Extraterritorial Application of US Securities Law: Will the US Become the Default Jurisdiction for European Securities Litigation?

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1. INTRODUCTION

US law applies to non-US residents and non-US entities in a variety of contexts. The Alien Tort Claims Act[1] allows US courts to hear some human rights cases brought by foreign citizens for conduct committed outside the United States.[2] Similarly, US courts have held that the US Bankruptcy Code does not require the presence of assets in the United States for ancillary insolvency proceedings against a foreign debtor.[3] In securities regulation, the SEC has continuously expanded its extraterritorial reach with strong support from the judiciary, most notably the Second Circuit Court of Appeals.[4]

Many US commentators are concerned about this trend. John Bellinger, the former Legal Advisor to the US Department of State, for example, has urged that the United States not become a 'world court' for apartheid abuses in South Africa or similar claims.[5] Securities law commentators have criticized the extraterritorial reach of US laws[6] and the potential impact on Europe in particular.[7] One commentator, Margaret Sachs, thoroughly researched the legislative history of the 1933 Securities Act and the 1934 Securities Exchange Act and found substantial evidence that Congress intended these laws not to reach transactions in foreign markets, but instead only transactions within the United States.[8] Commentators outside the United States have also expressed dissatisfaction with the 'long arm' of US law, and in particular US securities law.[9]

The US Supreme Court, in a case to be decided later this year, *Morrison v. National Australia Bank*,[10] may curtail the jurisdiction of US courts in cases where foreign plaintiffs sue foreign defendants over securities purchased in foreign securities markets. At the same time, Congress could move in the opposite direction. Section 7216 of the Wall Street Reform and Consumer Protection Act of 2009,[11] not yet enacted but pending in Congress, could expand the extraterritorial jurisdiction of US courts in these cases. This could have lasting implications for European jurisdictions, companies, attorneys, investors, and financial institutions.

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1 28 U.S.C. s. 1350 (stating in part: 'The district court shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States').

2 The Supreme Court in *Sosa v. Alvarez-Machain* (03-339) 542 U.S. 692 (2004), 331 F.3d 604, tried to curtail the types of cases that are actionable under the Alien Tort Claims Act holding that new causes of action based on violations of international law norms 'should be undertaken, if at all, with great caution'. *Id.*, 287.

3 See *Haarhuis v. Kunnan Enters, Ltd.*, 177 F.3d 1007, 1012 (D.C. Cir. 1999), holding that s. 304 of the US Bankruptcy Code does not expressly require the presence of assets in the United States for ancillary insolvency proceedings against a foreign debtor.

4 Roberta S. Karmel, 'The Second Circuit's Role in Expanding the SEC's Jurisdiction Abroad', *St. Johns Law Review* 65 (1991): 743.

5 See John B. Bellinger III, 'The U.S. Can't Be the World's Court – New York Isn't the Right Venue to Sue for Apartheid Abuses', WSJ, 27 May 2009, <http://online.wsj.com/article/SB124338378610356591.html>.

6 See, for example, Stephen J. Choi & Linda J. Silberman, 'Transnational Litigation and Global Securities Class Action Lawsuits', *Wisconsin Law Review* 2009 (2009): 465; Stephen Choi & Andrew Guzman, 'Portable Reciprocity: Rethinking the International Reach of Securities Regulation', *Southern California Law Review* 71 (1998): 903, 927 ('with such expansive jurisdiction, even if a judgment is granted, foreign legal action may be required to enforce it').

7 See, for example, Andrew Longstreth, 'Coming to America', *American Lawyer*, November 2006, 11/2006 Am. Law. S53 (Westlaw); Mary Jacoby, 'For the Tort Bar, a New Client Base: European Investors', *Wall Street Journal*, 2 September 2005, A1.

8 Margaret V. Sachs, 'The International Reach of Rule 10b-5: The Myth of Congressional Silence', *Columbia Journal of Transnational Law* 28 (1990): 677, 700–701.

9 See, for example, Oliver Knöfel, 'Whistleblowing und Sarbanes-Oxley – Kein Extraterritorialer Arbeitnehmerschutz?', *Recht der Internationalen Wirtschaft* 7 (2007): 493, 494; Sascha Lotze, *US-amerikanisches Kapitalmarktsrecht und Internet* (2002), 78; Peter Versteegen, Kölner Kommentar zum WpÜG (2003), s. 24 WpÜG, 34; Rainer Süßmann, Geibel/Süßmann Kommentar zum WpÜG, s. 24 WpÜG, 8; Jan von Hein, Grundfragen des europäischen Übernahmekollisionsrechts, 5 AG 213, 224 (2001); Timo Holzborn, Ausschluss ausländischer Aktionäre nach s. 24 WpÜG – 'Die Disclaimer Problematik', 2 BKR 67, 73–76 (2002); Oliver Klepsch, Steinmeyer/Häger, Kommentar zum WpÜG, s. 24 WpÜG, 10.

10 547 F.3d 167, 172 (2d Cir. 2008).

11 The Wall Street Reform and Consumer Protection Act of 2009 (Introduced in House), H.R. 4173; 111th Congress, s. 7216. Extraterritorial Jurisdiction of the Antifraud provisions of the Federal Securities Laws.

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2. *MORRISON V. NATIONAL AUSTRALIA BANK*

US courts have analysed the question of whether section 10(b) of the 1934 Securities and Exchange Act[12] and SEC Rule 10b-5 can be applied to foreign litigants in securities fraud cases as a question of subject matter jurisdiction. The most frequently used approach is the Second Circuit's so-called 'conduct and effects' test, which looks at whether conduct contributing to the violation took place in the United States or whether the conduct had an effect on US investors.[13] US courts have avoided a bright line rule to determine which cases can be litigated in US courts and which cannot. As a result, US courts apply the conduct and effects test inconsistently.[14] This inconsistency is especially problematic in the context of 'foreign cubed' litigation,[15] that is securities lawsuit involving a foreign plaintiff suing a foreign issuer in a US court for violations of US securities laws based on securities transactions in a foreign country.[16]

The Supreme Court in *Morrison v. National Australia Bank*[17] may bring some clarity to this issue. Morrison and other Australian plaintiffs had purchased shares of National Australia Bank (NAB) in Australian securities markets. They sued NAB in federal court in New York under section 10(b) alleging that NAB had misrepresented to shareholders its exposure to bad mortgages in a Florida subsidiary and that conduct in Florida caused this misrepresentation because Florida employees had altered financial statements. The Second Circuit applied the conduct and effect test and found an insufficient connection between the alleged securities fraud and the United States to allow the suit to go forward, in part because the alleged misrepresentations to investors had been made in Australia rather than in Florida. Plaintiffs asked the Supreme Court to review the case and the Supreme Court agreed to do so. Briefs were filed in early 2010 and oral argument was heard in March 2010.

A group of twenty-one US law professors, including the authors of this article, submitted an amicus brief to the Supreme Court in Morrison asking the Court to ensure that private parties outside the United States not be allowed to use US courts to litigate claims that exceed the subject matter that Congress intended to regulate in section 10(b). The professors discussed the detailed legislative history compiled by Professor Margaret Sachs, who joined the amicus brief, and concluded that Congress had intended the federal securities laws only to cover purchases and sales of securities within the United States. The professors also observed that as a matter of policy, it was better to have a bright line rule that would allow civil suits under section 10(b) only in connection with securities purchased or sold within the United States. First, issuers and investors should know in advance whether US law applies to their transactions, whether foreign law applies, or both. Issuing and investing in securities should not be a guessing game, and the 'conduct and effect' test of the Second Circuit was too unpredictable. A clear rule focused on the location of the transaction would be more predictable. Second, allowing foreign plaintiffs to sue foreign defendants in US courts over securities purchased and sold in foreign countries would turn the United States into the global arbiter of securities fraud allegations, causing significant damage to US foreign relations and undermining international cooperation in combating securities fraud. Third, imposing the US system of securities litigation on the rest of the world could lead to suboptimal outcomes given the sharp differences between the United States and most other countries in substantive securities law, procedural law, and the way class actions are administered. Many countries, the professors pointed out, choose to combat securities fraud with government enforcement rather than private litigation, and the United States should respect the right of other countries to regulate their own markets.

Morrison and the other plaintiffs, on the other hand, have urged the Court to retain the conduct and effects test and also to find that the Second Circuit applied the test too narrowly in their case when it refused to find jurisdiction. Most of the conduct that perpetrated the fraud, plaintiffs claim, occurred in Florida, and the United States has a legitimate interest in protecting foreign investors from fraud perpetrated within its borders, regardless of where the security is purchased or sold. Congress in 1933 and 1934, plaintiffs urged, also had intended the federal securities laws to apply in these situations. Plaintiffs cited very little legislative history to support this argument. Plaintiffs instead argued that the expansive language of section 10(b) itself required the Court to apply section 10(b) to cases involving fraudulent conduct within the United States that affects markets elsewhere.

3. CONGRESS MAY SUBJECT NON-US SECURITIES TRANSACTIONS TO US SECURITIES LITIGATION

Regardless of the Supreme Court's ruling in *Morrison v. NAB*, Congress could overrule the holding in that case because this is a matter of statutory construction. The Court is being asked to interpret an Act of Congress, and Congress may respond to an interpretation it does not like by amending the Act.

In the aftermath of the 2008 financial crisis, there is reason to worry that Congress may do that. US investment banks including

12 15 U.S.C. s. 78j (2006).

13 For a thorough discussion of case law, see Erez Reuveni, 'Extraterritoriality as Standing: A Standing Theory of the Extraterritorial Application of the Securities Laws', *UC Davis Law Review* 43 (2010): 66, Part I, <http://ssrn.com/abstract=1496049>.

14 *Ibid.*

15 See Hannah L. Buxbaum, 'Multinational Class Actions under Federal Securities Law: Managing Jurisdictional Conflict', *Columbia Journal of Transnational Law* 14 (2007): 17.

16 See *Morrison v. National Australia Bank Ltd.*, 547 F.3d 167, 172 (2d Cir. 2008). The Supreme Court granted certiorari in *Morrison v. National Australia Bank Ltd.*, No. 08-1191, 2009 WL 4111014 (U.S. 30 Nov. 2009).

17 547 F.3d 167, 172 (2d Cir. 2008), No. 08-1191, 2009 WL 4111014 (U.S. 30 Nov. 2009).

Goldman Sachs have been accused of designing deceptive derivative securities transactions that were used by the government of Greece to conceal the fact that its debt levels exceed those allowed by the European Union (EU). The difficulties of Greece and the role of US investment banks illustrates the impact that conduct within the United States can have on world markets. In the Lehman Brothers bankruptcy, a court-appointed bankruptcy examiner alleged that Lehman hid debt on its balance sheet at the end of each quarter by selling assets – including mortgage backed securities – for a few days to banks in London that were promised that Lehman would repurchase (repo) the same assets for cash at the beginning of the next quarter, with the same arrangement being repeated at the end of the following quarter. US law firms refused to opine that the transaction was a true sale of the assets under US law, but a UK law firm did opine that the transaction was a true sale under UK law if the reported value of the assets was 105% of the sale price. The transaction, called 'Repo 105' was consummated in London, and Lehman's auditors opined that Lehman could book the transaction as a sale on its financial statements in its US securities filings. This incident underscored the affect that conduct in one country can have on markets elsewhere.

Congress could respond to these and other allegations of transnational securities fraud by passing legislation that provides financial and other support for international cooperation among regulatory authorities in combating securities fraud and regulating securities markets. Congress also, however, could support unilateral US action as Congress has done in its approach to combating terrorism and some other global problems. Congress thus could expand the jurisdictional reach of the SEC as well as the subject matter jurisdiction of US courts over private suits involving purchase and sale of securities on foreign markets.

Congress is currently considering a bill introduced last year, The Wall Street Reform and Consumer Protection Act of 2009, H.R. 5173.[18] Section 7216 of H.R. 5173[19] (section 7216) would explicitly provide for extraterritorial jurisdiction with respect to anti-fraud provisions in the federal securities laws if there is 'conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors'. This 'significant steps' standard is probably broader – and covers a wider range of defendants – than the Second Circuit's 'conduct and effect' test, which arguably covers only conduct in the United States that directly causes the misrepresentation to foreign investors.[20] The proposed language covers the Securities Act of 1933 – section 22,[21] the Securities Exchange Act of 1934 – section 27,[22] and the Investment Advisers Act of 1940 – section 214.[23] As of this publishing, it is unclear whether Congress will enact this language and whether the final version of the bill will include section 10(b) of the Securities Exchange Act of 1934, the provision under which private plaintiffs sued in *Morrison v. NAB* and in most other similar cases. If this bill is enacted and if it does include section 10(b), Professor John Coffee has correctly observed that 'the United States could become a magnet for global class actions'.[24] US lawyers may benefit from 'securities litigation tourism' just as lawyers in the United Kingdom have benefited from 'libel tourism' in which aggrieved parties from around the world take advantage of expansive UK libel laws to bring suits in the United Kingdom claiming that their reputations were damaged in the United Kingdom. It is unlikely, however, that turning any single country into a global litigation mill for a particular subject matter – whether securities law or libel law – enhances that country's role in the world economy.

4. THE IMPACT OF TRANSNATIONAL SECURITIES LITIGATION

In the past decade, US courts have faced a rise in foreign cubed cases.[25] In 2008, foreign cubed cases exceeded any previous year

18 H.R. 4173; 111th Congress – Introduced in House of Representatives.

19 § 7216, Extraterritorial Jurisdiction of the Antifraud Provisions of the Federal Securities Laws:

(a) Under the Securities Act of 1933 – Section 22 of the Securities Act of 1933 (15 U.S.C. 77v(a)) [Under the Securities Exchange Act of 1934 – Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) [...and] Under the Investment Advisers Act of 1940 – Section 214 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-14) is amended by adding at the end the following new subsection:

(c) Extraterritorial Jurisdiction – The jurisdiction of the district courts of the United States and the United States courts of any Territory described under subsection (a) includes violations of Section 17(a), and all suits in equity and actions at law under that section, 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.

20 See *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir. 1975). Bersch found that s. 10(b) applied when 'all the elements of a defendant's conduct necessary to establish a violation' occurred in the United States. Subsequent case law applying the conduct and effects test has reached a broader range of conduct, but it is unclear how broad.

21 15 U.S.C. 77v(a).

22 15 U.S.C. 78aa.

23 15 U.S.C. 80b-14.

24 John C. Coffee, Jr., 'High Court and Congress on a Collision Course', Nat'l L.J. (18 Jan. 2010).

25 See Cornerstone Research, 'Securities Class Action Filings 2009: Mid-year Assessment', <http://securities.cornerstone.com/pdfs/2009_Mid-Year_Assessment.pdf>, 2009, 7. See also Cornerstone Research, 'Securities Class Action Filings 2009: Mid-year Assessment News Release', <http://securities.cornerstone.com/pdfs/2009_Mid-Year_Release.pdf>, 2009, 1 (elaborating that: 'This report introduces a new metric, the Class Action Filing-Foreign Index (CAF-F Index™), that measures the number of securities class action filings in U.S. federal courts against defendant corporations headquartered outside the United States. Federal securities class action lawsuits against issuers with non-U.S. headquarters ("foreign firms") have been rising for more than a decade and reached 31 filings (13.8 percent of total filings) in 2008, with an average of 18 foreign firms (9.4 percent of total filings) sued in each year since 1997. Thus far in 2009, 18 lawsuits have been filed against foreign firms, representing 20.7 percent of the total').

and the trend is continuing.[26] One reason for this development could be a lack of securities class actions in European jurisdictions.[27] This void increases incentives for forum shopping by plaintiffs' lawyers. Forum shopping by foreign plaintiffs may also result from a tendency in the United States towards higher judgments and settlements.[28] The effect will be magnified if US courts can be persuaded to intervene in shareholder derivative suit claims and other disputes under the laws of an issuer's state or country of incorporation.

For European jurisdictions, the extraterritorial application of US law can create confusion, legal uncertainty, and difficulties regulating private parties that engage in regulatory arbitrage by taking their litigation to the United States when it is convenient for them to do so. European jurisdictions may also feel compelled to change their laws to conform with US law. European plaintiffs' attorneys may be able to utilize US legal remedies and other benefits of the US legal system, but they are exposed to competition with US attorneys who have an advantage in conducting US litigation.

Finally, there is the enormous impact of transnational securities litigation on non-US companies. Increasing the extraterritorial application of US law could mean that European companies will be exposed to US law even if they are not cross-listed companies that choose to sell American Depository Receipts (ADRs) or other securities in the United States. Under an expansive US litigation regime, many companies will be covered by US securities law if they have any operations in the United States where conduct causing securities fraud elsewhere could be alleged. This could have lasting implications for the financial reporting, corporate governance, and business operations of European companies.

Combined, all of these trends could have long-term effects on international relations, diplomacy, and cross-border investment. Some of these effects are discussed in more detail below.

4.1. European Jurisdictions and European Companies

Forum shopping by lawyers – both US lawyers and European lawyers – representing European plaintiffs is incentivized by attractive features of the US legal system such as the availability of securities class actions, a tendency towards higher damages and settlement amounts, little or no exposure of plaintiffs to liability for defendants' legal fees even if the defendants prevail, and the possibility of including some aspects of derivative actions in their claims. If section 7216 becomes law and allows the extraterritorial application of US anti-fraud provisions, this law could further incentivize forum shopping by plaintiffs' attorneys. Over time, this may lead to assimilation of US law into the regulatory approaches of European jurisdictions that feel compelled to adopt portions of US law in order to discourage forum shopping.[29] Assimilation of US legal rules in turn may result in increased transaction costs for the changing jurisdiction.

Some aspects of US law could be quite troubling for EU jurisdictions. In securities class actions, for example, US law allows plaintiffs to proceed on the basis of the 'fraud on the market theory' rather than requiring plaintiffs to prove actual reliance on misleading statements.[30] This approach has been rejected in most other countries.[31] The application of section 10(b) of the 1934 Act[32] and Rule 10b-5 in conjunction with the fraud on the market theory substantially increases the potential liability of issuers and can lead to questionable results.[33] EU jurisdictions may not want this rule to apply to their securities markets. Under section 7216, however, US law could apply to EU companies that are accused of conduct violating US securities laws, even if they have no securities traded in the United States.

Class actions involving all or mostly foreign plaintiffs also give rise to unique difficulties with class certification under Federal Rule of Civil Procedure 23 and identification of a lead plaintiff as required by the Private Securities Litigation Reform Act of 1995 (PSLRA).[34] The SEC itself has suggested that securities class actions present unique considerations and that 'a more jurisdictionally restrictive standard may be warranted in the class action context'.[35] Section 7216 by contrast suggests that Congress could be on the verge of ignoring this advice and establishing a more expansive class action regime instead.

Many countries have made different decisions than the United States about trade-offs between the interests of plaintiffs and the interests of defendants in class action litigation. These decisions shape both substantive law and procedural law. Some countries

26 See Stanford Law School Securities Class Action Clearinghouse & Cornerstone Research, 'Securities Class Action Filings 2009: A Year in Review', <http://securities.stanford.edu/clearinghouse_research/2009_YIR/Cornerstone_Research_Filings_2009_YIR.pdf>, 2010, 11.

27 See Buxbaum, *supra* n. 15, 61.

28 See Christof Aha & Jens Föderer, 'Die Roche – Entscheidung des U.S. Court of Appeals', *Recht der Internationalen Wirtschaft* 6 (2003): 450, 451.

29 See *ibid.*, 458; Bernd Schünemann, 'The Sarbanes-Oxley Act of 2002: A German Perspective', *Buffalo Criminal Law Review* 36 (2004): 35, 49; see Holzborn, *supra* n. 9. An example of assimilation of legal norms is the introduction of the derivative suit in s. 148 AktG (German Corporation Act) and the German business judgment rule in s. 93 I 2 AktG. Both of these provisions are modelled after the US example albeit certain elements were added. In the case of the German derivative suit, a requirement of stockownership of at least EUR 100,000 was added to avoid frivolous suits.

30 See *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

31 See Buxbaum, *supra* n. 15, 61.

32 48 Stat. 881, 15 U.S.C. s. 78a et seq. (enacted 6 Jun. 1934).

33 Aha & Föderer, *supra* n. 28, 456.

34 See Stephen J. Choi & Linda J. Silberman, 'Transnational Litigation and Global Securities Class Action Lawsuits', *Wisconsin Law Review* 2009 (2009): 465, 479 (discussing these difficulties).

35 Brief of the Securities Exchange Commission as amicus curiae in *Morrison v. Australia National Bank* in response to the court's request, 4, n. 1, 547 F.3d 167 (2d Cir. 2008).

reject class action litigation entirely because they believe that it is too expensive, because it encourages frivolous litigation, because it does not deter securities fraud, or for other reasons.[36] Not every country wants a class action litigation system or wants its securities markets subject to one. It would be preferable for other nations to make this choice for themselves. Once again, section 7216 could have the opposite effect of forcefully exporting US law on other jurisdictions, including Europe.

4.2. Overlapping Regulation

The application of the US Sarbanes-Oxley Act of 2002[37] to foreign companies illustrates the impact of extraterritorial application of US law. Many of the provisions of the Sarbanes-Oxley Act do not correspond with the applicable law in Member States of the EU and the respective rules, regulations, and initiatives of the EU.[38] A European company, however, has some ability to avoid the Sarbanes-Oxley Act if it avoids listing its securities in the United States. Another example of overlapping regulation[39] is the investigation of United States and European companies by multiple regulators from different jurisdictions for payments to foreign government officials.[40] Perhaps the most significant case to date is the Siemens bribery investigation involving the US Department of State, the SEC, and the Public Prosecutor in Munich, Germany. Siemens implicitly acknowledged its exposure to disparate and overlapping regulation by pleading guilty on several counts and simultaneously settling with the US DOJ, SEC, and the Munich Prosecutors Office.[41]

Currently, cross-listed companies, that is, companies that are listed on their home stock exchange as well as a foreign exchange, are more likely to be exposed to conflicting legal requirements than companies that are only listed on their home stock exchange. Increasing the extraterritorial application of US law through an expansive application by US courts of the 'conduct and effects' test or Congressional enactment of section 7216, however, could mean that more European companies could be exposed to the anti-fraud provisions of US securities law whether or not their securities are traded in the United States. European companies could be faced with substantive legal requirements that are inconsistent with the substantive laws and corporate governance standards in their home jurisdiction.[42]

More specifically, US securities law could be inconsistent with the law in European countries on such basic questions as when issuers have a duty to disclose information to investors and what information is sufficiently material that issuers must disclose it. Because of EU privacy laws, contractual arrangements, or other considerations, a company could possibly be prohibited from disclosing information in EU jurisdictions that the company is required to disclose in the United States. EU companies that are cross listed in the United States have to deal with these problems because they voluntarily subject themselves to US securities law, but US foreign cubed litigation threatens to force these problems on other EU companies as well.

4.3. Legal Uncertainty

Overlapping regulation and inconsistent legal rules create uncertainty.[43] Individual board members of European companies and their attorneys will not know which legal rules apply and what effects these rules may have. They will also face uncertainty when they assess the marginal cost and marginal benefits of complying with the perceived dominant legal system. Not knowing which legal system is dominant can make these decisions enormously difficult.

36 See Samuel P. Baumgartner, 'Class Actions and Group Litigation in Switzerland', *Northwestern Journal of International Law & Business* 27 (2007): 301, 310–312 ('proponents of such a [class action] device in Switzerland face considerable doctrinal, jurisprudential, cultural, and economic objections. Among them are a traditional focus on the individual nature of a claim; limitation of judicial power vis-à-vis the legislature, thus disallowing the large-scale judicial discretion necessary to manage complex litigation; strong emphasis on the litigants' right to be heard, which would need to be slighted in complex cases; different respective roles of judges and attorneys; lack of American-style fee structures and entrepreneurial lawyering; and the many practical changes that would be necessary to introduce a class action device. Moreover, there is a clear preference for legislation rather than litigation to deal with new social problems, including mass torts').

37 Pub.L. 107-204, 116 Stat. 745 (enacted 30 Jul. 2002).

38 See, for example, Schünemann, *supra* n. 29, 49–50; Hans-Georg Kamann & Martina Simpkins, 'Sarbanes-Oxley Act: Anlass zu verstärkter Internationaler Kooperation?', *Recht der Internationalen Wirtschaft* 3 (2003): 183, 184.

39 It is important to distinguish 'overlapping' from 'conflicting' regulation. Conflicting regulation could violate international law. The territorial integrity of a state is only breached by the extraterritorial application of foreign law and results in the breach of international law if there is a specific 'true conflict' in the substantive legal norms of the respective states. See Ulrich Stürmer, *Die extraterritoriale Anwendung Amerikanischer Anlegerschutzbestimmungen – Ein Beitrag zum International Aktienverkehrsrecht aus Völkerrechtlicher Sicht unter Besonderer Berücksichtigung des Insiderrechts* (Peter Lang Verlag, Europäische Hochschulschriften, Reihe II, Bd/vol. 187, 1977), 17. See also Karl M. Meessen, 'Kollisionsrecht als Bestandteil des Allgemeinen Völkerrechts: Völkerrechtliches Minimum und Kollisionsrechtliches Optimum', in *Festschrift für*, ed. F.A. Mann, s. 227 ff. See *Hartford Fire Insurance Co. v. California*, 509 U.S. 764 (1993), opining that: 'The only substantial question in this litigation is whether "There is in fact a true conflict between domestic and foreign law".'

40 Linda Chatman Thomsen, Dominick D. Barbieri & Mathew S. Miller, 'Dealing with Multiple Regulators: Reflections on Parallel Investigations, Regulators' Differing Roles, and Issues to Consider in Representing Organizational Clients', in *Practicing Law Institute Corporate Law and Practice Course Handbook Series* (2009), 903, 922.

41 See Statement of Offense, *United States v. Siemens Aktiengesellschaft*, Cr. No. 08-367-RVC (D.D.C. 18 Dec. 2008), <www.justice.gov/opa/documents/siemens-ag-stmt-offense.pdf>, 39; see also David Crawford & Mike Esterl, 'Siemens Pays Record Fine in Probe', *Wall Street Journal*, 16 Dec. 2008, B2. For background and Siemens's reactions, see Siemens AG, 'Corporate Communications – Rechtsstreitigkeiten – Geschäftsjahr 2007', <www.siemens.com/press/pool/de/events/jahrespk2007/legal-proceedings-q4-2007-d.pdf>, November 2007.

42 Kamann & Simpkins, *supra* n. 38.

43 See, generally, Helmut Wagner, 'Legal Uncertainty – Is Harmonization of Law the Right Answer?, Discussion Paper No. 444', <www.fernunihagen.de/FBWIWI/forschung/beitraege/pdf/db444.pdf>, January 2009 (discussing and defining legal uncertainty generally).

Legal uncertainty generates transaction costs.[44] European company boards will inevitably incur costs in minimizing information asymmetries generated by different legal regimes that may or may not apply to their company. Paying US lawyers for advice is one of these costs. Legal advice would include ascertaining the legal setting of business transactions – for example, whether there is sufficient conduct or effects in the United States for US securities laws to apply – and advice on litigating disputes over what legal rules may apply. For companies that want to avoid securities fraud allegations, there will also be the cost of compliance with two sets of legal rules.

The extraterritorial application of US law, if legitimized by Congress in section 7216, could exacerbate legal uncertainty for European companies even further than it is already under the conduct and effects test. As discussed above, the proposed statutory language in section 7216 is arguably broader than the conduct and effects test. Relative to the total number of US securities fraud and securities class action cases, 'foreign cubed' cases are now relatively rare[45] – although there has been a substantial increase in foreign cubed cases in 2008.[46] Thus, most European companies are currently either not aware or are not concerned with potential legal risk, potential liability, or potential involvement in such suits. However, the enactment of section 7216 could make foreign cubed cases an integral part of the legal landscape in the United States and hence in Europe.

4.4. European Financial Intermediaries

A large proportion of US securities fraud cases involve banks, brokers, and other financial intermediaries. These intermediaries often have the 'deep pockets' that plaintiffs' lawyers are looking for. If section 7216 extends the application of US securities fraud provisions to non-US securities transactions, European financial intermediaries could become the dominant target for plaintiff's attorneys. European financial intermediaries could also change their procedures and operations to avoid US securities fraud litigation, putting them at a competitive disadvantage with US financial intermediaries that can do business in Europe without fear that European courts would subject them to suits by US plaintiffs over US transactions.

EU financial intermediaries, like EU issuers, are also at a competitive disadvantage in their interaction with the US political system. Campaign contributions have a substantial impact on public policy in the United States.[47] Plaintiffs' lawyers contribute generously to US political campaigns. The US financial services industry, however, also ranks among the most generous donors to US political campaigns and US issuers of securities also contribute. Non-US individuals and companies, by contrast, are expressly prohibited by US law from contributing to US political campaigns.[48] Non-US business interests also have a relatively weak lobby in Washington, DC.

The balance of political power inside the United States has in the past two decades led to legislation that favours defendants over plaintiffs in securities litigation, including the PSLRA. This may change after the 2008 financial crisis, but perhaps it is no surprise that Congress is not seriously considering repeal of PSLRA, however, Congress is seriously considering section 7216. PSLRA benefits all defendants including US financial intermediaries, but the defendants harmed by section 7216 will almost all be non-US financial intermediaries and issuers who are less able to defend themselves in the US political system.

4.5. European Lawyers

US attorneys compete with European attorneys. For instance, large New York-based US firms are often competing for the same clients with so-called magic circle firms in the United Kingdom and other large firms in mainland Europe. Recently, many companies in Europe and the United States suffered losses in the credit crisis and have reduced their payment of legal fees, forcing some law firms to file for bankruptcy, to downsize significantly, or to dissolve.[49] For US law firms representing plaintiffs and defendants, litigation involving securities transactions outside the United States is an attractive source of revenue.

Over the past decade, US plaintiffs' attorneys have expanded their client base with foreign investors and increased the scope of US securities class actions on a global scale.[50] US law firms may charge contingency fees. Plaintiffs' lawyers even if they lose a suit are protected by the American rule, under which each party is responsible for paying its own attorneys' fees. European law courts are more likely to apply the 'English' rule, that is, the losing party pays the attorneys' fees of the prevailing party. US class actions are cost-effective for lawyers given the enormous amounts of money involved, and European jurisdictions mostly do not offer securities class actions as a remedy for litigants. In addition, the tendency in the United States towards higher judgments and settlements, as well as the possibility for derivative suits,[51] makes the United States a lucrative place to litigate for plaintiffs' and

44 *Ibid.*, 6 (elaborating that: 'Legal uncertainty generates the following transaction costs: (a) costs of collecting information, (b) costs of legal disputes, (c) costs of setting incentives for pushing through legal claims, and (d) other transaction costs').

45 See Stanford Law School, *supra* n. 26 (the increase in foreign cubed cases started in 2008).

46 See *ibid.*

47 See Richard W. Painter, *Getting the Government America Deserves: How Ethics Reform Can Make a Difference* (Oxford University Press, 2009), Ch. 11.

48 In 1974, the prohibition on political contributions and expenditures by foreign nationals was incorporated into the Federal Election Campaign Act, 2 U.S.C. 431 et seq.

49 See Larry E. Ribstein, 'The Death of Big Law, University of Illinois Law & Economics Research Paper No. LE09-025', <http://ssrn.com/abstract=1467730>, 2009.

50 See Buxbaum, *supra* n. 15, 62.

51 Aha & Föderer, *supra* n. 28.

defendants' lawyers. While European law firms could participate in securities litigation in the United States, US law firms are at an enormous advantage as they will be perceived by clients to be familiar with US substantive and procedural law as well as the practical aspects of US litigation.

If section 7216 is enacted, European plaintiffs and defendants will likely turn to the expertise of American law firms. This will give US lawyers additional opportunities to expand an aggressive marketing campaign for legal services in Europe. The enactment of section 7216 thus could further exacerbate the already difficult situation for European law firms.

4.6. European Investors

US securities laws require issuers whose securities are sold or traded in the United States to disclose material information to investors and keep investors informed in a timely manner.[52] The SEC also requires all listed companies to file their reports on a centralized system that is accessible by investors, called EDGAR.

In Europe, each country is responsible for its own securities regulation and the EU has no central agency for securities regulation.[53] There is no centralized system like EDGAR for continuous disclosure of pertinent information to investors. Only fairly recently have European countries introduced mandatory and continuous issuer disclosure.[54] Such disclosure in Europe is often self-regulated rather than being enforced by a regulator.[55] The European Parliament and the European Commission have attempted to address disparate regulation and lack of enforcement in individual European Member States by adopting the Market Abuse Directive,[56] Transparency Directive,[57] the Markets in Financial Instruments Directive,[58] and the Prospectus Directive.[59] Despite many improvements,[60] the directives do not mandate coherent and comprehensive disclosure and issuers continue to make disclosures in disparate ways. Some scholars have argued that there is a need for a European SEC.[61] European investors continue to struggle finding material information on European companies. Even if they find appropriate sources, the information may be incomplete.[62]

Given the state of securities regulation in Europe, European investors arguably are more exposed to securities fraud than US investors. On the other hand, the financial crisis of 2008 revealed a substantial amount of financial mismanagement, and fraud, by US issuers and financial intermediaries. Regardless of the relative merits of securities regulation in the United States and in Europe, European investors are most likely to benefit if Europe addresses this issue itself. Giving EU plaintiffs greater access to US courts to sue EU issuers and financial intermediaries for alleged violations of US law may look attractive to EU investors in the short term, but if the US litigation system imposes substantial costs on EU companies, these costs will be passed on to investors. If Congress enacts section 7216, EU investors will, on the whole probably, earn a lower return on their investments than they would otherwise.

4.7. International Law

If section 7216 should pass, some litigants, commentators, and perhaps even national governments may argue that section 7216 is inconsistent with international legal rules governing extraterritorial jurisdiction. These include GATT/WTO and some of the side agreements or Bilateral Investment Treaties. Under broader principles of international law, the territorial integrity of a state can be breached by the extraterritorial application of foreign law if there is a specific conflict in the substantive legal norms of the respective states.[63] The extraterritorial application of US law thus raises questions under international law if 'there is in fact a true conflict between domestic and foreign law'.[64] It is unclear if there would be a conflict between the anti-fraud provisions of US securities law and its European counterparts. The scope of US anti-fraud provisions is broader than anti-fraud legislation in European countries, but it may be possible to comply with both regimes at the same time. On the other hand, if US law requires

52 To further the goal of the Sarbanes-Oxley Act of mandating disclosure on a rapid and current basis, the SEC extended the list of material events that require immediate disclosure by listed companies in the United States. See SEC Votes to Adopt Additional 8-K Requirements and to Propose Amendments to Form 20-F and Fund Manager Disclosure Requirements, *SEC News Digest*, 11 Mar. 2004, <www.sec.gov/news/digest/dig031104.txt>.

53 The Committee of European Securities Regulators (CESR) is an independent committee of European Union Member States' securities regulators, but it has no enforcement powers (see <www.cesreu.org/index.php?page=cesrinshort&mac=0&id=>).

54 Iris H-Y Chiu, 'Delegated Regulatory Administration in Mandatory Disclosure – Some Observations from EU Securities Regulation', *International Lawyer* 40 (2006): 737, 767.

55 *Supra* n. 54, 746.

56 Council Directive 2003/6, Art. 6, 2003 O.J. (L 96) 16 (EC).

57 Council Directive 2004/109, 2004 O.J. (L 390) 38 (EC).

58 Council Directive 2004/39, 2004 O.J. (L 145) 1 (EC).

59 Council Directive 2003/71, 2003 O.J. (L 345) 64 (EC).

60 Generally on improvement in the Markets in Financial Instruments Directive, see Francois P. Haas, 'The Markets in Financial Instruments Directive: Banking on Market and Supervisory Efficiency, IMF Working Papers', <http://ssrn.com/abstract=108716>, 2007, vol. 1–23.

61 See, for example, Roberta Karmel, 'The Case for a European Securities Commission', *Columbia Journal of Transnational Law* 38 (1999): 9; Yannis Avgerinos, 'The Need and the Rationale for a European Securities Regulator', in *Financial Markets in Europe: Towards a Single Regulator*, ed. Andenas & Avgerinos (2003); Gilles Thieffry, 'The Case for a European Securities Commission', in *Regulating Financial Services and Markets in the 21st Century*, ed. Ferran & Goodhart (2001); Eric Pan, 'Harmonization of U.S.-EU Securities Regulation: The Case for a European Securities Regulator', *Law and Policy in International Business* 34 (2003): 499.

62 Chiu, *supra* n. 54.

63 See Stürmer, *supra* n. 39; see also Meessen, *supra* n. 39.

64 See *Hartford Fire Insurance Co. v. California*, 509 U.S. 764 (1993).

disclosure of information that another country's law would prohibit to be disclosed, whether for privacy reasons or other reasons, there could be a true conflict of law and a credible case that the United States is in breach of international law.

4.8. Diplomacy

If section 7216 is enacted, European jurisdictions may feel compelled to change their laws to conform to US legal rules. European companies may feel compelled to modify their US activities. European governments may take issue with perceived pressure by the US legal system on their legislatures and regulators. They may also object to their companies being subjected to US jurisdiction in securities transactions that have no apparent US ties.

The United States does not always have a reputation for cooperation in foreign relations.[65] European governments have voiced concern about US attitudes towards international law.[66] Section 7216 could be one more impediment to good diplomatic relations if the United States is perceived as establishing its courts as international courts in securities matters with universal jurisdiction.

The US government could instead offer to cooperate with the EU to prevent securities fraud. The EU might in some ways change its law to conform with US law and the United States might in some ways change its law to conform with EU law. Exporting and imposing rules through extraterritorial reach, on the other hand, could be counterproductive not only for US diplomacy but also for international cooperation in combating securities fraud. If national securities regulators are unable or unwilling to cooperate with each other, there is likely to be more fraud.

5. CONCLUSION

The decision by the Supreme Court in *Morrison v. NAB* as well as the decision by Congress to perhaps enact section 7216 could have a lasting impact on European jurisdictions, companies, lawyers, and investors as well as on foreign trade and diplomacy. European Boards of Directors and company lawyers should follow upcoming events closely and prepare themselves for these impending changes. They should also ask Congress to reconsider section 7216. Finally, they should ask President Obama to live up to his pledge to improve international cooperation by refusing to sign such a provision into law.

65 See John R. Bolton, 'Is There Really Law in International Affairs?', *Transnational Law and Contemporary Problems* 10, no. 1 (2000): 48; see also 'Symposium Transcripts, Toward an International Criminal Court?', *Emory International Law Review* 14 (2000): 159 (debating the harmful effects to foreign policy in light of American exceptionalism).

66 See Robert J. Delahunty, 'The Battle of Mars and Venus: Why Do American and European Attitudes Toward International Law Differ?', *Loy. U. Chi. Int'l L. Rev.* 4 (2006): 11 (2006).