Congress and the Supreme Court are on course for a legal train wreck over global class actions. In granting certiorari in late November to *Morrison v. National Australia Bank*, 547 F.3d 1167 (2d Cir. 2008), the Court seems intent on cutting back on the extraterritorial scope of the federal securities laws, but Congress is simultaneously rushing to do the reverse, as the House passed legislation two weeks later that has precisely the opposite effect.

The story begins with the growth of the “f-cubed” class action, which refers to a class of (1) foreign purchasers who bought (2) a foreign issuer’s stock in (3) a foreign market. Predictably, plaintiffs wish to bring these actions in a U.S. court because (1) no class action is probably authorized in their own jurisdiction (at least not a large “opt out” class); (2) the contingent fee is prohibited in most of the world; or (3) “loser pays” fee-shifting rules face plaintiffs with high liability if they are unsuccessful. In addition, by adding a foreign class of plaintiffs to a domestic class, plaintiffs’ attorneys may be able to double or treble the potential damages and thereby gain settlement leverage.

Much commentary has suggested that, to the extent the U.S. is becoming a magnet for global class actions, the U.S. is losing its capital markets competitiveness. Not surprisingly, when the first “f-cubed” class action reached the Second Circuit in the *Morrison* case, the Circuit panel responded skeptically and affirmed the district court’s conclusion that it lacked subject matter jurisdiction. Still, the panel accepted the

---

* John C. Coffee, Jr. is the Adolf A. Berle Professor of Law at Columbia University Law School and Director of its Center on Corporate Governance.
possibility that there could be a “f-cubed” class action consisting only of foreign plaintiffs, but found the U.S.-based conduct alleged in Morrison was insufficient to support jurisdiction. In Morrison, National Australia Bank’s problems largely centered on an American subsidiary that had originated subprime mortgages and had sent inflated financial results to its parent in Australia. Viewing the alleged material misstatements as having been more directly caused by the parent, which should have better monitored both its subsidiary and its own financial controls, the Second Circuit refused to consider policy questions and urged Congress to address the issue. Still, language in the opinion suggests that the result would have been different if the parent company had been based in the U.S., even if it sold stock only in Australia.

Nothing in Morrison was particularly surprising. But surprises came when the plaintiffs sought certiorari (instead of settling cheaply) and when the Court granted cert. See 2009 U.S. LEXIS 8694 (November 30, 2009). The Second Circuit’s decision left intact the familiar “conduct” and “effect” tests that all the federal circuits have followed, with minor variations, since those tests were first formulated by Judge Henry Friendly in the mid-1970s. That the Court took this case, in the absence of any serious inter-Circuit conflict or an aberrant decision, strongly suggests that the Court wants to address for the first time the extraterritorial scope of the federal securities laws. And it is likely to be less deferential to the iconic Judge Friendly than the Circuits have been.

The next surprise came in December when the House of Representatives passed H.R. 4173, its omnibus financial reform legislation. Tucked away in a quiet corner and apparently unnoticed by the lobbyists was Section 7216 (“Extraterritorial Jurisdiction of the Antifraud Provisions of the Federal Securities Laws”). It vastly extends the
extraterritorial jurisdiction of U.S. courts and would seemingly dictate reversal of the result in Morrison. Indeed, “f-cubed” class actions would seem presumptively certifiable under its language.

What will happen when the Court hears Morrison? The federal securities laws are silent as to their application to transactions outside the United States. Judge Henry Friendly led the Second Circuit to develop two distinct tests: the “effect” test and the “conduct” test. Little controversy has surrounded the “effect test”: when statements made abroad by a foreign issuer impact the U.S. securities market and injure U.S. investors (such as when the foreign issuer’s securities are traded on a U.S. exchange), then U.S. courts possess subject matter jurisdiction over an antifraud suit brought by these investors. Friendly’s rationale was that the purpose of the federal securities laws was to protect U.S. investors. But when conduct occurs in the U.S. that injures foreign investors, the question of Congress’s desire to reach such a case is more debatable. In ITT v. Vencap, Ltd., 519 F.2d 1001, 1017 (2d Cir. 1975), Judge Friendly offered a rationale for finding subject matter jurisdiction to exist here also: namely, that the United States should not be “used as a base for manufacturing fraudulent securities devices for export, even when they are peddled only to foreigners,” because “[t]his country would surely look askance if one of our neighbors stood by silently and permitted misrepresented securities to be poured into the United States.” Essentially, Friendly’s logic was that the U.S. should be a good neighbor and should do unto other countries as it would have them do unto it.

The Supreme Court has never addressed subject matter jurisdiction in transnational securities fraud cases. But it has recently considered a similar issue in the
context of a transnational antitrust case – and reached a strikingly different result. In Hoffman-LaRoche Ltd. v. Empagran S.A., 542 U.S. 155 (2004), the Court faced an alleged international conspiracy to fix vitamin prices, resulting in higher prices both inside and outside the United States. Stating that it “ordinarily construes ambiguous statutes to avoid unreasonable interference with the sovereign authority of other nations,” the Court precluded foreign plaintiffs from bringing a Sherman Act claim in U.S. courts.

In Morrison, there were not even any U.S. class members to justify extending the putative class’s scope to include foreign plaintiffs. Hence, it would be even easier for the Court in such a case to assume that Congress intended that courts interpreting the scope of the federal securities laws would follow ordinary principles of international comity. If the Court follows Empagran’s focus on domestic injury only, the “effect” test would survive, but the “conduct” test seems in trouble.

Meanwhile, Congress is moving in precisely the opposite direction. Section 7216 of H.R. 5173 provides that extraterritorial jurisdiction shall exist with respect to the principal antifraud provisions in the federal securities laws if there is:

“conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors.”

This liberalized standard appears not to adopt the proximate causation standard that the Second Circuit has long required under its version of the conduct test. For example, in Morrison, there was substantial conduct in the United States, but in the Second Circuit’s view, the actions taken in Australia were “significantly more central to the fraud.” 547 F.3d at 176. Under the above language, false statements made to securities analysts in the United States or meetings with investment bankers could be deemed “significant steps”
sufficient to create jurisdiction, even if other extraterritorial conduct more directly caused the harm. On such a basis, the U.S. could become a magnet for global class actions.

Curiously, the significance of Section 7216 has not set off alarm bells or made its way onto the securities industry’s radar screen. Possibly, controversy has been muted because the actual proponent of this standard is not the plaintiff’s bar, but the SEC.

That in turn suggests a possible compromise: a revised standard could distinguish private and public enforcement, giving U.S. courts broad jurisdiction in SEC enforcement actions, but tightening the standard in private enforcement cases. This would address Judge Friendly’s central goal that the United States not be used as a base for fraud. For example, the statutory language could require in private enforcement cases that there be “conduct within the United States that was the direct proximate cause of the violation and that evidences that the defendant should have reasonably foreseen the plaintiff’s injury.” Others will argue that jurisdiction over private actions simply should be eliminated.

If legislation passes Congress with the current language of Section 7216 intact and if the Court affirms Morrison (as most expect it will), a frontal collision results. Although Congress’s language should control (because jurisdiction is normally not a Constitutional issue), cooler heads in the Senate might yet recognize that U.S. does not always need to play securities policeman for the world.