Protecting Foreign Investors from International Securities Fraud

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INTRODUCTION

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 Depository Receipts”\(^1\) 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, which eventually became a wholly owned subsidiary of the Australian bank. The profits of the American mortgage company consistently made up about 5% of the Australian bank’s annual net income. Unfortunately for optimistic investors of both entities, the subsidiary calculated its profits based on a valuation model that used incorrect interest assumptions, which resulted in overstatement of the company’s assets. Multi-billion 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 U.S. court for violations of Rule 10b-5 promulgated under Section 10(b) of the Securities Exchange Act of 1934. 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.\(^2\)

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\(^{1}\) American Depository Receipts are issued by U.S. depository banks and constitute a right to obtain the underlying foreign stock. American Depositary Receipts, U.S. Securities and Exchange Commission, http://www.sec.gov/answers/adrs.htm (last visited April 24, 2009).

\(^{2}\) This fact pattern is the precise facts of a recent Second Circuit decision that affirmed a dismissal of the foreign shareholders based on lack of subject matter jurisdiction. *Morrison v. Nat’l Austl. Bank Ltd.*, 547 F.3d 167 (2d Cir. 2008) (District Court for the Southern District of New York also dismissed domestic shareholder for failure to state a claim; however, domestic shareholder did not take part in this appeal).
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 seek to protect injured investors from international securities fraud? The settled approach of U.S. courts 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. 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.

This paper 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.³ 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.⁴ Notice that the three elements of this transaction all contain a “foreign”;⁵ where disputes arise as to the integrity of the information relied upon (or presumed relied upon) in executing foreign-cubed transactions, so-called foreign-cubed class actions are often the favored mechanism to resolve these disputes.

³ Morrison, 547 F.3d at 168.
⁴ Stuart M. Grant & Diane Zilka, The Role of Foreign Investors in Federal Securities Class Actions, in CORPORATE LAW AND PRACTICE HANDBOOK SERIES (Number B-1442) 91, 96 (Practicing Law Institute ed., 2004) (coined the term “foreign-cubed” for such transactions).
⁵ The term “foreign” is from the perspective of the national court that is presiding over the dispute. 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. The different “foreign” elements could be comprised of multiple different countries or a single foreign nation.
Over the past two decades, securities trading and business generally have experienced rapid expansion and increased globalization; once wholly-domestic corporations have evolved rapidly over time into sprawling international enterprises. National stock exchanges have undergone recent consolidation bringing many exchanges from around the world under common ownership.\(^6\) In this globalized environment, perpetrators of 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 point in time, in a particular location.\(^7\) 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 interconnected 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 of this article, I propose 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

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to which I subscribe because it stands to have the greatest effect in preventing international securities fraud and in providing relief to injured investors worldwide.

Various dynamics in American jurisprudence heavily favor U.S. courts as a forum for injured investors to bring actions for securities violations against corporate issuers. Among these plaintiff-favorable dynamics that normally do not exist (to the same extent) in other jurisdictions are an active U.S. plaintiffs’ bar, which seeks out and cultivates potential claimant groups against large issuers (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); the presumption of reliance in fraud claims, which is based on the Supreme Court’s recognition of the fraud-on-the-market theory;\(^8\) and the class action group litigation mechanism itself, which allows aggregation of small claims to make the high cost of litigation 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 the corporate-issuer defendants in that it allows them to dispose of claims in bulk via the preclusive effect given to prior judicial decisions (i.e., \textit{res judicata}).\(^9\)

The plaintiff-favorable (and defendant-valuable) dispute resolution mechanisms and substantive law in the U.S. produce an increasing number of foreign-cubed class actions brought in U.S. courts amidst the increasing trend of rapid globalization of business and securities

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\(^8\) David D. Brodsky & Jeff G. Hammel, \textit{The Fraud on the Market Theory and Securities Fraud Claims}, 230 N.Y.L.J. 82 (October, 24, 2003). To establish a claim for securities fraud, plaintiffs must show that (1) they relied upon defendant’s allegedly fraudulent conduct in purchasing or selling securities (transaction causation), and (2) that defendant’s conduct caused, at least in part, plaintiffs’ losses (loss causation). 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.

\(^9\) Teena-Ann V. Sankoorikal, et al., \textit{Current Legal Issues Relating to the Inclusion of Foreign Plaintiffs in Securities Class Actions}, Practicing Law Institute, PLI Order No. 14204, at 15 (August 25, 2008). It should be noted, however, that corporate defendants would likely exchange this advantage of wholesale resolution of claims for the reliance presumption.
transactions.\textsuperscript{10} As the number of foreign-cubed transactions has increased, a corresponding increase in foreign-cubed class actions has occurred.\textsuperscript{11} As a consequence of this growth pattern, U.S. Courts more frequently are faced with the difficult issues involved in foreign-cubed class actions.\textsuperscript{12}

This article begins with a discussion of the current level of extraterritorial application of U.S. securities laws to foreign-cubed class actions. It argues why the current regime is inadequate to prevent or deter fraud or to provide relief to injured investors. The article explains how the global economy requires massive cooperation among regulatory and legislative bodies to protect the integrity of financial markets through fraud prevention and deterrence and to provide access to relief for wronged investors. It also provides one person’s view as to what such cooperation might entail. This article does not deal with issues of personal jurisdiction based on the minimum contacts test of \textit{International Shoe v. Washington};\textsuperscript{13} the 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.

I begin the discussion in Part I 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.

\textsuperscript{11} Hannah Buxbaum conducted a survey of multinational securities class actions filed in U.S. federal court over a ten year period, 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. Hannah L. Buxbaum, \textit{Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict}, 46 \textit{COLUM J. TRANSNAT’L L.} 14, 39-41 (2007). 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, \textit{Subject Matter Jurisdiction of Securities Fraud Action Based on Foreign Transactions, under Securities Exchange Act of 1934}, 56 A.L.R. Fed. 288 (1982) (updated 2009).
\textsuperscript{12} Buxbaum, supra note 11, at 41.
\textsuperscript{13} \textit{International Shoe Co. v. Wash.}, 326 U.S. 310 (1945) (holding that a civil defendant could not be subjected to personal jurisdiction by courts in a given state unless it had “minimum contacts” within that state.)
In Part II, I compare the current extraterritorial application of securities law to the extraterritorial application of other areas of U.S. law. With this foundation, I begin making the case for my 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. In Part III, I discuss the problems with the current application of U.S. securities laws, describe the current level of international securities cooperation, and explain why both are insufficient in preventing international securities fraud. I conclude the article in Part IV with a discussion of various possible forms of international cooperation that could occur to 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 scope of subject matter jurisdiction those laws gave to federal courts.\footnote{Itoba, Ltd. v. LEP Group PLC, 54 F.3d 118, 121 (2d Cir. 1995).} Further, the Supreme Court has never addressed the extraterritoriality of U.S. securities laws, though it has addressed this question in other areas of U.S. law.\footnote{See Section III., infra.} The Supreme Court provided general direction to federal courts conducting this inquiry into Congressional intent when it crafted a presumption against extraterritorial application of U.S. law. 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 transactions at issue.\footnote{Foley Bros. v. Filardo, 336 U.S. 281, 285 (1949).} This presumption is based on the theory that “Congress is primarily concerned with domestic relations.”\footnote{Id.} Consequently, the lower courts have had to determine whether “Congress would have wished the precious resources of United States courts and law
enforcement agencies to be devoted to” these predominantly foreign transactions rather than allowing foreign nations to deal with the problem.18

The federal courts face two intertwined areas of law in addressing foreign-cubed securities class actions.19 These two areas are: substantive anti-fraud case law and judicially-created procedural tests that attempt to comply with obscure (or nonexistent) Congressional intent.20 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 have in obtaining subject matter jurisdiction over their claims, and compares the substantive law of foreign nations relating to securities fraud with that of the U.S.

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

Federal courts have consistently refused to adopt a bright-line rule that bars all foreign-cubed class actions that do not involve harm to U.S. investors.21 Courts have stated that observance of such a bright-line rule would “conflict with the goal of preventing the export of fraud from America.”22 In deciding whether to extend jurisdiction to cases involving foreign transactions, courts operate under the premise that “Congress is primarily concerned with domestic conditions.”23 The Supreme Court, in Foley Brothers v. Filardo, created a presumption against extraterritorial application of U.S. law, unless the party arguing in its favor can show that Congress intended the specific legislation in question to reach foreign conduct (i.e., whether

19 Buxbaum, supra note 11, at 14.
20 Id.
22 Id.
Congress wanted domestic resources to be devoted to a transaction that is predominantly foreign.\(^{24}\)

To determine whether Congress intended for U.S. law to apply to international securities fraud, courts analyze “(1) whether the wrongful conduct occurred in the United States, and (2) whether the wrongful conduct had a substantial effect in the United States or upon United States citizens.”\(^{25}\) These two approaches to finding subject matter jurisdiction are called the “conduct test” and the “effects test” respectively. Courts have held that either of the two tests may independently establish jurisdiction.\(^{26}\) But “[w]here appropriate,” the two tests have been applied together,\(^{27}\) 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.”\(^{28}\) Courts tend to search for a way to not apply domestic law to predominantly foreign transactions.\(^{29}\) Occasionally, they look beyond the conduct and effects tests in search of additional scale-tipping factors,\(^{30}\) or they utilize alternative means of dismissal.\(^{31}\)

(a) Conduct Test

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\(^{24}\) *Foley* was about a private contractor that contracted with the U.S. government for construction work in Iraq and Iran. 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. 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” 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, the Court held that the Eight Hour Law was inapplicable to a contract for construction work in a foreign country over which the U.S. has no direct legislative control. *Bersch*, 519 F.2d at 985.


\(^{26}\) See, e.g., *Robinson v. TCI/US West Communications Inc.*, 117 F.3d 900, 905 (5th Cir. 1997).


\(^{28}\) *Itoba Ltd.*, 54 F.3d at 122.


\(^{30}\) *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 664 (7th Cir. 1998) (noting that the conduct and effects jurisdictional analysis, in turn, has been guided by “policy considerations and the court’s best judgment.”).

\(^{31}\) *See* discussion found in I.B. *infra.*
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.\textsuperscript{32} Courts have used this test to reach foreign transactions because they reason that Congress would not want the U.S. to be used as a “base for fraudulent activity,” which is exported to other countries and harms foreign investors.\textsuperscript{33} To ensure responsible and appropriate application of U.S. securities laws, this conduct analysis contains two steps. Step one of the conduct approach 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 elsewhere.\textsuperscript{34} The second step of the conduct approach is to show the conduct in question directly caused the loss.\textsuperscript{35}

The fact pattern found in the introduction to this article, 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, which were subsequently filed with the Securities and Exchange Commission (the “SEC”). What conduct constituted the fraud? What conduct directly caused harm? On the one hand, 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. On the other hand, 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

\textsuperscript{32} Buxbaum, supra note 11, at 23.
\textsuperscript{33} Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118, 125 (2d Cir. 1998). See also, Buxbaum, supra note 11, at 24.
\textsuperscript{34} SEC v. Kasser, 548 F.2d 109, 115 (3d Cir. 1977); McLaughlin on Class Actions, Chapter 5: § 5:68.
\textsuperscript{35} McLaughlin on Class Actions, Chapter 5: § 5:68.
subsidiary’s figures into its financials and SEC filings? Or was the only conduct that caused harms the dissemination of the statements from Australia?\(^{36}\)

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. But the outcome will be highly fact specific and, thus, left to the philosophy of extraterritoriality held by the judge hearing each case.\(^ {37}\) 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—rather than substantive—issues, which fails to achieve 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, failure to extend jurisdiction would only embolden those who wish to defraud foreign securities investors, using the United States as a base of operations for perpetuating that fraud.\(^ {38}\) 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 investors from fraud. Third, holding that there is no jurisdiction where domestic conduct harmed foreign investors might induce reciprocal responses by other jurisdictions who could allow U.S. investors to recover for losses caused by fraudulent activity occurring in their own country.\(^ {39}\) This notion assumes that if the United States extends its securities laws to prevent fraudulent conduct from taking place on our shores

\(^{36}\) In the actual \textit{Morrison} case the court found no subject matter jurisdiction due, in large part, to its finding that the actions taken and not taken by 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.” \textit{Morrison}, 547 F.3d at 176.


\(^{38}\) \textit{Banque Paribas London}, 147 F.3d at 125.

\(^{39}\) \textit{Kasser}, 548 F.2d at 116.
that injures foreign investors, the United States reasonably can expect other countries to offer comparable protection.\textsuperscript{40} However, the reciprocal response of other jurisdictions cuts both ways. That is, the exercise of jurisdiction over predominantly foreign transactions may cause other countries to exercise jurisdiction over transactions involving predominantly U.S. interests and parties.\textsuperscript{41}

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 the securities transaction.\textsuperscript{42} The District of Columbia Circuit has the most strenuous requirement; it requires that the domestic conduct constitutes an independent violation of U.S. securities law.\textsuperscript{43} The Third, Eighth, and Ninth Circuits take the least restrictive approach, focusing on whether at least some of the U.S. conduct was designed to further a fraud that caused losses to investors.\textsuperscript{44} The middle of the road approach was taken by the Second,\textsuperscript{45} Fifth, and Seventh Circuits. These Circuits require the U.S. conduct to constitute \textit{substantial} acts in furtherance of the fraud.\textsuperscript{46} That is, the conduct taking place in the United States must have been a substantial part of the fraud and material to its success.\textsuperscript{47}

No real consistency exists in the fact patterns that courts deem sufficient or insufficient to exercise extraterritorial jurisdiction of U.S. securities laws. Some circuit courts have held

\begin{itemize}
  \item \textsuperscript{40} SEC \textit{Morrison} Amicus Brief (citing \textit{IIT v. Vencap, Ltd.}, 519 F.2d 1001, 1017 (2d Cir. 1975); \textit{Kasser}, 548 F.2d at 116).
  \item \textsuperscript{42} Sankoorikal, supra note 9, at 33.
  \item \textsuperscript{43} Zoelsch \textit{v. Arthur Andersen & Co.}, 824 F.2d 27, 31 (D.C. Cir. 1987).
  \item \textsuperscript{44} See, e.g., \textit{Kasser}, 548 F.2d at 114; \textit{Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.}, 592 F.2d 409, 421 (8th Cir. 1979); \textit{Grunenthal GmbH v. Hotz}, 712 F.2d 421, 425 (9th Cir. 1983).
  \item \textsuperscript{45} Note that the second court is deemed to be by far the most experienced circuit with respect to dealing with securities law. This may indicate that their approach has the most weight, but this article is concerned with international cooperation among securities regulatory and legislative bodies, not with which circuits possess the most securities acumen, the courts are doing the best they can under the circumstances.
  \item \textsuperscript{46} See, e.g., \textit{Robinson v. TCI/US West Communications Inc.}, 117 F.3d 900, 905-06 (5th Cir. 1997); \textit{Psimenos v. E.F. Hutton & Co., Inc.}, 722 F.2d 1041, 1045 (2d Cir. 1983); \textit{Kauthar}, 149 F.3d at 667.
  \item \textsuperscript{47} \textit{Kauthar}, 149 F.3d at 667.
\end{itemize}
incidental, and insufficient to extend jurisdiction, the filing of reports with the Securities and Exchange Commission and dissemination of material to shareholders in the U.S. On the other hand, some courts have found that the making of telephone calls and sending mail to the U.S. constitutes sufficient domestic conduct to impose the securities laws on the transaction.

The Second Circuit, in its most recent decision in this area, *Morrison v. National Australia Bank,* held that a misrepresentation in a securities filing does not constitute fraud until it is physically filed with the SEC. That is, there is no fraud until the actual filing takes place; therefore, 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 U.S. for the conduct test to justify extension of the securities laws to a predominantly foreign transaction.

In affirmative determinations of the existence of subject matter jurisdiction, courts often begin and conclude their analysis with the conduct test. For 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 the fact pattern found in the introduction of this

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48 See, e.g., *Kasser,* 548 F.2d at 115.
49 *Leasco Data Processing Equipment Corp. v. Maxwell* 468 F.2d 1326 (2d Cir. 1972).
50 *Morrison,* 547 F.3d 167.
51 *Berger,* 322 F.3d at 194.
52 *Berger,* 322 F.3d at 195 (citing *Psimenos,* 722 F.2d at 1045 (holding that courts need not “reach the question of whether the effects test provides an independent basis for jurisdiction” when there is jurisdiction under the conduct test)).
article failed to 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.  

(b) 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. The Schoenbaum v. Firstbrook decision of the Second Circuit contained the first articulation of the effects test. In a derivative action, fraudulent conduct occurred overseas artificially depressing shareholder equity. The court held appropriate the district court’s exercise of subject matter jurisdiction over the fraudulent transactions that took place outside the United States. The court placed great emphasis on the fact that the transaction involved securities that were registered and listed on the American Stock Exchange (in addition to the Toronto Stock Exchange), because the fraud deprived the foreign corporation of fair compensation when it issued stock, which reduced the equity of American investments in the corporation. This application of the effects test seems to be too narrow in scope for the test to be of any use to a foreign-cubed transaction, which by its definition involves transactions involving securities on a foreign exchange.

To establish jurisdiction under the effects test, the plaintiffs must establish 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.” Plaintiffs must show a

53 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., 54 F.3d at 122. In fact, the Morrison court counted it against the appellants for not having also discussed the effects of the conduct on U.S. interests.
54 SEC Morrison Amicus Brief (citing Banque Paribas, 147 F.3d at 125).
55 Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), modified on other grounds, 415 F.2d 215 (en banc).
56 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.
57 Id. at 208.
58 Buxbaum, supra note 11, at 22.
59 Bersch, 519 F.2d at 989.
“concrete harm.” 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, because of the express language in the securities acts—§ 17(a) of the ’33 Act limits the application to acts “in the offer or sale of any securities,” and § 10(b) of the ’34 Act is limited to acts “in connection with the purchase or sale of any security.” The Bersch court used this statutory language to require that the alleged fraudulent conduct committed abroad must result in injury to purchasers or sellers of securities “in whom the United States has an interest.” However, the quoted statutory language does not say anything about American purchasers and sellers of securities. The acts state that there is no fraud except where securities are offered, sold, or purchased, by anyone; 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 the 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 that goes beyond the general impact on the integrity of the financial markets, the effects test plays only a very limited role in the jurisdictional analysis of foreign-cubed transactions. In fact, 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

60 In re SCOR Holding (Switzerland) AG Litigation, 537 F. Supp. 2d 556, 562 (S.D.N.Y. 2008).
63 Bersch, 519 F.2d at 989.
64 SCOR Holding, 537 F. Supp. 2d at 562; Sankoorikal, supra note 9, at 19-20 (“[foreign-cubed] claims typically only proceed if the Conduct Test is satisfied.”) However, the general effects of the conduct has been used as an additional “scale-tipping” factor to weigh in favor of one party or the other.
foreign exchange. 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” of the two tests.

The plaintiffs in the introductory fact pattern recognized this fact and, forced to make the difficult decisions involved in appellate advocacy, narrowed the issues on appeal to only those they felt were winnable and pertinent to the decision of whether jurisdiction should be found. However, the court used the plaintiffs’ failure to argue the effects test on appeal to tip the scale in favor of a finding of no jurisdiction. 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 could not represent any injury to U.S. stock markets, because the plaintiffs purchased the underlying securities, which were traded on foreign exchanges, rather than the derivative securities traded on the New York Stock Exchange. So for a court to exercise subject matter jurisdiction based on the effects test, the class members would have needed to be themselves investors “in whom the United States [had] an interest” or purchased 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 (to dismiss claims of) the foreign claimants.

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66 Itoha Ltd., 54 F.3d at 122.
67 Morrison, 547 F.3d at 176.
68 Id.
69 Bersch, 519 F.2d at 989.
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,’”70 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 avoid the U.S. from becoming a base of fraud for export abroad. However, fraud and its resulting loss have still occurred, even if not directly affecting 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 mutual interests in ensuring that such fraud is prevented and deterred and that victims of such fraud have access to justice and should work together to develop the substantive law and procedural mechanisms that allow access to justice, deterrence of fraud, and protection of investors and market integrity to an equivalent extent regardless of the country in which a claim is brought.

**B. Other Hurdles for Foreign-cubed Securities Class Actions**

Where predominantly foreign actions have surpassed 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.71 The following is a discussion of what courts have used to deny claims of foreign investors.

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70 *Id.* at 171 (quoting *Banque Paribas*, 147 F.3d at 125).
71 Thompson, *supra* note 37, at 1132-33.
(a) **Class Certification.** Under the Private Securities Litigation Reform Act (“PSLRA”), securities class actions must still meet the basic structural requirements of Federal Rule of Civil Procedure (“F.R.C.P.”) 23 on Class Actions. That is, the class representatives may sue on behalf of all members of the class if they satisfy the F.R.C.P. 23(a) requirements of: (1) numerosity, (2) commonality, (3) typicality, and (4) adequacy, and they satisfy one of the requirements of F.R.C.P. 23(b) (e.g., superiority). Defendants have had some success in opposing the certification of the class under F.R.C.P. 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 is mixed, containing both foreign members 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. 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 as by its definition all 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 as well, by avoiding having any American

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74 F. R. Civ. P. 23(a)(3).
members, the class can show more easily 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 F.R.C.P. 23(b)—that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy—can wreak on plaintiff groups trying to obtain class certification.\textsuperscript{75} This hurdle in the litigation process is due to the potential difficulty plaintiffs have in enforcing a judgment against foreign assets of the defendant and the possibility that a judgment obtained will not having preclusive effect in other countries.\textsuperscript{76} The former issue is rarely a problem as defendants in the typical large multinational class actions\textsuperscript{77} will likely have adequate assets in the United States to satisfy a judgment.\textsuperscript{78}

On the other hand, the issue of preclusive effect is a serious problem to class certification where the proposed class contains some or all foreign claimants. However, under F.R.C.P. 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 of proof 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.

\textsuperscript{75} See, e.g., Buxbaum, \textit{supra} note 11, at 31.
\textsuperscript{76} Buxbaum, \textit{supra} note 11, at 31.
\textsuperscript{77} Addition support for this point is the required personal jurisdiction of the defendant, a topic beyond the scope of this paper; but the defendant must have the requisite level of minimum contacts as prescribed in the Supreme Court’s landmark decision \textit{International Shoe} for any to be able to hear the case. These minimum contacts most likely will entail various domestic assets of the foreign entity.
\textsuperscript{78} \textit{Id}.
(b) Selection of Lead Plaintiff. The PSLRA changed the process by which a lead plaintiff is selected in a securities class action.\(^7\) The PSLRA did away with the old first-to-file rule, allowing the first plaintiff to file a claim against the purported perpetrator to become the de facto lead plaintiff. 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.\(^8\) 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.\(^9\) This presumption can be rebutted by a showing that the plaintiff with the largest financial interest will not fairly and adequately protect the interests of the class or if it would face unique defenses not common to other class members.\(^1\)

Even if a foreign investor who purchased the securities on a foreign exchange was the investor with the largest financial interest at stake, the potential lead plaintiff will face two areas of difficulty. First, courts may find it logistically too complex to have a foreign lead plaintiff represent the class and will doubt the ability of a foreign investor to adequately manage U.S. litigation from abroad.\(^2\) However, this argument has less weight if the foreign investor is a large institution with substantial assets and resources. The argument also ignores the reality that the lead plaintiff’s U.S.-based counsel manages the litigation.

The second area 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 (e.g., lack of subject matter jurisdiction and \textit{forum non conveniens}). This second

\(^2\) See Buxbaum, \textit{supra} note 11, at 28.
difficulty only applies to class actions where 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 class actions with substantial foreign elements; classes are structured in this way in hopes 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 bar them from the class itself.

Where a proposed class consists of both foreign and U.S. investors, a compromise approach to the issues surrounding selection of a lead plaintiff has been adopted in some cases. The compromise approach adopts co-lead plaintiffs, one that traded in the U.S., and one from the foreign market transactions. In appointing co-lead plaintiffs, courts hope that the entire class will be adequately protected—the foreign members by the foreign lead plaintiff, the U.S. members by the U.S. lead plaintiff.

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

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85 Buxbaum, *supra* note 11, at 29.
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 interests implicated in the case weighs strongly in favor of dismissal or removal to another forum.\(^{86}\) The problem for plaintiffs in this challenge is that the courts do not factor into their decision to dismiss the case any differences between the substantive law of the foreign and U.S. jurisdictions, but focus solely on whether the case will be tried fairly at the proposed forum.\(^{87}\)

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.\(^{88}\) In securities fraud class actions, two issues arise when courts compare U.S. and foreign justice systems to determine whether an adequate available forum exists abroad. They are: (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.\(^{89}\) Some courts have determined the absence of these two plaintiff-favorable elements to be sufficient to deny removal to a foreign forum.\(^{90}\)

In *Gulf Oil*, the Supreme Court listed various private interests to be considered in making a *forum non conveniens* determination.\(^{91}\) These private interests include the relative ease of access to sources of proof; the availability of compulsory process on uncooperative witnesses; any practical problems that make a trial easy, expeditions, and inexpensive; the certainty of the

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\(^{86}\) Buxbaum, *supra* note 11, at 35-36.
\(^{87}\) *Id.* at 36 (citing *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 247, 255 (1981) (removal is appropriate even if plaintiffs are “not able to rely on a strict liability theory, and although their potential damages award may be smaller.”)).
\(^{89}\) Buxbaum, *supra* note 11, at 36-37.
\(^{90}\) *See, e.g.*, *DeRenesis*, 930 F. Supp. at 1007-09 (holding absence of presumption of reliance and class action mechanism made Canadian forum inadequate).
enforceability of a judgment; and other relative advantages and obstacles to a fair trial. The balance must weigh heavily in favor of the defendant in order for a court to dismiss, because the plaintiff’s choice of forum receives special deference.

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 in that the presumed deference to plaintiffs choice of forum (requiring defendants to show the interests weigh substantially in their favor) only applies where the plaintiffs have chosen their home forum, a fact that is absent in a foreign-cubed claim.

The *Gulf Oil* case also outlined the various public interest factors a court should weigh in *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 is located, (4) the avoidance of problems of conflicts of laws, 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. These public interest factors are to be weighed in light of the connection between the alleged fraudulent conduct to the plaintiffs’ chosen forum.

While the balance of these public interest factors typically favors plaintiffs in a *forum non conveniens* analysis, plaintiffs in foreign-cubed class actions alleging securities fraud will have difficulty arguing that the scale tips in their favor. This difficulty arises because the broad purpose of the public interest factors is to determine whether there is a connection between the

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92 Id. at 508.
93 Id.
94 Id. at 509.
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 likely would be found. However, such a case no doubt would involve injured U.S. plaintiffs, rendering the action no longer a foreign-cubed action. So 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 except for some generalized impact on market integrity, which is insufficient for jurisdiction under the effects test.

   Defendants may increasingly seek dismissal based on *forum non conveniens* as a preliminary matter due to the Supreme Court’s recent *Sinochem International* decision allowing courts to dismiss on the basis of *forum non conveniens* considerations before subject matter jurisdiction or personal jurisdiction are established.\(^{96}\) However, 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.”\(^{97}\)

   (d) International Comity. International Comity (“comity”) 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.\(^{98}\) Dismissal based on comity (also referred to as “comity of the nations doctrine”) occurs where an action involving the same underlying facts has already been filed in a foreign country.\(^{99}\) In order for a U.S. court to recognize a foreign proceeding, it must deem the proceeding to be orderly, fair, and not

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\(^{97}\) *Sinochem*, 549 U.S. at 425 (emphasis added).


\(^{99}\) Buxbaum, *supra* note 11, at 38.
detrimental to the interests of the United States.\textsuperscript{100} Similar to dismissal for \textit{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 in which it was filed to the United States’ interests involved in the case.\textsuperscript{101} Under this doctrine, if the interests of another sovereign nation outweigh the interests of the United States, and does not prejudice the interests of the United States, the U.S. court should defer to the laws and interests of the other sovereign nation.\textsuperscript{102}

In \textit{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.”\textsuperscript{103} The class action was brought by predominantly Canadian investors against a Canadian corporation, regarding securities registered and traded on a Canadian stock exchange (an apparent foreign-cubed action). In addition to these interests, there was a related bankruptcy proceeding and federal grand jury investigation taking place in the U.S. and eleven pending proceedings in Canada relating to the same alleged fraud.\textsuperscript{104} 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.\textsuperscript{105}

Deferral to the case already filed in the Canadian courts based on principles of comity in the \textit{Paraschos} case was likely proper, not because it was a foreign-cubed class action, but

\textsuperscript{100} \textit{Pravin Banker Assocs., Ltd. V. Banco Popular del Peru}, 165 B.R. 379, 384 (S.D.N.Y. 1994).
\textsuperscript{101} \textit{Buxbaum, supra} note 11, at 38.
\textsuperscript{102} \textit{Societe Nationale Industrielle Aeropsatiale v. United States District Court for the Southern District of Iowa}, 482 U.S. 522, 543 n. 27 (1987).
\textsuperscript{103} \textit{Paraschos v. YBM Magnex Intern., Inc.}, 130 F. Supp. 2d 642, 647 (E.D. Pa. 2000).
\textsuperscript{104} \textit{Id.} at 645.
\textsuperscript{105} \textit{Id.} at 647.
because it was a Canadian-cubed class action. That the “foreign” part of each of the three elements in the securities transaction were Canadian makes a good case that a Canadian court should hear the action, especially considering that at least some class members desired the action 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 a different country. That is, the stock of a British issuer was purchased by Indian investors, on a Japanese stock exchange. The analysis departs from the Paraschos case even more where the elements are not so simply defined as Japanese, Indian, and British, but where each element contains numerous different national identities, which is increasingly common given the interconnectedness of global stock exchanges and the banality of international commercial transactions transgressing multiple jurisdictions and involving parties from numerous different countries.

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

C. Comparative Group Securities Litigation

106 Thompson, supra note 37, at 1133.
Dismissal by U.S. courts of the foreign plaintiffs in the introduction’s fact pattern begs 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 (e.g., where the foreign investors reside), the only certain forum would be in Australia, which is the locale of the parent bank whose conduct the court deemed constituted the fraud, rather than the conduct of the domestic subsidiary mortgage company. The securities could have been purchased on a non-U.S. and non-Australian exchange and the investors could be both non-U.S. and non-Australian, but the defendant parent bank resides in Australia, which should be enough for a court in that country to find jurisdiction.

Further, 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.  

The plaintiff class’s chances of success in an Australian court are at best unclear. While Australian courts have allowed securities class actions, in recognition of the benefits inherent in group litigation mechanisms discussed below, no Australian court has allowed a presumption of reliance. Therefore, as the current law rests, plaintiffs in securities class actions must still show individual reliance. However, 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 utilized by Australian courts, where the alleged misstatement was “calculated to induce” the investor to enter into the transaction.

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108 *Morrison*, 547 F.3d at 176.
110 Id.
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 getting beyond the pleading stage and to arguing the case on the merits than in the, albeit imperfect, U.S. system.

Notwithstanding recent international developments in group litigation discussed below, the United States remains the most attractive forum for groups of plaintiffs who have been injured due to fraudulent events surrounding their ownership of certain securities. This attractiveness stems from strength of the U.S. regulatory regime and the accessibility of litigation for plaintiffs—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. 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”—and maximizing use of judicial resources. Hence, plaintiffs that would normally be considered the “little guy” can find 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, utilizing a quasi-public enforcement tool and expressing societal will, through the pursuit of relief from fraudulent actors and regulation of corporate malfeasance.

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112 Thompson, supra note 37, at 1144.
A benefit of U.S. class actions specific to the securities fraud area 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.\textsuperscript{115} It is prohibitively burdensome on class actions if each plaintiff in a group (of potentially thousands of members) is required to show he or she relied on the alleged misrepresentations when he or she purchased or sold the securities at issue. The presumption of reliance found in U.S. courts is exceptional in securities litigation worldwide.\textsuperscript{116}

On the other hand, class action litigation is no longer wholly unique to the United States. This method of efficient dispute resolution has steadily gained ground internationally over the last decade.\textsuperscript{117} Several major countries have introduced a type of group litigation mechanism through changes to their regulatory structure and also to the substantive and procedural law.\textsuperscript{118}

\textsuperscript{115} Recognizing the economic theory of the “efficient capital markets” hypothesis, the Supreme Court, in \textit{Basic Inc. v. Levinson}, 108 U.S. 224 (1988), adopted the fraud-on-the-market theory, which assumes that a stock price is a function of all material information about a company and any misstatement has a causal link to all individual investors in the stock because the misstatements defraud the market as a whole affecting the price of the stock. Under this premise, the Court determined that requiring a showing of actual reliance by each class member, effectively, would prevent plaintiffs from succeeding past summary judgment in all securities class actions. However, the plaintiffs cannot just sit back and enjoy the benefits of the presumption, to invoke the presumption of reliance, plaintiffs must allege and prove that (1) the defendant made public misrepresentations; (2) the misrepresentations were material; (3) the shares were traded on an efficient market; (4) the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and (5) the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed. Id. at 248.

\textsuperscript{116} 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 but are relegated to common law fraud adjudication. However, 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 (i.e., requiring a rebuttal). See, e.g., \textit{CC\&L Dedicated Enterprise Fund (Trustee of) v. Fisherman} (2001) 8 CCLT (3d) 240. For a full discussion on the fraud-on-the-market theory as applied by U.S. courts and a study of how Canadian and Australian courts and legislatures have treated the doctrine, see 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 (2005).


\textsuperscript{118} Heather Smith, \textit{Is U.S. Exporting Class Actions to Europe?}, Fulton County Daily Report, Mar. 1, 2006, at 2 (espousing that because of the dominance of American companies and globalization, European corporate and securities law is beginning to implement more and more American characteristics).
The following countries have at least begun to develop mechanisms for group litigation that have been or could be used in security fraud class actions: (1) Australia, (2) the United Kingdom, (3) Canada (including Quebec), (4) Sweden, (5) Germany, (6) Brazil, and (7) South Korea. Several other (largely European) nations have proposals at various stages in the legislative process to create such a dispute resolution mechanism. However, the U.S.-style class action still receives much opposition. Many of the European countries that allow group litigation have watered down versions of the U.S. system; others restrict group litigation to a specific type of action.

This opposition and reluctance is due in large part to public international perceptions 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. However, nations like Australia are beginning to realize that the encouragement of shareholder class

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120 See Ward K. Branch, Class Actions in Canada (1996).


122 Thompson, supra note 37, at 1141 (citing Heather Smith, Is U.S. Exporting Class Actions to Europe?, Fulton County Daily Report, Mar. 1, 2006, at 4).


125 See, e.g., Guillaume Cerutti & Marc Guillaume, Rapport sur l’action de groupe, Dec. 16, 2005 (France); Isabelle Romy, Litiges de Masse (1997) (Italy); Emil W. Stark & Stefan Knecht, Einführung einer Zwangsvereinbarung für Geschädigte bei Massenschäden?, 97 ZSR II 51 (1978) (Germany).

126 Buxbaum, supra note 11, at 61; Thompson, supra note 37, 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. See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).
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.\textsuperscript{128}

Second, the opposition to the U.S. system is also due to the difficulties in applying such a mechanism to the different dynamics existing in civil law countries.\textsuperscript{129} The difference between civil law countries and common law countries regarding the formers’ reluctance of civil law countries to adopt the class action procedure is the result of a societal preference for legislation—rather than litigation—to address social concerns (such as mass torts) in civil law nations;\textsuperscript{130} the two systems’ difference in the relative role of legislators and their political motivations; and the differing legislative process between the two types of system.\textsuperscript{131}

Lastly, adoption of the fraud-on-the-market doctrine is resisted by many nations for two major reasons. First, adoption could create an incentive for investors to remain uninformed. This argument is overcome by the mere fact that investors rarely make investments thinking about what the consequences will be if they rely on a misstatement by the issuer that causes them harm. Investors collect information and analyze issuer statements in order 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 bring the case by themselves and prove individualized reliance, which is what they would be forced to do without the reliance presumption, because the class action mechanism would be obstructed from proceeding. In the

\textsuperscript{128} Jason Betts, \textit{Australia: The Rise of Shareholder Class Actions in Australia}, Freehills, Mondaq’s Article Service 3-4 (2005), available at http://www.nera.com/newsletter/Shareholder_Class.Actions_Australia.pdf; Thompson, \textit{supra} note 37, at 1138 n.104 (noting that for the public Turkish authority to initiate proceedings in court takes two to three years and many more years for a judgment).


\textsuperscript{130} \textit{Id.} at 311.

\textsuperscript{131} \textit{Id.} at 311-12, n.62.
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.  

International opposition to United States system of adjudication in this area will cause strain if negotiations take place with an aim of collaboration and harmonization of international securities law in order to prevent fraud and injury to investors. To get some (increased protection from foreign perpetrators and improved market integrity), the United States may be required to give some; that is, relax some areas of its plaintiff-favorable procedures or substantive laws. Alternatively, such concessions may not be necessary as countries have begun to realize the utility of the class action mechanism. And as a result they may soon realize how impossible it is to take advantage of that utility while requiring proof of individual reliance.

II. COMPARE EXTRATERRITORIALITY OF SECURITIES LAW WITH 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. This is likely due to the common interest in regulatory enforcement of anti-fraud provisions as opposed to antitrust provisions or registration requirements that may have national protectionist implications, desire to shape prospective behavior that may not be itself “wrongful”—a clear difference to the case of fraudulent conduct, and have more severe damages penalties (e.g., treble damages as opposed to merely compensatory). The Second Circuit has stated that the “primary interest of a foreign state is in

132 Forcing each member of a class to prove actual reliance would effectively bar plaintiffs from bringing securities class actions under Rule 10b-5. See discussion of Basic v. Levinson, footnote 90 supra.
133 Just as the EU did, 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 Section IV.c. infra.
134 Buxbaum, supra note 11, at 61.
135 Buxbaum, supra note 11, at 62, n. 196.
the righting of a wrong done to an entity created by it. If our anti-fraud laws are stricter than a foreign state’s, that country will surely not be offended by their application.” 136 In sum, while countries may have complex and wide ranging national interests, incentives, and policies determined by their legislative and regulatory regimes, general anti-fraud enforcement objectives are similar from government to government, as most regulators agree that fraudulent conduct should be prevented or punished where prevention efforts fail. 137 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 Law

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. 138 This is likely due to the common interest among nations in preventing securities fraud, discussed above; whereas in antitrust cases, 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 considered to be generally silent on Congressional intent as to its extraterritorial application, the Act is not entirely without extraterritorial implication. Section 6a of the Sherman Act states that the Sherman 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,

136 Morrison, 547 F.3d at 175 (quoting IIT, Int’l Inv. Trust v. Cornfield, 619 F.2d 909, 921 (2d Cir. 1980)).
137 See Morrison, 547 F.3d at 175.
and reasonably foreseeable effect” on imports, domestic commerce, or American exporters.\textsuperscript{139} However, the Supreme Court’s analysis of the legislative history interpreted the above-quoted exclusionary rule as allowing federal courts to reach commercial transactions that do not involve American exports but which were wholly foreign, so long as the conduct had adverse effects on both foreign and domestic customers.\textsuperscript{140}

This interpretation highlights a second difference between extraterritorial application of securities and antitrust laws; it is the level of interference upon foreign interests caused by the extension of jurisdiction by federal courts to foreign conduct. This difference comes to light in the Court’s decision in \textit{F. Hoffmann-La Roche Ltd. v. Empagran S.A.}, where it noted that when the conduct implicated by the antitrust laws adversely affects both customers outside the United States and customers within the United States, but the foreign effects were independent of the domestic effects, the antitrust laws cannot be applied to the foreign effects.\textsuperscript{141} 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.\textsuperscript{142} Such application would materially interfere with a nation’s ability to independently regulate its own commerce.\textsuperscript{143} 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

\textsuperscript{140} The Supreme Court stated that where the defendant foreign and domestic vitamin manufacturers and distributors engaged in a price-fixing conspiracy and the conspiracy adversely affected 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. \textit{F. Hoffmann-La Roche Ltd. v. Empagran S.A.}, 542 U.S. 155, 124 S. Ct. 2359, 2365 (2004) (reversing the Court of Appeals under principles of “prescriptive comity,” because “[w]here foreign anticompetitive conduct plays 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 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.”).
\textsuperscript{141} \textit{Id.} at 164.
\textsuperscript{142} \textit{Id.}
\textsuperscript{143} \textit{Id.}
the interests of nations to prevent and redress fraud are more closely aligned (i.e., interest-balancing will not be required because the foreign states will not have a strong policy against the application of antifraud provisions as opposed to a strong policy against application of antitrust provisions).

The competing interests among nations in 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 where 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. For securities fraud conducted in one market, eventually (and perhaps indirectly) 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.\textsuperscript{144} When a company makes financial performance predictions and statements regarding company goals and significant corporate events, investors worldwide utilize this source as their main basis for financial decisions. What other source would have better access to information to make statements about a company’s affairs than those working in it? So where a country opposes the exposure of its issuers to antifraud enforcement, it may gain some short-term benefits, but the long-term adverse impact on the global economy likely will cause greater damage to that country’s economic prosperity.

\textbf{B. General Civil Litigation Discovery Rules}

How have courts treated application of the Federal Rules of Civil Procedure 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

\textsuperscript{144}See McLuhan discussion, note 165 infra.
Act are both silent as to the extraterritorial reach of discovery rules in civil litigation.\textsuperscript{145} 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 that information is outside the United States.”\textsuperscript{146}

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. Considerations courts should look at in determining whether extraterritorial discovery should be ordered are: (1) the need for the requested materials, (2) the objectives of the substantive legislation implicated in the dispute, (3) the parties’ nationality, (4) the hardship suffered by private parties.\textsuperscript{147} To avoid creating an incentive to place ownership of American assets in countries that assure 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.\textsuperscript{148} 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 forcibly the desired information. The Court also has stated that judges should take into account considerations of international comity in weighing the sovereign interests of the foreign nation and the requesting nation.\textsuperscript{149}

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 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

\textsuperscript{145} Born, \textit{supra} note 138, at 48.
\textsuperscript{146} Born, \textit{supra} note 138, at 48 (quoting Restatement (Third) of Foreign Relations Law, § 416).
\textsuperscript{147} Born, \textit{supra} note 138, at 48 (citing \textit{Société Internationale Pour Participations Industrielles et Commerciales v. Rogers}, 357 U.S. 197, 204-06 (1958); \textit{Société Nationale Industrielle Aerospatiale v. United States District Court}, 482 U.S. 522, 543-44 (1987)).
\textsuperscript{149} \textit{Id.}
companies has been the substance of spy thrillers for half-a-century.\(^{150}\) These tax havens were created via national laws prohibiting banks from sharing 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 include, Luxembourg, where funds from Bernard Madoff’s ponzi scheme were based;\(^{151}\) and Barbuda, which hosted Stanford International Bank.\(^{152}\) These developments have caused many financially strapped countries to increase the political pressure placed on countries with heightened bank-secrecy laws. Resulting from this international pressure several of the blacklisted countries recently committed to changing their laws to increase bank transparency and provide legal assistance in compliance with OECD tax standards.\(^{153}\) 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.\(^{154}\) However, Switzerland has said that the changes to its laws will come only through bilateral treaties, which could require amnesty for prior tax evasion,\(^{155}\) and will result in

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\(^{150}\) The Organisation for Economic Cooperation and Development (the “OECD”) has created a “blacklist” of uncooperative countries that are deemed tax havens. The OECD can sanction countries for not complying with its international tax standards. See OECD work on tax evasion, http://www.oecd.org/document/21/0,3343,en_2649_201185_42344853_1_1_1_1,00.html (last visited April 27, 2009).


\(^{152}\) Id.


\(^{155}\) Id.
the exchange of information only through detailed requests on specific cases, not automatically.  

While these bank-secrecy developments were aimed at benefiting tax authorities in collecting the necessary information to bring tax evaders to justice, the relaxing of these laws may also allow for greater reach and efficacy of discovery laws in civil litigation. One possible scenario would be where a fraudulent actor, of the Bernie Madoff variety, is prosecuted by tax authorities, who would obtain 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 to experience improved access to justice for their injuries caused by the fraudulent conduct.

C. Federal Criminal Law

For centuries a strong presumption of territoriality existed in the application of a sovereign nation’s criminal law. This presumption was largely based on the recognition that “criminal litigation involves a sovereign State directly seeking to enforce its laws.” Over the last century, as the world began to globalize and criminal conduct within one jurisdiction could more easily impact another jurisdiction, this strict territoriality presumption gradually began to erode. In Strassheim, the 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 has been

\[\text{Id.}\]
\[\text{See Born, supra note 138, at 51.}\]
\[\text{Id.}\]
present in the injured jurisdiction while effectuating the conduct. The Supreme Court has continued to recognize this 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. In short, criminal laws are not logically dependent on their locality.

The considerations involved in 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 criminal law against people 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 its 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 but affecting U.S. interests. However, just as in the extraterritoriality application of securities laws, the court will take into account various other considerations such as international comity before actually exercising jurisdiction. Because the antifraud provisions in securities laws are dealing 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 would tend to require more specific “effects” in the securities context, than in the criminal context.

III. NEED FOR MORE INTERNATIONAL UNIFICATION OF SECURITIES LAWS

161 Born, supra note 138, at 54.
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.”¹⁶² Since writing those words, the dynamics which Born described have only become more exaggerated. U.S. courts have refused to take the lead unilaterally in addressing the “generalized harms” caused by the perpetuation of international fraud,¹⁶³ because they have limited the application of the effects test to “concrete harm.” Congress and the SEC need to address the harm caused to the integrity of global financial markets on which countless investment decisions are based every day. They should seek to address this concern through cooperation with their foreign counterparts. The fraud to which U.S. courts have refused to extend jurisdiction (e.g., that found in foreign-cubed securities class actions) has a great impact on our domestic markets due to the “globalization of securities markets,”¹⁶⁴ the interconnectedness of the global economy in general, and the speed at which our lines of communication can extend to markets across the globe, our so-called “global village”.¹⁶⁵ The current status of globally-interwoven securities markets, along with the reluctance of U.S. courts to find jurisdiction in predominantly foreign cases, has provided corporate issuers with the opportunity to access the world’s markets while avoiding U.S. regulation and litigation.¹⁶⁶ If the

¹⁶² Born, supra note 138, at 99.
¹⁶³ Thompson, supra note 37, at 1134.
¹⁶⁵ Marshall McLuhan coined the term “Global Village” in his books to describe the global transformation that occurred once electric technology became widespread as it allowed information to spread more quickly. The globe contracted into a village, where all become aware of social and political functions instantaneously. See generally MARSHALL MCLUHAN, UNDERSTANDING MEDIA (Gingko Press, 1964, 2003), THE GUTENBERG GALAXY: THE MAKING OF TYPOGRAPHIC MAN (Routledge & Kegan Paul 1962), and LETTERS OF MARSHALL MCLUHAN (Oxford University Press, 1987).
¹⁶⁶ Thompson, supra note 37, at 1144.
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. caselaw by altering behavior to minimize litigation risk in the U.S.,
knowing 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. 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. 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.

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

After the Morrison 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 was 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

167 SEC Morrison Amicus Brief.
168 Id.
169 Thompson, supra note 37, at 1144.
resolution). Often, plaintiffs dismissed by U.S. courts will have no avenue to seek redress for the harm caused them by fraudulent corporate issuers.

The second point of clarity is that the caselaw 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 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 the information communicated in the U.S.” Such conduct would relegate non-U.S. investors to jurisdictions that provide inferior investor protection and accessibility to justice for fraudulent conduct.

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 U.S., a portion of the plaintiff class contains U.S. investors, or the securities at issue were purchased on U.S. markets. Currently, the United States provides injured investors with the most investor-

\[170\] Thompson, supra note 37, at 1129.

\[171\] Id.


\[173\] Id.

\[174\] Buxbaum, supra note 11, at 41 (“Many [] cases are clearing the jurisdictional obstacle. But often only succeed when there is an intermixing of foreign and U.S. based transactions.”).
friendly avenues to relief;\textsuperscript{175} it could 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, which impacts the integrity global financial markets, including those in the U.S. But 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 seeking recovery (and relying on government enforcement for relief) because their claims are too small individually to make the high cost of litigation worthwhile (i.e., without group litigation’s economies of scale, the cost of recovering many claims is too expensive to seek justice). 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.

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. They may refuse to recognize the judgments because they simply do not recognize the jurisdiction of U.S. courts on issuers located in their country, they are skeptical of the U.S. class action mechanism itself (and its accompanied binding of absent and passive class members with active ones), they think that with a presumption of reliance a case has not been fully heard on the merits, they do not recognize U.S.

\textsuperscript{175} Thompson, supra note 37, at 1129.
attorneys’ fee structures, or they have a policy to only recognize the judgments if there is a formal reciprocity treaty between the countries.\textsuperscript{176}

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.”\textsuperscript{177} 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.\textsuperscript{178} These impossible considerations have often been deemed to favor restraint on the part of courts in determining extraterritoriality of U.S. law.\textsuperscript{179}

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 parties.\textsuperscript{180} This extension might not be an issue, for the U.S. wants to see all issuers that commit fraud to be brought to justice, even its own. However, 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 impact international commerce only adversely.

Second, the limitations of other jurisdictions’ securities regimes could result in unfair treatment

\textsuperscript{176} Sankoorikal, supra note 9, at 29.
\textsuperscript{178} Id. at 1322.
\textsuperscript{179} See id. at 1323; see also Thompson, supra note 37, at 1144 (discussing the historical reluctance of U.S. courts to deal with global issues).
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 (i.e., 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.\footnote{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. 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.} 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 (e.g., the International Organization of Securities Commissions) and national legislators. It has been said that “the law applicable to transnational litigation affects the behavior of transnational actors.”\footnote{Samuel P. Baumgartner, \textit{Class Actions and Group Litigation in Switzerland}, 27 Nw. J. Int’l L. & Bus. 301,303 (2007).} Those tasked with making and applying international securities laws should recognize this “interplay between lawmaking and transnational actors and of how particular procedural choices may influence it in the long run.”\footnote{\textit{Id.}} 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.

\section*{B. Current International Securities Cooperation}
Currently, a movement towards international securities cooperation is occurring on three fronts. First, the International Organization of Securities Commissions (“IOSCO”) has created a document concerning cooperation in the area of sharing of information, which is called the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (“MMOU”).\textsuperscript{184} As of March 31, 2009, the MMOU has fifty-two signatories (i.e., securities regulatory agencies, including SEC). 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.\textsuperscript{185} 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 shadows of the September 11, 2001 attacks, the IOSCO recognized that increasing global activity in the securities markets produces a need for increased cooperation and consultation among its members.\textsuperscript{186} 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. The signatories agreed that the shared information would be kept confidential except to permit use of the information in enforcement and regulatory matters.\textsuperscript{187}


\textsuperscript{185} Id. at 2.

\textsuperscript{186} Id.

\textsuperscript{187} 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, 143-150 (2009).
Second, the Council of Europe harmonized its members’ securities laws regarding insider trading in its Convention on Insider Trading. 188 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.

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”). Drafted under the auspices of the Hague Conference on Private International Law, 189 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. 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 in identifying a single jurisdiction whose law would apply to any given situation.

The treaty provides a functional, algorithmic approach to determining the correct governing law. First, the account holder and the intermediary 190 may choose by agreement the governing law, as long as the intermediary has an office involved in the maintenance of

190 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, Article 1(1)(c).
securities accounts in the chosen jurisdiction. If no express designation exists between the parties, the law to which the parties agreed to govern the account agreement governs the issues addressed in the Convention. 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. 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. 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 (“UNIDROIT”) 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.

C. Insufficiency of Current International Cooperation

Many problems exist in the current level of international securities cooperation. I will discuss several of these problems in the following paragraphs before I lay out my view on what the necessary level of international cooperation would look like.

191 Hague Securities Convention, Article 4.
192 Hague Securities Convention, Article 4. The Convention’s logarithmic function in determining applicable law is not challengable. However, the Convention provides for a Review of Practical Operation of the practical operation of the Convention by the Secretary General of the Hague Conference on Private International Law to determine if any amendments are desirable. Hague Securities Convention, Article 14.
193 Hague Securities Convention, Article 5(1).
194 Hague Securities Convention, Article 5(2), (3).
(a) Lack of Follow Through. First, the current cooperation in this area is the efforts that have been made are not always carried through. A case-in-point is the Hague Securities Convention, which is yet to enter into force because it requires three nations to ratify or adopt it. 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.196 Other governments have assessed the Hague Securities Convention. For example, the European Commission assessed it and recommended that member states sign it (the European Union requires unanimous signatures by Member States for the Union to adopt it).197 While EU members are yet to sign the Convention, the EC’s recommendation of adoption was a big step towards its adoption, because the EU was seen as the main opponent to the treaty because it replaced the EU’s “place of relevant intermediary” approach with the functional approach outlined above.198 That said, the Convention remains even to be ratified by the present signatories. (This national legislative lag is a problem with the current approach to international lawmaker generally.)199 So 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 accountholders. Thus, the parties that are most-heavily involved in the

196 For Status of the Convention see http://www.hcch.net/index_en.php?act=conventions.status&cid=72; Mauritius has also signed the Convention, but they are a Non-Member State, and are thus not counted for the required three.
199 See
negotiation process likely will influence the terms for their own benefit, causing the entire agreement to be void of widespread acceptance.

(b) Lack of Harmonization. With the current international securities cooperation there is no harmonization to the substantive law. The parties cooperating are merely poking around the bush from the outside. The Hague Securities Convention deals with the issue of which law governs a dispute over an international transaction. The MMOU is concerned with the sharing of information in order to enforce the existing substantive securities laws of each nation. 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 because they seek justice against a multinational corporation that perpetuated securities fraud without regard to national boundaries.

(c) No Cooperative Action. In the case of the MMOU, the international cooperation only helps securities regulators act alone to better prevent fraud within its 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 v. Levinson, 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.\(^{200}\)

\(^{200}\) Further limitations inherent in this type of organization are discussed further in the final section of this paper.
This problem with the MMOU stems largely from the inherent limitations with so-called Trans Regulatory Networks,\(^{201}\) such as the IOSCO, which will be discussed in more detail below. Whereas the success of the MMOU, discussed above, stems from the potential strengths of TRNs. One strength of TRNs is their ability to address problems caused by globalization that occur across national borders and affect multiple nations’ interests. These problems would otherwise be difficult for governments to address alone; cooperation allows them to address collectively international issues.\(^{202}\)

\(\text{(d) Regional vs. Global.}\) A final insufficiency of international cooperation is that the only currently successful cooperative efforts remain regional. The EU’s Convention on Insider Trading is a commendable harmonization of the insider trading law in European nations, but the benefits of the Convention do not extend directly beyond the borders of Member States. Harmonization among commercial law was essential to the establishment of the European Union. Thus, the Convention on Insider Trading was a byproduct of the overall harmonization of commercial law in the EU, which was expansive. It should be no surprise that the EU Members agreed to its terms, as the underlying premise behind the EU is the bonding of similar and closely associated nations. However, today’s global economy requires more than mere regional harmonization; the marketplace is filled with international corporations that conduct business with little regard to state boundaries. It is essential, therefore, to develop international mechanisms and substantive law that apply consistently across all (or most) state lines so as to

\(^{201}\) For purposes of this article I will use Professor 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.” This type of organization is distinguished from treaty-based organizations like the World Trade Organization, the International Monetary Fund, or the World Bank. Verdier, \textit{supra} note 187, at 118.

\(^{202}\) \textsc{Anne-Marie Slaughter, A New World Order} 8-10 (2004).
develop a harmonized body of securities law reaches as far as modern commerce extends and effectively accomplish its objective in protecting investors in a globalized marketplace.\textsuperscript{203}

Countries may conflict on how to best 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.

\textbf{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,”\textsuperscript{204} and as Gary Born described our “interdependent” world fifteen years ago, we have only grown more interconnected than these sages could begin to 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.\textsuperscript{205}

\textsuperscript{203} While the EU’s recognition that the borders of its Member States are fluid to an extent far beyond the rest of the globalized economy when it comes to commercial transactions has compelled the Member States to harmonize certain areas of substantive commercial law, the EU has failed 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, \textit{supra} note 37, at 1128-29 (2007).

\textsuperscript{204} See discussion on Marshall McLuhan, footnote 165 \textit{supra}.

\textsuperscript{205} Buxbaum, \textit{supra} note 11, at 41. See also discussion on Marshall McLuhan, footnote 165 \textit{supra}.
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 (if any exist that will hear the claim) with less effective means of recovery. A new unilateral approach by U.S. courts likely would improve the current judicial framework; 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. The current judicial framework fails to address important issues. But I do not intend to criticize the judiciary’s attempts to deal with the issues. For the competing policies of comity, equity and effective judicial administration, investor protection, and international relations are difficult to balance and bear 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.

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.

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206 See Hannah Buxbaum’s “second-best solution” in Buxbaum, supra note 11, at 68-70. 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 U.S., the presence of these assets might itself justify a court’s exercising jurisdiction because whether or not the fraudulent conduct occurred in the U.S., the fraudulent actor still maintains a presence in the U.S. giving our courts an interest in enforcing anti-fraud provisions against it.

207 See footnote 6 supra.
and procedural relief mechanisms. The other three involve some form of cooperation among governments. The final approach discussed is most thoroughly discussed, as it 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, none is perfect; 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.

(i) Unilateral Amendment to National Laws

Perhaps the simplest approach to the problem of international securities fraud is for the U.S. to amend its own securities laws so as 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 doing business in the U.S. will be more highly observed or regulated so as to improve the integrity of the nation’s financial markets and protect its investors.

This unilateral approach also would be the most practical. The reader has likely been questioning throughout this article the probability of true international cooperation on any effective scale. Most attempts at international cooperation are always slow-moving and often futile. When cooperation does succeed, the result is so fraught with compromise that any negotiations result in a proportionate watered-down effect.

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 our anti-fraud provisions to claims arising out of securities transactions on U.S. markets.208 This rule would provide regulatory clarity to investors and issuers making decisions on which market to enter

208 See Buxbaum, supra note 11, at 68-69.
into. They would be able to easily and with certainty evaluate the regulatory limits in the United States and how those limits might impact their investment or business structure.\textsuperscript{209}

Also, this transaction-based approach would confine regulatory protection, which would allow investors to choose from a more diverse selection of investments.\textsuperscript{210} 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 protections of the United States regulatory regime. The price of any given security would more accurately account for such factors.\textsuperscript{211}

The benefits of this approach must be weighed against the two major problems it invokes. First, the potential plaintiffs that would have a U.S. court’s ear 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.\textsuperscript{212} 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, which causes problems in that defendants might not be guaranteed preclusive effect in the investor’s home country.\textsuperscript{213}

The second problem with this transaction-based approach is that it fundamentally fails to address the issues involved in the current trend of cross-border securities fraud occurring in our globalizing economy.\textsuperscript{214} The unilateral approach adds clarity to jurisdictional considerations and minimizes regulatory conflict among nations, but it increases the likelihood that and ability of

\textsuperscript{209} Id.
\textsuperscript{210} Id.
\textsuperscript{212} Buxbaum, supra note 11, at 69.
\textsuperscript{213} Id.
\textsuperscript{214} Id.
wrongdoers would take advantage of the isolated regulatory regimes.\textsuperscript{215} Therefore, a higher degree of cooperation is required across borders to address the difficult problem of fraud in foreign-cubed transactions.

\textit{(ii) Transnational Regulatory Network}

A second potential approach is for the IOSCO, a Transnational Regulatory Network ("TRN"), to facilitate the development of international standards regarding both the 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; however, it is not without its limitations and weaknesses.

The TRN-style intergovernmental cooperation allows for the facilitation of policy coordination across a given subject matter,\textsuperscript{216} which 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. These common interests are: (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 U.S. investors if the benefits received from other markets exceeded those damages.\textsuperscript{217} Securities commissioners have bonded on this common ground, under the IOSCO umbrella, and made various efforts at international cooperation and have seen some success in doing so.\textsuperscript{218} However, the extent of cooperation is inadequate because it does not account for the rapidly changing dynamics of

\textsuperscript{215} Id.
\textsuperscript{216} ROBERT KEOHANE, AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY 51-52 (1984).
\textsuperscript{217} Buxbaum, \textit{supra} note 11, at 57-58.
\textsuperscript{218} See International Organization of Securities Commissions, http://www.iosco.org/; see also the discussion regarding the MMOU in Section III.B., \textit{supra}.
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 in interest and need to ensure that preclusive effect is given to judicial decisions made to resolve international securities disputes.

An additional benefit of TRNs is that they do not possess the same threat to national sovereignty and liberty as that feared by general notions of world governmental organizations, because they are “decentralized, dispersed, and involve participants that are domestically accountable.” 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,” TRNs contain several weaknesses that limit their ability to accomplish effectively their purported benefits.

First, they are influenced by domestic constituencies that regulators are more accountable to than a global polity. 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. Such rulemaking would be far beyond the general scope of TRNs, which are organized with a focus on fairly narrow issues of law preventing 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.”

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219 Verdier, supra note 187, at 113.
220 Slaughter, A New World Order 167.
221 Verdier, supra note 187, at 115.
222 Verdier, supra note 187, at 115-16.
Second, the rules negotiated and implemented by TRNs can cause the costs and benefits of such rules to fall on different states (e.g., the more nations with more influence can leverage smaller nations into bearing the burden of the new rules). This problem arises in all intergovernmental institutions, and could work to ostracize various nations from the organization. If the financial powerhouses of the world (e.g., U.K., U.S., Japan, Singapore, and the like), small nations might continue to serve as safe harbors for international fraudsters; thus, negating any benefit that 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.

Lastly, TRNs are weak on enforcement, because states act in a self-interested fashion by reneging on the standards to which they previously agreed in order to obtain short-term economic benefits (such as trying to incentivize international corporations to headquarter in their country) at the expense of the TRN’s collective long-term objectives in setting the international standards. 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, and inclusiveness, and the capacity to dedicate sustained attention to complex regulatory issues, they are “decentralized and dispersed, incapable of exercising centralized coercive authority.” 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.

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224 Verdier, *supra* note 187, at 125
225 SLAUGHTER, A NEW WORLD ORDER 8.
226 SLAUGHTER, A NEW WORLD ORDER 11.
(iii) Bi- and Multi-lateral Agreements

A third form of cooperation that could effectuate international cooperation to address securities fraud is a network of bi- or multi-lateral 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 instance, in the European Union’s Convention on Insider Trading. However, as stated above when discussing this Insider Trading 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 agreements 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-sided nations. This approach also falls to the “safe-haven” weakness where 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.

(iv) World Organization for Securities Fraud Prevention (“WOSP”)

The final possible approach to cooperation, and the one to which I subscribe, 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 multi-lateral agreements. Such institutions are not without their own problems, but a properly constructed one could effectuate the level of international cooperation necessary to deter and prevent fraud and to provide injured investors access to justice. Analogizing to a brief discussion of 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 Bretton Woods Conference, which, *inter alia*, created the General Agreement on Tariffs and Trade ("GATT"). GATT was meant to address world tariff barriers and eliminate nontariff barriers. One round of negotiations on GATT (the "Uruguay Round") created the WTO to administer its negotiated agreements regarding international trade; GATT and the WTO have become the most important source of international trade law.

One major difficulty such a treaty-based organization results from the inherent political paralysis of such organizations; 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. The discussion above regarding the Hague Securities Convention illustrates this problem well. The WTO has not had such difficulty to any significant level, however. Nearly immediately upon its creation, the WTO reached the “tipping point” of global membership, 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 on the outside looking in. Because membership in the WTO became an economically beneficially objective, the WTO members are able to implement a “packaged deal” membership regime. That is, if a country wants unfettered trade access to the wealthiest nations, it must bring its

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228 Verdier, *supra* note 187, at 119.
229 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, *The Tipping Point*, which took this descriptive term international.
230 Significant bystanders are the Russian Federation, Iran, Yemen, and the Lebanese Republic.
domestic law in compliance with *all* the WTO agreements (with only a few exceptions).

The WTO membership structure creates worldwide coherence in trade law by forbidding members from choosing which agreements it prefers to join by determining which will benefit more than harm their own individualized interests.

The purpose behind the WTO is why the “tipping point” was achievable. The WTO’s case for a system of open trade is based largely on the economic theory and statistical fact that freer trade produces greater economic growth, which in turn produces increased peace among nations results that benefit everyone. 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.” The WTO’s trade policies, which allow unrestricted, international flow of goods and services, “sharpen[s] competition, motivate[s] innovation, and breed[s] success.”

A major strength of a treaty-based organization, such as the WTO, is the ability to enforce the agreements among members (a serious failing of TRNs). 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 in which nations can resolve trade disputes. 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.

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231 Significant exceptions to the package of agreements are the agreements regarding trade in civil aircraft, government procurement, dairy products, and bovine meat.
233 Id.
234 Id.
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. I will call this institution the World Organization for Securities Fraud Prevention (or “WOSP”). The WOSP will provide a dispute resolution procedure and its own substantive law regarding securities fraud in foreign-cubed transactions.

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, which 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”. Without this last point the regime will be ineffective in preventing securities fraud and providing access to justice for injured plaintiffs, because WOSP would become essentially a TRN where parties pick and choose when to apply international standards based on their own interests. 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-sided decisions.
Next, while the agreements negotiated among WOSP members would seek to prevent and deter international securities fraud, absolute elimination of securities fraud would be impossible. Injured parties must have a mechanism to seek relief. I propose that the mechanism for relief occur not through group litigation but, rather, 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 through their own country’s securities fraud representative to WOSP. This would begin a dispute resolution process within WOSP between the country harboring the purported fraudulent actor and the countries where 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 the judiciary “guessing” what the interests at play are.

WOSP dispute resolution process should have mandatory private negotiations between the governments to bring the perpetrator to justice and provide relief to injured investors. These private negotiations could provide quick and efficient relief to injured plaintiffs. However, if the result of these negotiations fail 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 located there. An alternative scheme would be a network of tribunals scattered worldwide. However, there are inefficiencies in disputes that involve other-
than-regional parties and extra costs involved in governments housing securities fraud representatives in multiple locations.

With that procedural framework, I 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 United States class action is the superior method of adjudication. This assertion is due, in part, to the presumption of reliance in federal courts. 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. 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. This agreement would eliminate the critics’ fear of duplicate recovery. On one hand, it would require countries to approve of each other’s substantive law.

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

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236 See note 3 supra. See also Basic v. Levinson, 485 U.S. 224 (1988).
237 See Buxbaum, supra note 11, at 33.
238 Buxbaum, supra note 11, at 32.
country or countries other than those of the investors, and the issuer’s stock was purchased on other nations’ stock exchanges. 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 certain access to justice.

The foreign-cubed action does not constitute a large proportion of securities fraud actions brought in U.S. or any nation’s courts. One could argue that this fact limits the necessity of the proposed large-scale international cooperation. However, 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, providing investors with improved and increased access to justice and, contemporaneously provide 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, but investors from multiple nations would effectively band together through their governments bringing collective actions against the government of the alleged fraudulent perpetrator and require that government to bring its citizens and corporate issuers that reside within its borders to justice and collect damages to be paid out to the injured investors of the plaintiff-governments. While the WOSP proposal does create inefficiencies, inherent in other treaty-based organizations such as the WTO, limiting its effect to the foreign-cubed case will limit the opposition by, say, 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, given the recent uncovering of international ponzi schemes, such as R. Allen Stanford’s scheme based in St. Croix. These types of frauds have a huge impact on investor confidence in the integrity of the markets; therefore, all countries should be concerned about international perpetrators of securities fraud and seek the most effective form of prevention.

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 creates more work for attorneys, rather than the initial fears of a decline.

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. However, just as the WTO was founded on the principle that free-trade being better for everyone, it might be possible that WOSP founders could equally bond over the principle that effective international fraud prevention and improved access to justice for international investors is better for all concerned.