

CONDUCT AND EFFECTS: REASSESSING THE
PROTECTION OF FOREIGN INVESTORS FROM
INTERNATIONAL SECURITIES FRAUD

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INTRODUCTION¹

A large Australian bank with international operations lists its securities on exchanges in Australia, New Zealand, the United Kingdom, and Japan. The bank also has “American Depositary Receipts”² listed on an American stock exchange. To expand the bank’s international operations, the bank’s management spent \$1.22 billion to acquire a majority interest in America’s then-sixth-largest mortgage company. The profits of the American mortgage company consistently made up about five percent of the Australian bank’s annual net income. Unfortunately, the subsidiary calculated its profits based on a valuation model that used incorrect interest assumptions, resulting in an overstatement of the company’s assets. Multibillion-dollar write-downs, amended Form 10-Q filings, earnings restatements, and the consequent plummeting of the parent bank’s stock price ensued. Three foreign shareholders, who purchased their shares in the bank on a foreign stock exchange, sued the bank in a U.S. court for violations of Rule 10b-5 promulgated under Section 10(b) of the Securities Exchange Act of 1934.³ The investors sought to represent a class of foreign purchasers of the bank’s stock during the time at issue. This class would function alongside a proposed domestic purchasers’ class that would be represented by a fourth domestic plaintiff who purchased his shares on an American exchange.

Should any of the bank’s shareholders suffering the adverse affects of the mortgage subsidiary’s willful manipulation of profits and the parent bank’s subsequent representations that incorporated those exaggerated figures be allowed to seek relief in U.S. courts? Stated another way, should U.S. courts undertake to protect injured investors from international securities fraud? The settled approach of U.S. courts

¹ The following hypothetical is based on the facts of *Morrison v. National Australia Bank*, a Second Circuit decision that affirmed a foreign shareholder’s dismissal based on a lack of subject matter jurisdiction. 547 F.3d 167, 168–70, 176 (2d Cir. 2008).

² American Depositary Receipts are issued by U.S. depository banks and constitute a right to obtain the underlying foreign stock. *Id.* at 168 n.1 (citing U.S. Sec. & Exch. Comm’n, American Depositary Receipts, <http://www.sec.gov/answers/adrs.htm>).

³ Securities Exchange Act of 1934, Pub. L. No. 73-291, ch. 404, tit. I, sec. 10(b), 48 Stat. 881, 891 (codified as amended at 15 U.S.C. §§ 78a–78nn (2006)). Pursuant to its statutory authority, the Securities and Exchange Commission (the “SEC”) promulgated Rule 10b-5 to govern fraud claims that arise out of the purchase or sale of securities. 17 C.F.R. § 240.10b-5 (2009).

answers this question by determining whether (1) the purportedly fraudulent conduct took place in the United States, (2) the conduct had a direct impact on specific U.S. investors or markets, and (3) concerns of international comity are implicated.⁴ Because of the multi-interest balancing required by this approach, the issue of whether to apply U.S. securities laws extraterritorially to transactions with multiple foreign elements has vexed federal courts for decades.⁵

This Article attempts to resolve the “vexing question of the extraterritorial application” of U.S. securities laws (or the securities law of any nation) to foreign-cubed securities class actions.⁶ Foreign-cubed securities class actions concern disputes regarding purported securities violations that arise out of foreign-cubed securities transactions. Foreign-cubed securities transactions occur when *foreign* investors purchase securities of *foreign* issuers on *foreign* stock exchanges.⁷ Notice that the three elements of this transaction all contain the word “foreign.”⁸ Where disputes arise as to the integrity of the information relied upon (or presumed relied upon) in executing foreign-cubed transactions, foreign-cubed class actions are often the favored mechanism to resolve these disputes.

Over the past two decades, securities trading (and business generally) has experienced rapid expansion and increased globalization. Domestic corporations have evolved rapidly into sprawling international enterprises. National stock exchanges have undergone recent consolidation, bringing many exchanges from around the world under common ownership.⁹ In this globalized environment, perpetrators of

⁴ See *infra* Part I.A–B.

⁵ See Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 COLUM. J. TRANSNAT'L L. 14, 17 (2007).

⁶ *Morrison*, 547 F.3d at 168.

⁷ Stuart M. Grant & Diane Zilka, *The Role of Foreign Investors in Federal Securities Class Actions*, in SECURITIES LITIGATION & ENFORCEMENT INSTITUTE 2004, at 91, 96 (PLI Corp. Law & Practice, Course Handbook Series No. B-1442, 2004) (coining the term “foreign-cubed” for such transactions).

⁸ Black's Law Dictionary defines “foreign” as “[o]f or relating to another country” or “[o]f or relating to another jurisdiction.” BLACK'S LAW DICTIONARY 539 (8th ed. 2004). In the context of this Article, the term “foreign” is viewed from the perspective of the national court that is presiding over the dispute. The different “foreign” elements could be composed of multiple different countries or a single foreign nation. For instance, if the dispute is brought before a U.S. court, the “foreign” investors might hail from Japan and Singapore, the “foreign” stock exchanges where the securities transactions occurred might reside in London and Rome, and the “foreign” issuers might be headquartered in Moscow.

⁹ See, e.g., Roger D. Blanc, *Intermarket Competition and Monopoly Power in the U.S. Stock Markets*, 1 BROOK. J. CORP. FIN. & COM. L. 273, 290 (2007); NYSE Euronext Corporate Timeline, <http://www.nyse.com/pdfs/NYSEEuronextTimeline-web.pdf> (last visited Nov. 20, 2009); NYSE Group Family Tree, <http://www.nyse.com/pdfs/nysegrouptimeline.pdf> (last visited Nov. 20, 2009); see also Shelley Thompson, *The*

fraud relating to securities transactions do not abide by the strictures of national boundaries or identities. In fact, in today's complex corporate world, securities fraud is rarely traceable to a single act that occurs at a discrete time and in a particular location.¹⁰ The international community can no longer expect to apply current securities laws—drafted to govern finite geographical areas—to transactions and corporate entities that do not consider those finite geographical limits a limit at all. Instead, the current global economy requires massive worldwide cooperation to prevent and deter fraud and to provide injured investors with access to relief for the wrongful conduct of multinational corporate issuers. Part of this cooperation requires agreement upon the selection of appropriate legal fora and the most effective substantive and procedural law to be applied. At the conclusion, this Article proposes several possible approaches that governments might take to accomplish this necessary goal. The final proposal—the formation of an international treaty-based institution, similar to the World Trade Organization—is the approach to which this Article subscribes. An international treaty-based institution stands to have the greatest affect in preventing international securities fraud and in providing relief to injured investors worldwide.

There are three reasons injured investors prefer to bring actions against corporate issuers for securities violations in U.S. courts. First, the United States has an active plaintiffs' bar, which seeks out and cultivates potential claimant groups against large issuers.¹¹ The existence of this plaintiffs' bar in the securities context is due in large part to the Supreme Court's creation of an implied private right of action for Rule 10b-5 fraud claims.¹² Second, there is a presumption of reliance in fraud claims, which is based on the Court's recognition of the fraud-on-the-market theory.¹³ Third, a class action mechanism exists that

Globalization of Securities Markets: Effects on Investor Protection, 41 INT'L LAW. 1121, 1122–23 (2007) (describing “a surge of international mergers over the past several years” in the world's capital markets); Derek N. White, ECNs RIP: How Regulation NMS Destroyed Electronic Communication Networks and All Their Market Improvements 16–23 (2008) (unpublished manuscript, available at http://works.bepress.com/derek_white/1) (describing the recent demutualization and subsequent consolidation of securities exchanges occurring in the United States and globally).

¹⁰ Brief of Securities & Exchange Commission as Amicus Curiae, in Response to the Court's Request at 6, *Morrison*, 547 F.3d 167 (No. 07-0583) [hereinafter SEC Amicus Brief] (quoting *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 346, 372 (2005)).

¹¹ See generally PRICEWATERHOUSECOOPERS, 2008 SECURITIES LITIGATION STUDY (2009), available at <http://10b5.pwc.com/PDF/NY-09-0894%20SECURITIES%20LIT%20STUDY%20FINAL.PDF> (providing evidence of an active plaintiffs' bar that has given rise to an increase in securities litigation).

¹² *Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971).

¹³ David M. Brodsky & Jeff G. Hammel, *The Fraud on the Market Theory and Securities Fraud Claims*, 230 N.Y. L.J. 82 (2003). To establish a claim for securities fraud,

allows aggregation of small claims to make the high cost of litigation more economical. While class actions remain an invaluable method of recovery for investors, this type of group litigation also serves an important function in the eyes of corporate-issuer defendants in that it allows them to dispose of claims in bulk via the preclusive effect given to prior judicial decisions (that is, *res judicata*).¹⁴

The United States's plaintiff-favorable (and defendant-valuable) dispute resolution mechanisms and substantive law make its courts an attractive place to bring foreign-cubed class actions.¹⁵ As the number of foreign-cubed transactions has increased, there has been a corresponding increase in foreign-cubed class actions—and the complex issues they raise—brought in U.S. jurisdictions.¹⁶

This Article begins with a discussion of the current level of extraterritorial application of U.S. securities laws to foreign-cubed class actions. It demonstrates why the current regime is inadequate to prevent or deter fraud or to provide relief to injured investors. The Article explains how the expanding global economy requires massive cooperation among regulatory and legislative bodies to protect the integrity of financial markets. It also describes what such cooperation might entail.¹⁷

plaintiffs must show that (1) they relied upon defendant's allegedly fraudulent conduct in purchasing or selling securities (transaction causation), and (2) defendant's conduct caused, at least in part, plaintiffs' losses (loss causation). *Id.* The fraud-on-the-market theory is based on the "efficient capital markets" hypothesis and creates a rebuttable presumption of the existence of transaction causation (i.e., that plaintiffs relied upon the allegedly fraudulent statements or nondisclosure) even if they were unaware of the fraud at the time of their purchase or sale. *Id.*

¹⁴ Teena-Ann V. Sankoorikal et al., *Current Legal Issues Relating to the Inclusion of Foreign Plaintiffs in Securities Class Actions*, in *MANAGING COMPLEX LITIGATION 2008: LEGAL STRATEGIES AND BEST PRACTICES IN "HIGH-STAKES" CASES* 11, 14–15 (PLI Litig. & Admin. Practice, Course Handbook Series No. H-786, 2008) (citation omitted). It should be noted, however, that corporate defendants would likely exchange this advantage of wholesale resolution of claims for the reliance presumption.

¹⁵ Buxbaum, *supra* note 5, at 41. *See, e.g., In re Royal Dutch/Shell Transp. Sec. Litig.*, 380 F. Supp. 2d 509, 547 (D.N.J. 2005); *In re Bayer AG Sec. Litig.*, No. 03 Civ.1546 WHP, 2004 WL 2190357, at *1 (S.D.N.Y. Sept. 30, 2004); *Froese v. Staff*, No. 02 CV 5744(RO), 2003 WL 21523979, at *1 (S.D.N.Y. July 7, 2003).

¹⁶ Hannah Buxbaum conducted a survey of multinational securities class actions filed in U.S. federal court from 1996 through 2005. She found 115 such cases and assessed how U.S. courts were dealing with the tough jurisdictional issues inherent in these cases. She found that sixteen of those cases were foreign-cubed claims. Buxbaum, *supra* note 5, at 39–41. For a listing of cases involving foreign transactions and securities fraud and how the courts applied the various judicial tests to the procedural and substantive issues faced in these types of cases, see George K. Chamberlin, Annotation, *Subject Matter Jurisdiction of Securities Fraud Action Based on Foreign Transactions, Under Securities Exchange Act of 1934*, 56 A.L.R. FED. 288 (1982 & Supp. 2009).

¹⁷ This Article does not deal with issues of personal jurisdiction based on the "minimum contacts" test of *International Shoe v. Washington*, 326 U.S. 310, 316 (1945);

Part I of this Article begins by laying out the current status of U.S. law as it is applied to foreign-cubed securities class actions and the various issues that arise for the parties involved. Part II compares the current extraterritorial application of securities law to the extraterritorial application of other areas of U.S. law. It then makes the case for a proposed solution to the conundrum of foreign-cubed transactions: massive international cooperation among securities regulatory agencies and legislative bodies to harmonize the substantive and procedural law that deals with claims of fraud in international securities transactions. Part III discusses the problems with the current application of U.S. securities laws, describes the current level of international securities cooperation, and explains why both are insufficient in preventing international securities fraud. This Article concludes in Part IV with a discussion of various possible forms of international cooperation that would better protect investors from and deter fraudulent conduct in international securities transactions.

I. STATUS OF THE LAW REGARDING FOREIGN-CUBED SECURITIES CLASS ACTIONS

When Congress enacted the U.S. securities laws, it was silent as to the extraterritorial scope of subject matter jurisdiction those laws gave to federal courts.¹⁸ Further, the Supreme Court has never addressed the extraterritoriality of U.S. securities laws aside from stating a general presumption against extraterritorial application of U.S. law.¹⁹ This presumption is based on the theory that “Congress is primarily concerned with domestic conditions.”²⁰ Consequently, the lower courts have had to determine whether “Congress would have wished the precious resources of U.S. courts and law enforcement agencies to be devoted to” these predominantly foreign transactions rather than allowing foreign nations to deal with the problem.²¹

rather, this Article assumes that plaintiffs have analyzed whether a judgment against the foreign issuer will be enforced in a foreign jurisdiction or whether the foreign issuer has sufficient assets to collect against in the United States. *Id.* (stating that, in accordance with “traditional notions of fair play and substantial justice,” a civil defendant could not be subjected to personal jurisdiction by courts in a given state unless the defendant had “minimum contacts” within that state (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940))).

¹⁸ *Itoba Ltd. v. LEP Group*, 54 F.3d 118, 121 (2d Cir. 1995).

¹⁹ *See infra* Part III.A. The single exception applicable to this general rule is where a court can show that Congress intended the law in question to reach the foreign conduct or transaction at issue. *Foley Bros. v. Filardo*, 336 U.S. 281, 284–85 (1949).

²⁰ *Foley Bros.*, 336 U.S. at 285.

²¹ *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 (2d Cir. 1975).

The federal courts face two intertwined areas of law in addressing foreign-cubed securities class actions.²² These two areas are substantive antifraud case law and judicially-created procedural tests that attempt to comply with obscure (or nonexistent) congressional intent.²³ The following subsections discuss the approach of U.S. courts in determining whether to exercise subject matter jurisdiction over a securities fraud claim involving foreign investors, issuers, and exchanges. This discussion is followed by an examination of some of the difficulties that foreign claimants face in obtaining subject matter jurisdiction over their claims, and a comparison of the substantive law relating to securities fraud in foreign nations with that of the United States.

A. General Approach of U.S. Courts to the Extraterritoriality of Securities Laws

Federal courts have consistently refused to adopt a bright-line rule barring all foreign-cubed class actions that do not involve harm to U.S. investors.²⁴ Courts have stated that a bright-line rule would “conflict with the goal of preventing the export of fraud from America.”²⁵ In deciding whether to extend jurisdiction to cases involving foreign transactions, courts begin with the assumption that the laws Congress passes are “primarily concerned with domestic conditions,” unless a party can show that Congress intended the legislation in question to reach foreign conduct.²⁶

To determine whether Congress intended U.S. law to apply to international securities fraud, courts analyze “(1) whether the wrongful conduct occurred in the United States [the conduct test], and (2) whether the wrongful conduct had a substantial effect in the United States or

²² Buxbaum, *supra* note 5, at 67.

²³ *Id.*

²⁴ Martin Flumenbaum & Brad S. Karp, ‘Foreign-Cubed’ Securities Class-Action Plaintiffs, 240 N.Y. L.J. 17 (2008).

²⁵ *Id.* (quoting *Morrison v. Nat’l Austl. Bank*, 547 F.3d 167, 175 (2d Cir. 2008)).

²⁶ *Foley Bros. v. Filardo*, 336 U.S. 281, 285 (1949). *Foley Brothers* involved a private contractor that contracted with the U.S. government for construction work in Iraq and Iran. *Id.* at 283. A construction worker for the contractor sued the company for overtime wages claiming that the Eight Hour Law, which forbids government contractors from requiring or permitting its workers to work more than eight hours in one calendar day without paying overtime rates, applies even though the work was done in a foreign country. *Id.* Because the statute had no indication “of a congressional purpose to extend its coverage beyond places over which the United States has sovereignty or has some measure of legislative control,” *id.* at 285, and the statute was enacted over a concern for domestic labor conditions, even though the statute stated that the law applies to “every contract” with the United States, *id.* at 282, 286, the Court concluded that the Eight Hour Law was inapplicable to a contract for construction work in a foreign country over which the United States has no direct legislative control. *Id.* at 287.

upon United States citizens [the effects test].”²⁷ Courts have held that either of these two tests may independently establish jurisdiction.²⁸ But, “[w]here appropriate, the two parts of the test are applied together because ‘an admixture or combination of the two often gives a better picture of whether there is sufficient U.S. involvement to justify the exercise of jurisdiction by an American court.’”²⁹ Courts tend to search for a way to avoid applying domestic law to predominantly foreign transactions.³⁰ Occasionally, they look beyond the conduct and effects tests in search of additional scale-tipping factors,³¹ or they use alternative means of dismissal.³²

1. Conduct Test

U.S. securities laws can be applied to predominantly foreign transactions if a certain level of the fraudulent conduct occurred within the United States, even without an independent effect on U.S. investors or domestic markets.³³ Courts have used this test to exert jurisdiction over foreign transactions because “Congress would not want the United States to become a base for fraudulent activity” that is exported to other countries and harms foreign investors.³⁴ To ensure responsible and appropriate application of U.S. securities laws, the conduct test consists of a two-part analysis. Part one requires a plaintiff class to show that the conduct that took place in the United States was more than “merely preparatory” to securities fraud that was conducted outside the United

²⁷ *Sec. & Exch. Comm’n v. Berger*, 322 F.3d 187, 192–93 (2d Cir. 2003).

²⁸ *See, e.g., Robinson v. TCI/US W. Cable Commc’ns Inc.*, 117 F.3d 900, 905 (5th Cir. 1997).

²⁹ *Morrison*, 547 F.3d at 171 (2d Cir. 2008) (quoting *Itoba Ltd. v. LEP Group*, 54 F.3d 118, 122 (2d Cir. 1995)).

³⁰ *See Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 30 (D.C. Cir. 1987) (summarizing U.S. courts’ practices of limiting their exercise of jurisdiction over foreign securities transactions) (citations and internal quotation marks omitted).

³¹ *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 664 (7th Cir. 1998) (noting that the conduct and effects jurisdictional analysis has been guided by “policy considerations and the courts’ best judgment”).

³² *See infra* Part I.B.

³³ *Buxbaum, supra* note 5, at 23.

³⁴ *Eur. & Overseas Commodity Traders v. Banque Paribas London*, 147 F.3d 118, 125 (2d Cir. 1998); *see also, Buxbaum, supra* note 5, at 24 (justifying the exercise of jurisdiction over foreign claimants on the grounds that “Congress [did not] intend[] to allow the United States to be used as a base for manufacturing fraudulent security devices for export” (quoting *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975))).

States.³⁵ The second part is to show the conduct in question directly caused the loss.³⁶

In the introduction's fact pattern, the conduct at issue was (1) the mortgage subsidiary's willful manipulation of its profits, and (2) the incorporation of those inaccurate figures into the bank's consolidated financials that were filed with the Securities and Exchange Commission (the "SEC"). What conduct constituted the fraud? What conduct directly caused harm? If the mortgage subsidiary had not created and sent inflated numbers to the parent bank in Australia, there would have been no fraud and no harm to investors. But, no misinformation would have been reported and no investors would have been defrauded were it not for the misleading public statements and filings made by the parent bank. Do the bank's statements consist of mere mechanical compiling of the subsidiary's figures into its financials and SEC filings, or was the dissemination of the statements from Australia the only conduct that caused harm?³⁷

This fact pattern illustrates the difficulties inherent in making a proper finding of subject matter jurisdiction. One could make persuasive arguments on both sides of the case. The outcome, however, will be highly fact specific and, therefore, left to the individual judge's philosophy of extraterritoriality.³⁸ This broad judicial discretion provides too much uncertainty for foreign plaintiffs regarding the likelihood of a U.S. court hearing their claims. Instead of litigation focusing on the merits of those claims, the cases are tied up on procedural issues that fail to achieve the goals of investor protection, access to justice, and deterrence of fraud.

There are several policy justifications that encourage the exercise of jurisdiction based on a finding of domestic wrongful conduct. First, extending jurisdiction would discourage those who wish to use the United States as a base of operations for defrauding foreign securities investors.³⁹ Second, the antifraud provisions of the U.S. securities laws were intended to assure high standards of conduct in securities transactions within our country and to protect domestic markets and

³⁵ Sec. & Exch. Comm'n v. Kasser, 548 F.2d 109, 115 (3d Cir. 1977); 1 JOSEPH M. MCLAUGHLIN, MCLAUGHLIN ON CLASS ACTIONS: LAW AND PRACTICE § 5:68, at 1292 (5th ed. 2009).

³⁶ MCLAUGHLIN, *supra* note 35 (citing Sec. & Exch. Comm'n v. Berger, 322 F.3d 187, 192 (2d Cir. 2003)).

³⁷ In *Morrison v. National Australia Bank*, the court found no subject matter jurisdiction due, in large part, to its finding that the actions of the parent bank in Australia were "significantly more central to the fraud and more directly responsible for the harm to investors than the manipulation of the numbers in Florida." 547 F.3d 167, 176 (2d Cir. 2008).

³⁸ Thompson, *supra* note 9, at 1135.

³⁹ *Banque Paribas London*, 147 F.3d at 125.

investors from fraud.⁴⁰ Third, extending jurisdiction over domestic conduct that harmed foreign investors might induce reciprocal responses by other jurisdictions.⁴¹ This notion assumes that if the United States extends its securities laws to prevent fraudulent conduct from taking place on its shores that injures foreign investors, the United States reasonably can expect other countries to offer comparable protection.⁴²

Circuit courts disagree on the exact nature of the conduct that must take place in the United States in order for it to justify extraterritorial jurisdiction over a securities transaction.⁴³ The Second,⁴⁴ Fifth, and Seventh Circuits have taken the middle-of-the-road approach. These Circuits require the conduct in the United States to constitute *substantial* acts in furtherance of the fraud.⁴⁵ The conduct taking place in the United States must have been a substantial part of the fraud and “material to its success.”⁴⁶ The District of Columbia Circuit Court, following the Second Circuit’s lead, has adopted the strict rule that requires domestic conduct to constitute an independent violation of U.S. securities law.⁴⁷ The Third, Eighth, and Ninth Circuits take the least restrictive approach, focusing on whether at least some of the conduct in the United States was designed to further a fraud that caused losses to investors.⁴⁸ Courts have not been consistent in determining what type of conduct is sufficient to warrant the court to exercise extraterritorial jurisdiction of U.S. securities laws. Some circuit courts have found filing reports with the SEC and dissemination of material to shareholders in the United States incidental and therefore insufficient to extend

⁴⁰ Sec. & Exch. Comm’n v. Kasser, 548 F.2d 109, 116 (3d Cir. 1977).

⁴¹ *Id.*

⁴² SEC Amicus Brief, *supra* note 10, at 8. Yet the reciprocal response of other jurisdictions can cut in either direction. The exercise of jurisdiction over predominantly foreign transactions may cause other countries to exercise jurisdiction over transactions involving predominantly U.S. interests and parties. See *Blechner v. Daimler-Benz AG*, 410 F. Supp. 2d 366, 372 (D. Del. 2006) (citing *Plessey Co. v. Gen. Elec. Co.*, 628 F. Supp. 477, 496 (D. Del. 1986)); *infra* Part IV.A.

⁴³ Sankoorikal, *supra* note 14, at 33.

⁴⁴ Note that the Second Circuit is deemed to be the most experienced circuit at dealing with securities law. See *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 32 (D.C. Cir. 1987). This may indicate that their approach has the most weight. This Article, however, is concerned with international cooperation among securities regulatory and legislative bodies, not with which circuits possess the highest securities acumen.

⁴⁵ See, e.g., *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 667 (7th Cir. 1998); *Robinson v. TCI/US W. Cable Commc’ns Inc.*, 117 F.3d 900, 905–06 (5th Cir. 1997); *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1045 (2d Cir. 1983) (citing *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1337 (2d Cir. 1972)).

⁴⁶ *Kauthar*, 149 F.3d at 667.

⁴⁷ *Zoelsch*, 824 F.2d at 31, 33.

⁴⁸ *Id.* at 31 (citations omitted).

jurisdiction.⁴⁹ Other courts have found that making telephone calls and sending mail to the United States is sufficient domestic conduct to impose the securities laws on the transaction.⁵⁰

The Second Circuit in *Morrison v. National Australia Bank*, its most recent decision in this area, stated that a misrepresentation in a securities filing does not constitute fraud until it is physically filed with the SEC.⁵¹ Under that standard, the preparation of fraudulent financial statements by a U.S. subsidiary that are sent to the foreign parent who consolidated those statements with its own and then filed it with the SEC only constituted fraud when the foreign parent filed. The U.S.-based conduct was held to be merely preparatory and insufficient to extend jurisdiction over the foreign parent. Other Circuits have held that the fraud should have been masterminded within the United States for the conduct test to justify extension of the securities laws to a predominantly foreign transaction.⁵²

In affirmative determinations of the existence of subject matter jurisdiction, courts often begin and conclude their analysis with the conduct test.⁵³ Finding jurisdiction under the conduct test is far easier and, therefore, more likely, than finding jurisdiction under its companion test—the effects test. In fact, the investors in *Morrison* did not argue the effects test at all on appeal, perhaps an acknowledgment of the inherent difficulty in satisfying the requirements for subject matter jurisdiction under the effects test.⁵⁴

2. Effects Test

The purpose of creating an effects test was to protect domestic investors or markets that suffer harm from actions occurring outside the United States.⁵⁵ The Second Circuit's opinion in *Schoenbaum v.*

⁴⁹ See, e.g., *Kasser*, 548 F.2d at 115.

⁵⁰ *Leasco Data Processing Equip.*, 468 F.2d at 1335.

⁵¹ See 547 F.3d 167, 176 (2d Cir. 2008).

⁵² E.g., *Sec. & Exch. Comm'n v. Berger*, 322 F.3d 187, 194 (2d Cir. 2003) (finding that the “fraudulent scheme was masterminded and implemented . . . in the United States”).

⁵³ *Id.* at 195 (concluding that the court need not reach the question of whether the effects test provided an independent basis for jurisdiction since jurisdiction existed under the conduct test).

⁵⁴ Note the potential error in this line of thinking, as courts often look to an “admixture or combination” of the two tests to determine whether jurisdiction exists. *Itoba Ltd. v. LEP Group*, 54 F.3d 118, 122 (2d Cir. 1995). In fact, the *Morrison* court counted it against the appellants for not having also discussed the effects of the conduct on U.S. interests. 547 F.3d at 176.

⁵⁵ SEC Amicus Brief, *supra* note 10, at 7 (citing *Eur. & Overseas Commodity Traders v. Banque Paribas London*, 147 F.3d 118, 125 (2d Cir. 1998)).

Firstbrook contained the first articulation of the effects test.⁵⁶ In a derivative action,⁵⁷ fraudulent conduct occurred overseas, artificially depressing shareholder equity.⁵⁸ The court held the district court's exercise of subject matter jurisdiction over the fraudulent transactions to be appropriate.⁵⁹ In reaching its decision, the court emphasized the fact that (1) the transaction involved securities registered and listed on the American Stock Exchange (in addition to the Toronto Stock Exchange), (2) the fraud deprived the foreign corporation of fair compensation when it issued stock, and (3) the fraud caused a reduction in the equity of American investments in the corporation.⁶⁰

To establish jurisdiction under the effects test, the plaintiffs must prove that the predominantly foreign transaction had more than an adverse effect on the "general economic interests [of the United States] or on American security prices."⁶¹ Plaintiffs must show a "concrete harm."⁶² In *Bersch v. Drexel Firestone, Inc.*, the Second Circuit held that under the effects test, jurisdiction can be found to reach a predominantly foreign transaction only where there was an intent that the securities be offered to someone in the United States.⁶³ This holding was based on the express language in the securities acts—Section 17(a) of the 1933 Act limits the application to acts "in the offer or sale of any securities,"⁶⁴ and Section 10(b) of the 1934 Act is limited to acts "in connection with the purchase or sale of any security."⁶⁵ The court in *Bersch* used this statutory language to require that the alleged fraudulent conduct committed abroad must result in injury to purchasers or sellers of

⁵⁶ 405 F.2d 200, 206 (2d Cir. 1968) ("We believe that Congress intended the [Securities and] Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the *effects* of improper foreign transactions in American securities." (emphasis added)).

⁵⁷ *Id.* at 204. While this case concerned a derivative action, as opposed to a class action, the analysis used by the courts in determining the extraterritorial application of U.S. securities laws remains the same, as the types of conduct and effects involved in both types of case are likely to be very similar, if not identical.

⁵⁸ *Id.* at 208–09.

⁵⁹ *Id.* at 208.

⁶⁰ *Id.* This application of the effects test is too narrow in scope for the test to be of any use to a foreign-cubed transaction that, by its definition, involves transactions involving securities on a foreign exchange.

⁶¹ *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985, 989 (2d Cir. 1975).

⁶² *In re SCOR Holding (Switz.) AG Litig.*, 537 F. Supp. 2d 556, 562 (S.D.N.Y. 2008).

⁶³ *Bersch*, 519 F.2d at 989.

⁶⁴ *Id.* (quoting Securities Exchange Act of 1933, Pub. L. No. 73-22, ch. 38, tit. I, § 17(a), 48 Stat. 74, 84–85 (codified as amended at 15 U.S.C. § 77q(a) (2006))).

⁶⁵ *Id.* (quoting Securities Exchange Act of 1934, Pub. L. No. 73-291, ch. 404, tit. I, sec. 10(b), 48 Stat. 881, 891 (codified as amended at 15 U.S.C. § 78j(b) (2006))).

securities “in whom the United States has an interest.”⁶⁶ The quoted statutory language, however, does not say anything about American purchasers and sellers of securities. The Acts, however, state that there is no fraud except where securities are offered, sold, or purchased, by *anyone*⁶⁷—a requirement that is met in a foreign-cubed action. But the court’s interpretation of the statute made it impossible for jurisdiction to be found in such cases based on the effects test alone.

Because of courts’ narrow application of the effects test and the requirement that the foreign conduct cause “concrete harm” to U.S. purchasers and sellers of securities, the effects test plays only a very limited role in the jurisdictional analysis for suits arising out of foreign-cubed transactions.⁶⁸ Courts have never relied solely on the effects test to find jurisdiction where fraudulent conduct occurred abroad and affected the purchase of a foreign company’s securities by a foreign purchaser on a foreign exchange.⁶⁹ At most, the level of effect a predominantly foreign transaction has had on U.S. investors and markets has been used as a scale-tipping factor to the conduct test, where a court deems it appropriate to assess the “admixture or combination”⁷⁰ of the two tests.

The plaintiffs in the introductory fact pattern recognized this fact and narrowed the issues on appeal to only those they felt were pertinent to the decision of whether jurisdiction should be found.⁷¹ The court, however, used the plaintiffs’ failure to argue the effects test on appeal to tip the scale in favor of a finding of no jurisdiction.⁷² If the plaintiffs had argued on appeal that the effects of the fraudulent conduct caused harm to U.S. investors or markets, the court likely would have dismissed the case because the foreign conduct did not cause any direct or “concrete harm” to U.S. markets and the foreign class did not represent any injury to U.S. purchasers of securities (such interests were represented by the domestic investor). Further, the class did not represent an injury to U.S. stock markets, because the plaintiffs purchased the underlying securities that were traded on foreign exchanges, rather than the derivative

⁶⁶ *Id.*

⁶⁷ See Securities Exchange Act of 1934, sec. 10(b), 48 Stat. at 891 (codified as amended at 15 U.S.C. § 78j(b) (2006)); Securities Exchange Act of 1933, § 17(a), 48 Stat. at 84–85 (codified as amended at 15 U.S.C. § 77q(a) (2006)).

⁶⁸ In re *SCOR Holding*, 537 F. Supp. 2d at 562; Sankoorikal, *supra* note 14, at 19–20 (stating that foreign-cubed “claims typically only proceed if the [c]onduct [t]est is satisfied”). In general, however, the conduct test has been used as an additional “scale tipping” factor to weigh in favor of one party or the other. See *Interbrew S.A. v. Edperbrascan Corp.*, 23 F. Supp. 2d 425, 432 (S.D.N.Y. 1998) (citing *Eur. & Overseas Commodity Traders v. Banque Paribas London*, 147 F.3d 118, 129 (2d Cir. 1998)).

⁶⁹ See generally Chamberlin, *supra* note 16.

⁷⁰ *Itoba Ltd. v. LEP Group*, 54 F.3d 118, 122 (2d Cir. 1995).

⁷¹ *Morrison v. Nat’l Austl. Bank*, 547 F.3d 167, 176 (2d Cir. 2008).

⁷² *Id.*

securities traded on the New York Stock Exchange (“NYSE”).⁷³ For a court to exercise subject matter jurisdiction based on the effects test, the class members would have needed to be investors “in whom the United States [had] an interest”⁷⁴ or purchasers of the domestic mortgage subsidiary’s stock or the derivative securities on the NYSE. This twisted mess displays the illogic and impracticality behind application of the effects test to class actions consisting of predominantly foreign elements. The effects test can only be used against the foreign claimants to dismiss their claims.

Even though courts acknowledge that “Congress would have wanted ‘to redress harms perpetrated abroad which have a substantial impact on investors or markets within the United States,’”⁷⁵ their application of the effects test has been effectively removed from the jurisdictional analysis for foreign-cubed transactions. It may seem sensible for U.S. courts to refuse to extend the jurisdiction of federal securities laws to reach foreign fraud except where some threshold level of the fraudulent conduct occurred on U.S. soil, because this will work to protect direct harm against markets and investors and prevent the United States from becoming a base of fraud for export abroad. Fraud and the resulting loss, however, have still occurred even if it does not directly affect U.S. interests. The generalized impact on U.S. markets and investors may be held as insufficient for U.S. courts to exercise jurisdiction, but in this globalized economy this damage cannot be overlooked as insignificant. The United States and other nations have a mutual interest in ensuring that securities fraud is prevented and deterred and that victims of securities fraud have access to justice. Countries should work together to develop substantive law and procedural mechanisms that will give victims access to justice, deter fraud, and protect investors and market integrity.

B. Other Hurdles for Foreign-Cubed Securities Class Actions

Where predominantly foreign actions have passed the threshold inquiry of subject matter jurisdiction, courts have applied other doctrines to reject a foreign-cubed class action, or a mixed action’s foreign components.⁷⁶ Following is a discussion of what courts have used to deny claims of foreign investors.

⁷³ *See id.*

⁷⁴ *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 989 (2d Cir. 1975).

⁷⁵ *Morrison*, 547 F.3d at 171 (quoting *Eur. & Overseas Commodity Traders v. Banque Paribas London*, 147 F.3d 118, 125 (2d Cir. 1998)).

⁷⁶ Thompson, *supra* note 9, at 1132–33 (citing *Dirienzo v. Philip Servs. Corp.*, 294 F.3d 21, 33 (2d Cir. 2002); *In re Royal Dutch/Shell Transp. Sec. Litig.*, 380 F. Supp. 2d 509, 548 (D.N.J. 2005); *In re Royal Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 357 (D. Md. 2004)).

1. Class Certification

Under the Private Securities Litigation Reform Act of 1995 (“PSLRA”),⁷⁷ securities class actions must still meet the basic structural requirements of Federal Rule of Civil Procedure (“FRCP”) 23 on Class Actions. The class representatives may sue on behalf of all members of the class if they satisfy the FRCP 23(a) requirements of (1) numerosity, (2) commonality, (3) typicality, and (4) adequacy; and if they satisfy one of the requirements of FRCP 23(b) (for example, superiority).⁷⁸ Defendants have had some success in opposing the certification of the class under FRCP 23, but the foreign-cubed action likely would overcome most of the obstacles to class certification that have plagued mixed-plaintiff groups (both U.S. and foreign members of the class) trying to bring multinational actions.

Plaintiffs in U.S. class actions have had difficulty obtaining class certification where the plaintiff class contains both foreign and American members. In order to gain class certification, the plaintiffs must show that the interests of the group are the same as those of the representative plaintiffs—the so-called typicality requirement.⁷⁹ Even where the claims of all members of the plaintiff group arise out of the same fraudulent conduct, the claims might depend on different legal arguments or standards depending on the location that each member purchased the stock. In foreign-cubed actions, however, this difficulty disappears because all of the members of the plaintiff class would be foreign.

Under the commonality requirement, members in mixed plaintiff groups struggle to show that the questions of law or fact that are common among all foreign and domestic members predominate the questions that might apply to individualized class members or groups of members. Foreign-cubed actions overcome this hurdle by excluding American members. The class can then show that the legal and factual issues common to the class are much more significant than issues pertaining to individual class members.

Commentators have noted the havoc that the superiority requirement under FRCP 23(b)—that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy—can have on plaintiff groups trying to obtain class certification.⁸⁰ This hurdle in the litigation process is due to the potential difficulty plaintiffs have in enforcing a judgment against foreign assets

⁷⁷ Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, tit. I, sec. 101(a), 109 Stat. 737, 739 (codified at 15 U.S.C. § 78u-4(a)(3)(A)(iii) (2006)).

⁷⁸ FED. R. CIV. P. 23(a)–(b).

⁷⁹ *Id.* at 23(a)(3).

⁸⁰ *See, e.g.*, Buxbaum, *supra* note 5, at 31.

of the defendant and the possibility that a judgment obtained will not have preclusive effect in other countries.⁸¹ The former issue is rarely a problem as defendants in the typical large multinational class actions⁸² will likely have adequate assets in the United States to satisfy a judgment.⁸³

The issue of preclusive effect, however, is a serious problem to class certification where the proposed class consists of some or all foreign claimants. But under FRCP 23(b), a plaintiff class need only satisfy one of the requirements of that section, and subsection (1) of that section allows certification where prosecuting separate actions against individual class members would create a risk of inconsistent or varying adjudications. This is certainly a low hurdle in a foreign-cubed action because the plaintiff group would likely contain members of multiple foreign nations, each having its own elements of fraud, available remedies, and mechanisms for seeking redress. Therefore, class certification is probably easier to obtain in an action made up of wholly foreign class members than an action containing U.S. class members.

2. Selection of Lead Plaintiff

The PSLRA changed the process of selecting a lead plaintiff in a securities class action.⁸⁴ The PSLRA did away with the old first-to-file rule that allowed the first plaintiff to file a claim against the purported perpetrator to become the de facto lead plaintiff.⁸⁵ Now, instead of the first-to-file rule, the first plaintiff to file a securities claim on behalf of a class must publish notice of that action and provide others in the class the opportunity to seek appointment as lead plaintiff.⁸⁶ The court then considers the applications and appoints the party who will most adequately represent the interests of the class. The PSLRA creates a presumption that the most adequate lead plaintiff will be the one with the largest financial interest at stake.⁸⁷ This presumption can be rebutted by (1) showing that the plaintiff with the largest financial interest will not fairly and adequately protect the interests of the class,

⁸¹ *Id.*

⁸² Additional support for this point is the required personal jurisdiction of the defendant, a topic beyond the scope of this Article. The defendant, however, must have the requisite level of “minimum contacts” as prescribed in the Supreme Court’s landmark decision *International Shoe v. Washington* for any U.S. court to be able to hear the case. 326 U.S. 310, 316 (1945). These “minimum contacts” most likely will entail various domestic assets of the foreign entity.

⁸³ Buxbaum, *supra* note 5, at 31 (citing *In re Royal Dutch/Shell Transp. Sec. Litig.*, 380 F. Supp. 2d 509, 547 n.8 (D.N.J. 2005)).

⁸⁴ 15 U.S.C. § 78u-4(a)(3) (2006).

⁸⁵ Buxbaum, *supra* note 5, at 27.

⁸⁶ *Id.* (citing 15 U.S.C. § 78u-4(a)(3)(A)).

⁸⁷ 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I).

or (2) showing that the plaintiff would face unique defenses not common to other class members.⁸⁸

Even if the proposed lead plaintiff is a foreign investor who purchased the securities on a foreign exchange and has the largest financial interest at stake, he will face two points of difficulty. First, courts may find it too complex logistically to have a foreign lead plaintiff represent the class and may doubt the ability of a foreign investor to adequately manage U.S. litigation from abroad.⁸⁹ But this argument has less weight if the foreign investor is a large institution with substantial assets and resources (not to mention a commercial presence in the United States). The argument also ignores the strong probability that the lead plaintiff's U.S.-based counsel manages the litigation, not the foreign investor.⁹⁰

The second point of difficulty is that foreign plaintiffs in foreign-cubed class actions are likely subject to unique defenses because their claims arise solely from foreign-market transactions (for example, lack of subject matter jurisdiction and *forum non conveniens*).⁹¹ This second difficulty only applies to class actions in which the class contains two groups of plaintiffs: one to represent the interests of foreign class members, and another to represent the interests of domestic class members. Such mixed classes constitute a majority of the class actions that consist of substantial foreign elements. Classes are frequently structured in this way in the hope that the class will have a better chance of avoiding dismissal. If other members of the class desiring to become lead plaintiff challenge the presumption favoring the investor with the largest financial interest at stake under these grounds, it could bar foreign members of the class from becoming lead plaintiffs, and perhaps even bar them from the class itself.

In some cases, courts have adopted a compromise approach to selecting the lead plaintiff in classes composed of both foreign and U.S. investors.⁹² This approach appoints co-lead plaintiffs—one that traded in the United States, and one from the foreign market transactions. In appointing co-lead plaintiffs, courts hope that the entire class will be

⁸⁸ *Id.* § 78u-4(a)(3)(B)(iii)(II).

⁸⁹ *See* Buxbaum, *supra* note 5, at 28.

⁹⁰ *Id.* at 26 (stating that “plaintiffs’ attorneys, rather than plaintiffs themselves . . . manag[e] class actions”).

⁹¹ *See generally id.* at 26–41 (discussing the jurisdictional issues that may arise during the course of securities class actions).

⁹² *See, e.g., In re Cable & Wireless, PLC, Sec. Litig.*, 217 F.R.D. 372, 375–76, 379 (E.D. Va. 2003) (appointing Canadian investor and U.S. investor as co-lead plaintiffs for a putative class including purchasers of stock traded on the London Stock Exchange and on the NYSE).

adequately protected—the foreign members by the foreign lead plaintiff, and the U.S. members by the U.S. lead plaintiff.⁹³

3. *Forum Non Conveniens*

As stated above, courts have often sustained defense motions for dismissal for lack of subject matter jurisdiction over foreign investors (under FRCP 12(b)(1)) and class certification. In addition to these threshold grounds, courts have dismissed foreign-cubed class actions under *forum non conveniens* and principles of international comity. Under both of these doctrines, U.S. courts consider whether an adequate alternative forum would be found in a foreign nation.

To convince a court to dismiss a class action on the basis of *forum non conveniens*, “the defendant must . . . show that an adequate forum is available elsewhere” and that the “private and public interest . . . implicated in the litigation weighs strongly in favor of dismissal” or removal to another forum.⁹⁴ The problem for plaintiffs in this challenge is that courts focus solely on whether the case will be tried fairly in the proposed forum without considering the differences (and the consequent shift in party favorability) between the substantive law of the foreign and U.S. jurisdictions.⁹⁵

To show that an adequate alternative forum exists, defendants in a securities fraud class action must show that all defendants would be amenable to service of process in the foreign jurisdiction and that the alternative forum will provide redress to the plaintiffs.⁹⁶ In securities fraud class actions, two issues arise when courts compare U.S. and foreign justice systems: (1) reliance is presumed in U.S. courts based on the fraud-on-the-market theory, and (2) federal civil procedure allows claims to be aggregated in a group litigation mechanism.⁹⁷ Some courts have determined the absence of these two plaintiff-favorable elements to be sufficient to deny removal to a foreign forum.⁹⁸

In *Gulf Oil Corporation v. Gilbert*, the Supreme Court listed various private interests to be considered in making a *forum non conveniens* determination.⁹⁹ These private interests include: the relative ease of access to sources of proof; the availability of compulsory process on

⁹³ Buxbaum, *supra* note 5, at 29.

⁹⁴ *Id.* at 35–36.

⁹⁵ *See id.* at 36.

⁹⁶ *Derensis v. Coopers & Lybrand Chartered Accountants*, 930 F. Supp. 1003, 1006 (D.N.J. 1996) (citing *Kultur Int'l Films v. Covent Garden Pioneer*, 860 F. Supp. 1055, 1063 (D.N.J. 1994)).

⁹⁷ Buxbaum, *supra* note 5, at 36–37.

⁹⁸ *See, e.g., Derensis*, 930 F. Supp. at 1007–09 (holding absence of presumption of reliance and class action mechanism made Canadian forum inadequate).

⁹⁹ 330 U.S. 501, 508 (1947).

uncooperative witnesses; any practical problems that make a trial easy, expeditious, and inexpensive; the certainty of the enforceability of a judgment; and other relative advantages and obstacles to a fair trial.¹⁰⁰ Because the plaintiff's choice of forum receives special deference, the balance must weigh heavily in the defendant's favor in order for a court to dismiss.¹⁰¹

While the balance of private interests typically favors plaintiffs in a *forum non conveniens* analysis, plaintiffs in foreign-cubed class actions will have difficulty arguing that the scale tips in their favor. This difficulty arises because the presumed deference to plaintiffs' choice of forum (requiring defendants to show that the interests weigh substantially in their favor) only applies when the plaintiffs have chosen their home forum—a fact that is absent in a foreign-cubed claim.

Gulf Oil also outlined the various public interest factors a court should weigh in a *forum non conveniens* analysis. They include (1) the administrative difficulty arising from overloaded court systems, (2) the societal desire to have localized controversies resolved locally, (3) the value in having the forum be the jurisdiction where the law that governs the action applies, (4) the avoidance of problems of conflicts of laws as well as the application of foreign laws, and (5) the burden of jury duty on citizens within the forum's jurisdiction who have no connection to the action.¹⁰² These public interest factors are to be weighed in light of the connection between the alleged fraudulent conduct to the plaintiffs' chosen forum.¹⁰³

Yet these public interest factors are typically construed against a plaintiff who alleges securities fraud in a foreign-cubed class action. This roadblock occurs because the purpose of the public interest factors is to determine whether there is a connection between the chosen forum and the alleged securities fraud. If a securities fraud targeted U.S. investors, and those investors were harmed, jurisdiction over the securities transaction would likely be found. But such a case would no doubt involve injured U.S. plaintiffs, rendering the action a nonforeign-cubed action. A foreign-cubed class (made entirely of foreign plaintiffs) will have difficulty showing that the alleged fraudulent conduct had any connection with the U.S. forum beyond a generalized impact on the integrity of the globalized market system.

Defendants may increasingly seek dismissal based on *forum non conveniens* as a preliminary matter due to the Supreme Court's recent *Sinochem International Co. v. Malaysia International Shipping Co.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.* at 508–09.

¹⁰³ *Van Cauwenberghe v. Biard*, 486 U.S. 517, 528 (1988).

decision that allows courts to dismiss on the basis of *forum non conveniens* considerations before subject matter jurisdiction or personal jurisdiction are established.¹⁰⁴ But such a premature determination may only be made if subject matter jurisdiction and personal jurisdiction are difficult to determine and the considerations of *forum non conveniens* “weigh heavily in favor of dismissal.”¹⁰⁵

4. International Comity

International Comity (“comity” or “comity of the nations doctrine”) is defined as one nation recognizing the legislative, executive, or judicial rights of another nation to protect the rights and interests of its own citizens or others within its territory.¹⁰⁶ Dismissal based on comity occurs when an action involving the same underlying facts has already been filed in a foreign country.¹⁰⁷ In order for a U.S. court to recognize a foreign proceeding, it must deem the proceeding “to be orderly, fair, and not detrimental” to the interests of the United States.¹⁰⁸ Similar to dismissal for *forum non conveniens*, except that a proceeding is already taking place in another country, dismissal based on international comity centers around the comparison of the claim’s connection with the jurisdiction where it was filed to the U.S. interests involved in the case.¹⁰⁹ Under this doctrine, if the interests of another sovereign nation outweigh the interests of the United States and do not prejudice the interests of the United States, the U.S. court should defer to the laws and interests of the other sovereign nation.¹¹⁰

In *Paraschos v. YBM Magnex International*, the court dismissed a class action on grounds of international comity because the action was “overwhelmingly dominated by Canadian interests.”¹¹¹ The class action was brought by predominantly Canadian investors against a Canadian corporation regarding securities that were registered and traded on a Canadian stock exchange (an apparent foreign-cubed action).¹¹² In addition to these interests, there was a related bankruptcy proceeding and a federal grand jury investigation taking place in the United States, as well as eleven pending proceedings in Canada relating to the same

¹⁰⁴ *Sinochem Int’l Co. v. Malay. Int’l Shipping Corp.*, 127 S. Ct. 1184, 1194 (2007).

¹⁰⁵ *Id.* (emphasis added).

¹⁰⁶ *Hilton v. Guyot*, 159 U.S. 113, 163–64 (1895).

¹⁰⁷ Buxbaum, *supra* note 5, at 38.

¹⁰⁸ *Pravin Banker Assocs. v. Banco Popular del Peru*, 165 B.R. 379, 384 (S.D.N.Y. 1994).

¹⁰⁹ Buxbaum, *supra* note 5, at 38.

¹¹⁰ *Société Nationale Industrielle Aérospatiale v. U.S. Dist. Court*, 482 U.S. 522, 543 n.27 (1987) (citing *Emory v. Grenough*, 3 U.S. (3 Dall.) 369, 370 n.3 (1797)).

¹¹¹ 130 F. Supp. 2d 642, 647 (E.D. Pa. 2000).

¹¹² *Id.* at 645.

alleged fraud.¹¹³ The court determined that Canadian interests outweighed those of the United States, that deferring to the Canadian judicial system and regulatory body would not be detrimental to the interests of the United States, and that the relief afforded to the plaintiffs under Canadian law and in Canadian courts would be adequate, even if different from that of U.S. courts.¹¹⁴

Deferral to the case already filed in the Canadian courts based on principles of comity in *Paraschos* was likely proper, not because it was a foreign-cubed class action, but because it was a Canadian-cubed class action. Because the “foreign” part of each of the three elements in the securities transaction was Canadian, a good case can be made that a Canadian court should hear the action, especially considering that at least some class members desired the action to be brought in Canada (indicated by their filing there). The analysis is wholly different in the case of diverse securities transactions where the “foreign” portions of the elements are each of a different country, for example, if the stock of a British issuer were purchased by Indian investors on a Japanese stock exchange. The analysis departs from the analysis in *Paraschos* even more when the elements are not so simply defined as Japanese, Indian, and British, but when each element contains numerous national identities. This dynamic is increasingly common given the interconnectedness of global stock exchanges as well as the banality of international commercial transactions, the transgressing in multiple jurisdictions, and the involvement of parties from numerous countries in each element of a given transaction.

While comity and *forum non conveniens* both ostensibly ensure that the plaintiffs will still have a fair and adequate foreign remedy when a U.S. court dismisses an action, securities litigation outside the United States is much less practical or useful for investor plaintiffs, making dismissed suits unlikely to be brought in foreign forums.¹¹⁵ Therefore, dismissal of a foreign-cubed securities class action—and any action seeking recovery from injury caused by the defendants—“is tantamount to plaintiffs having no remedy at all.”¹¹⁶ The next section exposes this point by comparing the U.S. procedural and substantive doctrines that make the U.S. justice system a useful and favorable forum that provides superior access to justice for injured investors.

¹¹³ *Id.*

¹¹⁴ *Id.* at 647.

¹¹⁵ Thompson, *supra* note 9, at 1133.

¹¹⁶ *Id.* (citing Laurel E. Miller, Comment, *Forum Non Conveniens and State Control of Foreign Plaintiff Access to U.S. Courts in International Tort Actions*, 58 U. CHI. L. REV. 1369, 1389 (1991)).

C. Comparative Group Securities Litigation

The U.S. court's dismissal of the foreign plaintiffs' case in the introduction's fact pattern raises the question of whether the investor-plaintiffs suffering losses from the parent bank's purported misrepresentations would have effective access to justice in another jurisdiction. Without knowing more about the plaintiff class (for example, where the foreign investors reside), the only semi-certain forum would be in Australia—the location of the parent bank. The securities could have been purchased on neither a U.S. nor an Australian exchange and the investors could have been neither American nor Australian, but the defendant parent bank's residence in Australia should be enough for a court in that country to find jurisdiction. Furthermore, according to the U.S. court that dismissed the case, the conduct in Australia was “significantly more central to the fraud and more directly responsible for the harm to investors” than the mortgage subsidiary's “number crunching” in Florida.¹¹⁷

The plaintiff class's chances of success in an Australian court are at best unclear. While Australian courts have allowed securities class actions, no Australian court has allowed a presumption of reliance.¹¹⁸ Therefore, as the current law rests, plaintiffs in securities class actions must still show individual reliance.¹¹⁹ But, based on a statement by the High Court of Australia, it may be that as the class action mechanism develops “down under,” the possibility of an inference of reliance as a matter of fact may be employed by Australian courts, where the alleged misstatement was “calculated to induce” the investor to enter into the transaction.¹²⁰ Securities class actions remain too undeveloped in Australia to know what relief might await the injured plaintiffs in the fact pattern. One thing is certain; the plaintiffs would face far more obstacles to get beyond the pleading stage and to argue the case on the merits than in the more developed, albeit imperfect, U.S. system.

Notwithstanding recent international developments in group litigation discussed below, U.S. courts remain the most attractive forum for groups of plaintiffs who have been injured due to fraudulent events

¹¹⁷ *Morrison v. Nat'l Austl. Bank*, 547 F.3d 167, 176 (2d Cir. 2008).

¹¹⁸ Jason Betts, *Australia: The Rise of Shareholder Class Actions in Australia*, MONDAQ, Apr. 21, 2005, at 4, reproduced at http://www.nera.com/newsletter/Shareholder_Class_Actions_Australia.pdf.

¹¹⁹ *Id.*

¹²⁰ Michael Duffy, *'Fraud on the Market': Judicial Approaches to Causation and Loss from Securities Nondisclosure in the United States, Canada, and Australia*, 29 MELB. U. L. REV. 621, 656 (2005) (noting “[i]f a material representation is made which is calculated to induce the representee to enter into a contract[,] and that person in fact enters into the contract[,] there arises a fair inference of fact that he was induced to do so by the representation” (quoting *Gould v. Vaggelas* (1985) 157 C.L.R. 215, 236 (Austl.))).

surrounding their ownership of certain securities. This attractiveness stems from the strength of the U.S. regulatory regime and the accessibility of litigation for plaintiffs.¹²¹ The use of the class action mechanism and a shift of the prohibitively high burden of proving individualized reliance have been largely unavailable to plaintiffs abroad.¹²² The class action dispute resolution mechanism empowers investor plaintiffs to aggregate their small claims and litigate as a group. By aggregating claims, plaintiff groups are able to attract quality counsel on contingency-based fee schedules and, consequently, the defendant's full attention. Thus, one can assume access to justice is increased, providing plaintiffs with an avenue to "achieve both financial compensation and specific corporate governance reforms," while maximizing use of judicial resources.¹²³ Hence, plaintiffs that would normally be considered the "little guy" can find a more equal legal footing in a dispute with a large corporation (the "big guy")—the age-old David and Goliath parallel. Combined with the implied private right of action, the class action further acts as a deterrent to fraud through the pursuit of relief from fraudulent actors and regulation of corporate malfeasance, using a quasi-public enforcement tool and expressing societal will.¹²⁴

A benefit of U.S. class actions specific to the securities fraud arena is that the cases are conducted with an underlying belief in the fraud-on-the-market theory; thus, plaintiff groups are not required to show individualized reliance on the alleged misrepresentations.¹²⁵ It is prohibitively burdensome on class actions if each plaintiff in a group (of

¹²¹ Thompson, *supra* note 9, at 1144.

¹²² See, e.g., Betts, *supra* note 118, at 2–3.

¹²³ *Id.* at 1–2.

¹²⁴ James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 ARIZ. L. REV. 497, 497 (1997).

¹²⁵ Recognizing the economic theory of the "efficient capital markets" hypothesis, the Supreme Court in *Basic, Inc. v. Levinson* adopted the fraud-on-the-market theory, which assumes that a stock price is a function of all material information about a company, and that any misstatement has a causal link to all individual investors in the stock because the misstatements defraud the market as a whole, which in turn affects the price of the stock. 485 U.S. 224, 247 (1988). Under this premise, the Court determined that requiring a showing of actual reliance by each class member would effectively prevent plaintiffs from succeeding past summary judgment in all securities class actions. *Id.* at 242. But the plaintiffs cannot just sit back and enjoy the benefits of the presumption of reliance; to invoke the presumption

plaintiff[s] must allege and prove: (1) that the defendant made public misrepresentations; (2) that the misrepresentations were material; (3) that the shares were traded on an efficient market; (4) that the misrepresentations would induce a reasonable, relying investor[s] to misjudge the value of the shares; and (5) that the plaintiff[s] traded the shares between the time the misrepresentations were made and the time the truth was revealed.

Id. at 248 n.27 (citing *Levinson v. Basic, Inc.*, 786 F.2d 741, 750 (1986)).

potentially thousands of members) is required to show that he or she relied on the alleged misrepresentations when he or she purchased or sold the securities at issue. As was implied above, the presumption of reliance found in U.S. courts is exceptional in securities litigation worldwide.¹²⁶

Class action litigation is, however, no longer wholly unique to the United States. This method of efficient dispute resolution has steadily gained international ground over the last two decades.¹²⁷ Several countries have introduced some form of group litigation through changes to their regulatory structure, substantive law, and procedural law.¹²⁸ The following countries have begun to develop mechanisms for group litigation that have been or could be used in security fraud class actions: (1) Australia,¹²⁹ (2) the United Kingdom,¹³⁰ (3) Canada (including Quebec),¹³¹ (4) Sweden,¹³² (5) Germany,¹³³ (6) Brazil,¹³⁴ and (7) South

¹²⁶ The fraud-on-the-market theory has been expressly rejected by Canadian courts because Canadian securities legislation lacks the same concepts involved in Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. See Duffy, *supra* note 120, at 639–41. But Canadian courts have accepted that reliance, as a question of fact, may be inferred from all the circumstances, and that inference could shift the burden to the defendants (that is, requiring a rebuttal). See, e.g., CC&L Dedicated Enter. Fund v. Fisherman, [2001] 8 C.C.L.T. 240, 256–257 (Can.). For a full discussion on the fraud-on-the-market theory as applied by U.S. courts, as well as a study of how Canadian and Australian courts and legislatures have treated the doctrine, see generally Duffy, *supra* note 120.

¹²⁷ See, e.g., Richard B. Cappalli & Claudio Consolo, *Class Actions for Continental Europe? A Preliminary Inquiry*, 6 TEMP. INT'L & COMP. L.J. 217, 221 (1992); Antonio Gidi, *Class Actions in Brazil—A Model for Civil Law Countries*, 51 AM. J. COMP. L. 311, 314 (2003); Roberth Nordh, *Group Actions in Sweden: Reflections on the Purpose of Civil Litigation, the Need for Reforms, and a Forthcoming Proposal*, 11 DUKE J. COMP. & INT'L L. 381, 382–83 (2001). See generally RACHEL P. MULHERON, *THE CLASS ACTION IN COMMON LAW LEGAL SYSTEMS: A COMPARATIVE PERSPECTIVE* (2004) (discussing the growth of class action lawsuits in the world's common law legal systems).

¹²⁸ Heather Smith, *Is U.S. Exporting Class Action to Europe?*, FULTON COUNTY DAILY REP. (Atlanta, Ga.), Mar. 1, 2006, at 6 (proffering the belief that, because of the dominance of American companies and globalization, European corporate and securities law are beginning to implement more and more American characteristics).

¹²⁹ Federal Court of Australia Amendment Act, 1991, No. 181 § 3 (1991); see also Betts, *supra* note 118, at 2; S. Stuart Clark & Christina Harris, *Multi-Plaintiff Litigation in Australia: A Comparative Perspective*, 11 DUKE J. COMP. & INT'L L. 289, 289–90 (2001).

¹³⁰ Civil Procedure Rules, 2009, Part 19(III) (2009) (U.K.), http://www.justice.gov.uk/civil/procrules_fin/contents/parts/part19.htm.

¹³¹ See generally 1 WARD K. BRANCH, *CLASS ACTIONS IN CANADA* (2009) (discussing the Canadian class action process in full).

¹³² Group Proceedings Act (Svensk författningssamling [SFS] 2002:599) (Swed.).

¹³³ See Thompson, *supra* note 9, at 1141 (citing Smith, *supra* note 128).

¹³⁴ See Gidi, *supra* note 127, at 325–26.

Korea.¹³⁵ Several other (largely European) nations have proposals at various stages in the legislative process to create such a dispute resolution mechanism.¹³⁶ The U.S.-style of class action still receives much opposition. Many of the European countries that allow group litigation have watered down versions of the U.S. system. Other countries restrict group litigation to a specific type of action.

This opposition and reluctance is due in large part to the international perception of U.S. litigation in three key areas. First, many nations prefer public—regulatory—enforcement (which can be accompanied by disgorgement or sanctions) over private litigation.¹³⁷

Second, the opposition to the U.S. system is due to the difficulties in applying such a mechanism to the different dynamics existing in civil law countries.¹³⁸ The difference between civil law countries and common law countries is threefold: the result of a societal preference for legislation, rather than litigation to address social concerns in civil law nations;¹³⁹ the difference in the two systems in terms of the relative role of legislators and their political motivations; and the differing legislative processes between the two types of systems.¹⁴⁰

Finally, many nations resist the adoption of the fraud-on-the-market doctrine for two major reasons. First, adopting it could create an incentive for investors to remain uninformed. Yet this argument is overcome by the mere fact that investors rarely make investment decisions based on what they believe the consequences will be if they rely on a misstatement by the issuer that ultimately causes them harm.

¹³⁵ Walter Douglas Stuber et al., *International Securities and Capital Markets—Developments in 2005*, 40 INT'L LAW. 701, 714 (2006).

¹³⁶ See, e.g., GUILLAUME CERUTTI ET AL., RAPPORT NO. 16, RAPPORT SUR L'ACTION DE GROUPE [THE REPORT ON CLASS ACTIONS] (2005) (Fr.); ISABELLE ROMY, LITIGES DE MASSE [MASS PROCEEDINGS] (1997) (Fr.).

¹³⁷ Buxbaum, *supra* note 5, at 61; Thompson, *supra* note 9, at 1138 n.104 (providing Turkey as an example, which has a public agency that regulates and supervises the nation's securities markets and forbids private actions by investors against corporate issuers or their executives). Note that in the United States, the Supreme Court has found an implied private cause of action under Rule 10b-5, allowing private investors to bring suits for securities fraud against the perpetrators. *Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971). Nations like Australia, however, are beginning to realize that the encouragement of shareholder class actions can supplement the slow-moving reflexes of government enforcement agencies and are often more intimidating to corporations with a propensity for misstatements or fraud. Betts, *supra* note 118, at 3–4; see also Thompson, *supra* note 9, at 1138 n.104 (noting it takes two to three years, and many more years for a judgment, for the public Turkish authority to initiate proceedings in court).

¹³⁸ Samuel P. Baumgartner, *Class Actions and Group Litigation in Switzerland*, 27 NW. J. INT'L L. & BUS. 301, 303 (2007) [hereinafter Baumgartner, *Class Actions*].

¹³⁹ *Id.* at 311–12.

¹⁴⁰ *Id.*

Investors collect information and analyze issuer statements to make good and profitable investments; that is, investors will still have an incentive to make the wisest possible investment decision based on the available information. Second, adoption would produce unfairness to those investors who actually did rely on the misstatements. This notion of fairness assumes that it is economical for investors who did rely on the misstatements to file a claim by themselves and to prove individualized reliance—which is indeed what they would be forced to do without the reliance presumption—because the class action mechanism would be obstructed from proceeding. In the end, whether other jurisdictions provide plaintiffs with a group-litigation relief mechanism will be largely ineffective in the securities fraud context if the jurisdictions do not also have a presumption of reliance.¹⁴¹

International opposition to the U.S. system of class action adjudication will strain negotiations aimed at collaboration and harmonization of international securities law. This clash will be a large obstacle to any international cooperation seeking to prevent securities fraud and injury to investors. To get some increased protection from foreign perpetrators and improved market integrity, the United States may be required to relax some areas of its plaintiff-favorable procedures or substantive laws.¹⁴² Alternatively, such concessions may not be necessary as other countries have begun to realize the utility of the class action mechanism. As a result, they may soon realize how impossible it is to take advantage of that utility while requiring proof of individual reliance.

II. COMPARISON OF EXTRATERRITORIALITY OF SECURITIES LAW TO THE EXTRATERRITORIALITY OF OTHER TYPES OF U.S. LAW

The application of U.S. securities antifraud laws and regulations to actions with predominantly foreign elements has been less contentious than attempts to apply other areas of U.S. law or regulations to foreign situations.¹⁴³ This is likely due to the common interest in regulatory enforcement of antifraud provisions and a desire to shape prospective behavior that may not itself be wrongful.¹⁴⁴ The Second Circuit has stated that “[t]he primary interest of [a foreign state] is in the righting of a wrong done to an entity created by it. If our anti-fraud laws are

¹⁴¹ Forcing each member of a class to prove actual reliance would effectively bar plaintiffs from bringing securities class actions under Rule 10b-5. *See supra* note 125 and accompanying text.

¹⁴² The European Union did this when it abolished its old Place of the Relevant Intermediary Approach and urged its members to adopt the Hague Securities Convention, which opted for the functional approach. *See infra* Part IV.C.

¹⁴³ Buxbaum, *supra* note 5, at 62.

¹⁴⁴ *See id.* at 62 n.196.

stricter than [a foreign state's], that country will surely not be offended by their application."¹⁴⁵ In sum, while countries may have complex and wide-ranging national interests, incentives, and policies determined by their legislative and regulatory regimes, most countries agree that it is the responsibility of the government to prevent and punish fraudulent conduct.¹⁴⁶ The following is a brief discussion of the extraterritoriality of other areas of U.S. law as compared to the extraterritorial application of U.S. securities antifraud provisions.

A. Antitrust Laws

In terms of both comity and conflict of laws, the extraterritorial application of U.S. antitrust laws is a more serious problem than application of securities antifraud provisions overseas.¹⁴⁷ This is likely due to the common interest among nations in preventing securities fraud, as discussed above. In antitrust cases, however, the various national interests are likely to be in total opposition.

One major legislative difference between extraterritorial application of securities and antitrust laws is the level of Congressional guidance provided. While the Sherman Act—the U.S. antitrust law—is generally considered to be silent on Congressional intent as to its extraterritorial application, the Act is not entirely without extraterritorial guidance. Section 6a of the Sherman Act states that the Act “shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations,” unless it has “direct, substantial, and reasonably foreseeable effect” on imports, domestic commerce, or American exporters.¹⁴⁸ But the Supreme Court’s analysis of the legislative history interpreted the above-quoted exclusionary rule as allowing federal courts to reach commercial transactions that may not involve American exports but which are wholly foreign, as long as the conduct has adverse effects on *both* foreign and domestic customers.¹⁴⁹

¹⁴⁵ *Morrison v. Nat’l Austl. Bank*, 547 F.3d 167, 175 (2d Cir. 2008) (alterations in original) (quoting *IIT v. Cornfeld*, 619 F.2d 909, 921 (2d Cir. 1980)).

¹⁴⁶ *See id.* at 175.

¹⁴⁷ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 416 note 3 (1986); Gary B. Born, *A Reappraisal of the Extraterritorial Reach of U.S. Law*, 24 LAW & POLY INT’L BUS. 1, 47 (1992) (citing *IIT*, 619 F.2d at 921). *See generally* SEC Amicus Brief, *supra* note 10, at 1–3.

¹⁴⁸ Sherman Act, 15 U.S.C. § 6a (2006).

¹⁴⁹ The Supreme Court stated that when the defendant, foreign and domestic vitamin manufacturers and distributors, engaged in a price-fixing conspiracy, and the conspiracy adversely affects both foreign and domestic purchasers of vitamins in a significant way, federal courts may apply antitrust laws to the conduct, but only if the foreign injury was not independent of the domestic injury. *F. Hoffmann-La Roche, Ltd. v. Empagran S.A.*, 542 U.S. 155, 158–59, 169 (2004) (reversing the court of appeals under principles of “prescriptive comity,” because “[w]here foreign anticompetitive conduct plays

This interpretation highlights a second difference between extraterritorial application of securities and antitrust laws—the level of interference upon foreign interests caused by federal courts extending jurisdiction to foreign conduct. This difference comes to light in the Court’s decision in *F. Hoffmann-La Roche, Ltd. v. Empagran S.A.*, where it noted that when the conduct implicated by the antitrust laws adversely affects customers both outside and within the United States, the antitrust laws cannot be applied to the foreign effects if the foreign effects were independent of the domestic effects.¹⁵⁰ The Court reached this conclusion in part because of its rule of statutory construction that seeks to avoid “unreasonable interference” with another nation’s sovereign authority.¹⁵¹ Such application would materially interfere with a nation’s ability to regulate its own commerce independently.¹⁵² Application of the antifraud provisions of U.S. securities laws should not cause as much interference with a foreign nation’s regulation and enforcement of antifraud provisions because the goals of nations in preventing and redressing fraud are more closely aligned. Interest-balancing would not be required because the foreign states would not have a strong policy against the application of antifraud provisions, while they would against the application of antitrust provisions.

The competing interests among nations in the application of antitrust law are in stark contrast to the aligned incentives found in the application of antifraud provisions of securities laws. There may be rare cases when a country opposes the proper application of antifraud provisions by another nation due to its interest in protecting its own securities issuers. This opposition is based on a misguided view of the role of antifraud provisions. Securities fraud that is conducted in one market eventually affects the integrity of all global securities markets. This widespread impact is due, in large part, to the speed at which information is disseminated across the globe.¹⁵³ When a company makes financial performance predictions and statements regarding company goals and significant corporate events, investors worldwide use this source as their main basis of financial decisions. What other source would have better access to information to make statements about a

a significant role and where foreign injury is independent of domestic effects, Congress might have hoped that America’s antitrust laws, so fundamental a component of our own economic system, would commend themselves to other nations as well. But, if America’s antitrust policies could not win their own way in the international marketplace for such ideas, Congress, we must assume, would not have tried to impose them, in an act of legal imperialism, through legislative fiat”).

¹⁵⁰ *Id.* at 164.

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *See infra* note 175.

company's affairs than those working in it? When a country opposes the exposure of its issuers to antifraud enforcement, it may indeed gain some short-term benefits, but the long-term adverse impact on the global economy will likely cause greater damage to that country's economic prosperity.

B. General Civil Litigation Discovery Rules

How have courts treated application of the Federal Rules of Civil Procedure ("Federal Rules") when it is necessary for parties to obtain evidence abroad? Can a court compel the disclosure of documents or other testimony located outside the United States? The Federal Rules and the Rules Enabling Act are both silent as to the extraterritorial reach of discovery rules in civil litigation.¹⁵⁴ Federal courts have recognized that they have the authority to "order a person subject to its jurisdiction to produce documents, objects, or other information relevant to an action or investigation, even if the information or the person in possession of the information is outside the United States."¹⁵⁵

Implicit in the above quote is that a court must have personal jurisdiction over the party it seeks to compel, even if the party is not present in the court's jurisdiction. In determining whether extraterritorial discovery should be ordered, courts should look at the following considerations: (1) the need for the requested materials; (2) the objectives of the substantive legislation implicated in the dispute; (3) the parties' nationality; and (4) the hardship suffered by private parties.¹⁵⁶ To avoid creating an incentive to place ownership of American assets in countries that ensure secrecy of certain records, the Supreme Court has held extraterritorial discovery proper even in the face of legislation in the foreign jurisdiction prohibiting disclosure of the requested materials.¹⁵⁷ Though it is necessarily difficult to obtain the information, unless the court has personal jurisdiction over the party it seeks to compel, it will be unable to obtain the desired information. The Court has also stated that judges should take into account considerations of international comity in weighing the sovereign interests of the foreign nation and the requesting nation.¹⁵⁸

Recent developments in bank secrecy laws and information-sharing standards might impact the extraterritorial application of discovery rules to aid in the international collection of fraud judgments by

¹⁵⁴ Born, *supra* note 147, at 48.

¹⁵⁵ *Id.* (quoting RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 442(1)(a) (1986)).

¹⁵⁶ Born, *supra* note 147, at 49 (citing *Société Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers*, 357 U.S. 197, 204–06 (1958)).

¹⁵⁷ *Rogers*, 357 U.S. at 205.

¹⁵⁸ *Id.* at 205–06.

successful civil plaintiffs. The mystique of small island-nations and minor European countries acting as attractive tax havens for the world's wealthiest individuals and companies has been the substance of spy thrillers for half a century.¹⁵⁹ These tax havens were created via national laws prohibiting banks from sharing the financial information of their customers. This secrecy allows the customers to stash treasures in nations where tax authorities of other countries are unable to discover relevant information to enforce their tax law. These same bank secrecy laws also enable the rich to hide from judgment creditors.

The recent economic downturn has exposed several large scale financial frauds that flourished under these lightly regulated jurisdictions. These jurisdictions include Luxembourg, where funds from Bernard Madoff's Ponzi scheme were based, and Barbuda, which hosted Stanford International Bank.¹⁶⁰ These developments have caused many financially-strapped countries to increase political pressure on countries with heightened bank secrecy laws.¹⁶¹ As a result of the international pressure, several of the blacklisted countries recently committed to changing their laws to increase bank transparency and provide legal assistance in compliance with the Organisation for Economic Cooperation and Development's ("OECD") tax standards.¹⁶² These countries include Andorra (a tiny country in the Pyrenees between France and Spain), Liechtenstein (a miniscule principality sandwiched by Austria and Switzerland), Switzerland (the largest of tax havens, controlling over \$2 trillion), Austria, and Luxembourg.¹⁶³ Switzerland has said, however, that the changes to its laws will only come through bilateral treaties (which could require amnesty for prior tax evasion),¹⁶⁴ and will result in the exchange of information only through detailed requests on specific cases, not automatically.¹⁶⁵

While these bank secrecy developments were aimed at benefiting tax authorities in collecting the necessary information to bring tax

¹⁵⁹ The Organisation for Economic Cooperation and Development ("OECD") has created a "blacklist" of uncooperative countries that are deemed to be tax havens. The OECD can sanction countries for not complying with its international tax standards. See OECD, OECD Work on Tax Evasion, http://www.oecd.org/document/21/0,3343,en_2649_201185_42344853_1_1_1_1,00.html.

¹⁶⁰ David Crawford, *Tax Havens Pledge to Ease Secrecy Laws*, WALL ST. J., Mar. 13, 2009, at A1.

¹⁶¹ See David Crawford & Jesse Drucker, *Swiss to Relax Bank Secrecy Laws*, WALL ST. J., Mar. 14–15, 2009, at A5.

¹⁶² See *id.*; see also Crawford, *supra* note 160; BBC News, *Switzerland Eases Banking Secrecy*, Mar. 13, 2009, BBC NEWS, <http://news.bbc.co.uk/2/hi/business/7941717.stm>.

¹⁶³ Crawford & Drucker, *supra* note 161.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

evaders to justice, relaxing these laws may also allow for greater reach and efficacy of discovery laws in civil litigation. One possible scenario would be if a fraudulent actor (of the Bernie Madoff variety) is prosecuted by tax authorities who obtained the fraudster's financial information from banks in the Caribbean, the South Pacific, and Europe in order to prosecute him for tax fraud. This information might then be deemed public, or subject to discovery from the IRS, allowing civil plaintiffs suing the fraudster improved access to justice for their injuries.

C. Federal Criminal Law

For centuries, a strong presumption of territoriality existed in the application of a sovereign nation's criminal law.¹⁶⁶ This presumption was largely based on the recognition that "criminal litigation involves a sovereign [s]tate directly seeking to enforce its laws."¹⁶⁷ Over the last century, as the world began to globalize and criminal conduct within one jurisdiction could more easily affect another jurisdiction, this strict territoriality presumption began to erode. In *Strassheim v. Daily*, the U.S. Supreme Court held that any conduct occurring outside a given jurisdiction that was intended to produce a detrimental impact in that jurisdiction will justify a state seeking punitive recourse against the cause of that harm as if the perpetrator was present in the injured jurisdiction while effectuating the conduct.¹⁶⁸ The Court has continued to recognize the point that a sovereign nation has a right "to defend itself" and apply its criminal statutes against criminal perpetrators regardless of where they effectuated the crime, so long as the perpetrators were its own citizens or the crime had an impact on its citizens.¹⁶⁹ In short, the application of criminal laws is not logically dependent on their locality.

The considerations involved in the application of federal criminal law to crimes committed abroad by foreigners work much the same way as the current judicial analysis in multinational violations of U.S. securities laws by foreigners. In criminal law, the "conduct test" is the typical application of federal law against those who break the law on our soil. It is in the "effects test" where the application of U.S. criminal law can be applied to illegal conduct occurring in another country. That is, does the illegal conduct have any major effects on U.S. citizens or interests? If so, the effects test would allow a U.S. court to exercise jurisdiction and apply federal criminal law to the crimes committed abroad that affect U.S. interests. Just as in the extraterritoriality application of securities laws, the U.S. courts will take into account

¹⁶⁶ See Born, *supra* note 147, at 51.

¹⁶⁷ *Id.*

¹⁶⁸ 221 U.S. 280, 285 (1911) (citations omitted).

¹⁶⁹ *E.g.*, *United States v. Bowman*, 260 U.S. 94, 98 (1922).

various other considerations (such as international comity) before actually exercising jurisdiction.¹⁷⁰ Because the antifraud provisions in securities laws deal with civil penalties, as opposed to criminal law dealing with criminal penalties, those laws may hold less weight in the eyes of the judiciary when weighed against principles of international comity. This balancing might be why courts tend to require more specific “effects” in the securities context than in the criminal context.

III. THE NEED FOR MORE INTERNATIONAL UNIFICATION OF SECURITIES LAWS

Fifteen years ago, Gary Born wrote that “[t]echnological, commercial and political changes have created an interdependent global economy, characterized by pervasively transnational commercial activities, in which no nation can ignore what occurs beyond its borders.”¹⁷¹ Since writing those words, the dynamics that Born described have become more exaggerated. U.S. courts have failed to unilaterally take the lead in addressing the “generalized harms” caused by the perpetuation of international fraud,¹⁷² because they have limited the application of the effects test to “concrete harm.”¹⁷³ Congress and the SEC need to address the harm caused to the integrity of global financial markets upon which countless investment decisions are based every day. They should seek to address this concern through cooperation with their foreign counterparts. The fraud over which U.S. courts have refused to extend jurisdiction (for example, that found in foreign-cubed securities class actions) has a great impact on our domestic markets due to the “globalization of securities markets,”¹⁷⁴ the interconnectedness of the global economy in general, and the speed at which our lines of communication can extend to markets across our so-called “global village.”¹⁷⁵ The current status of globally interwoven securities markets, along with the reluctance of U.S. courts to find jurisdiction in

¹⁷⁰ Born, *supra* note 147, at 54.

¹⁷¹ *Id.* at 99.

¹⁷² Thompson, *supra* note 9, at 1134.

¹⁷³ See *supra* notes 61–70 and accompanying text.

¹⁷⁴ For a full discussion on the consolidation of global securities markets occurring over the last decade, see generally Thompson, *supra* note 9.

¹⁷⁵ Marshall McLuhan coined the term “global village” in his books to describe the global transformation that occurred once electric technology became widespread, allowing information to spread more quickly. The globe contracted into a village, where all become aware of social and political functions instantaneously. See MARSHALL MCLUHAN, UNDERSTANDING MEDIA: THE EXTENSIONS OF MAN 6, 408, 454 (W. Terrence Gordon ed., Gingko Press 2003) (1964); MARSHALL MCLUHAN, THE GUTENBERG GALAXY: THE MAKING OF TYPOGRAPHIC MAN 31 (1962); Letter from Marshall McLuhan to Edward S. Morgan, Assistant Editor, Marketing Magazine (May 16, 1959), in LETTERS OF MARSHALL MCLUHAN 252, 253 (Matie Molinaro et al. eds., 1987).

predominantly foreign cases, has provided corporate issuers with the “opportunity to access the world’s markets while avoiding U.S. regulation and litigation.”¹⁷⁶ If the country-to-country treatment of international securities fraud continues down its current disparate path of substantive application and procedural relief mechanisms, companies will seek ways to capitalize on U.S. case law by altering their behavior to minimize litigation risk in the United States. They will realize that litigation in foreign jurisdictions will be much more issuer-favorable.

Securities transactions in a global marketplace can involve multiple participants, components, and events in several countries. For example, executive management might be headquartered in one country, the alleged false representations might be filed, published, or publicly announced in various other nations, accountants, lawyers, and underwriters might have prepared (knowingly or unknowingly) the fraudulent documents in still another jurisdiction, and marketing of the securities at issue might have reached various exchanges worldwide.¹⁷⁷ Because securities fraud is rarely traceable to a single act in a discrete place at a specific time, international harmonization of applicable substantive and procedural law and regulation is necessary for investor protection. On the contrary, if such action is not taken, the causal factors discussed in this Article will “result in greater risk for investors and far less integrity and stability in” global markets.¹⁷⁸

A. Problems with the Current U.S. Approach to Foreign-Cubed Securities Class Actions

After the *Morrison v. National Australia Bank* ruling applied the common law tests of its predecessor decisions, two points became clear. The first is that foreign investors, suffering the adverse impact of fraudulent conduct would have decreased access to justice in U.S. courts. As noted above, even if dismissed plaintiffs have an alternative forum to seek relief, they will be relegated to jurisdictions with less regulation, less investor protection, and antiquated disputed resolution mechanisms (many countries cling to the one plaintiff-one defendant concept of dispute resolution).¹⁷⁹ Often, plaintiffs dismissed by U.S. courts will have no avenue to seek redress for the harm caused them by fraudulent corporate issuers.¹⁸⁰

¹⁷⁶ Thompson, *supra* note 9, at 1144.

¹⁷⁷ SEC Amicus Brief, *supra* note 10, at 5–6 (citing *In re Alstom SA Sec. Litg.*, 406 F. Supp. 2d 346, 372 (S.D.N.Y. 2005)).

¹⁷⁸ Thompson, *supra* note 9, at 1144.

¹⁷⁹ *Id.* at 1129 (citing Jacob Zamansky, *How an Exchange Merger Can Create Big Losers*, FIN. TIMES, Aug. 24, 2006, http://www.ft.com/cms/s/0/96abb29e-330c-11db-87ac-0000779e2340.html?nclick_check=1).

¹⁸⁰ *Id.* at 1133 (citing Miller, *supra* note 116, at 1389).

The second point of clarity is that the case law allows foreign issuers to mitigate their exposure to litigation by minimizing the risk of a foreign-cubed class action in plaintiff-accessible U.S. courts. This may be accomplished

by ensuring that all public communications for non-U.S. investors are prepared and distributed outside the United States, even when they concern U.S. operations, and by communicating information outside the United States prior to or simultaneously with its communication in this country, so that non-U.S. investors cannot claim to rely on information communicated in the [United States].¹⁸¹

Such conduct would relegate the foreign investors to jurisdictions that provide inferior investor protection and accessibility to justice for fraudulent conduct.¹⁸²

The lack of conclusive direction from the Supreme Court and Congress has produced inconsistent application of judicially-crafted solutions in determining whether to apply U.S. securities laws to foreign-cubed class actions. As was shown above, the current U.S. approach yields only dismissals of claims by foreign investors who seek redress against foreign issuers who conducted fraudulent activities abroad. Unless a “material” portion of the fraudulent conduct occurred on U.S. soil or substantially affected direct and concrete interests within the United States,¹⁸³ a portion of the plaintiff class contains U.S. investors, or the securities at issue were purchased on U.S. markets, the claim will be dismissed. Although the United States provides injured investors with the most investor-friendly avenues to relief,¹⁸⁴ it can be argued that by denying investors in foreign-cubed class actions this opportunity to seek relief, the U.S. judiciary is partially complicit in or willfully blind to the perpetuation of international fraud. Such fraud impacts the integrity global financial markets—including those in the United States. Yet it is not the judiciary’s role to enforce against international fraud. And, under current law, U.S. courts are forced to weigh difficult issues (such as international comity) as discussed above.

Governments, including the U.S. government, have a duty to protect their citizens and citizen investors from fraud. Unfortunately for injured foreign investors, seeking relief outside the U.S. is difficult and unsatisfactory. As discussed earlier, many jurisdictions do not provide group litigation mechanisms, which prevent many investors from

¹⁸¹ Lewis J. Liman & David H. Herrington, *Whether ‘Foreign-Cubed’ Securities Class Actions Fit in U.S. Courts*, N.Y. L.J., Feb. 17, 2009, LegalTrac, Gale Doc. No. A194327403.

¹⁸² See generally Buxbaum, *supra* note 5, at 49–50.

¹⁸³ *Id.* at 41 (stating that many cases are clearing the jurisdictional obstacle and often only succeed when there is an intermixing of foreign and U.S.-based transactions); see also *supra* notes 61–70 and accompanying text.

¹⁸⁴ Thompson, *supra* note 9, at 1129.

seeking recovery because their claims are too small individually to make the high cost of litigation worthwhile.¹⁸⁵ Further, many jurisdictions require plaintiffs to prove subjective individualized reliance on the alleged fraud in making a purchase or sale of the securities in question.¹⁸⁶

If U.S. courts take the helm in adjudicating foreign-cubed fraud actions where other courts or agencies do not, there could be negative repercussions. First, foreign courts may not recognize U.S. judgments in foreign-cubed class actions.¹⁸⁷ Foreign courts may refuse to recognize the judgments because (1) they simply do not recognize the jurisdiction of U.S. courts on issuers located in their country, (2) they are skeptical of the U.S. class action mechanism itself, (3) they think that with a presumption of reliance a case has not been fully heard on the merits, (4) they do not recognize U.S. attorneys' fee structures, or (5) they have a policy to only recognize the judgments if there is a formal reciprocity treaty between the countries.¹⁸⁸

Second, considerations of international comity require a delicate balancing that goes beyond the substantive law at issue in a case. This area of international law is difficult for courts to apply consistently; it has been called an "amorphous never-never land whose borders are marked by fuzzy lines of politics, courtesy, and good faith."¹⁸⁹ The required judicial balancing test should consider (1) the American interests involved, making sure not to accord undue weight to those interests, and (2) whether the defendant's contacts can be construed to show that he voluntarily availed himself of U.S. jurisdiction and waived the protection of his own country's judicial and legislative system.¹⁹⁰ These impossible considerations have often been deemed to favor restraint on the part of courts in determining extraterritoriality of U.S. law.¹⁹¹

Third, foreign courts may try to retaliate against the U.S. courts' extension of jurisdiction by inappropriately extending their own jurisdiction to reach transactions involving primarily U.S. interests and

¹⁸⁵ See *supra* Part I.C.

¹⁸⁶ See *id.*

¹⁸⁷ Sankoorikal, *supra* note 14, at 29.

¹⁸⁸ *Id.* at 29–30.

¹⁸⁹ Note, *Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction*, 98 HARV. L. REV. 1310, 1322 (1985) (quoting Harold G. Maier, *Extraterritorial Jurisdiction at a Crossroads: An Intersection Between Public and Private International Law*, 76 AM. J. INT'L L. 280, 281 (1982)).

¹⁹⁰ *Id.*

¹⁹¹ See *id.* at 1323; see also Thompson, *supra* note 9, at 1144 (discussing the historical reluctance of U.S. courts to deal with global issues).

parties.¹⁹² This extension might not be an issue, for the United States wants all issuers that commit fraud to be brought to justice, even its own. But in at least two situations, the extension of foreign legal regimes against U.S. parties can have a negative impact on U.S. interests. First, the foreign courts may be applying their securities regimes solely due to a vendetta against the extraterritorial application of U.S. law by U.S. courts. Such emotional retaliation has no place in the law and can only adversely affect international commerce. Second, the limitations of other jurisdictions' securities regimes could result in unfair treatment of our issuers, such as a lack of preclusive effect as to future claims by class members or the requirement that the corporate issuer dispute each investor claim on an individual basis (that is, no provision for the bulk disposition of claims). In this instance, the United States may find unsatisfactory the fraud enforcement by other countries against U.S. issuers.

These sensitive foreign relations principles tend to discourage unilateral efforts to deter the perpetuation of securities fraud by U.S. courts in foreign-cubed class actions.¹⁹³ Therefore, deterrence of fraud and enforcement of violations of antifraud provisions should be a collective and cohesive effort of a coalition of securities regulatory bodies—for example, the International Organization of Securities Commissions (“IOSCO”)¹⁹⁴—and national legislators. It has been said that “[t]he law applicable to transnational litigation affects the behavior of transnational actors.”¹⁹⁵ Those tasked with making and applying international securities laws should recognize this “interplay between lawmaking and transnational actors and of how particular procedural

¹⁹² *Blechner v. Daimler-Benz AG*, 410 F. Supp. 2d 366, 372 (D. Del. 2006) (citing *Plessey Co. v. Gen. Elec. Co.*, 628 F. Supp. 477, 496 (D. Del. 1986)).

¹⁹³ A unilateral approach may also be discouraged because companies may no longer wish to list U.S. exchanges. However, the United States already has the most plaintiff-friendly system and international companies continue to list on U.S. markets. *Supra* note 15 and accompanying text. Further, with international harmonization of securities laws, all exchanges would be put back on equal footing when companies decide on which exchange to list their securities.

¹⁹⁴ International Organization of Securities Commissions (“IOSCO”) is known as a Trans-Regulatory Network (“TRN”). Formed in 1983 out of an inter-American regional organization, today IOSCO members regulate ninety percent of the world’s securities markets and is recognized as the “international standard setter for securities markets.” Int’l Org. of Sec. Comm’ns, IOSCO Historical Background, <http://www.iosco.org/about/index.cfm?section=history> (last visited Nov. 20, 2009) [hereinafter IOSCO Historical Background].

¹⁹⁵ Baumgartner, *Class Actions*, *supra* note 138, at 302 (quoting Samuel P. Baumgartner, *Is Transnational Litigation Different?*, 25 U. PA. J. INT’L ECON. L. 1297, 1305 (2004) [hereinafter Baumgartner, *Transnational Litigation*]).

choices may influence it in the long run.”¹⁹⁶ There is no better way to account for and weigh the incentives of international actors and the law that influences their behavior than broad cooperation among legislative and regulatory bodies.

Some efforts at international cooperation in securities law have been made. The following two sections discuss the current level of international cooperation in this area and the inadequacy of those efforts to prevent harm to investors or provide them with compensatory relief from fraudulent actors.

B. Current International Securities Cooperation

Currently, a (slow) movement toward international securities cooperation is occurring on three fronts. First, IOSCO has created a document concerning cooperation in the area of sharing of information called the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (“MMOU”).¹⁹⁷ As of September 21, 2009, the MMOU has fifty-five signatories (that is, securities regulatory agencies, including the SEC).¹⁹⁸ The self-proclaimed purpose of the MMOU is for the signatories “to provide one another with the fullest mutual assistance possible to facilitate” the regulation of securities transactions and the enforcement of compliance with their laws and regulations within their respective jurisdictions.¹⁹⁹ By helping securities regulatory bodies regulate and enforce the compliance of their national securities laws, the MMOU is aimed at combating cross-border securities market misconduct. In the shadow of the September 11, 2001 attacks, the IOSCO recognized that increasing global activity in the securities markets produced a need for increased cooperation and consultation among its members.²⁰⁰ Under the MMOU, the signatories agree to provide one another with investigative material related to bank and brokerage records, records identifying beneficial owners of non-natural persons, and the other critical information.²⁰¹ The signatories agreed that the shared information would

¹⁹⁶ *Id.* at 303 (quoting Baumgartner, *Transnational Litigation*, *supra* note 195, at 1306).

¹⁹⁷ Int’l Org. of Sec. Comm’ns, *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information* (May 2002) [hereinafter IOSCO MMOU], available at http://www.sec.gov/about/offices/oia/oia_bilateral/iosco.pdf.

¹⁹⁸ Sec. Comm’n Malay., List of IOSCO Multilateral MOU Signatories, <http://www.sc.com.my/main.asp?pageid=632&menuid=&newsid=&linkid=&type=> (last visited Nov. 20, 2009).

¹⁹⁹ IOSCO MMOU, *supra* note 197, at 1.

²⁰⁰ *Id.*

²⁰¹ *Id.* at 3.

be kept confidential except to permit use of the information in enforcement and regulatory matters.²⁰²

Second, the Council of Europe harmonized its members' securities laws regarding insider trading during its Convention on Insider Trading.²⁰³ This Convention created a system of mutual assistance among European countries, who agreed to exchange information to enable the effective supervision of securities markets and to establish definitively whether persons transacting on European securities markets are insiders.²⁰⁴

Lastly, the United Nations has tried to develop cooperation among members in the area of conflicts of laws for intermediated securities in its Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary ("Hague Securities Convention").²⁰⁵ Drafted under the auspices of the Hague Conference on Private International Law,²⁰⁶ this treaty harmonizes the law so as to remove the legal uncertainties for cross-border securities transactions. The need for this treaty exists because international networks of intermediaries act as holders of securities in cross-border securities transactions between issuers and the ultimate investors; each of the parties involved in the transaction may have multiple offices around the globe.²⁰⁷ Given the various parties involved in a given securities transaction, the question of which jurisdiction's law applies is difficult to determine. The Hague Securities Convention seeks to provide certainty in this area by identifying a single jurisdiction whose law would apply to any given situation.²⁰⁸

The treaty provides a functional, algorithmic approach to determining the correct governing law.²⁰⁹ First, the account holder and

²⁰² *Id.* at 5–6. For a fuller case study on the IOSCO and its MMOU see Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits*, 34 YALE J. INT'L L. 113, 143–50 (2009).

²⁰³ Convention on Insider Trading, Apr. 20, 1989, 1704 U.N.T.S. 133.

²⁰⁴ *Id.* art. 2.

²⁰⁵ Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, Jul. 5, 2006, 46 I.L.M. 649 [hereinafter Hague Securities Convention].

²⁰⁶ The Hague Conference is a worldwide intergovernmental organization that works for "[a] progressive unification of the rules of private international law." Statute of the Hague Conference on Private International Law art. 1, Oct. 31, 1955, 15 U.S.T. 2228, 220 U.N.T.S. 121.

²⁰⁷ See Hague Securities Convention, *supra* note 205, pmb1.

²⁰⁸ Luc Thévenoz, *Intermediated Securities, Legal Risk, and the International Harmonization of Commercial Law*, 13 STAN. J.L. BUS. & FIN. 384, 392–93 (2008).

²⁰⁹ See *id.* at 393 & n.21.

the intermediary²¹⁰ may choose the governing law by agreement, as long as the intermediary has an office involved in the maintenance of securities accounts in the chosen jurisdiction.²¹¹ If no express designation exists between the parties, the law which the parties agreed to govern the account agreement governs the issues addressed in the Convention.²¹² If no result is reached from these two inquiries, the governing law is the law of the location of the intermediary's office through which it entered into the account agreement, as long as the account agreement "expressly and unambiguously" identifies that office.²¹³ Finally, if still no governing law is determined, the law applicable will be the place of incorporation or organization of the intermediary, or its principal place of business.²¹⁴ Clearly, competent legal counsel for an intermediary would ensure that jurisdiction is established in an agreement between the parties or, at the very least, in the account agreement.

In the area of intermediated securities, beyond this conflict of laws issue addressed by the Hague Securities Convention, the International Institute for the Unification of Private Law has sought to supplement the Hague Securities Convention with various substantive rules to determine the rights of investors and collateral holders, provide internationally approved methods for perfecting these rights, and protect investors from the insolvency of intermediaries.²¹⁵

C. Insufficiency of Current International Cooperation

Many problems exist in the current level of international securities cooperation. The following subsections will discuss several of these problems and will then outline the optimal view of how international cooperation should look.

²¹⁰ The term "intermediary" means a person that in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity." Hague Securities Convention, *supra* note 205, art. 1(1)(c).

²¹¹ *Id.* art. 4.

²¹² *Id.* The Convention's logarithmic function in determining applicable law is not challengeable. Yet the Convention does provide for a "review of practical operation of the Convention" by the Secretary-General of the Hague Conference on Private International Law to determine the desirability of any amendments. *Id.* art. 14.

²¹³ *Id.* art. 5(1).

²¹⁴ *Id.* art. 5(2)–(3).

²¹⁵ See, e.g., Int'l Inst. for the Unification of Private Law ("UNIDROIT"), *UNIDROIT Convention on Substantive Laws for Intermediated Securities*, CONF. 11/2–Doc. 42 (Oct. 9, 2009); see also Thévenoz, *supra* note 208, at 411 (discussing UNIDROIT's "functional approach" to reducing the legal risks of holding securities through intermediaries).

1. Lack of Follow-Through

First, a common problem in international cooperation of securities regulators is that the efforts that have been made are not always carried through. For example, the Hague Securities Convention has not entered into force because it requires *three* nations to ratify or adopt it.²¹⁶ Thus far, only the United States and Switzerland have signed the treaty (in July 2006) and they are slowly proceeding toward ratification and adoption, respectively.²¹⁷ Yet, other governments have assessed the Hague Securities Convention. For example, the European Commission assessed the Convention and recommended that member states sign it.²¹⁸ While E.U. members have still not signed the Convention, the Commission's recommendation was a big step towards its adoption. Because the European Union (once seen as the main opponent to the Convention because it replaced the E.U. "place of relevant intermediary" approach with the functional approach outlined above²¹⁹) has endorsed the Convention, its entry into force seems more likely to become a reality. Yet, even where good harmonization efforts have taken place, the required adoption of those efforts is lacking.

In the case of the Hague Securities Convention, the reason for its lack of adoption may be due to the Convention's heavy favoritism of the banking intermediary in its functional choice-of-law analysis. Most of these banking intermediaries reside in Switzerland and the United States, which might explain the prompt signing of the Convention by these two nations and the subsequent reluctance by other nations who are likely more concerned about the treaty's favoring of intermediaries over account holders. Thus, the parties that are most heavily involved in the negotiation process likely will influence the terms for their own benefit, causing the entire agreement to lack widespread acceptance.

²¹⁶ Hague Securities Convention, *supra* note 205, art. 19(1).

²¹⁷ Hague Conference on Private International Law, Status Table for The Hague Securities Convention, http://www.hcch.net/index_en.php?act=conventions.status&cid=72. Mauritius has also signed the Convention, but it is a nonmember state and thus does not count toward the required three signatories. *Id.*

²¹⁸ Sandra M. Rocks & Kate A. Sawyer, *International Commercial Law: 2007 Developments*, 63 BUS. LAW. 1375, 1385–86 (2008) (citing Press Release, Eur. Union, Securities Markets: Commission Calls upon Member States to Sign Hague Convention (July 5, 2006), <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/03/1725&format=HTML&aged=0&language=EN&guiLanguage=en>). The European Union requires unanimous signatures by Member States for the European Union to adopt the Convention. See Press Release, Eur. Union, Frequently Asked Questions (FAQs) on Securities Convention: Commission Legal Assessment (July 5, 2006), <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/267&format=HTML&aged=0&language=EN&guiLanguage=en>.

²¹⁹ See *id.* at 1386.

2. Lack of Harmonization

With the current international securities cooperation there is no harmonization to the substantive law. The parties cooperating are merely beating around the issue, without addressing the core. The Hague Securities Convention deals with the issue of which law governs a dispute over an international transaction.²²⁰ The MMOU is concerned with the sharing of information in order to enforce the existing substantive securities laws of each nation.²²¹ Sharing information is a noble pursuit that will aid in enforcing current antifraud laws, but it does not help multinational classes of injured plaintiffs find a forum for relief.

3. No Cooperative Action

In the case of the MMOU, the international cooperation only helps securities regulators act alone to better prevent fraud within their own borders. While the level of cooperation encompassed by the MMOU is certainly an improvement and better than no cooperation at all, it fails to address the complexities involved in foreign-cubed transactions and the subsequent difficulties that arise in finding an appropriate forum in which plaintiffs can seek justice. The MMOU would not even apply in a 10b-5 action brought under the implied right of action of *Basic, Inc. v. Levinson*,²²² because the MMOU allows the SEC merely to obtain information from, say, the Australian Securities and Investments Commission, regarding some regulatory enforcement action in which the SEC was involved.²²³

This problem with the MMOU stems largely from the inherent limitations with so-called Trans-Regulatory Networks (“TRNs”),²²⁴ such as the IOSCO, which will be discussed in more detail below. One strength of TRNs is their ability to address problems caused by globalization that occur across national borders and affect multiple nations’ interests. While these problems would be difficult for

²²⁰ Thévenoz, *supra* note 208, at 393.

²²¹ Verdier, *supra* note 202, at 145.

²²² See *supra* note 125.

²²³ Further limitations inherent in this type of organization are discussed further in the final section of this Article. *Infra* Part IV.

²²⁴ This Article uses Professor Pierre-Hugues Verdier’s definition that “TRNs are informal multilateral forums that bring together representatives from national regulatory agencies or departments to facilitate multilateral cooperation on issues of mutual interest within the authority of the participants.” Verdier, *supra* note 202, at 118. This type of organization is distinguished from treaty-based organizations like the World Trade Organization, the International Monetary Fund, or the World Bank. *Id.*

governments to address alone, cooperation allows them to address international issues collectively.²²⁵

4. Regional vs. Global

A final deficiency of international cooperation is that the only currently successful cooperative efforts remain regional. The European Union's Convention on Insider Trading is a commendable harmonization of the insider trading law in European nations, but the direct benefits of the Convention do not extend beyond the borders of member states. Harmonization among the commercial laws of member states was essential to the establishment of the European Union.²²⁶ Thus, it follows that the Convention on Insider Trading was a byproduct of the overall harmonization of the E.U.'s expansive commercial law. It should be no surprise that the E.U. members agreed to its terms, as the underlying premise behind the European Union is the bonding of similar and closely associated nations.²²⁷ But today's global economy requires more than mere regional harmonization; the marketplace is filled with international corporations that conduct business with little regard for national or regional boundaries. It is essential, therefore, to develop international mechanisms and substantive law that apply consistently across all (or most) state lines so as to develop a harmonized body of securities law that reaches as far as modern commerce extends and effectively accomplishes its objective of protecting investors in a globalized marketplace.²²⁸

Countries may conflict on how best to regulate globalized economic activities. For instance, when the conduct test does provide a jurisdictional basis for foreign-cubed actions, it applies the U.S. regulatory regime on the conduct, which produces a conflict with the regulatory regimes of other countries with an interest in the litigation. If legislators and regulatory bodies cooperate with one another to prevent fraud worldwide, however, conflict-of-laws issues would be mitigated.

²²⁵ ANNE-MARIE SLAUGHTER, A NEW WORLD ORDER 8 (2004).

²²⁶ Ole Lando, *Principles of European Contract Law: An Alternative to or a Precursor of European Legislation?*, 40 AM. J. COMP. L. 573, 575 (1992).

²²⁷ See Consolidated Version of Treaty on European Union, pmbl., 2006 O.J. (C 321) 5, 9–10 (EU).

²²⁸ When it comes to commercial transactions, the borders of the European Union's member states are fluid far beyond the rest of the globalized economy. Nevertheless, the European Union has compelled the member states to harmonize certain areas of substantive commercial law, all the while failing to establish a central agency for securities regulation. Rather, each country is responsible for its own regulation and enforcement, which permits corporate issuers to disclose information in disparate ways, creating information inefficiencies for investors who purchase the issuer's stock. Thompson, *supra* note 9, at 1128–29 (2007).

IV. POSSIBLE APPROACHES TO FOREIGN-CUBED SECURITIES CLASS ACTIONS

In the increasingly intertwined and globalized economy, fraud in one nation's markets eventually will infiltrate the market integrity of other nations caused by the instant worldwide availability of information disseminated or statements made by the corporate issuer or others. As McLuhan so presciently described the "technological world" of the 1960s as a "global village,"²²⁹ and as Gary Born described our "interdependent" world fifteen years ago,²³⁰ we have only grown more interconnected than these sages could have begun predict. The globalization of business has increased the frequency of foreign-cubed actions over the past decade, thus, the jurisdictional issues involved in these cases will have increasing importance to U.S. courts in the years ahead and will have an increasing impact on investors.²³¹

As discussed above, the current approach of U.S. courts produces inconsistent results and fails to effectively prevent or deter international fraud because it refers plaintiffs to other jurisdictions with less effective means of recovery. A new unilateral approach by U.S. courts likely would improve the current judicial framework;²³² however, the best approach to the issue of foreign-cubed securities fraud actions is international harmonization of substantive and procedural laws effecting securities transactions.

The United States is the chief financial center of the world and has the greatest interest in prevention of securities fraud worldwide. Other nations' lack of adequate group litigation mechanisms and their requirement that claimants prove reliance creates huge bars to justice for plaintiffs and fails to deter fraudulent actors. U.S. courts cannot fix this international problem and the current judicial framework fails to address these important issues. But this Article is not intended to criticize the judiciary's attempts to deal with the issues; the competing policies of comity, equity and effective judicial administration, investor protection, and international relations are difficult to balance and have

²²⁹ See *supra* note 175 and accompanying text.

²³⁰ *Supra* note 171 and accompanying text.

²³¹ Buxbaum, *supra* note 5, at 41; see also *supra* note 175 (discussing McLuhan's idea of a "global village").

²³² See Buxbaum, *supra* note 5, at 68–70 (discussing Hannah Buxbaum's "second-best solution"). Another option might be merely to centralize foreign-cubed litigation in U.S. courts. This approach would highlight that it is mostly advantageous to sue in U.S. court if the defendant has substantial assets in the United States. The presence of these assets might itself justify a court's exercising jurisdiction because whether or not the fraudulent conduct occurred in the United States, the fraudulent actor still maintains a presence there, giving its courts an interest in enforcing antifraud provisions against the actor.

far-reaching and obtuse consequences. The legislative and executive branches should work with their foreign counterparts to prevent fraudulent conduct from infiltrating securities transactions, because the interconnectedness among the world's capital markets compels it.²³³

There are four possible forms in which effective international cooperation regarding the prevention and deterrence of international securities fraud might occur. One form is no cooperation at all, but rather unilateral national amendments to current substantive securities law and procedural relief mechanisms. The other three involve some form of cooperation among governments. The final approach discussed is the most extensive level of cooperation and, as such, stands to provide the most global protection to investors. Each possibility has strengths and weaknesses; however, the point remains that some form of effective cooperation is necessary to maintain international market integrity and protect investors infusing capital across national borders.

A. Unilateral Amendment to National Laws

The simplest approach to the problem of international securities fraud is for the United States to amend its own securities laws to clearly define the rights of investors affected by securities fraud—domestic and foreign—and the type, extent, and locale of conduct to which the laws extend. This approach could help to halt the inefficacy of the current judicially-created system discussed above. The new laws would put issuers on notice that conducting business in the United States will be more highly regulated to improve the integrity of the nation's financial markets and protect its investors.

This unilateral approach would also be the most practical. This Article has probably raised serious doubt that true international cooperation can occur on any effective scale. Most attempts at international cooperation are slow-moving and futile. When cooperation does succeed, the result is so fraught with compromise that any negotiations result in a proportionate watered-down effect.²³⁴

Hannah Buxbaum argued that the best alternative to international cooperation would be to adopt a simple, bright-line rule that limits subject matter jurisdiction under U.S. antifraud provisions to claims arising out of securities transactions on U.S. markets.²³⁵ This rule would provide regulatory clarity to investors and issuers making decisions on

²³³ See *supra* note 9.

²³⁴ See generally David B. Hunter, *International Climate Negotiations: Opportunities and Challenges for the Obama Administration*, 19 DUKE ENVTL. L. & POL'Y F. 247 (2009) (describing the slow-moving, complex nature of international negotiations on "climate change").

²³⁵ Buxbaum, *supra* note 5, at 68.

which market to enter into.²³⁶ They would easily and with certainty be able to evaluate the regulatory limits in the United States and how those limits might affect their investment or business structure.²³⁷

Also, this transaction-based approach would result in well-defined, albeit slight, regulatory protections, which would allow investors to choose from a more diverse selection of investments.²³⁸ If an investor chooses to invest in a foreign market, it will rely on that market's regulatory regime alone. The investor would not be able to rely on the protection of the U.S. regulatory regime.²³⁹ The price of any given security would more accurately account for such factors.²⁴⁰

The benefits of this approach must be weighed against the two major problems it invokes. First, the potential plaintiffs that would have access to U.S. courts would substantially vary from current principles of American adjudication. Courts would have to avert their eyes when injured U.S. investors come before them seeking relief for harm incurred due to securities transactions they made in foreign markets.²⁴¹ Further, U.S. investors would be excluded from class actions where they did not transact on U.S. markets. Conversely, foreign investors purchasing securities on U.S. markets would have access to group litigation mechanisms in the United States, even though the defendants might not be guaranteed preclusive effect in the investor's home country.²⁴²

The second problem with this transaction-based approach is that it fails to address the fundamental issues involved in the current trend of cross-border securities fraud occurring in our globalizing economy.²⁴³ The unilateral approach adds clarity to jurisdictional considerations and minimizes regulatory conflict among nations, but it increases the likelihood that wrongdoers would take advantage of the resulting isolated regulatory regimes.²⁴⁴ Therefore, a higher degree of cooperation is required across borders to address the difficult problem of fraud in foreign-cubed transactions.

B. Transnational Regulatory Network

A second potential approach is for TRNs such as IOSCO to facilitate the development of international standards regarding both the

²³⁶ *Id.* at 69.

²³⁷ *Id.*

²³⁸ *Id.* at 69 (citing Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT'L L. & BUS. 207, 221 (1996)).

²³⁹ *Id.*

²⁴⁰ Choi & Guzman, *supra* note 238, at 221.

²⁴¹ Buxbaum, *supra* note 5, at 69.

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.*

procedural and substantive law applicable to securities fraud. The IOSCO member regulatory bodies would then be tasked with implementing these standards into their domestic regulatory regimes. This approach would benefit investors and maintain market integrity better than unilateral attempts.

The TRN-style intergovernmental cooperation allows for the facilitation of policy coordination across a given subject matter.²⁴⁵ Such cooperation would be a natural phenomenon in the case of preventing the perpetuation of international securities fraud, because all market-based economies and their securities regulatory bodies have common regulatory interests in three areas: (1) preventing and deterring fraud in securities transactions; (2) providing reciprocity to protect other countries from fraud committed within their borders; and (3) preventing perpetrators from willingly paying damages for harm to their investors if the benefits received from other markets exceed those damages.²⁴⁶ Securities commissioners have bonded on this common ground, under the IOSCO umbrella, and have made various successful efforts at international cooperation.²⁴⁷ But, the extent of cooperation is inadequate because it does not account for the rapidly changing dynamics of securities transactions in the globalized business world. To protect investors and the integrity of international markets, the securities commissioners need to unify and harmonize the securities laws and the remedies available to the various parties as well as ensure that preclusive effect is given to judicial decisions made with regard to international securities disputes.

An additional benefit of TRNs is that they do not possess the same threat to national sovereignty and liberty as world governmental organizations, because they are “decentralized, dispersed, and involve participants that are domestically accountable.”²⁴⁸

While the difficulties that arise out of the increased globalization of securities law might be well addressed by TRNs because they “expand[] our global governance capacity without centralizing policy-making power,”²⁴⁹ TRNs contain several weaknesses that limit their ability to accomplish effectively their purported benefits.

First, they are influenced more by domestic constituencies—to whom the national regulators are more accountable—than by a global

²⁴⁵ ROBERT O. KEOHANE, *AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY* 51–52 (1984).

²⁴⁶ See Buxbaum, *supra* note 5, at 57–58.

²⁴⁷ See IOSCO Historical Background, *supra* note 194; see also *supra* Part III.B (discussing the impact of MMOU).

²⁴⁸ Verdier, *supra* note 202, at 115.

²⁴⁹ SLAUGHTER, *supra* note 225, at 167.

polity.²⁵⁰ The members of the IOSCO (and any TRN) are the regulatory bodies of sovereign nations. The SEC, for instance, has no ability to apply “standards” of how each nation should develop and apply its substantive and procedural law. Regulatory bodies are merely enforcement arms of the executive and legislative branches. This proposal would be difficult to implement, especially in the United States, because securities fraud is largely enforced by private actors.²⁵¹ Such rulemaking would also be far beyond the general scope of TRNs, which are organized with a focus on fairly narrow issues of law.²⁵² This narrow scope prevents them from being institutionally suited to address international issues that “must involve concessions and tradeoffs across issue-areas and, in some cases, threats and other manifestations of relative power.”²⁵³

Second, the rules negotiated and implemented by TRNs can cause the costs and benefits of such rules to fall on different states (for example, the nations with more influence can leverage smaller nations into bearing the burden of the new rules).²⁵⁴ This problem arises in all intergovernmental institutions, and could work to ostracize various nations from the organization. Small nations might continue to serve as safe harbors for international fraudsters and thus negate any benefit the TRN might bring. The idea of international cooperation will only succeed to prevent investor injury and improve market integrity if a large majority of the world is on board with the similar principles of fraud prevention.

Finally, TRNs are weak on enforcement, because states act in a self-interested fashion by renegeing on the standards to which they previously agreed in order to obtain short-term economic benefits at the expense of the TRN’s collective long-term objectives.²⁵⁵ If the member regulatory bodies are left to enforce the provisions of any standards or rules made within the TRN, they will have to face the economic and political pressures back home. In short, the TRN structure lacks accountability between the various members.

In the end, while TRNs have speed, flexibility, inclusiveness, and the capacity to dedicate sustained attention to complex regulatory issues,²⁵⁶ they are “decentralized and dispersed, incapable of exercising

²⁵⁰ Verdier, *supra* note 202, at 115.

²⁵¹ See Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. REV. 91, 100–11 (2007) (describing the evolution of the role of private actors in U.S. securities litigation).

²⁵² See Verdier, *supra* note 202, at 115.

²⁵³ *Id.* at 115–16.

²⁵⁴ *Id.* at 115.

²⁵⁵ *Id.* at 125.

²⁵⁶ SLAUGHTER, *supra* note 225, at 167.

centralized coercive authority.”²⁵⁷ The inherent limitations in TRNs overwhelm the IOSCO’s usefulness in such a grand scheme as addressing the problem of international securities fraud occurring in foreign-cubed transactions.

C. Bi- and Multilateral Agreements

A third form of cooperation that could effectuate international cooperation to address securities fraud is a network of bi- or multilateral agreements between nations with common desires to deal with the judicial difficulties in preventing international securities fraud and to provide injured investors improved access to justice. Such cooperation has occurred regionally; for example, in the E.U. Convention on Insider Trading.²⁵⁸ But, as stated above when discussing the Convention, this approach most likely would end up resulting in regional agreements among nations with similar interests and cultures. While it might be a good first step that could evolve into more widespread cooperation, the purported agreement’s approach would lack international effect, fail to prevent fraud occurring beyond the borders of allied nations, and fall short of finding some means to prevent (or coerce) economically self-interested and short-sighted nations. This approach also falls prey to the “safe-haven” weakness, whereby certain regions or nations could hold out from joining any agreements, providing protection to issuers and wealthy individuals that might have the propensity to perpetrate fraud.

D. World Organization for Securities Fraud Prevention (“WOSP”)

The final possible approach to cooperation, and the one to which this Article subscribes, is a treaty-based organization, such as the World Trade Organization (“WTO”). A treaty-based organization, as discussed in the following paragraphs, would overcome the inherent limitations of TRNs and would provide more widespread effect than bi- or multilateral agreements. Such institutions are not without their problems, but one that is properly constructed could effectuate the level of international cooperation necessary to deter and prevent fraud and to provide injured investors access to justice. Analogizing to the WTO model, the remainder of the Article will discuss how this institution might come into being, how it would be structured, and what difficulties it would face and need to address.

The WTO was a necessary byproduct of the 1947 Bretton Woods Conference, which, *inter alia*, created the General Agreement on Tariffs

²⁵⁷ *Id.* at 11.

²⁵⁸ *See supra* Part III.B.

and Trade (“GATT”).²⁵⁹ GATT was meant to address world tariff barriers and to eliminate nontariff barriers.²⁶⁰ One round of negotiations on GATT (the “Uruguay Round”) created the WTO to administer its negotiated agreements regarding international trade;²⁶¹ GATT and the WTO have since become the most important source of international trade law.²⁶²

One major difficulty that results from treaty-based organizations is the inherent political paralysis of such organizations.²⁶³ The complex political interests of the nations often prevent the obtainment of a quorum of signatories and their subsequent ratification of the agreement or treaty.²⁶⁴ In contrast, the WTO has not had any significant difficulty. Almost immediately upon its creation, the WTO reached the “tipping point” of global membership,²⁶⁵ causing membership within the organization to become an economically beneficial national objective. The WTO now has 153 member states, with very few significant nations still not members.²⁶⁶ Because membership in the WTO became an economically beneficial objective, the WTO members are able to implement a “packaged deal” membership regime. If a country wants unfettered trade access to the wealthiest nations, it must bring its domestic laws in compliance with *all* the WTO agreements,²⁶⁷ with only two exceptions.²⁶⁸ The WTO membership structure creates worldwide

²⁵⁹ General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT]; World Trade Org., The GATT Years: from Havana to Marrakesh, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm.

²⁶⁰ GATT, *supra* note 259, arts. 1, 2; *see also* Doha Development Agenda: European Communities on Market Access for Non-Agricultural Products, ¶¶ 2, 4, COM (Mar. 31, 2003), available at http://trade.ec.europa.eu/doclib/docs/2003/june/tradoc_113116.pdf.

²⁶¹ Agreement Establishing the World Trade Organization, art. 2, Apr. 15, 1994, 1867 U.N.T.S. 3, 33 I.L.M. 1144 (1994) [hereinafter WTO Agreement].

²⁶² World Trade Org., What Is the World Trade Organization?, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact1_e.htm [hereinafter, What Is the World Trade Organization?].

²⁶³ *See* Verdier, *supra* note 202, at 119 (citing SLAUGHTER, *supra* note 225, at 167).

²⁶⁴ The discussion above regarding the Hague Securities Convention illustrates this problem well. *See supra* Part III.C.1.

²⁶⁵ I am indebted to Malcolm Gladwell’s excellent work in behavioral economics for the catchy and useful term “the tipping point,” which I not-so-cleverly gleaned from his first bestselling work. *See* MALCOLM GLADWELL, THE TIPPING POINT (2002).

²⁶⁶ World Trade Org., Members and Observers, http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm (significant bystanders included the Russian Federation, Iran, Yemen, and the Lebanese Republic).

²⁶⁷ WTO Agreement, *supra* note 261, art. 16(4).

²⁶⁸ *Id.* annex 4. The initial Agreement listed four exceptions, however, two have since been terminated. Thus, the only remaining exceptions are agreements regarding trade in civil aircraft and government procurement. *See* World Trade Org., Overview: A Navigational Guide, http://www.wto.org/English/thewto_e/whatis_e/tif_e/agrm10_e.htm#dairyandbeef.

coherence in trade law by forbidding members from choosing which agreements they prefer to join, thus forcing them to subvert their own individualized interests.²⁶⁹

The purpose behind the WTO is the reason the “tipping point” was achievable. The WTO argues that its system of open trade benefits everyone because it is based on the economic theory and statistical fact that freer trade produces greater economic growth, which in turn produces increased peace among nations.²⁷⁰ The economic theory of “comparative advantage” is the idea that even the poorest nations “have assets—human, industrial, natural, financial—which they can employ to produce goods and services for their domestic markets or to compete overseas.”²⁷¹ The WTO’s trade policies, which allow unrestricted, international flow of goods and services, “sharpen competition, motivate innovation[,] and breed success.”²⁷²

Unlike TRNs, a major strength of a treaty-based organization like the WTO is the ability to enforce the agreements among members. To enforce the binding WTO agreements from country to country, the WTO has implemented its Dispute Settlement Understanding, which creates a process governed by a special assembly called the Dispute Settlement Body.²⁷³ Through a system of five well-defined phases of dispute resolution (including an appellate process), one or more countries can seek sanctions, damages, and injunctions against a trading partner for its lack of adherence to WTO agreements.²⁷⁴

To effectively prevent and deter international securities fraud and to provide justice for injured investors of securities fraud, developed and developing nations must join together in a round of negotiations to create an international organization that can develop and administer a system of international law regarding securities fraud, addressing the substantive and procedural issues discussed in this Article. For explanatory purposes, this Article refers to this institution as the World Organization for Securities Fraud Prevention (“WOSP”). The WOSP will provide a dispute resolution procedure and its own substantive law regarding securities fraud in foreign-cubed transactions.

²⁶⁹ See IMP. ADMINISTRATION, U.S. DEP’T OF COMMERCE, 2009 ANTIDUMPING MANUAL ch. 29, at 3 (2009), available at <http://ia.ita.doc.gov/admanual/2009/Chapter%2029%20International%20Agreements.pdf>.

²⁷⁰ What Is the World Trade Organization?, *supra* note 262.

²⁷¹ World Trade Org., The Case for Open Trade, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact3_e.htm.

²⁷² *Id.*

²⁷³ R. FOLSOM ET AL., PRINCIPLES OF INTERNATIONAL BUSINESS TRANSACTIONS, TRADE AND ECONOMIC RELATIONS (2005), as reprinted in INTERNATIONAL BUSINESS TRANSACTIONS 380, 380 (Ralph H. Folsom et al. eds., 9th ed. 2006).

²⁷⁴ *Id.* at 381–85.

First, membership in WOSP must be economically desirable. Similar to the recognition by major industrial nations joining the WTO that freer trade leads to greater economic prosperity, major financial nations would be incentivized to join WOSP due to their desire for market integrity—something that is adversely impacted by fraud in international securities transactions. Improving market integrity and decreasing harm to foreign investors will increase economic prosperity of all nations in a similar fashion to that of free trade. Further, WOSP would create a dramatic incentive for other nations to join its ranks because their own businesses would struggle to obtain international investment if they reside in a country that does not abide by the international rules that protect investors (individual and institutional) from securities fraud.

Once the “tipping point” of economic beneficence is achieved, WOSP must compel all members, new and old, to adopt *all* its agreements and resolutions as a “packaged deal.” This last point is essential; without it, WOSP would become a TRN wherein parties pick and choose when to apply international standards based on their own interests. This would make WOSP ineffective in preventing securities fraud and providing access to justice for injured plaintiffs. With WOSP, as with the WTO, countries must seek to act collectively for the greater, long-term good of market integrity, as opposed to making self-interested and short-sighted decisions.

Next, while the agreements negotiated among WOSP members would seek to prevent and deter international securities fraud, such members should recognize that absolute elimination of securities fraud is impossible. Thus, injured parties must have a mechanism to seek relief. The preferred mechanism for relief should not be through group litigation, but through the injured parties’ own governments (similar to the WTO process). Investors who reside in a WOSP member nation and suffer from alleged international securities fraud would submit a claim to WOSP through their own country’s securities fraud representative. This would begin a dispute resolution process within WOSP between the country harboring the purported fraudulent actor and the countries in which the injured investors reside.

This regime of intergovernmental dispute resolution will assuage issues of international comity that the judiciary is forced to weigh in resolving disputes between private parties. Instead, the governments themselves are involved and can hash out their interests directly in an informed manner, rather than having the judiciary “guess” at what interests might be at play.

The WOSP dispute resolution process should have mandatory private negotiations between the governments to ensure the perpetrator is brought to justice and to provide relief to injured investors. These

private negotiations could provide quick and efficient relief to injured plaintiffs. If the result of these negotiations fails to satisfy the interests of each government involved in protecting their citizens, financial institutions, and corporate issuers, the dispute would be referred to a WOSP Tribunal. The Tribunal should be centralized in a major international city, such as The Hague, Geneva, or the like, where governments commonly house their own representatives at other international organizations.²⁷⁵

With that procedural framework, the discussion must turn to the difficult issue of what areas the WOSP agreements will encompass and how those issues will be addressed. For most plaintiffs suffering loss from securities fraud, the U.S. class action is the superior method of adjudication. This assertion is due, in part, to the presumption of reliance in federal courts.²⁷⁶ That other nations require a showing that each member of the class relied on the alleged fraudulent representations acts as a barrier to harmed investors trying to access the courts to recover losses incurred. In other words, the securities law of other nations discourages effective recovery to harmed investors.²⁷⁷ For this reason, a WOSP agreement should adopt the fraud-on-the-market theory and presume reliance in the intergovernmental disputes heard by WOSP tribunals. There is international opposition to this presumption, but perhaps it can gain enough support among reasonable countries that, through the “packaged deal” approach discussed above, this element will exist in all international disputes for securities fraud.

Effective international cooperation regarding securities fraud must address several other areas of concern. Another WOSP agreement would be in the form of a “Reciprocity Convention,” that provides alleged fraudulent perpetrators, represented by their home governments, preclusive effect to judicial decisions of other signatory countries in the area of securities fraud.²⁷⁸ This agreement would eliminate the critics’ fear of multiple recoveries.

The WOSP agreements should be limited to securities fraud alleged in the case of a foreign-cubed transaction, where investors hail from multiple countries, the issuer resides in a country or countries other than those of the investors, and the issuer’s stock was purchased on

²⁷⁵ An alternate scheme might be a network of tribunals scattered worldwide. But, there are inefficiencies in disputes that involve other-than-regional parties and extra costs involved in governments housing securities fraud representatives in multiple locations.

²⁷⁶ See *supra* notes 11–15 and accompanying text; see also *Morrison v. Nat’l Austl. Bank*, 547 F.3d 167, 174–75 (2d Cir. 2008) (addressing appellees’ argument concerning U.S. courts’ recognition of the fraud-on-the-market doctrine).

²⁷⁷ See Buxbaum, *supra* note 5, at 33.

²⁷⁸ See *id.* at 32. But such a proposal may face opposition as it would require countries to approve of each other’s substantive law.

another nation's stock exchange. This approach will not allow foreign investors involved in foreign-cubed transactions access to the U.S. courts' plaintiff-favorable substantive and procedural protections, but it will provide them some form of justice under appropriate circumstances.

The foreign-cubed action does not constitute a large proportion of securities fraud actions brought in U.S., or any other nation's courts. One could argue that this fact limits the necessity of the proposed large-scale international cooperation. But, in the alternative, while these actions might be small in number, they are highly complex and long in duration. Further, the small quantity of actions could aid in limiting the size of WOSP. It may not need to be a gargantuan bureaucracy like the WTO. It might then be able to operate on a lean and streamlined basis (perhaps setting an example of efficiency for other intergovernmental entities), providing investors with improved and increased access to justice while contemporaneously providing corporate issuers with quicker resolution of investor disputes and claims.

Under the WOSP system, private class actions would be done away with in the foreign-cubed context. Investors from multiple nations would band together through a collective action brought by their government against the government of the alleged fraudulent perpetrator. The government of the alleged perpetrator will then bring its citizens and corporate issuers to justice and collect the damages to be paid out to the injured investors of the plaintiff-governments. While the WOSP proposal does create inefficiencies—similar to those inherent in other treaty-based organizations such as the WTO—limiting its effect to the foreign-cubed case will limit the opposition by those such as the U.S. plaintiffs' bar.

Two final forward-looking questions remain in an analysis of WOSP feasibility. First, would the WOSP be politically feasible? That is, would nations care enough about foreign-cubed transactions to create such an organization and make the attendant sacrifices required to do so? While foreign-cubed transactions might be small in number, their impact can be global. As mentioned above, the world's development into McLuhan's "global village" has created an environment where fraud in one corner of the world can quickly spread throughout, adversely impacting the world's financial markets. Also, international Ponzi schemes, such as R. Allen Stanford's scheme based in Antigua, have a huge impact on investor confidence in the integrity of the markets.²⁷⁹ Therefore, all countries should be concerned about international perpetrators of securities fraud and seek the most effective form of prevention.

²⁷⁹ See Clifford Krauss et al., *Texas Firm Accused of \$8 Billion Fraud*, N.Y. TIMES, Feb. 18, 2009, at A1, available at <http://www.nytimes.com/2009/02/18/business/18stanford.html>.

The second forward-looking, and open, question is how the private U.S. plaintiffs' bar would respond to such a treaty. While WOSP would effectively take foreign-cubed securities litigation out of the hands of the private bar, it likely would have only an insignificant impact on their work flow. This minor impact is the result of the low volume of such cases. Further, investors and corporate issuers would need attorneys to walk them through the WOSP procedure laid out above. As is usually the case, drastic changes in the law often create more work for attorneys, despite initial fears of a decline in work flow.

This WOSP approach is not perfect, and it may not be feasible if countries do not adequately value its potential impact (and if they cannot come to agreement on certain fundamental issues). But, just as the WTO was founded on the principle that free trade is better for everyone, WOSP founders could bond over the principle that effective international fraud prevention and improved access to justice for international investors is better for all concerned.