a deterrence-focused regime to be successful, it "must save more in social costs from fraud than it creates in enforcement costs."[145] The associated social costs are generally large-scale effects on domestic equity markets. For example, if an investor is afraid that a company she invests in will defraud her and that she will thereby suffer significant personal losses, she has less incentive to

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[143] Mary Jo White, Chair, Sec. & Exch. Comm'n, Address at the IOSCO 39th Annual Conference: The Challenge of Coverage, Accountability and Deterrence in Global Enforcement (Oct. 1, 2014), https://www.sec.gov/news/speech/2014-spch100114mjw [https://perma.cc/VP8P-7GVN] (stating that SEC's goal is to "send the strongest possible message of deterrence to would-be fraudsters").

[144] Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 HARV. J.L. & PUB. POL'Y 1187, 1189 (2013); *see also* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1535-36, 1545-57 (2006) [hereinafter Coffee, *Reforming the Securities Class Action*]; Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1325 (2008) (explaining that private securities litigation is used to protect integrity of capital markets rather than to compensate investors). Empirical evidence also suggests that private class actions cannot be justified through a compensation rationale. *See* Michael Klausner, *Personal Liability of Officers in US Securities Class Actions*, 9 J. CORP. L. STUD. 349, 362-65 (2009). Specifically, Professor Klausner's evidence shows that "among class actions that settled with no payment by any officer, a large majority of parallel SEC actions resulted in substantial sanctions for the officers involved." *Id.* at 365.

[145] Rose, *Multienforcer Approach*, *supra* note 28, at 2178.

invest, making capital more difficult to acquire for firms (i.e., harming capital liquidity) and harming the efficiency of the market.[146] This cost of underdeterrence is insignificant on the individual scale, but when this sentiment is widespread among investors, capital becomes increasingly—and problematically—illiquid.

Another cost of underdeterrence is capital illiquidity caused by high bid-ask spreads.[147] Parties who drive liquidity—namely, market makers[148] and specialists—never know whether the party on the other side of the transaction is trading on material nonpublic information—that is, is a corporate insider or tippee—or whether they are an investor trading without nonpublic information.[149] This incentivizes parties who create liquidity to "recoup the losses suffered in trades with the well informed by gains in trades with liquidity traders" by increasing the bid-ask spread.[150] High bid-ask spreads are especially prevalent in markets that lack transparency. As transparency increases, bid-ask spreads decrease because market makers and specialists suffer fewer losses from trading against parties that trade on material, nonpublic information.[151] Because

[146] *See id.* at 2179-80; *see also* Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977, 1010 (1992) (explaining that stock that is overvalued because of fraud leads investors to overinvest but stock that is undervalued causes companies to struggle to raise capital). Some commentators argue that the increased costs that individual investors face as a result of fraud are no cause for concern. *See, e.g.*, Merritt B. Fox, *Civil Liability and Mandatory Disclosure*, 109 COLUM. L. REV. 237, 253 (2009) [hereinafter Fox, *Civil Liability*]. In these commentators' views, these costs are simply redistributions of private wealth and therefore are not the concern of a deterrence regime because the investors can protect themselves by, for example, diversifying their portfolios to minimize the impact of fraudulent activity. *See id.* These commentators are instead concerned with the aggregate impact of a generalized hesitance to invest and the impact that behavior has on a firm's ability to raise capital. *See id.* at 264-67; Rose, *Multienforcer Approach*, *supra* note 28, at 2179.

[147] *See* Fox, *Securities Class Actions*, *supra* note 81, at 1203-04. The bid-ask spread is "the difference between the lower price at which [market-makers or specialists] accept seller orders and the higher price at which they accept buyer orders." *Id.*

[148] A market maker is "a broker-dealer that holds itself out in the interdealer market as being ready to purchase and sell that security for its own account on a regular and continuous basis." SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1469 (2d Cir. 1996) (citing 15 U.S.C. § 78c(a)(38) (2018)).

[149] Fox, *Securities Class Actions*, *supra* note 81, at 1203.

[150] Lawrence R. Glosten & Paul R. Milgrom, *Bid, Ask and Transaction Prices in a Specialist Market with Heterogeneously Informed Traders*, 14 J. FIN. ECON. 71, 72 (1985).

[151] *See* Fox, *Civil Liability*, *supra* note 146, at 265; Fox, *Securities Class Actions*, *supra* note 81, at 1204; Glosten & Milgrom, *supra* note 150, at 89-90 (finding that illiquidity is exacerbated "the greater the fraction of informed traders and the better their information" and, conversely, minimized where there are fewer informed traders); *see also* Douglas W. Diamond & Robert E. Verrecchia, *Disclosure, Liquidity, and the Cost of Capital*, 46 J. FIN. 1325, 1326 (1991) ("Disclosure improves future liquidity of a firm's securities . . . and this

greater transparency is achieved by increased compliance with the securities laws' mandatory disclosure requirements, an enforcement regime that successfully deters securities fraud avoids liquidity problems by incentivizing greater compliance with disclosure requirements, which has the effect of both incentivizing investment and minimizing bid-ask spreads.

Underdeterrence of securities fraud also leads to corporate governance–based allocative inefficiencies.[152] Namely, "[i]naccurate disclosures . . . can disguise poor management and prevent value-enhancing changes in control."[153] Professor Merritt Fox explains four ways in which greater disclosure—and thus, less opportunity for fraud—improves or eliminates this corporate governance–based inefficiency. First, accurate disclosure places accurate information in the hands of the largest, and therefore most influential, shareholders.[154] There is evidence that these large shareholders sometimes then use that information to effectuate value-enhancing changes in the companies in which they are invested.[155] Put simply, "a better-informed shareholder is more likely to vote for share-value-maximizing choices with regard to all matters."[156]

Second, better transparency leads to stronger incentives for management to respect fiduciary duties.[157] That is, management is only actually required to respect its fiduciary duties to shareholders if there is a punishment for not doing so; however, if the shareholders are unaware of the breach because of inaccurate or incomplete disclosures, "managers are not inclined to provide information that might suggest the existence of a breach of a fiduciary duty," harming corporate governance.[158] Third, Fox hypothesizes that accurate disclosures allow potential acquirers to more accurately assess the risk of acquiring the corporation and thus more accurately value it.[159] Finally, accurate disclosures can lead to increased use of share-based management compensation.[160] While managers are generally hesitant to accept a compensation package that relies heavily on shares rather than salary, more accurate disclosures make share price more accurate because the market trades on better—more complete and

reduces the cost of capital for the firm, with the reduction in cost of capital larger for larger firms.").

152 *See* Rose, *Multienforcer Approach*, *supra* note 28, at 2179-80. For an empirical study demonstrating that corporate disclosure best facilitates allocative efficiency, see Merritt B. Fox et al., *Law, Share Price Accuracy, and Economic Performance: The New Evidence*, 102 MICH. L. REV. 331, 338-41 (2003).

153 Rose, *Multienforcer Approach*, *supra* note 28, at 2180.

154 *See* Fox, *Civil Liability*, *supra* note 146, at 255-56.

155 *See id.* at 256-57.

156 Fox, *Securities Class Actions*, *supra* note 81, at 1202.

157 *See* Fox, *Civil Liability*, *supra* note 146, at 258.

158 Merritt B. Fox, *Required Disclosure and Corporate Governance*, 62 L. & CONTEMP. PROBS., Summer 1999, at 113, 118-20 [hereinafter Fox, *Required Disclosure*].

159 Fox, *Civil Liability*, *supra* note 146, at 259.

160 *Id.*

accurate—information, so managers should, at least in theory, be less hesitant to accept share-based compensation.[161] Share-based compensation has significant governance benefits because it aligns the financial interests of management with those of the company.

On the other side, when enforcement is overly vigorous, it may also result in serious social costs. If a regime seeks to penalize every bit of fraudulent conduct regardless of size or impact, the fear of liability may cause companies to invest in services to protect themselves that they would not otherwise invest in, thereby decreasing market capital.[162] Further, heightened fear of enforcement may lead companies to disclose too much information out of concern that a court may second-guess the disclosure decision if challenged.[163] This not only increases costs for the firm that overdiscloses but may also contribute to inaccurate share pricing because of an overabundance of information in the market.[164] Overdeterrence may also have an opposite, equally problematic effect: it may cause a chilling effect such that securities issuers do not disclose *anything* for fear of liability.[165] In the narrower context of extraterritorial enforcement, overenforcement can scare companies from listing on domestic markets, hindering the success of American markets.[166] A model of enforcement can

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[161] *Id.*

[162] *See id.* Despite the risk of inefficiency, for several years, this so-called "broken windows" theory of enforcement was the SEC's dominant enforcement regime. *See* CTR. FOR CAPITAL MKTS. COMPETITIVENESS, U.S. CHAMBER OF COMMERCE, EXAMINING U.S. SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT: RECOMMENDATIONS ON CURRENT PROCESSES AND PRACTICES 5, 30 (2015), https://www.centerforcapitalmarkets.com/wp-content/uploads/2015/07/021882_SEC_Reform_FIN1.pdf [https://perma.cc/PBJ4-X7FF] (describing broken windows policy as one that "presumes that aggressive action against infractions of all sizes, including minor infractions, sends a broad message that deters others from violating the law").

[163] *See* Rose, *Multienforcer Approach*, *supra* note 28, at 2186 (citing Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417 (2003)).

[164] *See generally* Fox, *Required Disclosure*, *supra* note 158.

[165] *Cf.* Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43154, Investment Company Act Release No. 24,599, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (regulating selective disclosure); Letter from Sullivan & Cromwell, to Jonathan G. Katz, Sec'y, Sec. & Exch. Comm'n (Apr. 28, 2000), https://www.sec.gov/rules/proposed/s73199/sulcrom1.htm [https://perma.cc/UF3T-JJZ5] ("The potential 'chilling effect' of Regulation FD . . . could also significantly impact the scope and quality of disclosures currently available to securities markets."). Although both this letter and this Release were written in the context of selective disclosure and insider trading, they reflect the common concern that overregulation of securities markets harms investors.

[166] *See* Giuffra, *supra* note 81; *see also* Brief of *Amici Curiae* the Securities Industry and Financial Markets Association et al. In Support of Respondents at 11-16, Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010) (No. 08-1191) (discussing evidence that domestic

therefore only be a successful deterrent if it minimizes the costs of both under- and overenforcement.

Now that the goal of deterrence and the stakes of such a goal are clear, the inquiry becomes: What is the ideal model to achieve that goal? For many commentators, the ideal model is an optimal enforcement model. Taking an economic lens to the issue of enforcement, optimal enforcement models theorize on how best to maximize efficiency by minimizing social costs.[167] Professor Amanda Rose, for example, proposes a model of securities fraud enforcement that unifies enforcement in a single agency rather than allowing private plaintiffs, the SEC, and the DOJ all to separately enforce.[168] Professor Yuliya Guseva instead recommends that the SEC reorient its focus on low-cost preventative monitoring schemes rather than overhauling its enforcement regime.[169] These are two amongst many proposals. The import is that proposals for optimal enforcement models are often theoretical in nature because they abandon existing mechanisms and enforcement norms in favor of theories that, given all possibilities, limit enforcement-based externalities.[170]

This Note's approach, detailed in Part III, instead relies on a practical application of extant law to argue that, without any serious alteration of the current state of the law, a workable model of extraterritorial securities fraud enforcement exists. Without some congressional intervention with a similar magnitude to that of the PSLRA, other commentators' proposed optimal models of enforcement are not feasible for the SEC or private litigants to adopt. However, Part III will demonstrate how the existing bits of law discussed in Part I can act together to minimize the costs of under- and overdeterrence discussed in this Part to create a model of enforcement that, without adopting any extra means than currently exist, successfully deters securities fraud.

markets already suffered from foreign disinvestment and arguing that allowing extraterritorial enforcement will worsen this issue).

167 The generally accepted understanding of optimal enforcement is that which balances "the cost of catching and convicting offenders, the nature of punishments . . . and the responses of offenders to changes in enforcement." Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 170 (1968); *see also* Steven Shavell, *The Optimal Structure of Law Enforcement*, 36 J.L. & ECON. 255, 261 (1993) ("[T]he measure of social welfare is the social benefits associated with commission of acts less the harm due to them and the costs of law enforcement.").

168 *See generally* Rose, *Multienforcer Approach*, *supra* note 28.

169 *See generally* Guseva, *supra* note 88 ("[T]he Commission should not strengthen prosecution *qua* prosecution. Instead, the post-*Morrison* trends call upon the Commission to design better tools for *preventative* monitoring.").

170 *See, e.g.*, Edward G. Fox, Merritt B. Fox & Ronald J. Gilson, *Economic Crisis and the Integration of Law and Finance: The Impact of Volatility Spikes*, 116 COLUM. L. REV. 325, 371 (2016) (claiming that levels of liability are optimal where "the improvement in economic welfare from deterring issuer misstatements is at least as great as the social costs arising from prosecuting the action").

III. A WORKABLE MODEL OF EXTRATERRITORIAL SECURITIES FRAUD ENFORCEMENT

A. *Three Themes*

Throughout this Note, three themes have become apparent: (1) the relative value of private extraterritorial enforcement, (2) the relative value of public extraterritorial enforcement, and (3) tests for determining whether extraterritorial enforcement is permissible in a given circumstance (i.e., whether the conduct-and-effects test or the transactional test should apply). This Part will now take what may initially seem to be disparate themes and show how *Morrison* and § 929P(b) are not merely useful considerations but are necessary to craft a workable model of enforcement. This Part focuses less on the policy arguments that this Note has presented thus far because it seeks to glean which existing tools are useful to develop a workable model of enforcement. To that end, while the policy arguments have been helpful for clarifying the existing tools, they are not useful in forwarding a workable model of enforcement.

1. Private Enforcement

It seems that both the Court in *Morrison* and Congress in drafting § 929P(b) shared the principal concern of limiting frivolous private enforcement.[171] While this Note argued that this was the Court's intention, as seen, one may dispute the contention that the Court was primarily concerned with limiting only private enforcement (i.e., was not concerned with limiting public enforcement) in *Morrison*. However, it seems essentially out of the question to suggest that the Court maintained no interest in limiting private enforcement. As shown, *Morrison* considered a private extraterritorial enforcement action, and much of the language of the opinion and questioning at oral argument was riddled with concern about the deleterious effects of extraterritorial enforcement actions. It is therefore clear that the Court sought to limit—if not eliminate—those actions.[172] Eliminating the conduct-and-effects test and replacing it with the transactional test was the Court's means of limiting extraterritorial actions.

Similarly, with respect to Congress's intent, one can quibble about whether § 929P(b) reinstated the conduct-and-effects test for public enforcement actions. However, it is clear that the provision did not reinstate the test for private enforcement actions.[173] Instead, § 929Y required the SEC undertake a study to determine whether courts or Congress should reinstate the conduct-and-effects test for private enforcement actions. The results of that study were

[171] *See supra* notes 83-86 and accompanying text. That Congress only drafted § 929P(b) to refer to public enforcement actions further supports this claim.

[172] *See supra* note 84-85 and accompanying text.

[173] *See, e.g.*, Melvin v. Brayshaw, No. 19-cv-00712, 2019 WL 6482220, at *4 (C.D. Cal. Oct. 3, 2019) (refusing to extend *Scoville* to private enforcement actions, finding that Dodd-Frank only impacted public enforcement).

inconclusive.[174] Additionally, the PSLRA, passed fifteen years before *Morrison* and Dodd-Frank, demonstrates that Congress, when drafting § 929P(b), had a sustained interest in substantially cabining private securities fraud enforcement actions because the PSLRA similarly sought to limit private plaintiffs' ability to bring securities fraud class actions.[175] Congress passed the PSLRA with a Senate supermajority over President Clinton's veto, which only further exemplifies Congress's strong desire to limit private enforcement actions.[176] On these accounts, it seems that limiting—or even eliminating—private securities actions satisfies both Congress and the Court.

Many academic commentators are also critical of private extraterritorial enforcement actions. Among the myriad critiques are: that because of the nature of damages payouts in private actions, private shareholder suits are inefficient means of enforcement;[177] that shareholders are poorly incentivized to enforce efficiently and thus may sue frivolously;[178] and that settlements in cases with parallel private and public enforcement suits tend to result in higher settlements

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[174] *See generally* SEC STUDY, *supra* note 22.

[175] *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.) (increasing, among other things, evidentiary burden on securities fraud plaintiffs). The PSLRA sought to "curb frivolous and abusive securities litigation." 141 CONG. REC. 35,554 (1995) (statement of Rep. Bliley). There is empirical evidence that it was successful in achieving Congress's goal of limiting private enforcement actions. *See* Marilyn F. Johnson, Karen K. Nelson & A.C. Pritchard, *Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act*, 23 J.L. ECON. & ORG. 627, 630 (2007). However, other empirical evidence suggests that the PSLRA had a largely negative impact on meritorious securities litigation in contravention of Congress's purported goals. Stephen J. Choi, *Do the Merits Matter* Less *After the Private Securities Litigation Reform Act?*, 23 J.L. ECON. & ORG. 598, 622-23 (2007) (conceding that PSLRA had negative impact on viability of meritorious litigation "for suits that would have returned a relatively modest amount in the pre-PSLRA period" but demonstrating that it had limited impact on viability for suits that would have returned large returns).

[176] *See* James Chen, *Private Securities Litigation Reform Act (PSLRA)*, INVESTOPEDIA, https://www.investopedia.com/terms/p/pslra.asp [https://perma.cc/HS66-W7HV] (last updated Mar. 29, 2020).

[177] This problem is frequently referred to as the "circularity problem." *See* Coffee, *Reforming the Securities Class Action*, *supra* note 143, at 1536 n.5 (defining circularity problem as issue "that the costs of the action fall principally on innocent shareholders" rather than liable directors); Amanda M. Rose, *Form vs. Function in Rule 10b-5 Class Actions*, 10 DUKE J. CONST. L & PUB. POL'Y, no. 2, 2015, at 57, 61 [hereinafter Rose, *Form vs. Function*]. Several scholars have proposed changes to the existing enforcement regime to address this compensation issue. *E.g.*, Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1489 (1996) (advocating for regulatory civil penalties to supplement SEC enforcement actions rather than private enforcement suits).

[178] *See, e.g.*, David Freeman Engstrom, *Agencies as Litigation Gatekeepers*, 123 YALE L.J. 616, 630-31 (2013) (describing "zealousness critique" of private enforcement); Rose, *Multienforer Approach*, *supra* note 28, at 2193-2200 (analyzing how properly aligned incentives add value to litigation).

in the private suits than corresponding suits without parallel SEC enforcement actions—meaning the current regime is an inefficient, overly compensatory one.[179] Although some commentators have presented evidence that private class actions are justified because they give minority investors an opportunity to litigate claims that they would otherwise lack the chance to[180] or because the advantages of differently incentivized enforcers that a decentralized enforcement system carries outweigh the costs of such a system,[181] the general tide of commentators suggests that the current regime of private extraterritorial enforcement is, at best, problematic.[182]

2. Public Enforcement

Another theme of this Note is that parties disagree on what to do with public enforcement. Some commentators argue in favor of a robust public enforcement scheme, while others argue against that regime.[183] The objections to having any extraterritorial enforcement scheme are not without merit. There is good reason to desire significant foreign presence in American markets, and giving American investors the opportunity to invest in foreign companies can lead to great profits for those investors. As seen, before *Morrison*, there was substantial evidence that foreign firms were pulling out of American markets because of overenforcement. Thus, it was seemingly a reasonable response to cut back on extraterritorial enforcement to ensure more robust investment opportunities and preserve market efficiency.

But, it is possible—and at least one reading of the opinion would suggest—that the Court spoke too broadly in *Morrison*. The concerns regarding overenforcement before *Morrison* stemmed largely from a concern with F-cubed cases rather than a concern with overzealous public enforcement.[184] Importantly,

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[179] *See, e.g.*, James D. Cox & Randall S. Thomas with Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 771, 777 (2003).

[180] *See generally* Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637 (2006).

[181] James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Laws*, 100 CALIF. L. REV. 115, 178-81 (2012); Webber, *supra* note 9, at 266 ("While loss of the class action could prompt enhanced public enforcement via the SEC and other regulatory bodies, resource constraints suggest that public actors may be limited in their ability to fill the void.").

[182] *See, e.g.*, Fox, *Civil Liability*, *supra* note 146, at 279-83 (proposing securities liability scheme that, among other things, eliminates fraud-on-the-market presumption in most cases, making class certification difficult if not impossible).

[183] *Compare* Rose, *Multienforcer Approach*, *supra* note 28, at 2204-05 (arguing that multienforcer system leads to perverse results), *with* SEC STUDY, *supra* note 22, at 5 ("It has long been recognized that meritorious private litigation under the federal securities laws is an important tool to combat securities fraud . . . ."), *and* Email from Forty-Two Law Professors, *supra* note 22, at 5.

[184] *See, e.g.*, Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 269-70 (2010); Brief of the Government of the Commonwealth of Australia, *supra* note 86, at 5 (stating that its brief only concerned public enforcement); Stephen J. Choi & Linda J. Silberman, *Transnational*

F-cubed cases are never public enforcement actions because, by their nature, F-cubed cases involve private, foreign plaintiffs. Further, although the Court did not explicitly adopt the government's position, in its amicus brief, the government distinguished between private and public enforcement actions, explaining that "SEC enforcement actions are unlikely to produce conflict with foreign nations" but that private enforcement actions "present a significant risk" of such conflict.[185] A call for eliminating public enforcement therefore cannot be justified on the same grounds that limiting private enforcement was, and thus must have some independent justification.

The *Morrison* opinion, however, does not provide such an independent justification, nor do the myriad amicus briefs filed.[186] In fact, the *Morrison* Court did not even address the question. An appropriate response, then, is to turn to Congress's response to *Morrison* to determine whether Congress agreed with the Court's ostensible limitation on public enforcement actions. There is, as was detailed extensively above, an ongoing debate about whether § 929P(b) has any effect on *Morrison*'s holding with respect to public enforcement actions.[187] Notwithstanding the policy questions raised by the provision, the legislative history of § 929P(b) does not support an elimination of public enforcement actions because the history clearly demonstrates that Congress sought to preserve the SEC and the DOJ's ability to enforce extraterritorial violations of the substantive antifraud provisions.[188]

Therefore, it is a viable conclusion that extraterritorial public enforcement is permissible after *Morrison* and Dodd-Frank. This result also balances the Court's policy rationales for its decision in *Morrison*—ensuring foreign companies continue to list on domestic markets and facilitating an efficient market—with Congress's express intent in passing § 929P(b). It is also the conclusion that both the District of Utah in *Traffic Monsoon* and the Tenth Circuit in *Scoville*—the first courts to reach a holding that turns on the issue—

Litigation and Global Securities Class-Action Lawsuits, 2009 WIS. L. REV. 465, 466 (noting that concerns about extraterritorial enforcement are most acute in F-cubed cases); Herz-Roiphe, *supra* note 89 at 1881-83. Although some data suggests a concern with F-cubed cases was unfounded, *see* Bartlett et al., *supra* note 10, at 971, Bartlett et al. give a large caveat with their data: "[T]hese overall data leave open the possibility that F-squared and F-cubed cases were common before *Morrison* and simply that more cases would have been brought after 2010, had *Morrison* not been decided." *Id.* at 988.

[185] *See* Brief for the United States as Amicus Curiae Supporting Respondents at 26-27, *Morrison*, 561 U.S. 247 (No. 08-1191).

[186] *See, e.g.*, Brief for Commonwealth of Australia, *supra* note 86, at 5; Brief for the Republic of France as *Amicus Curiae* in Support of Respondents at 30-33, *Morrison*, 561 U.S. 247 (No. 08-1191) (tailoring argument against extraterritorial enforcement actions exclusively to private, F-cubed actions).

[187] *See supra* Section I.C.

[188] *Supra* Sections I.C, I.D.

reached.[189] Taking these results together, allowing for extraterritorial public enforcement seems to comport with the greater weight of existing mechanisms.

3. Which Test Applies?

The final theme that runs throughout this Note is determining which test—conduct-and-effects or transactional—should govern in determining a federal court's power to hear an enforcement action (if judged under the conduct-and-effects test) or in determining a plaintiff's ability to bring such an action (if judged under the transactional test). This question is, in many respects, similar to the question about what to do with public enforcement discussed in Section III.A.2. That is, it turns on a determination of whether *Morrison* or § 929P(b) controls because the case and the provision instruct district courts to apply different tests. However, the question is independent because a theoretical model of enforcement could, for example, propose a distinct test for judging whether extraterritorial enforcement is appropriate. Thus, it is important to discern what work existing mechanisms do in determining what test is appropriate to best craft a workable model of enforcement.

At least in 2010, the Court believed that the transactional test should control for determining whether a plaintiff may bring an extraterritorial enforcement action.[190] If courts—or other commentators suggesting a model of enforcement—adopt this test, neither the SEC nor private plaintiffs have the authority to sue for an alleged extraterritorial violation of § 10(b) or Rule 10b-5 because the Court affirmatively concluded that neither the statute nor the rule overcame the presumption against extraterritoriality.[191] Congress, in passing Dodd-Frank, made no substantive changes to those provisions that would cause them to overcome that presumption; § 929P(b) spoke only of a federal court's subject-matter jurisdiction to hear such an enforcement action, which was not disputed in *Morrison*.[192]

However, Congress, in passing § 929P(b), seemingly intended to grant the SEC the ability to bring these enforcement actions.[193] Admittedly, Congress did

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[189] *See* SEC v. Scoville, 913 F.3d 1204, 1215-18 (10th Cir.), *cert. denied*, 140 S. Ct. 483 (2019); SEC v. Traffic Monsoon, LLC, 245 F. Supp. 3d 1275, 1288-94 (D. Utah 2017), *aff'd sub nom.* SEC v. Scoville, 913 F.3d 1204 (10th Cir. 2019), *cert. denied*, 140 S. Ct. 483 (2019).

[190] *See Morrison*, 561 U.S. at 269.

[191] *See id.* at 264 ("The provision seems to us 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.").

[192] *See id.* at 254.

[193] *See supra* notes 95-103 and accompanying text. As discussed, there is a long-standing dispute about whether legislative history is owed deference and, if so, how much. Despite this disagreement, recent evidence suggests that many federal judges regularly rely on legislative history in interpreting statutes. *See* Gluck & Posner, *supra* note 96, at 1302. *Traffic Monsoon* and *Scoville*—which both relied on legislative history—conform to these norms discovered by Professor Gluck and Judge Posner's research, and it seems reasonable to expect that other federal courts in the future will similarly rely on legislative history.

not, in the bare language of § 929P(b), state its express intent to overrule *Morrison*'s bar on public extraterritorial enforcement actions.[194] Such a rigid requirement makes little sense, however, given the state of the case law when Congress drafted § 929P(b).[195] To that end, it is more sensible to apply the conduct-and-effects test as codified in § 929P(b) to determine whether a court, reviewing any SEC action, has the jurisdiction to entertain the action.

B. *A Workable Model of Enforcement*

Taken together, the three themes just discerned make up the workable model of enforcement this Note will now propose and defend. Those themes are: there is agreement among the Court and Congress that private extraterritorial enforcement is not justifiable, § 929P(b) and the recent Tenth Circuit litigation suggest public extraterritorial enforcement is justifiable, and the provision and recent litigation require courts to apply the conduct-and-effects test to determine whether extraterritorial application of § 10(b) and Rule 10b-5 is appropriate in a given instance. The import of these three themes is that the most workable model of extraterritorial securities fraud enforcement is exclusive public enforcement (i.e., no private enforcement) of extraterritorial violations of § 10(b) and Rule 10b-5 with the district court's jurisdiction to entertain the dispute determined by the conduct-and-effects test. This is the model of enforcement this Note now defends.

As a preliminary matter, for public enforcement to be a successful deterrent absent a private enforcement scheme, it must toe the line between overenforcement—which raises many of the same concerns as the pre-*Morrison* private enforcement scheme—and underenforcement. As shown, a scheme that fails in either respect is not a successful deterrent because it creates (or, perhaps, fails to eradicate) many of the same externalities as the fraud itself and thus is not a workable model of enforcement.[196] If this scheme is to be workable, then, the SEC and the DOJ, with their limited resources, must serve as intelligent gap fillers, meaning the entities must make up for any gaps left open by nonexistent

[194] *See* Painter, *supra* note 23, at 200.

[195] *See Traffic Monsoon*, 245 F. Supp. 3d at 1291-92 ("[T]he more reasonable assumption is that *Morrison* was issued too late in the legislative process to reasonably permit Congress to react to it."); Painter, *supra* note 23, at 199 ("[I]t 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.").

[196] *See* Rose, *Multienforcer Approach*, *supra* note 28, at 2178. Admittedly, "reasonable minds may differ" as to the relative value of private enforcement. *Id.* at 2221; *see also* Webber, *supra* note 9 (arguing in favor of private securities class actions). However, because this Note seeks to use existing mechanisms to craft a model of enforcement, the theoretical value of private enforcement is less significant given the fact that the Court and Congress seem to agree that private extraterritorial enforcement raises too many problems to be used in the narrow context of extraterritorial enforcement.

private enforcement while limiting overdeterrence costs.[197] This not only requires a willingness to enforce extraterritorial violations of the antifraud provisions but also a resource-contingent ability to do so.

The SEC's ability to enforce violations of the antifraud provisions without private enforcement actions has been extensively questioned because of its limited resources.[198] These arguments sound in a concern regarding underenforcement. For several reasons, these concerns are significantly less acute in the narrower context of extraterritorial enforcement as compared to securities fraud enforcement generally. First, there is evidence that foreign nations are cooperating in international enforcement efforts, which is likely to reduce costs, rendering the SEC capable of funding much more expansive extraterritorial enforcement actions.[199] Second, this proposal for a workable model of enforcement applies only to extraterritorial enforcement, and thus it does not serve as an outright rejection of the utility of private class actions in securities litigation. In some domestic cases, private class actions may well be useful.[200] Instead, this Note maintains that, for the smaller subset of extraterritorial enforcement actions in particular, private class actions are unnecessary and do not comport with existing statutory and policy limitations. To that end, the concern that the SEC lacks the resources to pursue these

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[197] Some commentators argue that although the SEC faces resource-based limitations in its ability to enforce against securities fraud, it makes "better dollar-for-dollar use of the shareholders' money," and thus public enforcement may be preferable to private enforcement. William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 149 (2011). That is, perhaps the better question is not whether the SEC can pick up *all* of the slack of private enforcement actions lost if § 929P(b) eliminated private enforcement but instead whether the SEC could pick up *some* of the slack and do so more efficiently than private enforcement. *Cf. id.* at 150 (reframing this inquiry similarly in the context of fraud-on-the-market liability).

[198] *See, e.g.*, Stephen J. Choi & A.C. Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison*, 13 J. EMPIRICAL LEGAL STUD. 27, 47 (2016) (concluding that SEC is less likely to enforce international violations due to resource constraints);Webber, *supra* note 9, at 266.

[199] *See* G20, DECLARATION: SUMMIT ON FINANCIAL MARKETS AND THE WORLD ECONOMY 9 (2008), https://g20.org/en/g20/Documents/2008-Washington-Declaration%20of%20the%20Summit%20on%20Financial%20Markets%20and%20the%20World%20Economy.pdf [https://perma.cc/3MBC-72TS] (listing policy commitments to aid in securities enforcement); *Cooperative Arrangements with Foreign Regulators*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml [https://perma.cc/V9U4-A59E] (last updated Mar. 14, 2017).

[200] *Compare* Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 WIS. L. REV. 333, 346 (arguing that private class actions are meritorious because they protect concentrated investors), *with* Coffee, *supra* note 30, at 409-10, *and* Rose, *Form vs. Function*, *supra* note 177, at 66 ("'[F]ollow on' suits represent a pure deadweight cost to society.").

enforcement actions is minimal because it would only need to increase its enforcement efforts in a small subset of cases.[201]

Admittedly, in the years since *Morrison*, empirical data suggests that the number of extraterritorial actions brought by the SEC has not increased much, if at all.[202] Without seeking to comment on the validity of Guseva's data, this trend is explainable without causing great concern for the model of enforcement proposed herein. As noted extensively above, after *Morrison* and until *Traffic Monsoon*, courts in every jurisdiction were wary to decide whether the SEC had the ability to bring extraterritorial enforcement actions.[203] Thus, the SEC may have reasonably believed that its resources were best used enforcing domestic securities fraud violations until the Court definitively answered the question regarding its ability to bring extraterritorial actions. Given the lack of empirical studies released since *Traffic Monsoon* and *Scoville*, it is currently too early to determine whether the SEC has, since those decisions, become more willing to bring more extraterritorial enforcement actions. However, it is fair to note the SEC seemingly *could*, given the existing state of the law and the fact that it would only need to fill litigation gaps in a small subset of cases, begin to fill in gaps in extraterritorial enforcement left open after *Morrison* and § 929P(b) removed private extraterritorial enforcement.

While the SEC and DOJ's resource-based contingency is one common critique of eliminating private enforcement of securities fraud, this Note previously suggested that capital illiquidity and corporate governance–based allocative inefficiency are also significant risks associated with underenforcement.[204] Admittedly, there is no strong evidence to support the fact that the SEC would be any better at avoiding underdeterrence than private plaintiffs.[205] However, as Rose notes, for a regime that eliminates private

201 Even before *Morrison*'s heightened barriers on extraterritorial litigation, F-cubed claims made up less than ten percent of all domestic securities litigation. Bartlett et al., *supra* note 10, at 971. *But cf.* MICHAEL FELDBERG, ALLEN & OVERY, U.S. INSIDER TRADING ENFORCEMENT GOES GLOBAL 1 (2013), https://www.aohub.com/aohub/attachment_dw.action?key=Ec8teaJ9VapYSer219Q7FF7eOOGbnAEFKCLORG72fHz0%2BNbpi2jDfaB8lgiEyY1JAvAvaah9lF3d%0D%0AzoxprWhI6w%3D%3D&attkey=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQJsWJiCH2WAVfnLVn2ghRGNUKS1CAKeH0&fromContentView=1&fromDispatchContent=true&nav=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQ%2FHLCIrtYuIY%3D&uid=frsvcLdHNrI%3D&popup=HxapDW%2FMKd4%3D&freersslink=true [https://perma.cc/3A3F-XQCE] ("[T]he SEC has in recent years shown an increasing willingness to pursue insider trading enforcement actions with substantial international dimensions.").

202 *See* Guseva, *supra* note 88, at 2078; *see also* Bartlett et al., *supra* note 10, at 1000.

203 *See supra* Section I.D.

204 *See supra* notes 145-61 and accompanying text.

205 *See* Choi & Pritchard, *supra* note 198, at 47 (finding that SEC enforcement strategy would not change if Congress eliminated private enforcement because the SEC has limited resources); Rose, *Multienforcer Approach*, *supra* note 28, at 2227-29.

enforcement to be *less* efficient than the current regime, three factors must hold true:

> (1) if a federal enforcer were given exclusive enforcement authority, it would systematically err on the side of underdetterence; (2) additional enforcers save more in underdeterrence costs than they create in enforcement costs; and (3) no alternative reforms designed to align the federal enforcer's incentives more closely with the public's interest in optimal deterrence are available that would lead to an even greater net savings in social costs.[206]

As there is not strong evidence that all of these factors will hold true,[207] given the state of the law as it exists, eliminating private enforcement in the extraterritorial enforcement context seems to minimize negative externalities even if it leads to underdeterrence. Thus, concerns related to capital illiquidity and corporate governance–based allocative inefficiency, although not eliminated, are minimized to the extent possible under the proposed model of enforcement.[208]

A successful enforcement regime cannot merely limit underenforcement; it must also successfully eliminate the social costs of securities fraud by avoiding rampant overenforcement.[209] Limiting the SEC's ability to bring extraterritorial enforcement actions with the conduct-and-effects test protects from concerns of overenforcement. The test essentially prevents the SEC from reinstating a broken windows policy for extraterritorial enforcement as it had for domestic violations for many years.[210] That is, it requires the SEC prove sufficient conduct or effects within the United States before bringing an enforcement action rather than attempting to enforce against all fraud regardless of its conduct or effects. The latter regime would run the risk of effectuating a return to the pre-*Morrison* climate of rampant overenforcement (or, at least, foreign companies could reasonably perceive a risk thereof), which would likely cause foreign issuers to pull out of domestic markets.[211] This overenforcement would heighten the social costs of enforcement, and thus a test that does not require some sort of metric

[206] Rose, *Multienforcer Approach*, *supra* note 28, at 2178.

[207] *See generally id.*

[208] It bears repeating here that if eliminating private enforcement allows underdeterrence costs to persist, it is only in the narrow context of extraterritorial enforcement and thus should not raise great cause for concern.

[209] *See* Rose, *Multienforcer Approach*, *supra* note 28, at 2179-81. Rose seems to assume in her article that systematic underenforcement by the SEC would still probably be preferable to private enforcement because the degree to which private plaintiffs overenforce securities fraud is so high. *See id.* at 2219-24.

[210] *See* CTR. FOR CAPITAL MKTS. COMPETITIVENESS, *supra* note 162, at 5.

[211] *See* Giuffra, *supra* note 81. Some, however, argue that the conduct-and-effects test will actually lead to overenforcement. *See* Buxbaum, *supra* note 83, at 24 ("[T]he conduct test may reach conduct that affects neither U.S. market conditions nor the financial interests of U.S. investors.").

for meting out cases that are economically insignificant is not workable. The conduct-and-effects test, however, has such a metric—the "substantial" requirement—that acts as a sufficient guardrail on the SEC's ability to bring an extraterritorial enforcement action and therefore limits the risk of opening up foreign firms to aggressive overenforcement which would lead to disinvestment in domestic markets.

As a public enforcer, the SEC also avoids many of the perverse incentives to which private plaintiffs fall prey.[212] For instance, private plaintiffs rationally seek personal wealth maximization, which often leads to overenforcement, whereas a public enforcer does not.[213] Private plaintiffs, enforcing separately, therefore view each case as a distinct opportunity for wealth maximization rather than an opportunity to potentially extend a long-standing enforcement strategy or secure a successful action against a different defendant.[214] A properly incentivized public enforcer such as the SEC better deters fraud by comparatively limiting overenforcement.

Taking all this together, the model proposed herein is not perfect—it does not guarantee a full elimination of extraterritorial fraud, nor does it even guarantee that it is the best model designed to deter fraud. However, a full elimination of fraud, either domestic or international, is not a realistic goal of any enforcement regime. Further, this Note's aim was not to propose a model of enforcement that was *optimal* but instead was to propose a model of enforcement that, given the existing state of the law, the SEC and courts could begin using tomorrow. This sort of model is important; rather than proposing a tear down of the entire system, this Note aimed to offer some hope that extraterritorial securities fraud can, in large part, be deterred.

[212] *See* Rose, *Multienforcer Approach*, *supra* note 28, at 2200-03; *see also* John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 302 (2007) (demonstrating that empirical data suggest that private securities enforcement may be inferior to public enforcement); Grundfest, *supra* note 31, at 969-71.

[213] *See* Thomas D. Rowe, Jr., *Predicting the Effects of Attorney Fee Shifting*, L. & CONTEMP. PROBS., Winter 1984, at 139, 151-52 (discussing reasons plaintiffs may proceed with "nuisance litigation").

[214] For example, the SEC may negotiate with defendants who had a minor role in the fraudulent conduct and promise to abstain from pursuing an enforcement action against them in exchange for their testimony. SEC. & EXCH. COMM'N, DIV. OF ENF'T, ENFORCEMENT MANUAL 99-100 (2017), https://www.sec.gov/divisions/enforce/enforcementmanual.pdf [https://perma.cc/SKK4-729H] (outlining policy for cooperation with individuals); Press Release, Sec. & Exch. Comm'n, SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations (Jan. 13, 2010), https://www.sec.gov/news/press/2010/2010-6.htm [https://perma.cc/YLL5-FVGV]. These deals are common and improve the SEC's ability to enforce; however, private plaintiffs likely view the defendant as another potential source of revenue and thus would enforce against him with no consideration of how his testimony may have improved their case. *See* Rose, *Multienforcer Approach*, *supra* note 28, at 2202.

CONCLUSION

What one is left with is a theoretical debate about whether the SEC, private plaintiffs, or both will best deter securities fraud. This Note presented evidence that the SEC is in the best position to avoid overdeterrence costs and that there is no strong reason to believe that private plaintiffs can limit underdeterrence costs any more than the SEC. On that view, the SEC is the most well-incentivized enforcer. Based on the existing law, it seems that Congress and the Court agree that private enforcers are poorly incentivized. Taking these factors together, this Note sought to propose and defend a model of enforcement that considers the existing state of the law and instructs the SEC on how to best defend against extraterritorial enforcement violations of the substantive antifraud provisions.

While this Note is a start, it does not come close to finishing the job of fixing and solidifying a model of extraterritorial enforcement for the SEC. The tension between *Morrison* and Dodd-Frank remains largely unresolved, and it is unclear whether the Tenth Circuit's litigation will do much nationwide to address that tension. Even if it does, without a definitive change to Dodd-Frank or a Supreme Court ruling explicitly overturning *Morrison*, serious uncertainty remains. Further, the question of the SEC's ability to engage in extraterritorial enforcement will not abate; if anything, as globalization and technology increase, the question will become increasingly salient.[215] In an effort to respond to these issues in a timely fashion, however, the resolution should begin where this Note does and find common points of agreement between Congress and the Court. Doing so best creates a system of enforcement that successfully deters extraterritorial fraud while limiting risks of disinvestment in American markets, capital illiquidity, and corporate governance–based allocative inefficiency. Put simply, doing so creates a system that works.

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[215] For example, in April 2020, the SEC garnered a settlement from an international hacker who allegedly hacked into the SEC's EDGAR database to steal corporate earnings releases and use them in an international trading ring. *See* Dave Michaels, *Traders Accused of Profiting from Hack Agree to Settle with SEC*, WALL STREET J. (Apr. 9, 2020, 5:43 PM), https://www.wsj.com/articles/traders-accused-of-profiting-from-hack-agree-to-settle-with-sec-11586465592; Press Release, Sec. & Exch. Comm'n, Foreign National and American Trader Settle Fraud Charges in EDGAR Hacking Case (Apr. 9, 2020), https://www.sec.gov/news/press-release/2020-85?mod=article_inline [https://perma.cc/EN7W-AHM8] ("As alleged in our complaint, the defendants engaged in an international scheme to obtain and use hacked information to enrich themselves . . . ."). Under the enforcement scheme proposed herein, this scheme could still likely be prosecuted by the SEC because the hackers engaged in substantial deleterious conduct—namely, the hacking—in America.