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THE EXTRATERRITORIAL REACH OF THE U.S. SECURITIES LAWS AND NON-CONVENTIONAL SECURITIES: RECENT DEVELOPMENTS AFTER *MORRISON* AND DODD–FRANK

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INTRODUCTION

Following the Wall Street crash of 1929, Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934.[1] Among other things, these two Acts sought to regulate and prevent deceptive conduct in securities transactions, in order to ensure legitimacy in the securities market.[2] Congress' concern with regulating the capital markets was primarily domestic.[3] The U.S. securities laws do not specify whether they apply extraterritorially,[4] meaning "beyond the geographic limits of a particular jurisdiction."[5]

However, since the enactment of these two Acts, the U.S. securities markets have become increasingly part of a globalized economy. For the past forty years, courts have begun to apply the Securities Acts to conduct that took place outside

1. Nathan Lee, *The Extraterritorial Reach of United States Securities Actions after Morrison v. National Australian Bank*, 13 RICHMOND J. GLOBAL L. & BUS. 623, 623 (2015).

2. Rosemary J. Thomas, *The Fraud-on-the-Market Theory: A "Basic"ally Good Idea Whose Time Has Arrived, Basic, Inc. v. Levinson*, 22 IND. L. REV. 1061, 1061–62 (1989).

3. Daniel S. Kahn, *The Collapsing Jurisdictional Boundaries of the Antifraud Provisions of the U.S. Securities Laws: The Supreme Court and Congress Ready to Redress Forty Years of Ambiguity*, 6. N.Y.U. J.L. & BUS. 365, 369 (2010).

4. Maria Slobodchikova, *Private Right of Action in Transactions with Cross-Border Security Swaps*, 35 REV. BANKING & FIN. L. 739, 752 (2016).

5. BLACK'S LAW DICTIONARY, 666 (9th ed. 2009).

the borders of the United States,[6] leading to a skyrocketing[7] of foreign-cubed cases.[8] The majority of transnational securities fraud cases that have found their way into U.S. courts[9] were premised on the anti-fraud provisions in Section 10(b) of the Securities Exchange Act[10] and its accompanying rule, Rule 10b-5.[11]

The Securities Exchange Commission ("SEC") used its rulemaking power to promulgate Rule 10b-5 in 1942, in order to close possible gaps under Section 10(b).[12] These rules have become the best-known provisions of the American securities regulation regime.[13] They are the most important enforcement tools of the SEC, and Rule 10b-5, in particular, has become the weapon of choice for many parties in litigation alleging securities fraud.[14] While such a private right of action is not expressly stated in the statute, courts have left little doubt as to its existence.[15] The Supreme Court has characterized Section 10(b) of the Securities Exchange Act as an anti-fraud "catchall" that is not only limited to those securities that are registered with the SEC.[16] Instead, it includes all securities,

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6. Lee, *supra* note 1, at 623.

7. Julie B. Rubenstein, *Fraud on the Global Market: U.S. Courts Don't Buy It; Subject-Matter Jurisdiction in F-Cubed Securities Class Actions*, 95 CORNELL L. REV. 627, 629 (2010).

8. *See In re Elan Corp. Sec. Litig.*, No. 08-cv-08761, 2009 WL 1321167, at *2 (S.D.N.Y. May 11, 2009) (defining "foreign-cubed" securities class actions as "actions in which a set of 1) foreign plaintiffs is suing 2) a foreign issuer in an American court for violations of American securities laws based on securities transactions in 3) foreign countries") (citation omitted).

9. Genevieve Beyea, *Morrison v. National Australia Bank and the Future of Extraterritorial Application of the U.S. Securities Laws*, 72 OHIO ST. L.J. 537, 540 (2011).

10. 15 U.S.C. § 78j(b) (2006).

11. 17 C.F.R. § 240.10b-5 (2010).

12. Rule 10b-5, Exchange Act Release No. 3230, Fed. Sec. L. Rep. (CCH) (May 21, 1942).

13. Steve Thel, *Taking Section 10(b) Seriously: Criminal Enforcement of Sec Rules*, 2014 COLUM. BUS. L. REV. 1, 2 (2014).

14. David He, *Beyond Securities Fraud: The Territorial Reach of U.S. Laws after* Morrison v. N.A.B., 2013 COLUM. BUS. L. REV. 148, 154 (2013).

15. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975) ("[W]e confirmed with virtually no discussion the overwhelming consensus of the District Courts and Courts of Appeals that [a private] cause of action did exist"); *see also* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 (1971).

16. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 203 (1976).

registered or otherwise.[17] The rule is intended to provide the SEC with a flexible tool to deal with new manipulative devices,[18] and it is constructively ambiguous, leaving the door open for courts and regulators to determine "how wide a net to cast."[19] Due to its broad, vague, and far-reaching language, the rule has generated extensive judicial discussion.[20] It is not explicitly restricted to fraud in connection with sales or transactions in the U.S. markets, but rather applies to the use of manipulative or deceptive devices in connection with the purchase or sale of any registered or unregistered security.

Delineating the scope and the extraterritorial reach of Section 10(b) of the Securities Exchange Act has been a challenge for courts for many years. In 2010, the Supreme Court finally addressed this issue for the first time in the watershed decision of *Morrison v. National Australia Bank*.[21] With this decision, the Court overturned decades of settled case law by establishing a new test to determine whether conduct falls within the scope of Section 10(b) of the Securities Exchange Act (the "transactional test"). And while the test seems to establish a clear boundary at first glance (which is why the test is also called "bright line test"), subsequent decisions by the lower courts have revealed that this is not the case.

Essentially, the Supreme Court established a location-based test to determine whether a transaction is sufficiently domestic. But as the world financial markets have become more and more interconnected,[22] this line has proven hard to

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17. Kelly Morris White, *Is Extraterritorial Jurisdiction Still Alive? Determining the Scope of U.S. Extraterritorial Jurisdiction in Securities Cases in the Aftermath of* Morrison v. National Australia Bank, 37 N.C. J. INT'L L. & COM REG. 1187, 1192–93 (2012); *see* Michael J. Calhoun, *Tension on the High Seas of Transnational Securities Fraud, Broadening the Scope of the United States Jurisdiction*, 30 LOY. U. CHI. L.J. 679, 683 (1999).

18. Ernst, 425 U.S. at 203 (1976).

19. He, *supra* note 14, at 154.

20. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) (the Chief Justice described the discussion regarding private actions, in my opinion, appropriately as "a judicial oak which has grown from little more than a legislative acorn").

21. Morrison v. Nat'l Austl. Bank, 561 U.S. 247, 269 (2010).

22. *See* Larry Cramer, *Vestiges of Beale: Extraterritorial Application of American Law,* 1991 SUP. CT. REV. 179, 182 (1991); Robert H. Hillman, *Cross-Border Investment, Conflict of Laws, and the Privatization of Securities Law,* 55 LAW & CONTEMP. PROBS. 331, 331 (1992).

draw. Securities markets can operate fluidly across international borders, with many parties conducting their transactions electronically.[23] This is especially true for non-conventional securities, such as derivatives. Simply put, those instruments are "financial contract[s] whose value depends on the values of one or more underlying assets or indexes of asset values"[24] that can have attenuated connections to the location of the transaction.[25] And indeed, with regard to those instruments, decisions after *Morrison* have shown that the transactional test alone faces some difficulties in sufficiently addressing their complex structure, and courts do not regard this test alone to be sufficient.[26]

In addition, just a month after the Supreme Court's decision in *Morrison*, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd–Frank Act"), which contains an amendment to the Securities Exchange Act concerning the territorial reach of actions brought by the SEC. There has been much debate about whether Congress intended to reverse the Supreme Court's decision with this amendment. While it seems at first glance that the legislative history supports that conclusion, it might be ineffective due to a procedural aspect of the *Morrison* decision, as elaborated on below. The Dodd–Frank Act not only addressed territoriality as a general issue, but further undertook to provide regulation for certain kinds of derivatives, namely, providing the Commodity Futures Trading Commission ("CFTC") and the SEC with broad discretion to address the international reach of its regulation, and both have taken very different approaches.

This Note will mainly address the extraterritorial reach of Section 10(b) of the Securities Exchange Act with regard to

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23. Kaitlin A. Bruno, *The Halfway Point Between Barbary Coast and Shangri-La: Extraterritoriality and the Viability of the Economic Reality Method Post-*Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE, 65 AM. U. L. REV. 435, 437 (2015).

24. Christian Johnson, *Regulatory Arbitrage, Extraterritorial Jurisdiction, and Dodd–Frank: The Implications of US Global OTC Derivative Regulation,* 14 NEV. L.J. 542, 547 (2014).

25. Slobodchikova, *supra* note 4, at 753.

26. Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 216 (2d Cir. 2014) ("[W]hile a domestic transaction or listing is necessary to state a claim under § 10(b), a finding that these transactions were domestic would not suffice to compel the conclusion that the plaintiffs' invocation of § 10(b) was appropriately domestic.").

recent developments concerning derivatives and other non-conventional financial instruments. In Part I, this Note will discuss the overruled "conduct" and "effects" tests before addressing the *Morrison* decision itself. Part II will determine whether all kinds of actions are indeed subject to *Morrison*, or whether different treatment for criminal actions or actions by the SEC and the Department of Justice ("DOJ") together is warranted. Part III will describe the case law that evolved after *Morrison*, and provide a critical assessment of the interpretations that courts have undertaken. Part IV will analyze the different approaches taken by the two regulatory authorities to address the recent changes with regard to the regulatory perspective, and will argue that the SEC should follow the CFTC's approach.

I.
THE IMPACT OF *MORRISON* ON THE EXTRATERRITORIAL REACH OF SECURITIES LAW

A. *The Extraterritorial Reach Before Morrison*

Before *Morrison*, courts developed two different tests to determine the existence of subject matter jurisdiction with respect to the anti-fraud rules. These tests have been commonly referred to as the "conduct" and "effects" tests. The Second Circuit— sometimes described as the "Mother Court" of securities law[27]—has been the most influential court in terms of the development of jurisprudence in this area, because it is located at the center of the financial markets.[28] However, this has not hindered other courts from deviating from the Second Circuit's approach.[29] Although the two tests were independently developed, courts decided that they could be combined with each other in some instances,[30] and have applied a mixture of both tests.[31] In practice, these tests gave rise to substantial criticism.

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27. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting).

28. Beyea, *supra* note 9, at 542.

29. *See* Russel J. Weintraub, *The Extraterritorial Application of Antitrust and Securities Laws: An Inquiry into the Utility of a "Choice-of-Law" Approach*, 70 TEX. L. REV. 1799, 1812 (1992).

30. Junsun Park, *Global Expansion of National Securities Laws: Extraterritoriality and Jurisdictional Conflicts,* 12 U.N.H. L. REV. 69, 72 (2014).

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

As shown below, the circuits had a non-uniform and inconsistent approach that left the specific extent of extraterritoriality unpredictable.[32] Furthermore, the increasing amount of trade conducted over the internet increased the risk of an unexpected impact of overseas activities on the U.S. securities market. Thus, the "conduct" and "effects" tests risked expanding the scope of the U.S. securities laws too far.[33] The far-reaching interpretation of national laws could infringe upon the sovereignty of other countries, harm international relations,[34] or lead to overlapping enforcement by the authorities.[35] In order to address those issues, the Supreme Court introduced a new test, the transactional test, as the primary standard to be used to determine the reach of Section 10(b) of the Securities Exchange Act. By establishing a new test, the Supreme Court aimed to provide clarity and prevent ambiguity about the reach of Section 10(b).[36]

1. *The "Effects" Test*

The "effects" test was first introduced[37] by the Second Circuit in *Schoenbaum v. Firstbrook*.[38] In that case, the Second Circuit concluded that a transaction outside of the United States could potentially depreciate a company's share price in the

32. *See* Louise Corso, *Section 10(b) and Transnational Securities Fraud: A Legislative Proposal to Establish a Standard for Extraterritorial Subject Matter Jurisdiction*, 23 GEO. WASH. J. INT'L. L. & ECON. 573, 576 (1989).

33. Kun Young Chang, *Multinational Enforcement of U.S. Securities Laws: The Need for the Clear and Restrained Scope of Extraterritorial Subject-Matter Jurisdiction,* 9 FORDHAM J. CORP. & FIN L. 89, 110 (2003).

34. *Id.* at 117–18.

35. *See* Complaint at 1, SEC v. McClellan, No. CV-105412 (JCS) (N.D. Cal., 2010) (American Arnold McClellan obtained non-public information while working at Deloitte, and disclosed it to his wife who informed her relatives in the U.K. Under the conduct/effects test the U.K. residents could have been prosecuted in the United States. However, in this case the SEC coordinated with the U.K. authority who brought separate charges in the United Kingdom, *see Three guilty of insider trading,* FSA/PN/060/2012 (May 28, 2012), http://www.fsa.gov.uk/library/communication/pr/2012/060.shtml.).

36. *See* Richard Painter, Douglas Dunham & Ellen Quackenbos, *When Courts and Congress Don't Say what they Mean: Initial Reactions to* Morrison v. National Australian Bank *and to the Extraterritorial Jurisdiction Provisions of the Dodd–Frank Act,* 20 MINN. J. INT'L L. 1, 6 (2011).

37. Park, *supra* note 30, at 70; White, *supra* note 17, at 1205.

38. Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968).

United States, and "adversely affect" the U.S. securities markets and U.S. investors, with the latter establishing the starting point for the test. Since Congress passed the Securities Exchange Act to protect domestic investors and securities markets,[39] courts should not prevent the Act from being applied to claims in underlying foreign jurisdictions.[40] In later decisions, the Second Circuit refined this test, and stipulated that the "effects" for the purpose of this test must be strong enough to generate "foreseeable and substantial harm to interests in the United States,"[41] and that mere adverse effects were insufficient.[42] Also foreign conduct with only general effects,[43] for example, conduct that affects general confidence in the securities markets, would not give rise to a claim under Section 10(b) of the Securities Exchange Act. Rather, there has to be a showing of harm to specific interests within the United States.[44] Nevertheless, ambiguity remained as to what degree a plaintiff must establish effects in the United States in order to meet the requirements of the test.

2. *The "Conduct" Test*

The "conduct" test was first articulated in *Leasco Data Processing Equipment Corp. v. Maxwell*.[45] In this case, it was difficult for the Second Circuit to find jurisdiction under the "effects" test.[46] The court held that Congress intended the statute to apply to conduct that took place within the United States, and allowed a federal court to handle cases where the fraudulent conduct occurred.[47] "Accordingly, a U.S. court could obtain jurisdiction over foreign-related transactions that involved domestic misconduct even though the fraud did not harm U.S. investors or markets,"[48] to prevent the United States from

39. *Id.* at 206.
40. *Id.*
41. Tamari v. Bache & Co. S.A.L., 730 F.2d 1103, 1108 (7th Cir. 1984).
42. Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 989 (2d Cir. 1975).
43. Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 COLUM. J. TRANSNAT'L L. 14, 22 (2007).
44. Beyea, *supra* note 9, at 543.
45. Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972).
46. *Id.* at 1333–35.
47. *See id.* at 1334.
48. Park, *supra* note 30, at 71.

being "used as a base for manufacturing fraudulent security devices for export, even when these [were] peddled only to foreigners."[49] However, not all conduct within the United States gave rise to jurisdiction by U.S. courts—rather, they did not have jurisdiction when the domestic activity was "merely preparatory" or "relatively small in comparison to those abroad."[50] A plaintiff needed to establish significant activities that directly caused losses to investors outside the United States.[51] These preconditions had to be met by private parties as well as by the SEC.[52]

This rather strict[53] standard has not been upheld by all the circuit courts.[54] In particular, the Third, Eighth, and Ninth Circuits used the most lenient form of the "conduct" test, and held that mere preparation of the conduct may be sufficient to meet the test's requirements.[55] The Fifth and Seventh Circuits used a less strict form of the "conduct" test, and required that the conduct within the United States "directly [caused] the plaintiff's alleged loss in that the conduct forms a substantial part of the alleged fraud and is material to its success."[56] The D.C. Circuit used the strictest form, and required that the American-based conduct had to itself constitute a securities violation.[57]

B. *The Decision in* Morrison

In *Morrison*, Australian shareholders who had purchased stock on an Australian exchange filed a class action lawsuit against an Australian bank for violating the anti-fraud provisions of the Securities Exchange Act.[58] The plaintiffs alleged that they were misled by management's statements concerning

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49. IIT v. Vencap. Ltd., 519 F.2d 1001, 1017 (2d Cir. 1975).
50. Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir. 1975).
51. *Id.* at 993.
52. Park, *supra* note 30, at 71–72.
53. Varen R. Moore, *What Happens in London, Stays in London: The Long and "Strong" Arms of Dodd–Frank's Extraterritorial Provisions*, 16 N.C. BANKING INST. 195, 200 (2012).
54. Kahn, *supra* note 3, at 375 (for a detailed overview of the circuits split).
55. SEC v. Kasser, 548 F.2d 109, 114 (3d Cir. 1977); *see* Park, *supra* note 30, at 72.
56. Kauthar SDN BHD v. Sternberg, 149 F.3d 659, 667 (7th Cir. 1998).
57. Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 31 (D.C. Cir. 1987).
58. Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869, 2873 (2010).

a mortgage servicing company it intended to acquire.[59] The lower courts dismissed the case because of an absence of subject matter jurisdiction.[60] The Supreme Court agreed with the outcome, but rejected the underlying reasoning, specifically disputing the basis for deciding whether to grant extraterritorial applicability to the U.S. securities laws.[61]

The decision was mostly driven by the various factors of the case. The plaintiffs, as well as the defendants, were Australian.[62] The plaintiffs had bought "ordinary shares" of the bank, and the stock was listed on foreign stock exchanges.[63] There were various connections to the United States, most importantly the conduct of a subsidiary in Florida, where allegedly misleading public statements were made, and the listing of American Depositary Receipts ("ADRs")[64] on a U.S. exchange.[65] However, the Supreme Court concluded that the domestic dimensions of the case were negligible, because the case involved no securities listed on a domestic exchange, and all aspects of the purchases complained of by the claimants occurred outside the United States.[66]

First, on a procedural note, the Supreme Court corrected a "threshold error" in the Second Circuit's longstanding approach to questions of extraterritorial reach.[67] Until this decision, federal courts had always treated the question of extraterritorial application of the securities anti-fraud provisions as a question of subject matter jurisdiction.[68] But the Supreme Court held that the question was one of the merits and does not refer "to a tribunal's power to hear a case."[69] As jurisdiction over the present claims is conferred by the Securities Exchange Act,[70] the location of fraudulent conduct does not af-

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59. *Id.* at 2876.
60. *Id.*
61. *Id.* at 2876–83, 2888.
62. *Id.* at 2875–76.
63. *Id.*
64. For a discussion on ADRs and why their nature is an obstacle for the holding of a case *see infra* Part II.
65. Morrison, 130 S. Ct. at 2875, 2883–84 (2010).
66. *Id.* at 2888.
67. *Id.* at 2877–78.
68. Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 984–90 (2d Cir. 1975); Beyea, *supra* note 9, at 546–47.
69. Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869, 2877 (2010).
70. 15 U.S.C. § 78aa (2006).

fect jurisdiction. It is only relevant as to whether a particular fraudulent scheme or act violates Section 10(b), but does not have an impact on whether the federal courts have subject matter jurisdiction over Securities Exchange Act claims.[71] Thus, the Supreme Court addressed whether the plaintiffs' allegations stated a claim for relief.[72]

After this clarification, the Supreme Court reaffirmed[73] the presumption against extraterritoriality: "[T]he legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."[74] The Supreme Court then looked at Section 10(b) of the Securities Exchange Act and found nothing in its language that either explicitly expanded its reach overseas or implicitly indicated Congress' intent to have it apply extraterritorially.[75] Rather, it applies only to deceptive conduct in connection with the purchase or sale of any security registered on a national exchange or any security not so registered.[76] The Court held that the term "national exchange" within Section 10(b) of the Securities Exchange Act only refers to exchanges within the United States. The Court was not able to find any evidence of congressional intent to regulate foreign exchanges, nor could it find any such congressional authority in the established principles of international law.[77] The Supreme Court interpreted the phrase "any security not so registered" to mean purchases and sales of securities that constitute domestic transactions in securities not registered on national exchanges.[78]

However, the Supreme Court's conclusion that Section 10(b) of the Securities Exchange Act did not apply extraterritorially was not enough to settle the matter. Some of the deceptive conduct in this case occurred in the United States, and the Court had to address the relevance of these factors. First, the Supreme Court held that the "conduct" and "effects" tests were inadequate due to their vagueness and ambiguity, point-

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71. *See* Pedrera Sanchez v. Crocs, Inc., No. 11-1116, 2016 U.S. App. LEXIS 13285, at *19 (10th Cir. 2016).
72. *Morrison*, 130 S. Ct. at 2877 (2010).
73. *See, e.g.,* Foley Bros., Inc. v. Filardo, 69 S. Ct. 575 (1949).
74. *Morrison*, 130 S. Ct. at 2877 (2010).
75. *Id.* at 2881.
76. *Id.* at 2884.
77. *Id.* at 2884–85.
78. *Id.* at 2884–87.

ing out that they were unpredictable, inconsistent, and that they incorrectly used congressional silence to justify judge-made rules.[79] It formulated a new test for domesticity by looking at the "focus" of the Securities Exchange Act.[80] This focus is the purchase and sale of securities, rather than the place where the deceptive conduct originated.[81] The Supreme Court derived in effect a two-prong test out of this conclusion:[82] the first prong is that the security must be listed on a domestic exchange, and the second prong is that the transaction regarding other securities not listed on a domestic exchange must take place in the United States.[83] As the case met neither requirements, the plaintiffs "failed to state a claim on which relief could be granted."[84]

II.
The Implications Following the *Morrison* Decision

A. *Introduction*

While the Supreme Court had hoped that the newly adopted test would provide a clear and easy way to determine whether the Securities Exchange Act applies,[85] it has proven in practice to be much more complicated than the Court envisaged.[86] At least with regard to private actions, it is clear that these are altogether subject to *Morrison*,[87] and that it is almost impossible[88] for plaintiffs in foreign-cubed cases to gain re-

79. *Id.* at 2879–80.

80. *Id.* at 2884.

81. *Id.* at 2884.

82. Cornwell v. Credit Suisse Grp., 729 F. Supp. 2d 620, 622–23 (S.D.N.Y. 2010).

83. Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869, 2886 (2010).

84. *Id.* at 2884–88.

85. Richard A. Grossmann, *The Trouble with Dicta: Morrison v. National Australia Bank and the Securities Act*, 41 Sec. Reg. L.J. 349 (2013) (doubting whether the Securities Act does indeed have the same focus as the Securities Exchange Act, and arguing that the different focus of the acts merits different treatment).

86. Slobodchikova, *supra* note 4, at 761.

87. Lee, *supra* note 1, at 632.

88. See for example *In re* Vivendi Universal. S.A. Sec. Litig., 765 F. Supp. 2d 512, 533–34 (S.D.N.Y. 2011), *aff'd sub nom. In re* Vivendi, S.A. Sec. Litig., 838 F.3d 223 (2d Cir. 2016), where the jury awarded $9 billion prior to *Morrison*; this award was however reduced on appeal by roughly eighty percent

dress in the United States under *Morrison*.[89] This issue was addressed by Section 929Y of the Dodd–Frank Act. The Act ordered the SEC to collect public comments and provide a recommendation as to whether and to what extent extraterritorial application of Section 10(b) of the Securities Exchange Act should extend to private rights of action.[90] In April 2012, the SEC released a comprehensive 106-page study that laid out the possible alternatives to a private right of action, as proposed by trade groups, academics, and foreign governments.[91] The report made no specific recommendations to Congress regarding the steps it should take going forward—indeed, one option proposed by the SEC "would be for Congress to take no action."[92] At least until now, it seems that Congress has followed this recommendation.

The situation is, however, entirely different for SEC and DOJ enforcement actions. First of all, an almost 100-year-old case—*United States v. Bowman*[93]—raises the question of whether governmental authorities can circumvent *Morrison* in enforcement actions regarding criminal matters. Furthermore, an amendment to the Securities Exchange Act introduced by the Dodd–Frank Act seems to have been intended to reverse *Morrison* with regard to these actions. At first glance, it is unclear if this has been achieved.

B. *Different Reach for Criminal Enforcement?*

In *United States v. Bowman*, the Supreme Court applied a criminal anti-fraud statute extraterritorially despite applying the presumption against extraterritoriality to a similar civil statute thirteen years earlier.[94] The Supreme Court came to this conclusion, because "the same rule of interpretation

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post-*Morrison*, because the Court restricted the scope of the case to purchasers of Vivendi's ADRs.

89. Moore, *supra* note 53, at 209.

90. Study on Extraterritorial Private Rights of Action, Exchange Act Release No. 63,174, 99 SEC Docket 2249 (Oct. 25, 2010).

91. SEC Staff, Study on the Cross-Border Scope of the Private Right of Action Under Section 10(b) of the Securities Exchange Act of 1934 (2012), https://www.sec.gov/news/studies/2012/929y-study-cross-border-private-rights.pdf.

92. *Id.* at 58–59.

93. United States v. Bowman, 260 U.S. 94 (1922).

94. Am. Banana Co. v. United Fruit Co., 213 U.S. 347 (1909).

should not be applied to criminal statutes, which are, as a class, not logically dependent on their locality for the government's jurisdiction, but enacted because of the right of the government to defend itself against obstruction, or fraud wherever perpetrated."[95] This reasoning has not only led many courts to apply a number of criminal statutes extraterritorially,[96] but also has led to a split among the courts regarding the reach of *Bowman*.

Several courts adopted a very narrow approach.[97] They believed "a court can overcome the presumption and infer congressional intent to apply" those statutes extraterritorially only to "statutes that protect" contracts with the government "from fraud and obstruction."[98] Other courts interpreted *Bowman* more broadly and considered governmental interests,[99] the nature of the offense,[100] and policy considerations[101] to determine whether a statute applies extraterritorially.[102]

So far, only the Second Circuit has addressed this issue with regard to the Securities Exchange Act. In *United States v. Vilar*, the court held that criminal actions by the DOJ for Section 10(b) violations were subject to the presumption against extraterritoriality.[103] The court limited *Bowman's* holding to cases in which the government defends its own rights, such as preventing fraud against itself. According to the court, *Bowman* articulated a presumption against extraterritorial applica-

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95. *Bowman*, 260 U.S. at 98.

96. *See, e.g.*, United States v. Gatlin, 216 F.3d 207 (2d Cir. 2000); United States v. Mitchell, 553 F.2d 996 (5th Cir. 1977); United States v. Dawn, 129 F.3d 878 (7th Cir. 1997); United States v. Vasquez-Velasco, 15 F.3d 833 (9th Cir. 1994); United States v. Frank, 599 F.3d 1221 (11th Cir. 2010).

97. *See* United States v. Goldberg, 830 F.2d 459, 462 (3d Cir. 1987) (finding that Bowman "held that in cases of offenses against the operations of the Government of the United States, Congress need not have specified that extraterritorial jurisdiction existed before there could be prosecution in our courts"); *Gatlin*, 216 F.3d at 211.

98. Zachary D. Clopton, *Bowman Lives: The Extraterritorial Application of U.S. Criminal Law after Morrison v. National Australia Bank*, 67 N.Y.U. ANN. SURV. AM. L. 137, 167 (2011).

99. *See* Stegeman v. United States, 425 F.2d 984, 986 (9th Cir. 1970); United States v. Aguilar, 883 F.2d 662, 692 (9th Cir. 1989).

100. Brulay v. United States, 383 F.2d 345, 350 (9th Cir. 1967).

101. United States v. Wright-Barker, 784 F.2d 161, 167 (3d Cir. 1986).

102. *See* Clopton, *supra* note 98, at 165–72 (for a detailed overview of the caselaw).

103. United States v. Vilar, 729 F.3d 62 (2d Cir. 2013).

tion of federal statutes. However, the court found that an exception applies for certain criminal statutes that are enacted to enable the government to defend itself against obstruction or fraud wherever perpetrated.[104] With respect to Section 10(b) of the Securities Exchange Act, the court concluded that *Bowman's* exception does not apply because that statute's purpose is not to defend the government's rights, but rather to prohibit crimes against private individuals or their property.[105] The court relied mostly on the text of *Bowman*, but also stressed that the presumption applies in order to prevent international discord.[106] For these reasons, the court held that the presumption against extraterritoriality applies to Section 10(b) of the Securities Exchange Act.[107]

At least for now, it does not seem that *Bowman* supports extraterritorial enforcement. However, this should not lead one to believe that *Bowman* is no longer good law—several courts have held that this decision can still be applied after *Morrison* outside of the Securities Exchange Act.[108] This conclusion is indeed justified, as *Bowman* explicitly recognized the

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104. *Id.* at 73.

105. *Id.* at 72.

106. *Id.* at 74. The court did not address the issue of whether governmental agencies have the inherent power to overcome the presumption against extraterritoriality, and possess the authority to create international discord. *See* David Keenan & Sabrina P. Schroff, *Taking the Presumption against Extraterritoriality Seriously in Criminal Cases after Morrison and Kiobel*, 45 LOY. U. CHI. L.J. 71, 90–91 (2013) (stating this is the case because prosecutors speak on behalf of the U.S. government); Curtis A. Bradley & Jack L. Goldsmith, *Customary International Law as Federal Common Law: A Critique of the Modern Position*, 110 HARV. L. REV. 815, 861 (1997) (addressing that the federal political branches are constitutionally authorized and institutionally competent to make foreign relations judgments).

107. United States v. Vilar, 729 F.3d 62, 74 (2d Cir. 2013).

108. *See* United States v. Leija-Sanchez, 820 F.3d 899, 901 (7th Cir. 2016) ("A decision such as Bowman . . . is not affected by yet another decision showing how things work on the civil side"); United States v. Weingarten, 632 F.3d 60, 66 (2d Cir. 2011) (holding that the prohibition on sex tourism applies extraterritorially based on *Morrison* and *Bowman* because the statute explicitly applies to travel in foreign commerce and congressional intent for extraterritorial application may be inferred); United States v. Belfast, 611 F.3d 783, 810–16 (11th Cir. 2010) (noting Morrison's affirmation of the presumption, applying the Torture Act extraterritorially based on its explicit language, and applying the use and carrying of a firearm in relation to a crime of violence extraterritorially based on *Bowman*).

presumption's continuing validity on ordinary criminal cases.[109]

There are good reasons to apply *Morrison* to civil and criminal actions alike, given the forceful articulation of the presumption against extraterritoriality in *Morrison*. Looking at *Morrison* itself, it does not indicate anywhere that it applies only to the civil context. Rather, the Supreme Court rested the presumption against extraterritoriality on the general observation that "Congress ordinarily legislates with respect to domestic, not foreign matters."[110] This observation is no less true with regard to criminal, as opposed to civil, matters.

Additionally, the Supreme Court held that the presumption is justified because it preserves "a stable background against which Congress can legislate with predictable effects."[111] If one of the advantages of the presumption is predictability, it would be severely undermined if courts had to grapple with the intent behind each law anew, to determine whether it applies only in the criminal or civil context. Indeed, this would lead to "judicial-speculation-made-law,"[112] which *Morrison* tries to prevent.

Finally, the Supreme Court held that courts have to "give the statute the effect its language suggests . . . not to extend it to admirable purposes it might be used to achieve."[113] This notion renders policy arguments regarding the functionalist differences between civil and criminal matters mute. At first glance, it might be true that with regard to the SEC and the DOJ, courts could reasonably expect that there will be some coordination between the State Department and the executive agencies, and in this case there is less risk for unwanted international friction.[114] Furthermore, due to resource constraints, there is only a small chance that actions brought by these agencies will result in a flooding of the courts with unreasonable claims.[115] But if Congress had wanted these issues to be

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109. United States v. Bowman, 260 U.S. 94, 98–99 (1922).
110. Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869, 2877 (2010).
111. *Id.* at 2881.
112. *Id.*
113. *Id.* at 2886.
114. *See* Clopton, *supra* note 98, at 187.
115. Allison Marston Danner, *Enhancing the Legitimacy and Accountability of Prosecutorial Discretion at the International Criminal Court*, 97 AM. J. INT'L L. 510, 519 (2003).

considered, it would have explicitly implemented corresponding rules. After all, whether such considerations prevail is a different question than whether courts should interpret a statute to apply extraterritorially or not.[116] Taken together, there is no reason to assume that *Morrison* intended to treat criminal enforcement differently than civil enforcement.

C. *Section 929P(b) of Dodd–Frank*

The Dodd–Frank Act spans over 2,300 pages, affecting nearly every aspect of the financial services industry and representing the single most significant reform of U.S. financial regulation in over eighty years.[117] Congress passed this Act a month after *Morrison* was decided. It contains a last-minute, seemingly "hastily-drafted" Section 929P(b) that reflects Congress' reaction to the Supreme Court's decision in *Morrison*.[118] However, this amendment was drafted before the decision was rendered, the legislature had to rely on assumptions about what the Supreme Court might possibly decide, and did not make changes to the draft after the decision was published. For actions brought by the SEC and the DOJ, it establishes a statutory basis for the jurisdiction of claims under the antifraud provisions of the Securities Exchange Act and the Securities Act. Section 929P(b) states:

> The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 17(a) involving—
>
> (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
>
> (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.[119]

Despite the SEC and the Solicitor General's assertions that the application of Section 10(b) of the Securities Ex-

116. Keenan & Schroff, *supra* note 106, at 92.
117. He, *supra* note 14, at 166.
118. Richard Painter et al., *supra* note 36, at 19–20.
119. Dodd–Frank Act, Pub. L. No. 111-203, 124 Stat. 1864 (2010).

change Act was not a question of jurisdiction,[120] Section 929P(b) only says that courts have subject matter jurisdiction over an action brought by the SEC and DOJ involving securities fraud. Read literally, Section 929P(b) grants the SEC and the DOJ jurisdiction over anti-fraud violations that no court ever denied they possessed.[121] But the Supreme Court did not decide *Morrison* on jurisdictional grounds. Rather, it held that the pertinent securities law did not cover "foreign" transactions. This statutory provision has triggered intense debate about whether it overrules *Morrison*. While this does not appear to be the case from the plain text, it seems that congressional intent points in a different direction.[122] It seems that the validity of securities fraud actions brought by the U.S. government should continue to be measured by the "conduct" and "effects" tests rather than by the transactional test.

Several congressional debates that took place after *Morrison* indicate that Congress intended for Dodd–Frank to reverse this decision. Representative Paul Kanjorski, the sponsor of Section 929P(b), referenced the *Morrison* decision and stated that the "bill creates a single national standard for protecting investors affected by transnational frauds by codifying the authority to bring proceedings under both the "conduct" and the "effects" tests developed by the courts regardless of the jurisdiction of the proceedings."[123] Representative Kanjorski's intent clearly seems to give the anti-fraud provisions extraterritorial application.[124]

Furthermore, if courts treat Section 929P(b) as merely jurisdictional, this provision would be superfluous, because it

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120. *See* Brief for the United States as Amicus Curiae Supporting Respondents at 6 n.1, *Morrison*, 130 S. Ct. at 2869 (No. 08-1191), 2009 WL 3460235.

121. He, *supra* note 14, at 167.

122. *See* Richard W. Painter, *The Dodd–Frank Extraterritorial Jurisdiction Provision: Was it Effective, Needed or Sufficient?*, 1 HARV. BUS. L. REV. 195, 200–05 (2011).

123. 156 CONG. REC. H5205, 5237 (daily ed. June 30, 2010).

124. *Id.* ("Thus, the purpose of the language of section 929P(b) of the bill is to make clear that in actions and proceedings brought by the SEC or the Justice Department, the . . . [anti-fraud provisions] may have extraterritorial application, and that extraterritorial application is appropriate, irrespective of whether the securities are traded on a domestic exchange or the transactions occur in the United States, when the conduct within the United States is significant or when conduct outside the United States has a foreseeable substantial effect within the United States").

would essentially bring about no change whatsoever since courts did not lack jurisdiction. Given the clear congressional intent, most commentators stated (without much discussion) that the Dodd–Frank Act reversed *Morrison*,[125] even though some acknowledge that the amendment might be inaccurate.[126] However, this is not the only possible interpretation of the congressional intent, because, as one commentator, Richard Painter, has pointed out, Congress could have indeed intended something entirely different with its amendment. Congress could have wanted to address the extraterritorial application of the federal securities laws as a question of jurisdiction—as the courts had done before *Morrison*—and to address the merits of Section 10(b) by saying that federal courts have jurisdiction over certain DOJ and SEC actions.[127] Thus, the interpretation of Congress' intent is more complicated than it may initially appear.

In the end, however, what Congress may have intended might not be relevant, as case law provides compelling arguments to disregard the legislative history since the plain language of the present statute is not ambiguous. The language clearly grants jurisdiction to district courts over enforcement actions under Section 10(b) by the SEC and DOJ and leaves no room for other interpretations. The lack of ambiguity of the wording of Section 10(b) has two consequences. First, the potential surplusage of the statute does not mean that it has to

125. *See* John C. Coffee, Jr., *Symposium on Extraterritoriality: Essay: Extraterritorial Financial Regulation: Why E.T. can't come Home*, 99 CORNELL L. REV. 1259, 1261 n.6 (2014); John E. Birkenheier & George Vasios, *The Application of Morrison in an Era of Electronic Trading and Increasingly Global Markets*, 15 J. BUS. & SEC. L. 53, 56–57 (2015); Park, *supra* note 30, at 77; Lee, *supra* note 1, at 645; He, *supra* note 14, at 167–68; White, *supra* note 17, at 1230–31.

126. Nidhi M. Geervarghese, Note, *A Shocking Loss of Investor Protection: The Implications of Morrison v. National Australia Bank*, 6 BROOK. J. CORP. FIN. & COM. L. 235, 250 (2011) ("Congress may have erroneously addressed the power of the federal courts to hear a case, rather than the scope of the antifraud provisions of the Exchange Act."); Andrew Rocks, *Whoops! The Imminent Reconciliation of U.S. Securities Laws with International Comity after Morrison v. National Australia Bank and the Drafting Error in the Dodd–Frank* Act, 56 VILL. L. REV. 163, 188–98 (2011); Beyea, *supra* note 9, at 540 (noting that the amendment "may be ineffective"); Moore, *supra* note 53, at 216 (stating that it is unclear whether the amendment addresses "Morrison's core holding").

127. Painter, *supra* note 122, at 203.

be interpreted contrary to its plain meaning.[128] As the Supreme Court has pointed out, "it is beyond our province to rescue Congress from its drafting errors."[129] Second, the Supreme Court ruled that the legislative history of a statute does not have to be considered when its text is plain and unambiguous.[130]

And indeed, so far courts have shown little willingness to deviate from the literal meaning of Section 929P(b) of the Dodd–Frank Act. Courts have only assessed it in some detail in two cases, albeit as dicta. In other cases, courts addressed this issue only briefly (or even in a footnote), and either paraphrased Section 929P(b),[131] mentioned that Congress may have intended to overwrite *Morrison*,[132] or did indeed reinstate

128. Marx v. Gen. Revenue Corp., 568 U.S. 371, 385 (2013) ("The canon against surplusage is not an absolute rule"); Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy, 548 U.S. 291, 299 n. 1 (2006) ("While it is generally presumed that statutes do not contain surplusage, instances of surplusage are not unknown").

129. Lamie v. U.S. Trustee, 540 U.S. 526, 542 (2004) (quoting United States v. Granderson, 511 U.S. 39, 68 (1994)).

130. *Id.* at 534 ("It is well established that 'when the statute's language is plain, the sole function of the court—at least where the disposition required by the text is not absurd—is to enforce it according to its terms") (quoting Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6 (2000) (internal quotation marks omitted) (in turn quoting United States v. Ron Pair Enterprises, Inc. 489 U.S. 235, 241 (1989) (in turn quoting Caminetti v. United States, 242 U.S. 470, 485 (1917))).

131. Without scrutinizing the scope of the provision see Asadi v. G.E. Energy (USA), LLC, No. 4:12-345, 2012 U.S. Dist. LEXIS 89746, at *17–18 (S.D. Tex. June 28, 2012) ("Section 929P(b) gives the district courts extraterritorial jurisdiction . . . over certain enforcement actions brought by the SEC or the United States."); Liu Meng-Lin v. Siemens AG, 763 F.3d 175, 181 (2d Cir. 2014) ("Congress provided the district court with limited extraterritorial jurisdiction over specific types of antifraud suits brought by governmental entities . . . "); *but see* Meng-Lin Liu v. Siemens A.G., 978 F. Supp. 2d 325, 328 (S.D.N.Y. 2013) (the District Court affirmed the extraterritorial application without discussion, "Section 929P(b) permits the SEC to bring enforcement actions for certain conduct or transactions outside the United States").

132. SEC v. Compania Internacional Financiera S.A., No. 11 Civ. 4904(DLC), 2011 U.S. Dist. LEXIS 83424, at *19 n.2 (S.D.N.Y. July 29, 2011); SEC v. Sabrdaran, No. 14-cv-04825-JSC, 2015 U.S. Dist. LEXIS 25051, at *46 (N.D. Cal. March 2, 2015); SEC v. Brown, No. 14 C 6130, 2015 U.S. Dist. LEXIS 25787, at *16–17 (N.D. Ill. Mar. 4, 2015).

the "conduct" and "effects" tests.[133] However, no courts have had yet to decide this "complex interpretation issue."[134]

The most in-depth scrutiny was conducted by the District Court for the Northern District of Illinois in *SEC v. Chi. Convention Ctr.*[135] Through general methods of statutory interpretation, the court stressed that if the statute's language is plain, the sole function of the court is to enforce it according to its terms, unless doing so would frustrate the overall purpose, lead to absurd results, or contravene clearly expressed legislative intent. If the plain meaning is unclear, outside considerations—like the legislative history—can be used to glean legislative intent.[136] The meaning of 10(b) seemed to the court "clear on its face,"[137] and it appears in the jurisdictional portions of the Exchange Act.

The court then acknowledged that a plain reading of the words of the statute leads to the superfluity of the provision, given that the Court in *Morrison* concluded that federal courts already had the power to hear SEC enforcement cases involving foreign transactions.[138] However, the court emphasized that it is unclear whether it should construe a provision that appears unambiguous on its face to avoid superfluity.[139] The court then took a closer look at the legislative history and acknowledged that it clearly intended to reinstate the "conduct" and "effects" tests. However, the court wasn't clear about what weight it should give to the legislative history that is contrary to

133. *In re* Optimal U.S. Litig., 865 F. Supp. 2d 451, 456 n.28 (S.D.N.Y. 2012) (noting that Congress restored "the conducts and effects test for SEC enforcement actions"); Perkumpulan Inv'r Crisis Ctr. Dressel-WBG v. Wong, No. C09-1786-JCC, 2014 WL 1047946, at *11 (W.D. Wash. Mar. 14, 2014) ("Congress expressly sought to preserve the S.E.C.'s enforcement authority as it relates to extraterritorial securities fraud."); S.E.C. v. Gruss, No. 11 Civ. 2420, 2012 WL 3306166, at *3 (S.D.N.Y. Aug. 13, 2012) ("Section 929P(b) of the Dodd–Frank Act allows the SEC to commence civil actions extraterritorially in certain cases."); S.E.C. v. Tourre, No. 10 Civ. 3229(KBF), 2013 WL 2407172, at *1 n.4 (S.D.N.Y. June 4, 2013) ("[T]he Dodd–Frank Act effectively reversed Morrison in the context of SEC enforcement actions . . . .").

134. *See* S.E.C. v. Chi. Convention Ctr., LLC., 961 F. Supp. 2d 905, 916 (N.D. Ill. 2013).

135. *Id.*

136. *Id.* at 912.

137. *Id.*

138. *Id.* at 913.

139. *Id.* at 913–14.

the plain text.[140] It is clear that "legislative history 'does not permit a judge to turn a clear text on its head.'"[141] In the opinion of the court, the matter is further complicated because the text of the provision was not amended after the *Morrison* decision was rendered.[142] However, the court ultimately decided not to resolve this issue, because the SEC's complaint survives under either the *Morrison* transactional test or the "conduct" and "effects" tests.[143]

In the most recent decision to date, *SEC v. Battoo,*[144] the court decided a case in which the conduct in question happened before the Dodd-Frank Act's enactment. As it held that the Dodd-Frank Act does not apply retroactively, the court did not have to address whether the "conduct" and "effects" tests were reinstated by the Dodd-Frank Act.[145] Nevertheless, the court showed unease in concluding that the Dodd-Frank Act reversed *Morrison*. It pointed out that Section 929P(b) gives courts subject matter jurisdiction, but *Morrison* held that the pertinent securities law did not cover foreign transactions.[146]

Even though the Dodd-Frank Act was enacted seven years ago, it is still not clear whether the "conduct" and "effects" tests or the transactional test applies to actions brought by the SEC or the DOJ. As elaborated above, the case law provides compelling arguments that prove that the legislative history should be bypassed. Given that the courts have taken different approaches to resolving this issue, it seems likely that courts will be split when addressing it in the future. To circumvent this problem, one solution would be to avoid the application of federal law altogether and seek relief under state laws (common law fraud, unjust enrichment, and breach of fiduciary duty).[147]

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140. *Id.* at 915.

141. *Id.* (quoting Spivey v. Vertrue Inc., 528 F.3d 982, 985 (7th Cir. 2008)).

142. *Id.*

143. Also, other courts declined to answer this question based on this conclusion. *See* SEC v. Funinaga, No. 2:13-CV-1658 JCM (CWH), 2014 WL 4977334, at *7 (D. Nev. Oct. 3, 2014).

144. SEC v. Battoo, 158 F. Supp. 3d 676 (N.D. Ill. 2016).

145. *Id.* at 692.

146. *Id.* at 693.

147. White, *supra* note 17, at 1234–35.

III.
Brave New World: Non-Conventional Securities

A. *Introduction*

Even if the Dodd–Frank Act reinstated the "conduct" and "effects" tests for actions by the SEC and DOJ, at least with regard to private claims the question remains how the transactional test is to be applied. And while the first prong in *Morrison*—transactions in securities listed on domestic exchanges—seems to be rather straightforward, courts have struggled with its implementation, and have indeed held that listing on a domestic exchange alone is not sufficient.[148] With regard to the second prong, *Morrison* "provide[d] little guidance as to what constitutes a domestic purchase or sale."[149] Given the complexity of non-conventional financial instruments, the effectiveness of a one-sentence criterion for the application of U.S. law has proven unrealistic. Courts had to refine the transactional test in order to apply it to the many different forms that financial instruments can take in practice, and they predominately used three methods to make this determination:[150] the transfer of title test,[151] the irrevocable liability test,[152] and the

148. Even without looking at complex non-conventional financial instruments, the scope of this prong has been difficult to assess. For example, the decision provides no guidance on how to address cross-listed (shares that are traded primarily on a local exchange, but are also traded in a secondary listing) and dual-listed (shares that are directly listed on multiple stock exchanges) companies. *See* City of Pontiac Policemen's & Firemen's Rent. Sys. v. UBS AG, 752 F.3d 173 (2d Cir. 2014) (holding that it is not sufficient if a company is simply cross-listed on a domestic stock exchange because the paramount factor is the location of the securities transaction and not the location of the stock exchange); *In re* UBS Sec. Litig., 2011 U.S. Dist. LEXIS 106274, at *14 (S.D.N.Y. 2011) (holding that only the location of the transaction, and not the exchange, is relevant, thus a dual-listing on a domestic exchange is not sufficient).

149. Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012).

150. Bruno, *supra* note 23, at 445.

151. *See* Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1310–11 (11th Cir. 2011) (vacating the lower court's dismissal because the stocks closed in Miami and the title of shares was transferred to the plaintiff).

152. *See* Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co., 753 F. Supp. 2d 166, 178 (S.D.N.Y. 2010) (holding that it is not sufficient to place a buy order for the stock in the United States because the plaintiffs did not incur irrevocable liability at that point of the transaction).

economic reality test.[153] However, the tests were not able to meet the challenges that the transactional test provided for non-conventional securities. The following section provides an overview of the development of the case law with regard to derivatives and other non-conventional securities.

B. *The First Prong: Just Securities Listed or Also Securities Traded?*

A literal reading of the language of the holding in *Morrison* implies that the anti-fraud provisions will apply as soon as a security is listed on a domestic exchange. Indeed, the phrase "securities listed on domestic exchanges" was repeated three times in the opinion, which indicates that the Court meant what it wrote.[154] Furthermore, the opinion's emphasis on protecting domestic exchanges supports this outcome, because if the securities are listed on a domestic exchange, no matter where fraud is conducted, it will have an effect on the price of those securities on the domestic exchange.[155] Indeed, courts have had little trouble finding that if a transaction takes place on an exchange outside the United States, Section 10(b) of the Securities Exchange Act does not apply, no matter where the fraudulent conduct occurred.[156]

However, the conclusion that only the place of listing is relevant contradicts the facts of *Morrison*: National Australia Bank's ADRs were listed on a domestic exchange. ADRs are certificates that give an owner the right to obtain the underlying foreign stock they represent, and they are securities under the Securities Exchange Act.[157] However, the owner of an ADR certificate does not hold title to the foreign shares it refer-

153. *See* Valentini v. Citigroup, Inc., 837 F. Supp. 2d 304, 324 (S.D.N.Y. 2011) (holding that plaintiffs' convertible notes were in reality put options in domestic stocks).

154. Morrison v. Nat'l Austl. Bank, 561 U.S. 247, 267–70 (2010).

155. Beyea, *supra* note 9, at 564.

156. Cornwell v. Credit Suisse Group, 729 F. Supp. 2d 620, 623–24 (S.D.N.Y. 2010) (holding that Section 10(b) of the Securities Exchange Act does not "apply to transactions involving a purchase or sale, wherever it occurs, of securities listed only on a foreign exchange."); Stackhouse v. Toyota Motor Co., Nos. CV 10-0922 DSF (AJWx), et al., 2010 U.S. Dist. LEXIS 79837, at *2 (C.D. Cal., 2010).

157. S.E.C., Investor Bulletin: American Depositary Receipts, 1 (Aug. 2012), https://www.sec.gov/investor/alerts/adr-bulletin.pdf.

ences.[158] The title owner of the underlying shares is either the depositary, the custodian, or their agent.[159] American investors prefer to hold the ADR certificate rather than the foreign stock certificate, as they perceive those to be more secure than the underlying foreign stock since ADRs are subject to the Securities Act and the Securities Exchange Act.[160] While ADRs are usually exchange traded, this does not have to be the case.[161]

However, the ADRs in *Morrison* were listed on the New York Stock Exchange.[162]Additionally, if a company lists ADRs on a national stock exchange, the ADRs must be registered with the SEC according to Section 12(b) of the Exchange Act,[163] and the registration process typically involves the registration of two securities: the underlying shares and the ADRs themselves.[164] Furthermore, ordinary shares underlying the listed ADRs are technically also listed on the exchange.[165] The Court's conclusion in *Morrison* that the relevant securities were not listed on a domestic exchange seems to be inaccurate, since the National Australia Bank's common stock was listed on the New York Stock Exchange.

And indeed, courts have struggled with the listing on domestic exchanges requirement ever since *Morrison* was published. So far, courts have yet to address (security-based) swaps,[166] and only one decision concerned Contracts for Dif-

158. He, *supra* note 14, at 182.

159. Pinker v. Roche Holdings Ltd., 292 F.3d 361, 367 (3d Cir. 2002).

160. *Id.* at 367 ("ADRs were created in 1927 to assist American investors who wanted to invest internationally, but were reluctant to do so due to regulatory and currency exchange difficulties.").

161. He, *supra* note 14, at 184.

162. Morrison v. Nat'l Austl. Bank, 561 U.S. 247, 251 (2010).

163. 15 U.S.C. § 78l(b) (2006).

164. Cleary Gottlieb Steen & Hamilton LLP, *Guide to Public ADR Offerings in the United States*, 11 (Oct. 1, 2012), https://www.clearygottlieb.com/~/media/cgsh/files/publication-pdfs/guide-to-public-adr-offerings-in-the-united-states-2012.pdf.

165. *In re* Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512, 528 (S.D.N.Y. 2011), *aff'd sub nom. In re* Vivendi Universal, S.A. Sec. Litig., 838 F.3d 223, 265 (2d Cir. 2016).

166. A security swap is a financial instrument that allows investors to manage risk. It is a derivative contract through which two parties exchange financial instruments, and parties bet on the underlying instruments. These instruments can be almost anything, and often reference securities of a foreign jurisdiction. *See* Slobodchikova, *supra* note 4, at 743.

ference (CFDs).[167] However, the case law developed with regard to ADRs provides some clues about how other nonconventional securities might be treated. The following section provides arguments about why the lower courts misread the *Morrison* decision when they predominately decided that it does not apply to venues outside the stock exchange, and also erred when they established a trade requirement for listed securities.

1. *Over-the-Counter Transactions*

Transactions that don't occur on an exchange are typically referred to as "over-the-counter" (OTC) transactions. They allow parties to exchange stocks, bonds, derivative products, ADRs, and other financial instruments directly or through a registered broker-dealer, without the use of a centralized trading platform, such as a securities exchange.[168] The broker-dealers themselves have to meet registration requirements,[169] and the anti-fraud provisions in Section 10(b) apply to these markets.[170] The question is: Under what conditions is a transaction on this market considered domestic?

The Southern District of New York had to address this issue in September 2010, just a few weeks after *Morrison* was rendered. In *In re Société Générale Securities Litigation*, one of the plaintiffs purchased ADRs in the U.S. OTC market, and brought an action claiming anti-fraud violations with regard to those trades.[171] Without much discussion about the nature of ADRs, the court found that those were predominantly foreign securities transactions under *Morrison*.[172] The court held that ADRs were not traded on an official U.S. securities exchange,

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167. Freudenberg v. E*Trade Fin. Corp., Nos. 07 Civ. 8538, 07 Civ. 8808, 07 Civ. 9651, 07 Civ. 10400, 07 Civ. 10540, 2008 U.S. Dist. LEXIS 62767, at *7 (S.D.N.Y. 2008) ("CFD purchasers acquire the future price movement of the underlying company's common stock (positive or negative) without taking formal ownership of the underlying shares. . . . CFDs have no fixed expiration date, CFD holders receive the benefit of any dividends paid on the underlying shares, and the CFD may include voting rights on the underlying shares.").

168. He, *supra* note 14, at 179.

169. 15 U.S.C. § 78o(a)–(b) (2011).

170. 15 U.S.C. § 78j(b) (2011).

171. *In re* Société Générale Sec. Litig., No. 08 Civ. 2495(RMB), 2010 U.S. Dist. LEXIS 107719 (S.D.N.Y. 2010).

172. *Id.* at *19–21.

but in a less formal market with lower exposure to U.S.-resident buyers.[173] This decision was criticized for "evinc[ing] a poor understanding of transactions in ADRs."[174] Indeed, the court relies on a literal reading of *Morrison* and disregards the fact that the transactions, whether OTC or over centralized trading platforms, can take place in the United States. Nevertheless, this case remains good law, and provides an argument that ADRs or other non-conventional securities traded on a less formal market than the stock exchange, may not be considered as securities listed on a domestic exchange under *Morrison.*

Several recent decisions confirm this understanding.[175] For example, in *In re: Volkswagen "Clean Diesel" Marketing,* Volkswagen's ADRs represented foreign shares on a German exchange and were traded on an American OTC market.[176] Without looking at the nature of the ADRs for the purpose of the first prong (that the security must be listed on a domestic exchange) or the nature of transactions taking place on the OTC market, the court concluded that this market is not an "exchange" within the meaning of *Morrison.*[177] It held that the Securities Exchange Act differentiated between those two markets, and *Morrison* only explicitly referenced "domestic exchanges."[178] For this reason, the first prong of the transactional test was not satisfied. This conclusion isn't restricted to transactions of ADRs. Rather, the Third Circuit has also con-

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173. *Id.* at *20. However, in a separate footnote, the court interprets the decision in *Cornwell* to mean that even if the ADRs had been listed on an official American exchange, because of their predominately foreign nature, the Exchange Act's anti-fraud provisions would still be inapplicable. The court seems to conclude that Section 10(b) Securities Exchange Act is inapplicable to all ADRs. *Id.* at *19 n.5.

174. Beyea, *supra* note 9, at 565 n.170.

175. Myun-Uk Choi v. Tower Research Capital LLC, No. 14 CV 9912 (KMW), 2017 U.S. Dist. LEXIS 18174, at *7 (S.D.N.Y. 2017) ("[T]he CME Globex is not registered with the CFTC as a domestic contract market."); Stoyas v. Toshiba Corp., 191 F. Supp. 3d 1080, 1091 (C.D. Cal. 2016) ("[An] OTC market . . . is likely just that—an OTC market, not an exchange as meant by *Morrison* . . . .").

176. *In re* Volkswagen "Clean Diesel" Marketing, Sales Practices & Prod. Liab. Litig., MDL No. 2672 CRB (JSC) 3:15-md-02672-CRB, 2017 WL 66281 (N.D. Cal. 2017).

177. *Id.* at *3–4 (quoting Stoyas v. Toshiba Corp., 191 F. Supp. 3d 1080 (C.D. Cal. 2016)).

178. *Id.* at *4.

firmed this approach for stocks traded on the OTC market,[179] relying solely on the aforementioned differentiation in the Securities Exchange Act.[180]

Only in *SEC v. Ficeto*[181] did the court decide to go beyond the literal reading of *Morrison*. There, the court conducted an extensive analysis of the history of the Exchange Act and concluded that domestic OTC transactions should be treated the same as transactions on national exchanges.[182] The bright line transactional test differentiates only between foreign and domestic exchanges, but not between domestic exchanges and the OTC market.[183] Furthermore, it concluded that transactions on OTC markets "are as inherently imbued with our national interest as trades on national exchanges."[184] The goal of the Exchange Act is to treat securities the same way, no matter on which kind of market they are traded,[185] and the market manipulation of OTC securities is a type of securities fraud that Section 10(b) of the Securities Exchange Act was meant to address.[186] The court held that *Morrison* did not bar the application of 10(b) to OTC transactions.

The reasoning of the court seems to be far more convincing than the reasoning in the other decisions, because the Supreme Court did not try to establish a rule that covered only certain exchange venues, rather it is almost entirely silent on OTC or other markets. Looking at the underlying reasoning of the decision, it is clear that the Supreme Court had a different focus than a special trading venue, as it did not tie its decision to a specific trading venue. It aimed to establish a general rule that protects investors regarding trades happening on U.S. soil, but did not want its decision to be understood as a limitation to transactions on the securities exchange.

This argument, of course, goes both ways. The Supreme Court decided that "Section 10(b) does not provide a cause of

179. United States v. Georgiou, 777 F.3d 125, 134 (3d Cir. 2015).

180. *See In re* Poseidon Concepts Sec. Litig., No. 13cv1213 (DLC), 2016 WL 3017395, at *12 (S.D.N.Y. 2016) (calling the Third Circuit's logic "compelling").

181. SEC v. Ficeto, 839 F. Supp. 2d 1101 (C.D. Cal. 2011).

182. *Id.* at 1109–10.

183. *Id.* at 1109.

184. *Id.* at 1108.

185. *Id.* at 1110.

186. *Id.*

action to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign exchanges."[187] A literal reading of the term "foreign exchange" would mean that—despite the forceful articulation of the presumption against extraterritoriality—even after *Morrison* an action for trades outside of exchanges, for example on the OTC market, under the "conduct" or "effects" tests would still be permissible and thus not overruled. But the decision reveals that the Supreme Court did not intend such a reading, as it did not draw a strict distinction between the trading venues. That its holding can be extended to markets other than foreign exchanges is also supported by the Court's reasoning with regard to the lack of national public interest to regulate foreign transactions. There, the Court explicitly mentions that such an interest does not exist with regard to securities exchanges and OTC markets.[188] While a literal reading might indeed give reason to believe that the first prong only applies to transactions over national exchanges, an overall assessment of the decision reveals that transactions on other venues are also covered.

2. *Transactions on the Stock Exchange: Listing Alone May Not Be Sufficient*

Regarding ADRs listed on a domestic exchange, there are various possible scenarios where a solution cannot be clearly established under *Morrison*. The underlying stock could be either registered on a domestic or foreign stock exchange, a party could buy the stock itself on a foreign exchange, or the stock could be traded only on a foreign exchange. Courts have struggled to draw a clear line, and it seems like, contrary to a literal reading of *Morrison*, the listing on a domestic stock exchange does not warrant the application of Section 10(b) of the Securities Exchange Act.[189]

In *United States v. Martoma*, the defendant moved to dismiss two insider trading charges, and argued that transactions in ADRs were extraterritorial transactions not covered by Sec-

187. Morrison v. Nat'l Austl. Bank, 561 U.S. 247, 247 (2010).

188. *Id.* at 263.

189. Alexander S. Birkhold, *The Problematic Extraterritorial Reach of U.S. Regulators and Nonconventional Securities*, 40 YALE J. INTL. L. ONLINE 1, 4 (2015).

tion 10(b) of the Securities Exchange Act.[190] The court rejected this argument, and held that the ADRs in question were securities, and were listed and traded on the New York Stock Exchange.[191] Consequently, the first prong of *Morrison* was satisfied. The court distinguished *Société Générale* because the ADRs at issue were traded on the New York Stock Exchange, "which means that the formation of contracts for those trades, the passing of the title and the incurring of the liability on the part of sellers and purchasers occurred in the U.S."[192] The court did not address where the represented stock was traded or purchased. Rather, the trade of the ADRs on the New York Stock Exchange was sufficient. Hence, if the shares that are represented by ADRs on a domestic stock exchange are purchased outside the United States, the first prong would also be technically satisfied, as in this case the stock is also listed on the domestic stock exchange.

Nevertheless, other courts have rejected this so-called "listing theory," calling it a "selective and overly technical reading of *Morrison*."[193] The courts seem to focus predominantly on the place where the represented stock is traded. Contrary to the courts' reasoning concerning OTC transactions, the courts try to grapple with the intent of the Supreme Court—and stress that the latter "was concerned with the territorial location where the purchase of the sale was executed."[194]

Some courts have gone even further and assumed that the Supreme Court in *Morrison* simply misunderstood the implication of his decision. "[The Supreme Court] stated the test as being whether the alleged fraud concerned the purchase or sale of a security listed on an American stock exchange, when he really meant to say a security listed and traded on a domestic exchange."[195] In *In re* Vivendi Universal. S.A. Sec. Litig., the shares traded primarily on an exchange in France. They were registered under Section 12(b) of the Exchange Act, but were

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190. United States v. Martoma, No. S1 12 Cr. 973(PGG), 2013 WL 6632676 (S.D.N.Y. Dec. 17, 2013).

191. *Id.* at *3.

192. *Id.* at *5.

193. *In re* Alstom SA Sec. Litig., 741 F. Supp. 2d 469, 472 (S.D.N.Y. 2010).

194. *Id.*

195. *In re* Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512, 530 (S.D.N.Y. 2011), *aff'd sub nom. In re* Vivendi, S.A. Sec. Litig., 838 F.3d 223, 265 (2d Cir. 2016) (the Second Circuit only addressed the second prong).

not listed on a U.S. exchange. Only the ADRs were listed on the New York Stock Exchange. The court held that registering of shares is not the same as listing the stock on an exchange.[196] It concluded that the purchase had not been domestic since the shares were not actually traded on a domestic exchange.[197]

Whether shares themselves are listed or registered does not change the outcome of the application of Section 10(b) of the Securities Exchange Act if the shares are nevertheless traded on a foreign stock exchange. Instead, courts[198] held that Section 10(b) only applies to securities transactions that take place on a domestic exchange.[199] It seems that so far the courts have applied a rather strict approach, and have struck down cases relating to ADRs under the first prong as long as the represented stock is not traded on a domestic exchange.

Yet this approach is not restricted to ADRs and has also been applied to CFDs.[200] In *SEC v. Compania Internacional Finaciera*, the defendants had traded CFDs in the United Kingdom with respect to a U.S. company, whose stock was listed on the New York Stock Exchange.[201] There, the court focused on the language of *Morrison*, and held that the defendants' deceptive trading activities "were tied to the transactions on the NYSE in Arch's domestic securities," and fell within the scope of Section 10(b) of the Securities Exchange Act.[202]

Indeed, as with OTC transactions, it is necessary to read the *Morrison* decision as a whole, and not restricted to its literal meaning. After all, the Supreme Court highlighted in its decision that the Securities Exchange Act is centered on the purchase and sale of securities in the United States. The paramount factor is the place where the transaction is concluded, and not where a company fulfills its reporting requirements by listing or registering its stock. *Morrison's* emphasis on "transac-

196. *In re* Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512, 529 (S.D.N.Y. 2011).

197. *Id.* at 530.

198. *See In re* Infineon Techs. AG Sec. Litig., No. C 04-04156 JW, 2011 U.S. Dist. LEXIS 152965, at *10 (N.D. Cal. Mar. 17, 2011); *In re* Satyam Comput. Servs. Sec. Litig., 915 F. Supp. 2d 450, 475 (S.D.N.Y. 2013).

199. *In re* Satyam Comput. Servs., 915 F. Supp. at 475.

200. *See supra* note 167.

201. SEC v. Compania Internacional Financiera S.A., No. 11 Civ. 4904(DLC), 2011 U.S. Dist. LEXIS 83424 (S.D.N.Y. July 29, 2011).

202. *Id.* at *20–21.

tions in securities listed on domestic exchanges,"[203] makes clear that the focus of both prongs was on domestic transactions of any kind, with the domestic listing acting as a proxy for a domestic transaction. Additionally, the Supreme Court explicitly rejected the argument that the "national public interest pertains to transactions conducted upon foreign exchanges and markets,"[204] which also supports the conclusion that the Court was focused on the transaction. The decision as a whole supports the conclusion that the requirements of Section 10(b) of the Securities Exchange Act are not limited to the listing of securities. Looking at non-conventional securities that are not listed on any exchange, such as (security-based) swaps, but merely pegged to a U.S. listing, those should not fall within the reach of Section 10(b) of the Securities Exchange Act under the first prong.

However, the solution proposed by courts also poses problems. The requirement of a domestic transaction in this context merits asking why the Court needed to establish two different prongs, if in the end both require a domestic transaction. This would mean that whenever a transaction fulfills the first prong, the second one is also automatically fulfilled, rendering the second prong superfluous. Thus, the first prong poses an additional (listing) requirement, and is not an alternative. And, if a domestic transaction is the only hurdle, the Court could have easily said so. This suggests that the first prong has another meaning as the plain text suggests.

Recall that one of the purposes of the decision is the protection of domestic exchanges. As long as the securities are listed on a domestic exchange, fraud conducted anywhere will have an effect on the price of those securities on the domestic exchange. Another option to safeguard this interest (than requiring that the transaction takes place in the United States) would be to focus on whether a transaction is executed on the domestic exchange or market, meaning whether the initial transfer of a financial instrument occurs at that venue. This would mean that a transaction on the trading venue is covered by the anti-fraud provisions, and ensure that it reaches only domestic transactions, without focusing on the place where the deception originated. It would ensure that national securi-

203. Morrison v. Nat'l Austl. Bank, 561 U.S. 247, 249 (2010).
204. *Id.* at 263.

ties exchanges are indeed protected. This approach would also limit the reach of the anti-fraud provisions. If the execution happens in a foreign venue and only has an effect on the domestic exchange because a U.S. listing is pegged to a foreign security, the transaction would not be domestic under the first prong. This solution would be a middle way between a pure "listing-theory" and the additional requirement of a domestic transaction. It would, on the one hand, address the issue that purely foreign transactions are not covered, while also posing a different hurdle with the second prong.

As shown above, the decisions by the various lower courts made in connection with the first prong are hard to reconcile, even if the lower courts are only partially responsible for the confusion. The main confusion was triggered by *Morrison* itself, which didn't clarify in what circumstances the "listing" of a security is relevant. The lower courts addressed the issues arising out of *Morrison* differently—though in some cases they follow a literal understanding of the decision, in others they rely on the intent behind the decision while ignoring how the decision reads on its face. As it currently stands, it seems that transactions on the OTC market do not satisfy the transactional test, since OTC markets are not exchanges within the meaning of this decision. With regard to transactions on the stock exchange, the decisions read together reveal that *Morrison* does not actually mean what it says, at least when it concerns non-conventional securities. It is not enough for a security to be merely listed on a domestic exchange; the transaction must also occur on that domestic exchange.

However, neither approach is convincing. The predominant view on the first issue does not take into consideration that the Court did not want to address a special trading venue, and the holding should not be restricted to securities exchanges. Regarding the second issue, consideration of intent is justified, but requiring a domestic transaction goes too far. The Supreme Court's focus on the domestic exchanges should be taken into consideration, which justifies that the place of the execution of the transaction is relevant.

C. *The Second Prong Unmasked*

1. *Mapping the Terrain Under Absolute Activist*

The Second Circuit had the first chance to elaborate a test to determine whether a transaction was domestic within the meaning of the second prong in *Absolute Activist Value Master Fund Ltd. v. Ficeto*.[205] The court had to examine whether foreign hedge funds' purchases through a U.S. broker-dealer of securities issued by U.S. companies were a domestic transaction.[206] Even though it did not involve non-conventional securities, the considerations that were weighed in the decision reveal some of the problems with the application of the transactional test to complex financial instruments.

First, the court scrutinized the statutory and ordinary definitions of "purchase" and "sale."[207] The court turned to contract law and determined that a purchase or sale occurs when the purchaser and seller become obliged to complete the transaction, or when the parties acquire irrevocable liability.[208] Furthermore, a sale in its ordinary definition is considered "the transfer of property or title for a price."[209] From these principles, the court established the rule that domestic transactions under *Morrison* occur where the parties[210] obtain irrevocable liability or transfer title in the United States.[211] According to the court, irrevocable liability means for the purchaser to take and pay for a security, and for the seller to deliver a security.[212] It is worth mentioning that the court did not rely on the identity of the securities at issue. Based on the language in *Morrison*, it held that the term "domestic" was used as a modifier for "transactions," and not for "securities." The court concluded that the "location" of the securities (where the se-

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205. Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 66–67 (2d Cir. 2012).

206. *Id.* at 62–64 (describing a pump-and-dump scheme employed with U.S. penny stocks).

207. *Id.* at 67.

208. *Id.*

209. *Id.* at 68.

210. The location of someone who is not party to the agreement but purchases shares as a result of a merger is not relevant. *See In re* Vivendi, S.A. Sec. Litig., 838 F.3d 223, 265 (2d Cir. 2016).

211. Absolute Activist, 677 F.3d at 67; *accord* United States v. Vilar, 729 F.3d 62, 76 (2d Cir. 2013).

212. Absolute Activist, 677 F.3d at 68.

curities are issued and registered) does not have any bearing on whether the sale is domestic.[213]

This approach has—with little modification—been adopted by the other circuit courts.[214] However, this form of the transactional test shaped by the Second Circuit does not fit cases regarding non-conventional securities—especially security-based swaps—with ease.[215] First of all, strict application of the *Absolute Activist* irrevocable liability test enables an easy way to escape liability within the United States,[216] and enables forum shopping.[217] Even if a scheme is conducted and developed within the United States, private parties can easily execute the security-based swap outside the territory of the U.S. and avoid application of the U.S. anti-fraud laws.[218] Furthermore, commentators have brought up concerns that this test does not take into account the nature of security-based swaps. As no title or ownership passes in swap transactions, the irrevocable liability test would ignore the relevant location of the transaction that is determined by the swaps' economics, and

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213. *Id.* at 68–69; *accord* SEC v. Amerindo Inv. Advisors, 639 F. App'x 752, 753 (2d Cir. 2016).

214. U.S. v. Georgiou, 777 F.3d 125, 135 (3d Cir. 2015); SEC v. Levine, 462 Fed. App'x. 717, 719 (9th Cir. 2011) ("[T]he Securities Act governs the . . . sales because the actual sales closed in Nevada when [a defendant] received completed stock purchase agreements and payments."); Quail Cruises Ship Mgmt. v. Agencia de Viagens, 645 F.3d 1307, 1310–11 (11th Cir. 2011) (holding that submitting the stock transfer documents constitutes a transfer of title that established a domestic transaction); U.S. v. Isaacson, 752 F.3d 1291, 1299 (11th Cir. 2014) (the relevant fund operated out of New York City and the defendant's office was in Florida, supporting "the inference that the [fund] purchased the securities in the United States"). *See also* Loginovskaya v. Batratchenko, 764 F.3d 266, 274 (2d Cir. 2014) (the transaction happens where the meeting of minds occurs).

215. *But see* Alisha Patterson, *Securities Law – Section 10(b) Liability not Applicable to Domestic Securities-Based Swap Agreements on Foreign Securities* – Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198 (2d Cir. 2014)*, 38 SUFFOLK TRANSNAT'L L. REV. 233, 248 (2015) (arguing that the irrevocable liability test should also be applied in these cases because these financial instruments are still securities).

216. Slobodchikova, *supra* note 4, at 764.

217. Justice Stevens voiced the fear that the *Morrison* test enables forum shopping in his concurring opinion. *See* Morrison v. Nat'l Austl. Bank, 561 U.S. 247, 285 (2010) (Stevens, J., concurring).

218. This applies at least with regard to private actions. Whether the same is the case for actions by the SEC or DOJ will depend on the applicability of the Dodd–Frank Act. *See supra* Part II.C.

exchange it for a formalistic approach.[219] But, as addressed further below, this aim to address the economic reality of the agreement is without merit under *Morrison*.

The complications associated with non-conventional financial instruments are best illustrated in a case[220] regarding Collateralized Loan Obligations ("CLOs").[221] The issuer was a Cayman Islands company, and the indenture trustee was a bank located in New York.[222] The plaintiffs were offshore funds. The subscription agreement provided that the subscription by the investor was irrevocable on the part of the investor, but would not constitute an agreement until accepted by the issuer.[223] The plaintiffs argued that under the terms of the subscription agreement, the sale of the notes was nonbinding until the purchase price was received by the trustee in New York, and the issuer could revoke the agreements any time prior to closing. The transaction would only be completed upon payment. The court followed this argument and held that irrevocable liability was incurred when the funds were delivered to the trustee in New York.[224] In general, the wiring of funds to an American bank would not satisfy the transactional test because this would be just one step in applying to invest in the funds.[225] But in this case, the subscription agreement stipulated that the delivery of the funds automatically concluded the transaction because that act made the contract irrevocably binding.[226]

This decision is troubling for a variety of reasons. First of all, the whole transaction is predominately foreign, and offers only a weak link via the trustee to the United States. If the domestic payment would indeed suffice to trigger liability under the anti-fraud provisions, this would again permit the punishment of conduct that occurred in a foreign country,

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219. *See* Slobodchikova, *supra* note 4, at 765, with further references.

220. Arco Capital Corps. v. Deutsche Bank AG, 949 F. Supp. 2d 532 (S.D.N.Y. 2013).

221. "A CLO is created by aggregating large numbers of commercial debt obligations, dividing the rights to the repayment stream into many subdivisions, and selling those subdivisions as tradable securities." Am. Sav. Bank, FSB v. UBS PaineWebber, Inc., 330 F.3d 104, 107 (2d Cir. 2003).

222. *Arco Capital Corps.*, 949 F. Supp. 2d at 535.

223. *Id.* at 536.

224. *Id.* at 542–43.

225. *Id.* at 542.

226. *Id.* at 543.

concerning securities of a foreign company that are traded entirely on a foreign exchange. And this is the result that *Morrison* specifically wanted to prevent. Furthermore, it is not very hard to imagine how a person could escape liability in this scenario; all that is required is that the trustee is located outside the United States. And indeed, it was not long before the irrevocable liability test was abandoned with regard to non-conventional securities.

2. *Addressing the Nature of Nonconventional Securities: Elliot and Parkcentral*

In the Second Circuit's decision in *Parkcentral v. Porsche Auto. Holdings SE*, the court acknowledged the difficulty in applying its established test under *Absolute Activist* with regard to non-conventional securities.[227] The case concerned an OTC swap executed in the United States, but referencing German securities that were issued by Volkswagen and traded on European stock exchanges.[228] The defendant was not a party to the swap agreements in question but made allegedly fraudulent statements about its intentions regarding the stock of Volkswagen. It revealed its true intentions—that it planned to gain control over the issuer—when it almost had the required majority of Volkswagen's shares.[229] At that point, the price of the Volkswagen stock increased rapidly, causing a total loss of approximately $38 billion for the plaintiffs.[230]

The District Court—where the case was filed under the plaintiff *Elliott Associates*—held that the plaintiffs could not rely on Section 10(b) of the Securities Exchange Act, because such an approach "would extend extraterritorial application of [the Act's] antifraud provisions to virtually any situation in which one party to a swap agreement is located in the United States."[231] It conducted the economic reality test and pointed to the fact that the value of a security-based swap is necessarily dependent on the value of the underlying security.[232] As such,

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227. Parkcentral Glob. HUB Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 201 (2d Cir. 2014).

228. *Id.*

229. *Id.* at 204.

230. *Id.* at 205.

231. Elliott Assocs. v. Porsche Automobil Holding SE, 759 F. Supp. 2d 469, 474 (S.D.N.Y. 2010).

232. *Id.* at 475–76.

these swaps are intrinsically tied to the German shares, and the economic reality is that they are traded on a foreign exchange. Courts have used this test in the past to determine whether a complex instrument fell under the definition of a "security" within the meaning of the Securities Act and the Securities Exchange Act,[233] and the Court found this method's analytical structure to be a useful analytical tool.[234]

The Second Circuit took an entirely different approach and decided not to apply the economic reality test, the irrevocable liability, or the passage of title test. Instead, the court adopted yet another way of determining whether a transaction is domestic. It started by scrutinizing the language of *Morrison* and concluded that the Supreme Court did not say that the transactional test was sufficient. Rather, the Court used language providing that transaction location was a necessary element to make Section 10(b) applicable.[235] The Supreme Court held that while a domestic transaction is necessary to invoke Section 10(b), it is not always sufficient based on the details of the parties and the transactions.

The court started a fact-based inquiry and determined that the facts of *Parkcentral* were too foreign to comport with the underlying principles of *Morrison*.[236] The case concerned an alleged fraud by foreign defendants that occurred in a foreign country regarding foreign securities traded on a foreign exchange.[237] Holding the defendant liable in that scenario would contravene *Morrison*, as this conclusion would permit (yet again) the regulation of foreign conduct. For this reason, the Second Circuit affirmed the dismissal of the action. Notably, however, the court limited its opinion by narrowing its holding to the case at hand. The court did not want to establish a test that could reliably determine when a particular reliance on Section 10(b) will be appropriately domestic.[238]

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233. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 858 (1975) (a purchase into a housing cooperative did not constitute a security).

234. Reves v. Ernst & Young, 494 U.S. 56, 63 (1990) (holding that this test provides sufficient flexibility to ensure that instruments are not able to escape the coverage of the Securities Acts).

235. *Parkcentral Glob. HUB Ltd.*, 763 F.3d at 214–15.

236. *Id.* at 216.

237. *Id.*

238. *Id.* at 217.

Parkcentral has so far proven to be an important milestone. The court claims to be interpreting *Morrison*, but, in fact, it created an entirely new test ("sufficiency-test") that allows for a flexible approach in order to determine the application of the Securities Exchange Act to non-conventional securities. Indeed, this interpretation is consistent with the Supreme Court's instruction to apply the statute flexibly, and is consistent with the statute's purpose of remedying deceptive and manipulative conduct that has the potential to harm the public interest or the interests of investors.[239] However, since the court did not give its test general applicability, this decision marks a return to the unpredictability criticized by the Supreme Court in *Morrison*.

As it currently stands, courts have not broadened the reach of *Parkcentral* beyond non-conventional financial instruments.[240] In only one case, the court seems to expand the holding to promissory notes without significant explanation, but denies the applicability of *Morrison* based on an analysis of the facts of the case.[241] Additionally, no courts post-*Parkcentral* have rejected the Second Circuit's approach. Only one court (in a 2017 decision concerning sponsored ADRs),[242] with muddled reasoning, opted to apply a mixture of the standard under *Absolute Activist* (irrevocable liability and transfer of title test), as well as an intensive fact-based inquiry under *Parkcentral*.[243] The latter was, however, only conducted in order to reject the defendant's arguments, and was not used as an analysis on its own. Given the lack of detailed reasoning, it remains

239. U.S. v. Litvak, 808 F.3d 160, 177 (2d Cir. 2015).

240. *In re* Poseidon Concepts Sec. Litig., 13cv1213 (DLC), 2016 WL 3017395, at *12–13 (S.D.N.Y. May 24, 2016) (rejecting the defendant's argument to extend the *Parkcentral* decision to stock transactions); Atlantica Holdings, Inc. v. BTA Bank JSC, No. 13–CV–5790 (JMF), 2015 WL 144165, at *8 (S.D.N.Y. Jan. 12, 2015) (rejecting the defendant's argument to extend the decision to subordinated notes).

241. Sec. & Exch. Comm'n v. Wang, No. LA CV13-07553 JAK (SSx), 2015 WL 12656906, at *12 (C.D. Cal. Aug. 18, 2015).

242. An unsponsored ADR is established with little or no involvement by the issuer of the underlying security. A sponsored ADR, in contrast, is established with the active participation of the issuer of the underlying security. Pinker v. Roche Holdings Ltd., 292 F.3d 361, 367 (3d Cir. 2002).

243. *In re* Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prods. Liability Litig., MDL No. 2672 CRB (JSC) 3:15-md-02672-CRB, 2017 WL 66281, at *4–7 (N.D. Cal. Jan. 4, 2017).

unclear what thought process shaped the District Court's opinion. However, in light of the strong domestic nexus of the case, it seems likely that the court did not see a compelling reason to refrain from applying the irrevocable liability standard.[244]

One issue that gives rise to concerns is something that *Parkcentral* does not address: the lack of rejection of the economic reality test used by the Second Circuit.[245] It seems unconvincing to argue that this test, without additional preconditions, is in keeping with the spirit of *Morrison*, since it does not embody *Morrsion's* sole focus on the location of the transaction, meaning the sale and the purchase of a security.[246] Rather, this test is focused solely on the economic impact of a transaction, and does contradict the transactional test.

One commentator pointed out that relying on the economic reality test would be especially problematic with regard to derivatives, such as the security-based swap in the present case.[247] It would leave American parties without domestic recourse when the referenced shares relate to a foreign company on a foreign exchange. But this argument does not take into account that allowing for a remedy in the United States, would enable a claim against the foreign issuer based on foreign conduct for damages out of a transaction in which he did not take part, the kind of scenario the Supreme Court specifically tried to prevent. In this regard, one must bear in mind that courts in general have emphasized that foreign issuers can be completely unaware of a domestic swap transaction, and dragging them into the American courts should be handled

244. *Id.* at *4 ("[T]he ADRs that Plaintiffs purchased were sold to US investment advisers for the benefit of the US-resident Plaintiffs and were delivered through DTC, the principal US securities clearing and settlement system, to accounts at US financial institutions, and title transferred in the United States.").

245. *See* Wu v. Stomber, 883 F. Supp. 2d 233, 253 (D.D.C. 2012) (holding that the test is "inconsistent with the bright line test set forth by the Supreme Court in *Morrison*, which focuses specifically and exclusively on where the plaintiff's purchase occurred"); Phelps v. Stomber, 883 F. Supp. 2d 188, 208–09 (D.D.C. 2012) (employing identical reasoning as in *Wu*).

246. *See* Thomas J. McCartin, *A Derivative in Need: Rescuing U.S. Security-Based Swaps from the Race to the Bottom*, 81 BROOK. L. REV. 361, 382 (2015).

247. *Id.* at 383–84.

restrictively.[248] Issuers of an underlying security often have no ability to determine the number of swap transactions in existence, let alone the identity of the parties to the swap transactions or the amounts involved in their transactions, due to the inapplicability of registration and reporting requirements to security-based swap agreements.[249]

A more convincing approach would be to apply the economic reality test after the threshold of the transactional test has been passed, and to make it part of the sufficiency analysis. This approach would satisfy *Morrison*, but, at the same time, address the specifics of non-conventional instruments. However, no court has tried this approach to date.

As the above sections regarding the second prong have pointed out, recent case law by the lower courts has shown that the transactional test did not achieve its goal of acting as a bright line for the determination of the territorial reach of Section 10(b) of the Securities Exchange Act. Rather, at least with regard to non-conventional securities, this test serves as the minimum threshold that requires a fact-intensive evaluation after this hurdle has been passed. Given the lack of a clear ruling on the economic reality test in *Elliot*, it remains to be seen what role this test will play in the future. Since the other circuits besides for the Second Circuit have not yet addressed this issue, the topic will likely remain unsettled for years to come.

IV.
International Coordination and Enforcement

So far, the Note has analyzed the extraterritorial reach regarding civil and criminal cases. However, any analysis of this issue would be incomplete without taking the regulatory perspective into consideration, especially given that the Dodd–Frank Act provides for substantial changes in this area. In the following section, the Note will address the different approaches taken by the CFTC and the SEC, and will argue why the CFTC's approach should prevail.

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248. *In re* Bear Stearns Cos. Sec., Derivatives, and ERISA Litig., 995 F. Supp. 2d 291 (S.D.N.Y. 2014) (regarding the private right of action under the), *aff'd sub nom.* SRM Glob. Master Fund L.P. v. Bear Stearns Cos., 829 F.3d 173 (2d Cir. 2016).

249. *Id.* at 306.

As the 2007–2008 financial crisis struck, financial policymakers tried to coordinate their regulatory response through the G-20. And while they had different opinions about the causes of the financial crisis, they agreed in Pittsburgh in 2009 on certain aspects of OTC derivatives regulation, attempting to standardize contracts, developing mandatory central clearing of standard OTC derivatives, requiring reports to trade depositories, and imposing higher capital requirements for non-centrally cleared contracts.[250]

Several months after the Pittsburgh G-20 Summit, Congress enacted the Dodd–Frank Act, which split regulatory jurisdiction over derivatives between the SEC and the CFTC. While the CFTC has jurisdiction over swaps, the SEC has jurisdiction over security-based swaps.[251] As the SEC regulates the underlying securities, Congress granted oversight to the SEC instead of the CFTC, reflecting the CFTC's and SEC's existing jurisdictional scope.[252] In order to fulfill their obligations under the Dodd–Frank Act, the CFTC and the SEC had to define the limits and requirements applicable to OTC derivatives counterparties (dealers and end users) and determine the operation of those requirements to counterparties during cross-border transactions. To achieve this, both Commissions have to consult and coordinate with foreign regulatory authorities to promote an effective and consistent global regulation of derivatives.[253] And while the CFTC opted for substituted compliance,[254] the SEC took another approach. This part of the Note will briefly address the reasoning behind the different approaches, and will argue why the SEC should follow the CFTC's approach.

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250. Leaders' Statement, The Pittsburgh Summit, U.S. Dep't of the Treasury (Sept. 24–25, 2009), https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

251. 15 U.S.C. § 78c(a)(68)(A) (2012).

252. John Welling, *In Defense of the Dealers: Why the SEC Should Allow Substituted Compliance with the European Union for Security-Based Swap Dealers*, 85 FORDHAM L. REV. 909, 915 (2016).

253. 15 U.S.C. § 8325 (2012). If this should fail, the Dodd–Frank Act expressly provides the Commissions with the authority to prohibit entities from non-compliant jurisdictions from entering U.S. markets. 15 U.S.C. § 8305 (2014).

254. *See infra* Part IV.A.

A. *The CFTC's Struggle with Substituted Compliance*

On June 6, 2016, the CFTC signed a memorandum of understanding ("MOU") with the European Securities and Markets Authority ("ESMA") regarding cooperation with respect to derivatives clearing organizations.[255] This agreement is one of the most recent milestones in international cooperation on derivatives regulation, and brought an end to years of negotiations about how to regulate central clearing counterparties that operate in the United States and the EU.

This agreement can be seen as a step forward from the originally "aggressive assertion of extraterritorial regulatory authority" by the CFTC.[256] In its Proposed Guidance[257] from June 29, 2012 the CFTC essentially claimed authority to write the rules for all swap participants worldwide that transact with U.S. entities.[258] However, it did create a structure for "substituted compliance," according to which the regulatory requirements for an institution as a whole or in part may be waived on the basis of a substantially similar regime in the entity's home jurisdiction.[259] The ultimate applicability of substituted compliance was intended to be at the discretion of the CFTC, that aimed for an outcome-based approach in order to determine whether the requirements are designed to meet the same regulatory objectives as the Dodd–Frank Act.[260]

This approach triggered an intensive and highly-politicized backlash,[261] and a public letter written by nine finance ministers and the Commissioner of the EU, which ex-

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255. Memorandum of Understanding between European Sec. & Mkts. Auth. and U.S. Commodity Futures Trading Comm'n (June 2, 2016), http://www.cftc.gov/idc/groups/public/@internationalaffairs/documents/file/cftc-esma-clearingmou060216.pdf.

256. Sean J. Griffith, *Substituted Compliance and Systemic Risk: How to Make a Global Market in Derivatives Regulation*, 98 MINN. L. REV. 1291, 1331 (2014).

257. Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41,214, 41,238 (July 12, 2012).

258. However, entitles may fall below a de minimis exception. *See* 7 U.S.C. § 1a(33) (2012). For further definitions by the CFTC, see Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 Fed. Reg. 30,596 (May 23, 2012).

259. Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, *supra* note 257, at 41, 229.

260. *Id.* at 41, 232.

261. *See* Griffith, *supra* note 256, at 1339.

pressed concern that the CFTC's example would lead to fragmentation and lack of regulatory coordination.[262] Ultimately, on July 11, 2013, the CFTC and the European Commission reached an agreement to converge on a harmonized approach to cross-border swap regulation.[263] The agreement stresses that there are several areas in which the U.S. and EU rules are (almost) identical.[264] The CFTC has "proposed that substituted compliance will be permitted for the requirements applicable in the EU that are comparable to . . . those applicable in the US,"[265] while within the EU there is a system of equivalence, based on a broad outcome-based assessment. In cases of joint jurisdiction, an entity's compliance with either set of requirements will achieve compliance with both, and allow market participants to determine their own choice of law rules. With regard to central counterparties, the parties aimed to resolve differences as soon as possible.[266] However, it took until June 6, 2016 to resolve open issues.[267]

As a result of these developments, the CFTC issued a final interpretative guidance on cross-border issues.[268] While it made relatively minor alterations to the regulatory structure in the Proposed Guidance, the final version is much more open to the concept of substituted compliance. It established that the process of regulatory harmonization around substituted compliance will be an ongoing process. It includes consultation with foreign legislators or regulators to develop rules that enable the CFTC to arrive at a determination of comparabil-

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262. Letter from Guido Mantega, Minister of Fin., Government of Brazil, et al. to Jack Lew, U.S. Sec'y of the Treasury (Apr. 18, 2013), http://www.fsa.go.jp/inter/etc/20130419-1/01.pdf.

263. Press Release, U.S. Commodity Futures Trading Comm'n, The European Commission and the CFTC Reach a Common Path Forward on Derivatives (July 11, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6640-13.

264. *See* Levon Garslian, *Towards a Universal Model Regulatory Framework for Derivatives: Post-Crisis Conclusions from the United States and the European Union*, 37 U. PA. J. INT'L L. 941 (2016).

265. *Id.*

266. *Id.*

267. U.S. Commodity Futures Trading Comm'n & European Comm'n, Common Approach for Transatlantic CCPs (Feb. 10, 2016), http://www.cftc.gov/idc/groups/public/@newsroom/documents/speechandtestimony/eu_cftcstatement.pdf.

268. Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013).

ity.[269] In particular, the CFTC mentioned, it "generally would" permit substituted compliance whenever possible.[270] This approach has not triggered criticism as intense as under the initial approach, and resulted in the CFTC's approval of substituted compliance regimes with various countries (recently with Japan in September 2016).[271]

B. *The SEC and Dodd–Frank*

The SEC has longstanding experience in coordinating its enforcement actions on an international level. The International Securities Enforcement Cooperation Act ("Enforcement Act") empowered the SEC to use foreign government resources to reach potential violators of the U.S. securities laws.[272] This includes formal and informal arrangements for the exchange of information and assistance, enforcement cooperation, and technical assistance with foreign regulators.[273] The SEC uses foreign governments to help access incriminating documents, and sometimes foreign governments assist by helping the SEC prosecute violators overseas. The SEC has currently entered into over forty MOUs with foreign regulators to improve the flow of information.[274] The SEC became a signatory to the International Organization of Securities Commissions MOU, which is the first global multilateral informa-

269. *Id.* at 45, 343–44.

270. *Id.* at 45, 342.

271. Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 63,376 (Sept. 15, 2016).

272. Under it, the SEC has a broad array of possibilities on how to deal with foreign regulators. For example, Section 24(c) grants the SEC discretionary authority to provide non-public documents to domestic and foreign persons. Securities Exchange Act § 24(c), 15 U.S.C. § 78x(c) (2010). Furthermore, Section 21(a)(2) of the Securities Exchange Act allows the SEC discretion to conduct an investigation to gather information and evidence necessary to assist a foreign authority with its own investigation. Securities Exchange Act § 21(a), 15 U.S.C. § 78u(a)(2) (2015).

273. Katherine Drummonds et al., *Securities Fraud*, 53 AM. CRIM. L. REV. 1733, 1801 (2016).

274. *See Cooperative Arrangements with Foreign Regulators*, U.S. SEC. & EXCHANGE COMM'N, https://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml (last visited April 7, 2017).

tion sharing arrangement.[275] The SEC (as well as the CFTC) now subject any transaction involving an American counterparty to the requirements for its cross-border approach.[276] And, following the CFTC's lead, the SEC originally looked to adopt its own substituted compliance framework to address the issue.[277] But in the end, despite its experience with global cooperation, the SEC did not make any determinations regarding the issue, and has not said if it will do so in the future, thus lacking a definitive approach in this regard.[278]

This is surprising for a variety of reasons. First of all, it does not consider the economic implications. Many large companies transact in both swaps and security-based swaps, and currently operate under two different approaches (the CFTC and SEC) to cross-border transactions for economically equivalent products. Economic efficiency would be increased if these inconsistent approaches were unified.[279] Duplicative requirements also carry the risk of fragmentation of the market. If companies are unwilling to comply with duplicative requirements, they could retreat from the global market. This would decrease the overall liquidity of the global market and expose the American economy to systemic risks because American financial companies will continue to rely on the credit of foreign companies in other markets.[280] Alternatively, those dealers could opt to sell less-regulated, more profitable products.

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275. Press Release, U.S. Sec. & Exchange Comm'n, SEC Announces IOSCO Unveiling of Multilateral Agreement on Enforcement Cooperation (Oct. 31, 2003), https://www.sec.gov/news/press/2003-145.htm.

276. *See* Application of "Security-Based Swap Dealer" and "Major Security-Based Participant" Definitions to Cross-Border Security-Based Swap Activities, 79 Fed. Reg. 47,278 (Aug. 12, 2014).

277. *See* Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 Fed. Reg. 30,968 at 31,085 (May 23, 2013).

278. *See* Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected with a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent, 80 Fed. Reg. 27,444 (May 13, 2015).

279. Welling, *supra* note 252, at 936.

280. Coffee, *supra* note 125, at 1260.

Furthermore, if Dodd–Frank's security-based swap requirements are substantially similar—and according to the CFTC they are so within certain jurisdictions—regulated companies would be required to comply with the same requirements in multiple jurisdictions. This would not only mean that the work doubles for the companies, but it also would not lead to further protections for the market.[281] If the requirements under another jurisdiction are substantially similar, this would also ensure that a goal of the Dodd–Frank Act—to provide sufficient regulation to prevent another financial crisis—would be fulfilled. Substituted compliance would also address the downside of uniform regulation which several countries would face. By definition, a uniform approach does not allow for alternatives, and thus would not enable the competition of different solutions. Such an approach is prone to become ossified, unresponsive, and unable to manage a crisis.[282] Furthermore, a uniform approach increases the risk that the regulators as a whole oversee systemic risk in the markets.[283] Substituted compliance would not give rise to these dangers, because the different regulators stay independent, and are still able to assess risks on their own. In response to concerns that risks could still be overlooked when regulators take a similar approach, substituted compliance would not make the situation worse. The regulators are taking such an approach already, as evidenced by the CFTC.

Conclusion

As this Note has shown, enforcement of unconventional securities has undergone many changes in recent years, and it seems likely that change will continue to occur in the future. In the international context, it seems that a uniform approach is on the horizon, but the SEC has taken a step back from this direction by deciding not to adopt substituted compliance, despite better arguments.

Within the United States, the way courts interpret *Morrison* is troubling at best. The new transactional test did not create a predictable method to determine whether transactions

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281. Welling, *supra* note 252, at 929.

282. *See* Griffith, *supra* note 256, at 1345.

283. *See* Paul G. Mahoney, *The Exchange as Regulator*, 83 Va. L. Rev. 1453, 1493–94 (1997).

are domestic for the purpose of the anti-fraud provisions of the Securities Exchange Act. Rather, the application by the lower courts to non-conventional securities and OTC transactions has shown that an effective one-sentence criterion for the application of the U.S. laws to the anti-fraud claims seems either unrealistic or requires courts to take a much more flexible approach to handling these cases.

In either case, the way that courts applied *Morrison* does not serve as a way to ensure predictability of the territorial reach of the U.S. securities laws. Courts decided to follow either a literal understanding of *Morrison* or rely solely on the intent of *Morrison*. Given the forceful articulation of the presumption against extraterritoriality not only in this case but also in other cases in recent years, it seems clear that the Supreme Court did not want its decision to be limited to a literal reading.[284] In this regard, it comes as a surprise that courts have opted to reduce *Morrison* under the first prong to securities exchanges, while it is clear that the Supreme Court intended to include all kinds of trading venues. And where courts do decide to follow the intent of *Morrison*, their interpretation of reliance on a domestic transaction risks rendering the first prong superfluous, instead of viewing the place of execution as decisive. Under the second prong, courts have taken a far more consistent approach, but unfortunately, the economic reality test, which is not in line with *Morrison*, has still not been overruled. And while the exact scope under *Morrison* is still unresolved, the far bigger issue is that it is still unclear if the transactional test is even applicable to actions by the government in general or in criminal cases. In both cases, this should be the case. However, courts have shown a tendency to go in the other direction.

While the Supreme Court may revisit *Morrison* in some years to clarify the scope of the decision, the legacy of *Morrison* will largely depend on the creativity and willingness of the lower courts to further refine their approach.

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284. Kiobel v. Royal Dutch Petroleum. Co., 569 U.S. 108, 116–17 (2013) (the Court applies the presumption against extraterritoriality in the context of the Alien Tort Statute and stresses its need to prevent "unwarranted judicial interference in the conduct of foreign policy").