

Studying the Hegemony of the Extraterritoriality of U.S. Securities Laws: What It Means for Foreign Investors, Foreign Markets, and Efforts at Harmonization

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ABSTRACT

We live in an interconnected, globalized world where territorial borders are increasingly blurred, and a single decision can have international effects. But there is one concept that hinders the progress of further multi-lateral efforts in global securities law—extraterritoriality. The United States has been using extraterritoriality for decades to inject its presence into the global sphere. Extraterritorial applications have been unrestrained, arbitrary, inconsistent, unnecessary, and dangerous. Any restraint shown by the United States in curbing this abusive practice has been rendered meaningless over the years. For example, comity considerations or the reinvigoration of the presumption against extraterritoriality are the veil by which the United States hides its true intention: utilizing the unilateral expansion of U.S. law as a means to assert its dominance internationally to achieve global regulation. By adjudicating the claims of other nationals in cases that have little to no connection the United States, extraterritoriality creates over-regulation.

The United States applies its laws extraterritorially to advance its own economic and political interests, and will similarly decline to assert extraterritorial jurisdiction when that too advances its interests. The effects of this attitude impact mostly foreign states, as it is foreigners who feel the consequences of extraterritorial applications, and not the United States. Three issues demonstrate this hegemony: (1) the manipulation potential under current standards for determining if extraterritorial application is appropriate (Morrison's transactional test and the domestic "focus" analysis); (2) the United States' unwillingness to enter into multilateral agreements; and (3) the injurious effects on investors and capital markets—both domestic and foreign. This study aims to highlight these shortcomings and stresses the need for an international solution. With the Exchange Act's regulatory

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functions, it is possible to geographically reach foreign investors and markets in new, creative ways. An approach that considers comity, reduces foreign friction, and emphasizes accountability, free trade, transparency, and protection for all investors and markets—domestic and foreign—is the basic premise for progress. The study concludes by underscoring the critical need to revive the United States’ willingness to promote multilateral decision-making and work towards the harmonization of securities laws—either procedurally or substantively.

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I. INTRODUCTION TO EXTRATERRITORIALITY

A. *Illustrating the Problem*

In a modern globalized world, it is hard to conceive of a transaction—be it securities, antitrust, competition, etc.—that does not touch upon multiple borders. For example, in the 2010 seminal Supreme Court case *Morrison v. National Australia Bank*,¹ Justice Scalia (authoring the majority opinion) asserted that “it is a rare case of prohibited extraterritorial application that lacks all contact with the territory of the United States.”²

This trend of increasing unilateral decision-making by dominant states—such as the United States—has been a prime example for other states to follow the same path and works against the basic principles of international law. Thus, while one can easily conclude that the United States is fine with applying its securities laws to foreign nationals, can we similarly agree that the United States would welcome, or even tolerate, other states applying their laws upon U.S. nationals?³

1. 561 U.S. 247 (2010).
2. *Id.* at 266.
3. See Austen L. Parrish, *Evading Legislative Jurisdiction*, 87 NOTRE DAME L. REV. 1673, 1706 (2013) (observing that “U.S. courts should be wary of fostering a system that inherently undermines sovereignty” and, in referring to foreign courts, noting that they are “less likely to reach decisions that promote American interests”).

It is very likely that other states may seek to apply their laws extraterritorially in this fashion.

This appears to leave the United States, one of the leading nations in extraterritorial application,⁴ with two options: (1) accept that other states can apply their laws extraterritorially, regardless of consistency with U.S. customs,⁵ since to do otherwise would result in clear violations of international law principles; or (2) decide that it is time to reconsider the concept of extraterritorial application of its securities laws and instead work to promote multi-state efforts at harmonization of securities laws.⁶

B. Outline

This study aims to describe the consequences of the United States' consistent and abusive practice of using extraterritorial regulation to apply its securities laws abroad. Part I gives a brief overview of the origins and purpose of the extraterritoriality of securities law and then discusses the generally agreed-upon conclusions about this issue.

Part II's main objective is to place extraterritoriality in the modern era. More specifically, it will analyze the role of the United States in shaping this excessive trend and, after concluding whether the United States is properly categorized as a positive leader or hegemonic dominator, it will present the effects on foreign investors, foreign markets, and the judicial system.

Part III will shift gears and provide the future implications of the extraterritorial application of securities law. This section opens by offering the current trajectory of this concept should current practices continue. Problems with over-regulation are then analyzed, including those that are likely to arise in the future. Part III concludes by stressing the need for an international solution in light of the United States' position as a global actor, international comity and accountability, and for there to be any hope for international efforts at harmonization.

Part IV introduces the two main solutions for harmonization in the securities law of states—*procedural* and *substantive* harmonization. The advantages and disadvantages of each approach are discussed, followed by the factors that the path towards a globalized solution should entail. Suggestions for how to proceed at this stage along with its current desirability and feasibility are then addressed.

4. *Id.* ("After years of the U.S. being one of the few to apply its laws extraterritorially, other countries have begun to follow suit.")

5. See Austen Parrish, *The Interplay Between Extraterritoriality, Sovereignty, and the Foundations of International Law*, in STANDARDS AND SOVEREIGNS: LEGAL HISTORIES OF EXTRATERRITORIALITY 1, 11 (Mar. 29, 2017) (unpublished manuscript) (on file with author) [hereinafter Parrish, *Interplay*] (observing the "reciprocity problem," it is noted that "[i]ncreasingly other nations have begun to act unilaterally—mimicking in their own ways the exceptionalism the U.S. promoted").

6. *Id.* at 3.

C. A Brief Background on Extraterritoriality of Securities Law

1. Definition of Extraterritoriality

Extraterritoriality, generally, is the application of a state's laws to conduct occurring outside its territorial borders.⁷ This study delves into mainly prescriptive jurisdiction, which is, simply put, “the authority of a state to make laws applicable to persons, property, or conduct.”⁸

2. Origins of The Presumption Against Extraterritoriality

The presumption, which is utilized by courts to lessen the unintended extensions of U.S. statutes, has developed as an attempt to limit extraterritorial applications. It holds that “Congress is primarily concerned with domestic conditions,”⁹ and that courts should always begin with this stance. In first utilizing the presumption, Justice Story in *The Apollon* stated, “[t]he laws of no nation can justly extend beyond its own territories, except so far as regards its own citizens.”¹⁰ This was the concept of “territorial sovereignty,” which was designed to “reduce conflict, maintain peace, and constrain would-be empire builders.”¹¹

Professor Anthony Colangelo advances two rationales for the presumption: (1) Congress legislates only with domestic matters in mind, and (2) avoiding international friction that could result from the unintended overreach of U.S. law.¹² However, Colangelo takes care to note that this unintended qualifier refers to unintended actions by the political branches—thus, if courts apply the law extraterritorially against the wishes of Congress, the courts risk “international discord,” but if the courts refuse to apply the statute extraterritorially when Congress so intended, they are “overriding the political branches.”¹³ It appears that before harmony within the international sphere can take place, the U.S. branches must work together to achieve domestic harmony. However, this conclusion also implies that the courts may have more power when deciding whether to apply a provision extraterritorially, even more so than congressional power.

In achieving this national harmony, the United States, since early on, has utilized two critical canons of constructions in geographically reaching cross-border conduct: (1) the presumption against extraterritoriality (discussed above), and (2) the *Charming Betsy* canon.¹⁴ The canon set forth by Chief Justice Marshall's *Charming Betsy* opinion requires courts to begin with the principle that “an act of

7. Curtis A. Bradley, *INTERNATIONAL LAW IN THE U.S. LEGAL SYSTEM* 169 (2d ed. 2015).

8. RESTATEMENT (FOURTH) OF FOREIGN RELATIONS LAW: JURISDICTION § 101, pt. I, ch. 1 (AM. LAW INST., Tentative Draft No. 3, 2017).

9. *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949).

10. 22 U.S. (9 Wheat.) 362, 370 (1824).

11. See Parrish, *Interplay*, *supra* note 5, at 2–3.

12. See Anthony J. Colangelo, *The Frankenstein's Monster of Extraterritoriality Law*, 110 AM. J. INT'L L. UNBOUND 51, 53 (2016) (emphasis added).

13. *Id.*

14. See Anthony J. Colangelo, *A Unified Approach to Extraterritoriality*, 97 VA. L. REV. 1019, 1031–32 (2011) [hereinafter Colangelo, *A Unified Approach*].

Congress ought never to be construed to violate the law of nations if any other possible construction remains”¹⁵

Despite this, case law displays an increase in inconsistent holdings and arbitrary decision-making in its extraterritorial applications and use of the presumption. For instance, judges have sometimes applied a strict presumption only to render it completely meaningless in other similar cases. I will illustrate this point with two cases. First, in *Hartford Fire*,¹⁶ the Supreme Court, over a heated dissent by Justice Scalia, disregarded the presumption and held that the Sherman Act applies to foreign conduct. Then, about ten years later in *Empagran*,¹⁷ the Supreme Court yet again confronted a case under the Sherman Act, but this time concluded that foreign conduct does not fall within the Act’s provisions. Thus, the presumption had not been rebutted and the Court regarded it as a highly important safeguard.

These inconsistencies are only a taste of the shortcomings of the use and reliance on extraterritorial regulation. While the presumption used to be justified in concepts so simple as sovereignty and international law, “the presumption no longer vindicates these international rules because the rules themselves have evolved to embrace extraterritoriality.”¹⁸ This seems to imply that the concepts of extraterritoriality and the presumption are at odds with each other.

While regarding the presumption and extraterritoriality as mutually exclusive or inconsistent does have some appeal (perhaps as a first step to eradicate extraterritoriality), there are some built-in protections. For example, sometimes judicial safeguards, like the presumption, do prevent the unintended application of U.S. law abroad.¹⁹ But, nevertheless, the presumption’s current malleable features may render it almost completely superficial, if not nonexistent. As discussed, the courts can easily shape a case one way to achieve a certain favorable result and reframe another similar case as the opposite to achieve a different favorable result—this is *judicial characterization*. Courts can readily use this mechanism as a safety valve or escape device to achieve a specified result under the shadow of law, even though it is clearly against congressional intent, precedent, and at odds with the Restatements, etc. Thus, extraterritorial regulation is appropriately analogized to “unilateral law,” and has, within the recent decades, unfortunately become “commonplace.”²⁰

15. *Murray v. The Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804).

16. *Hartford Fire Ins. Co. v. Cal.*, 509 U.S. 764 (1993).

17. *F. Hoffmann-La Roche Ltd v. Empagran S.A.*, 542 U.S. 155 (2004).

18. See Colangelo, *A Unified Approach*, *supra* note 14, at 1033.

19. See *Empagran*, 542 U.S. at 169 (denying extraterritorial application where international comity would be promoted and where the “foreign injury is independent of domestic effects”); *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (denying extraterritorial application due to the lack of an affirmative intent by Congress in the statute to apply the statute extraterritorially).

20. See Parrish, *Interplay*, *supra* note 5, at 6.

3. Purpose of Extraterritoriality

Historically, the purpose of extraterritorial applications of securities laws has been the protection of U.S. investors and U.S. capital markets.²¹ While admirable, whether or not the goals of the Exchange Act align with this purpose is questionable. For example, after the new “focus” inquiry from *Morrison* was advanced, it is difficult to see how U.S. investors and markets are protected by a binding precedent that mandates looking only to “domestic exchanges/transactions.”²² However, it is certainly easy—though not intuitive—to see foreign investors in U.S. markets borrow the protections of U.S. law. But the same cannot be said for all U.S. investors. For instance, what if those U.S. investors buy foreign shares?

Morrison’s protections extend to any investor—domestic or foreign—who deals on a domestic exchange or with a domestic transaction. However, foreign transactions by both domestic and foreign investors will fall outside the protections of *Morrison*. Thus, these protections are wholly independent of the degree of harmful effects, amount of conduct in the United States, and the citizenship of the investor. Does this really make sense?

This inability to protect investors and markets stems from the fact that investors thrive on diversified portfolios that contain both domestic and foreign investments. Similarly, U.S. capital markets flourish with a steady inflow of foreign capital. But *Morrison* denies protection to anything that is “foreign” (as shown in the representation above) and, thus, disincentivizes investments in foreign transactions and participation in foreign markets, thereby harming U.S. investors and markets.

Furthermore, extraterritoriality and the presumption against such application have broader purposes in the modern context. For example, according to Parrish, the presumption (as reinvigorated in the 1990s) advocates the “recognition that extraterritorial laws regulating foreigners are problematic and should be used with great care.”²³ Continuing today, its purpose is to facilitate the United States as an international political actor in using its unilateral extraterritorial regulation to engage in the global market.²⁴ In other words, extraterritorial applications seem to create the golden ticket for U.S. dominance in the international sphere. There is something inherently problematic about this trend.

4. Present-Day Conclusions

Despite the above assertions, nevertheless, present-day uses do reveal a moderate cut-back and cautionary approach when considering extraterritorial applications. This is demonstrated again by the reinvigoration of the presumption in the

21. See Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT’L L. & BUS. 207, 224 (1996).

22. See *infra* note 32.

23. See Parrish, *Evading Legislative Jurisdiction*, *supra* note 3, at 1701.

24. See Parrish, *Interplay*, *supra* note 5, at 1 (observing that extraterritoriality is “one of the principal ways the United States and other nations now engage globally”).

1990s²⁵ and the shift from an international law orientation to one centered only on domestic conditions and the statutory interpretation of congressional statutes.²⁶

However, the return to territorial concerns does not imply that the U.S. system—namely the legislature and the judiciary—has shifted its concern to better protect investors and capital markets, both domestic and foreign. In fact, this study takes just the opposite stance: the purported cut-back in extraterritorial application does not resolve the hegemonic expansion of U.S. securities law abroad and masks the real problem of failing to achieve international harmonization.

Two significant factors are behind this movement, for which other scholars and commentators take very similar positions.²⁷ First, the United States seems to be losing interest in concluding multilateral agreements. Professor Parrish examined “the degree” to which the United States has become “disengage[d]”²⁸ from multilateral agreements and treaties. U.S. reluctance to participate in multilateral agreements forced international lawyers to look for another avenue of redress for

25. See Colangelo, *A Unified Approach*, *supra* note 14, at 1043 (observing that “the Court’s recent reinvigoration of the presumption against extraterritoriality in *Morrison* appears strongly to support a separation of powers model that preferences foreign territorial sovereignty as a default rule”).

26. See Anthony J. Colangelo & Christopher R. Knight, *Post-Kiobel Procedure: Subject Matter Jurisdiction or Prescriptive Jurisdiction*, 19 UCLA J. INT’L L. FOREIGN AFF. 49, 54 (2015) (“It followed that whether and how a presumption against extraterritoriality applied concerned a statute’s conduct regulating rules, not its subject matter jurisdiction provisions for courts.”) (this text is particularly important because conduct regulating rules are merits questions, as opposed to questions of subject matter jurisdiction); Zachary D. Clopton, *Replacing the Presumption Against Extraterritoriality*, 94 B. U. L. REV. 1, 10 (2014) (observing that “[c]ourts in recent years have put less emphasis on international law” and instead focus on “legislative attention”); Parrish, *Evading Legislative Jurisdiction*, *supra* note 3, at 1674 (noting that absent competing evidence “Congress was presumed to have exercised only its territorial jurisdiction”).

27. See Parrish, *Interplay*, *supra* note 5, at 11 (“Often because global challenges require comprehensive responses, extraterritorial regulation leads to the sort of piece-meal fragmentation that is not helpful.”); Colangelo & Knight, *supra* note 26, at 52 (“Judicial treatment of what type of jurisdiction the presumption against extraterritoriality operates on is messy and inconsistent.”); Parrish, *Evading Legislative Jurisdiction*, *supra* note 3, at 1673–74 (noting that “[e]xtraterritorial regulation . . . was disfavored and in tension with basic international law principles”); 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, 544 (2011) (“Too broad an extraterritorial application of the securities antifraud rules may amount to an impermissible interference with foreign securities markets”); Austen L. Parrish, *Reclaiming International Law from Extraterritoriality*, 93 MINN. L. REV. 815, 872 (2009) [hereinafter Parrish, *Reclaiming International Law*] (“Using extraterritorial laws then as a way to achieve international agreement seems a particularly misguided strategy”); 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, 102–03 (2003) (“[T]he continued expansion of U.S. jurisdiction over transnational fraudulent transactions cannot be justified in global markets.”); Mark P. Gibney, *The Extraterritorial Application of U.S. Law: The Perversion of Democratic Governance, the Reversal of Institutional Roles, and the Imperative of Establishing Normative Principles*, 19 B.C. INT’L & COMP. L. REV. 297, 305 (1996) (“Extraterritoriality is essentially a situation where rulemakers in one country get to pick and choose which of their own rules they will apply in other countries.”).

28. See Parrish, *Reclaiming International Law*, *supra* note 27, at 836 (noting the “lost enthusiasm” of the United States towards engaging in the international sphere).

their clients' needs. Parrish documented the resulting trend of resorting first to "extraterritorial domestic remedies, rather than international ones, when faced with an international challenge."²⁹ This was a simple solution for the United States, who could easily "export . . . its brand of justice"³⁰ globally without having to worry about the obligations of any treaty—a clear example of "American exceptionalism."³¹ Thus, the exponential rise in extraterritoriality began.

Second, the U.S. Supreme Court decision in *Morrison* and congressional passage of Dodd-Frank, both in 2010,³² spawned a variety of methods for the manipulation of U.S. law applicability. For example, Professors Wulf Kaal and Richard Painter correctly observe that U.S. law will not apply to parties "provided their transactions are definitively outside the United States."³³ More specifically, it is now easier to structure a transaction to deliberately escape liability under U.S. security laws and profit from one's own deceptive practices upon others. As a simple example, it is very possible for a foreign issuer to induce U.S. investors to purchase shares on a foreign exchange based on fraudulent records and subsequently not be subject to U.S. liability because they did not transact on a domestic exchange or with a domestic security under the *Morrison* analysis. As a twist, a U.S. issuer is similarly able to evade U.S. liability if they induce U.S. investors to buy fraudulent dually listed shares off a foreign exchange. Equally disturbing, those defrauded U.S. investors cannot depend on their country of nationality—the United States—to

29. *Id.* at 833.

30. *Id.* at 841.

31. *Id.* at 846 (emphasis added).

32. Dodd-Frank Wall Street Reform and Consumer Protection Act, § 929P(b), Pub. L. No. 111-203, 124 Stat. 1376, 1865 (2010); *Morrison v. National Australia Bank*, 561 U.S. 247, 252, 254, 266–67, 269 (2010). As a brief background, *Morrison*—which was a class action suit—concerned a foreign-cubed transaction: Australian plaintiffs sued National Australia Bank (an Australian company) for shares bought on the Australian and other foreign exchanges. The financial records of HomeSide, NAB's U.S. subsidiary, were allegedly fraudulently overstated and induced the plaintiffs to purchase shares. Upon initial reading of the decisions of both the Second Circuit and the Supreme Court, it is difficult to perceive any major differences in the opinions, as the Supreme Court did in fact affirm the holding of the court below. However, at a closer glance, the opinion of the Supreme Court is markedly different from the Second Circuit both procedurally and substantively. Justice Scalia, in his majority opinion, concluded that the extraterritorial reach of the Exchange Act is a "merits question," not one of subject matter jurisdiction, and, in rejecting the conduct/effects tests, articulated a "transactional test" for which Section 10(b) of the Exchange Act now applies only to "securities listed on domestic exchanges" and "domestic transactions in other securities" after determining that the "focus" of the Exchange Act was upon the "purchases and sales of securities in the United States." One month later, Congress enacted the Wall Street Reform and Consumer Protection Act (Dodd-Frank) in an attempt to reverse *Morrison*. Specifically, Section 929P(b) sought to codify the conduct/effects tests in proceedings brought by the SEC/DOJ. However, this provision of the Act was a failure because it was drafted in jurisdictional language after *Morrison* concluded extraterritoriality was a merits question. This fatal flaw resulted in confusion and ambiguity throughout the U.S. district and circuit courts in determining whether to apply *Morrison* or Dodd-Frank scrutiny in suits brought by the SEC/DOJ.

33. See Wulf A. Kaal & Richard W. Painter, *Forum Competition and Choice of Law Competition in Securities Law After Morrison v. National Australia Bank*, 97 MINN. L. REV. 132, 135, 192 (2012) [hereinafter Kaal & Painter, *Forum Competition*] (observing the manipulation potential but also hopeful that this *transactional test* is only temporary since, after all, "it is rooted in geography and an increasing number of securities transactions defy geographical boundaries").

provide them with redress. They are being punished for transacting on foreign markets or, in more critical words, for promoting foreign capital flow.

The *Morrison* decision brought the end to foreign-cubed transactions³⁴ by rendering an investor’s nationality and the conduct or effects involved in such a transaction completely irrelevant to the court’s analysis. Thus, the above points demonstrate the manipulation potential under current standards. Current law in this area very likely transforms the territory of the United States into a “Barbary Coast for those perpetrating frauds on foreign securities markets.”³⁵

The Table below summarizes what has been covered so far in this study and displays the results in a comparative representation of *earlier* and *later* cases dealing with the extraterritorial application of cross-border securities cases. As can be easily gathered, these drastic shifts from the earlier era to the most recent has been prompted and also acknowledged in large part by the *Morrison* holding and its implications (though arguably such changes were present even prior to *Morrison*).

	<i>Early Cross-Border Securities Cases</i>	<i>Later Cross-Border Securities Cases</i>
Method of Analysis	International Law & Sovereignty	Statutory Construction & Interpretation
Doctrines & Considerations in Court’s Examination	(1) International Comity (2) <i>Charming Betsy</i> Canon	(1) Presumption Against Extraterritoriality (2) Discerning Congressional Intent
Question of Extraterritoriality	Subject Matter Jurisdiction	Merits Question (Prescriptive Jurisdiction)
Standard in Determining Propriety of Extraterritoriality	Conduct/Effects Tests	Transactional with Domestic “Focus” Test

II. PLACING EXTRATERRITORIALITY OF SECURITIES LAW IN A MODERN CONTEXT

A. *The United States: Positive Leader or Hegemonic Dominator?*

The United States, and in particular the Second Circuit, has been the forerunner in applying securities laws extraterritorially—discerning whether Congress would have wanted it to apply extraterritorially due to the Exchange Act’s silence

34. See Parrish, *Evading Legislative Jurisdiction*, *supra* note 3, at 1698 (asserting that *Morrison* “put an end to so-called ‘foreign cubed’ cases”).

35. *Morrison*, 561 U.S. at 270.

on the issue.³⁶ But did this “judicial-speculation-made-law”³⁷ seek to *guide* other states in securities enforcement measures or merely to *control* it? More specifically, has this consistent practice positioned the United States as a positive leader or hegemonic dominator?

To answer this question requires an examination of the consequences that the actions of the United States has produced. In his forthcoming article on the relationship between extraterritoriality, sovereignty, and international law, Professor Parrish puts forth two conclusions. First, extraterritoriality of domestic laws constitutes “an attack upon international law,” and, second, it is the isolationists and anti-internationalists “that have sought to undermine international institutions and the multilateral cooperation upon which international law rests.”³⁸

Regarding the first point, extraterritoriality is at odds with enhancing the international system because it involves unilateral self-interest³⁹ and promotes American exceptionalism.⁴⁰ As technology and communication systems advanced, their merger with globalization paved the way for the United States to extend its domestic doctrines abroad in a “hegemonic fashion that displaced traditional international law.”⁴¹ This merger gave the United States the green light to indirectly—and stealthily—control other states and served as the perfect invitation to experiment with extraterritoriality. And by displacing international law, we are attacking its premises.

His second point denotes efforts that are designed to impede international cooperation. Those efforts he describes likely refer to the same issue: *the perverse use of extraterritoriality*. For example, Parrish appropriately notes that extraterritoriality is viewed as “unseemly meddling or bullying” at best and “unlawful and imperialistic empire building” at worst.⁴² In other words, the very essence of extraterritoriality is unilateral action, which inevitably draws a sharp line between the powerful/wealthy states and the weaker/poorer states. For example, less developed states are not likely to notice this, and less wealthy states are not likely to revolt against this.

B. The Impact of the U.S. Securities Acts on Foreign Investors and Markets

We have already noted that extraterritorial applications of U.S. securities laws are able to reach foreign investors and markets in relation to foreign conduct, but

36. *Id.* at 255.

37. *Id.* at 261.

38. See Parrish, *Interplay*, *supra* note 5, at 2.

39. See Paul B. Stephan III, *The Political Economy of Extraterritoriality*, 1 POL. & GOVERNANCE 92, 93 (2013) (“There is every reason to think that national interest rather than global welfare will dominate what choices states make.”).

40. See Parrish, *Interplay*, *supra* note 5, at 2, 6 (observing how extraterritoriality marked a return to imperialism eras and reflects an attitude of American exceptionalism since extraterritorial applications rarely constrains U.S. actors).

41. *Id.* at 5–6.

42. *Id.* at 3.

what exactly are the implications of this reach? What are the social, economic, and political consequences on foreign investors and foreign markets?

Foreign hostility is among one of the chief criticisms asserted by foreign investors. Among numerous others, this hostility relates to the following shortcomings of extraterritorial applications: (1) lack of accountability of the United States to foreign investors;⁴³ (2) inability of foreign investors to exercise a substantial presence in the political process;⁴⁴ and (3) simply, unfairness.⁴⁵ This unfairness could simply refer to the decrease in possible investments available to U.S. investors due to *Morrison* or increase in U.S. disclosure and compliance requirements. Therefore, as a result, U.S. investors are less able to diversify their portfolios with international investments and thus less likely to reduce overall investment risk.⁴⁶

Furthermore, Professors Kaal and Painter correctly assert the dangers of imposing U.S. securities laws abroad due to the “*sharp* differences between the United States and most other countries in substantive securities law, procedural law, and the way class actions are administered.”⁴⁷ They note the “confusion, legal uncertainty and difficulties” involved when the United States extends its laws upon, for example, European jurisdictions, and also observe that some states may even “feel compelled to change their laws to conform with U.S. law.”⁴⁸ However, in attempting to comply with some of the strict mandates of U.S. law, such as disclosure requirements, the other state may find that complying with such U.S. laws are against their own laws—this could even create “a credible case that the United States is in breach of international law.”⁴⁹

In relation to foreign market anxieties, extraterritorial applications of U.S. securities laws results in social, political, and also economic consequences, such as (1) a resulting information gap between domestic and foreign markets;⁵⁰

43. See Austen L. Parrish, Morrison, *The Effects Test*, and the Presumption Against Extraterritoriality: A Reply to Professor Dodge, 105 AM. SOC. INT'L L. 399, 401 (2011) [hereinafter Parrish, *The Effects Test*] (“Extraterritorial laws regulating foreigners are inherently undemocratic . . .”); Gibney, *supra* note 27, at 305–06.

44. Parrish, *The Effects Test*, *supra* note 43, at 401.

45. See Parrish, *Evading Legislative Jurisdiction*, *supra* note 3, at 1701.

46. Choi & Guzman, *supra* note 21, at 226.

47. Wulf A. Kaal & Richard W. Painter, *Extraterritorial Application of U.S. Securities Law – Will the U.S. Become the Default Jurisdiction for European Securities Litigation?*, 7 EUR. COMP. L. 90, 91 (2010) [hereinafter Kaal & Painter, *Extraterritorial Application*].

48. *Id.* at 93.

49. *Id.* at 97.

50. See Hannah L. Buxbaum, *Transnational Legal Ordering and Regulatory Conflict: Lessons from the Regulation of Cross-Border Derivatives*, 1 U.C. IRVINE J. INT'L, TRANSNAT'L, & COMP. L. 91, 94 (2016) (observing that this gap “poses significant challenges to the transnational economic order” and that investors transacting on foreign markets may “face difficulties in accessing financial and other disclosure that would permit cross-market comparison of investments, and bear increased transaction costs”).

(2) the coercive power by the dominant state—the United States;⁵¹ and (3) reduced competition and, therefore, cash inflow.⁵² Regarding cash inflow, there is a tension between a state's need to strengthen global regulation and the need to maintain market competitiveness⁵³—a tension that centers on attracting capital. If the state cannot maintain its competitiveness, its capital markets will suffer within both the domestic *and* international sphere.⁵⁴ For example, extraterritorial applications may discourage investments by Americans in foreign issues and, consequently, reduce the participation of American investors with foreign issuers; thus, “[t]his reduction in capital mobility is harmful to all parties in the market.”⁵⁵

Markets can also suffer indirectly from the standard the state uses to determine the extraterritorial reach of its securities laws. Whether the state uses some form of the conduct test, effects test, or transaction test, manipulation is very possible. On this point, Professors Stephen Choi and Andrew Guzman observe the injurious effects on capital mobility that result from standards that “limit the ability of American investors to purchase securities issued abroad . . .”⁵⁶ It is possible that this limitation comes from not only the ability to evade liability,⁵⁷ but also from the fear that investors apprehend when they know that little recourse will be available to them should a dispute arise or the fear that issuers anticipate the possibility of being sued.⁵⁸ For example, under the *Morrison* standard, an investor will know (or should know) that if he or she transacts on a foreign exchange, even if with a U.S. issuer with dually listed stock, U.S. law will not protect him or her, since Section 10(b) of the Exchange Act only applies to “securities listed on domestic exchanges and domestic transactions in other securities.”⁵⁹ Alternatively, if we use either the conduct or effects test, an issuer may be reluctant to transact on a U.S. exchange or with domestic transactions because he or she will fear that any small U.S. presence—such as a meeting held in the United States (the *conduct* test) or a loss caused to one U.S. investor out of millions (the *effects* test)—will satisfy the standard needed to impose liability upon that issuer.

51. Cf. Choi & Guzman, *supra* note 21, at 209 (asserting that “countries applying extraterritorial rules are insulated from competitive pressures” and also “may craft regulatory regimes that satisfy the interests of either government bureaucrats or special interest groups”).

52. *Id.* at 226–27 (noting that extending U.S. laws in the global sphere “does not necessarily work to further the goals of capital market integrity” since the United States derives market integrity from “greater capital mobility”).

53. See Buxbaum, *supra* note 50, at 95.

54. Choi & Guzman, *supra* note 21, at 225 (observing the harm from the reduction of liquidity in the international capital market, the drop in the issue price of securities from the decrease in investors, the forfeiture of projects due to funding inabilities, and the expected loss to society from not undertaking these projects).

55. *Id.*

56. See Choi & Guzman, *supra* note 21, at 224–25.

57. *Id.* at 225 (“To avoid these regulations, for example, some foreign issuers may simply restrict their offerings to investors who are not residents of the United States.”).

58. Chang, *supra* note 27, at 92 (noting “the possibility of being sued based on the extraterritorial application of U.S. antifraud provisions . . .”).

59. *Morrison v. National Australia Bank*, 561 U.S. 247, 267 (2010).

All this comes down to is that such standards do not provide adequate protections for both investors and issuers. Perhaps the problem is not only the standard used, *but the concept of extraterritoriality itself.*

C. *The Effects of Extraterritoriality on Foreign States*

The widespread effects of extraterritoriality are also felt on foreign states as a whole. For example, the different jurisdictions implicated by a multi-national transaction create problems for regulators, who “routinely confront territorial limits on their authority to reach actors and activity that affect their markets.”⁶⁰ An ineffective regulatory system undermines multilateral efforts at harmonization between states⁶¹ and encumbers development of the rule of law.⁶² If a sound rule of law cannot be maintained, the development of the state could be severely obstructed.⁶³

Additionally, aside from the internal mayhem caused by extraterritoriality, Professor Kun Young Chang notes the more extensive consequences of such an overreaching approach to the extraterritoriality of U.S. securities laws. For example, its use “may give rise to a breach of international comity as well as cause frequent conflicts with the sovereignty of other countries.”⁶⁴ Young Chang also correctly observes that these practices “will not ensure predictability and certainty in the application of securities laws”⁶⁵ For example, we have already noted the possibilities for manipulation by both investors and courts under current, as well as prior, standards. Furthermore, differing jurisdictions, rules, applicability, etc.—all factors involved in analyzing the use of extraterritoriality—create ambiguity and inconsistencies in deciding cross-border cases.

D. *Resulting Assumptions and Reactions in the Judicial System*

How are courts to hear and decide cases when the other branches of the government fail to provide clear guidance when enacting statutes or fail to maintain satisfactory efforts regarding international cooperation with foreign states? It is the task of Congress to enact statutes that clearly guide courts when applying U.S. law extraterritorially, not to create confusion regarding its scope or applicability. Similarly, it is the job of the executive to maintain healthy foreign relationships, and this includes the responsibility to promote global cooperation in all fields, including securities law. These deficiencies tend to empower the judiciary (for

60. See Buxbaum, *supra* note 50, at 94.

61. Parrish, *Evading Legislative Jurisdiction*, *supra* note 3, at 1703 (“Unilaterally imposed extraterritorial measures often undermine and hamper those multilateral efforts.”).

62. Cf. Parrish, *The Effects Test*, *supra* note 43, at 401 (asserting that extraterritoriality fosters a world in which a state is “free to impose its own vision on others, and where exceptionalism, rather than the rule of law, controls”).

63. *Id.* (asserting that “extraterritorial law is in tension with the right to self-governance and self-determination”).

64. Chang, *supra* note 27, at 100–01; see also Choi & Guzman, *supra* note 21, at 208 (“Extraterritoriality results in frequent conflicts between the United States and other nations.”).

65. Chang, *supra* note 27, at 102.

better or worse) to take action and increase the likelihood that courts will engage in “case-by-case decisionmaking.”⁶⁶ This can only result in “vague standards” and “invite litigation.”⁶⁷

Furthermore, without any guidance or standardized rules, this kind of discretion gives the judiciary the power to articulate its own standards and tests for which to decide cases involving cross-border claims. Justice Scalia criticizes, for example, the practice of the Second Circuit in disregarding the presumption, for formulating its own standards for the extraterritoriality of securities laws, and for setting the stage for sister circuits to either set their own approach or adopt the same as another circuit.⁶⁸ Thus, we can see how little acts of carelessness—such as a disregard of the presumption here or the adoption of another extraterritorial standard there—can develop into, or even stimulate, an unrestrained practice of unilateral U.S. power via extraterritorial applications.

Despite this, it seems the U.S. judiciary has sometimes taken due notice of these inadequacies. For example, as noted above, the last couple of decades have displayed a decline in U.S. willingness to find extraterritorial applications appropriate. For example, the U.S. Supreme Court has been more restrained in applying its securities laws abroad and has even concluded that U.S. statutes “should not be so readily interpreted to apply to foreigners acting abroad.”⁶⁹ This appears to suggest that the United States is limiting access to its courts by either “restricting the extraterritorial reach of its law” or also by “imposing more rigorous standards,” and this is seen in U.S. caselaw as well.⁷⁰

Professor Parrish demonstrates this trend by highlighting three recent Supreme Court cases and their relation to the presumption against extraterritoriality:⁷¹ (1) *Morrison*⁷² (highlighting the importance of maintaining the presumption); (2) *Kiobel*⁷³ (extending the presumption to jurisdictional statutes);

66. See Stephan, *supra* note 39, at 97.

67. *Id.*

68. *Morrison v. National Australia Bank*, 561 U.S. 247, 248 (2010) (“This disregard of the presumption against extraterritoriality has occurred over many decades in many courts of appeals and has produced a collection of tests for divining congressional intent that are complex in formulation and unpredictable in application.”).

69. See Parrish, *Interplay*, *supra* note 5, at 8.

70. James L. Stengel & Kristina P. Trautmann, *Determining United States Jurisdiction over Transnational Litigation*, 35 REV. LITIG. 1, 3 (2016).

71. See Parrish, *Interplay*, *supra* note 5, at 9.

72. *Morrison*, 561 U.S. 247 (2010).

73. *Kiobel v. Royal Dutch Petro. Co.*, 569 U.S. 108 (2013); see also Anthony J. Colangelo, *What Is Extraterritorial Jurisdiction?*, 99 Cornell L. Rev. 1303, 1339 (In reiterating that the presumption is a “canon of statutory construction,” Colangelo noted that “applying it directly to the ATS itself would be awkward, because the ATS, like § 78aa of the Exchange Act, is a jurisdictional statute.”). However, going one step further, the fact that courts began to apply the presumption to jurisdictional statutes demonstrates how U.S. courts—particularly the U.S. Supreme Court—want to limit its extraterritorial effects on other states. The seminal case illustrating this phenomenal new trend is the *Kiobel* case, where the Supreme Court faced the issue of whether to apply the presumption against extraterritorial application to the Alien Tort Statute (ATS) in light of the 2010 *Morrison* opinion. They did. This is interesting because the presumption against extraterritoriality is used only in situations where the statute

and (3) *Nabisco*⁷⁴ (applying the presumption regardless of the type of prescriptive jurisdiction implicated). This fading tendency to find extraterritorial application should continue, but it needs to be further refined. Though Professor Parish—and subsequent Supreme Court cases—agree that the presumption against extraterritoriality matters, that is not the end of the matter.

What is really going on underneath this new trend? Is this sudden emphasis on the importance of the presumption compensating for something? For example, what was the purpose in restricting the tendency to find extraterritoriality appropriate or in imposing more rigorous standards? At first blush, it appears to be done to curb extraterritoriality. But is this really what the United States is doing? For example, what *Morrison* actually achieves is the complete denial of the private right of action for U.S. investors transacting on a foreign exchange or with a foreign transaction. *Morrison* also forecloses the ability of U.S. and foreign investors to diversify away the unsystematic risk of foreign transactions in investment decisions and arbitrarily disadvantages them without logical justification.

While this limits the inclination to apply U.S. law and imposes a more rigorous standard, it cannot possibly be construed as a necessary means to curb the harmful effects of extraterritoriality nor to promote international harmony. Instead, it is a charade designed to project U.S. law abroad in the same fashion it has exhibited in prior decades. Procedural safeguards, such as the presumptions, appear to be rendered nothing more than a pretext for the persistent hegemonic application of U.S. securities law abroad.

III. THE FUTURE IMPLICATIONS OF EXTRATERRITORIAL APPLICATION OF SECURITIES LAW ON INTERNATIONAL EFFORTS AT HARMONIZATION

A. *The Current Trajectory of Extraterritorial Application of Securities Law*

Where do we go from here? So far, this study has illuminated the dangers of excessive uses of extraterritorial applications and how this promotes unilateralism and exceptionalism by dominant states. What will come to pass if these conditions stay static remains to be seen. One thing is for sure: this trajectory will not contribute to international cooperation or multilateral efforts at harmonization.

This part of the study will focus on three major problems (currently existing and forthcoming) that are likely to be exacerbated under the status quo: (1) the continued manipulation of the laws, not just by investors and issuers, but also by the courts, (2) the increase in inconsistent litigation, and (3) the potential consequences on the state of Canada.

aims at regulating the substance of the transaction; it simply does not apply to jurisdictional statutes. Despite this, the Supreme Court in *Kiobel* applied the presumption to the ATS.

74. *RJR Nabisco, Inc. v. European Cmty.*, 195 L. Ed. 2d 476 (2016).

First, current procedures for determining the reach of U.S. securities laws provide the plaintiff (via counsel) with “two bites at the apple”⁷⁵ to comply with U.S. law and utilize its remedies and provisions for liability. In other words, there are two ways for U.S. law to apply: (1) if the statute clearly indicates congressional intent for extraterritorial application, or (2) if the focus of the statute is on domestic activity. The *Nabisco* opinion reveals more about this two-step framework. Step one asks whether congressional intent has clearly rebutted the presumption. If *yes*, the statute is applied extraterritorially, but if *no*, then the Court proceeds to determine the “focus” of the statute. If the focus of the statute is on conduct in the United States, then there is a domestic focus and the statute can be applied in that case, regardless of whether foreign conduct is at issue. However, if the statute focuses on foreign conduct, then there can be no extraterritorial application regardless of any U.S. conduct.⁷⁶

Professor Dodge argues that these two methods are very flexible. For example, the first step is not a clear statement rule and the second step is not dependent on the location of the conduct. This flexibility, according to Dodge, “may make it possible for courts to apply the presumption against extraterritoriality ‘in all cases’”⁷⁷ Professors Brilmayer and Parrish, among other scholars, also make this point, arguing that this flexibility “create[s] an unintended loophole that provides courts leeway to skirt the presumption against extraterritoriality,”⁷⁸ and effectively creates a system where U.S. securities law can apply extraterritorially if either “(1) the case is sufficiently tied to the United States (because the focus occurred there), so that Congress does not need to specify that U.S. law applies, or (2) Congress indicated sufficiently and unambiguously its preference that U.S. law should apply so that it does not matter that the focus is located somewhere else.”⁷⁹ With this invented “focus” analysis, the presumption can *never* prevent U.S. law from applying extraterritorially if the Court finds a domestic focus, and thus the presumption becomes completely useless.

Second, and similarly, the United States’ projected path regarding litigation practices turns the presumption against extraterritoriality into a “presumption in favor of extraterritorial jurisdiction.”⁸⁰ Thus, courts are now the extraterritorial regulators of their judicial decision-making, which upsets the balance between Congress and the courts (since it cannot be certain when the presumption will

75. See Lea Brilmayer, *The New Extraterritoriality: Morrison v. National Australia Bank, Legislative Supremacy, and the Presumption against Extraterritorial Application of American Law*, 40 SW. L. REV. 655, 663 (2011).

76. *RJR Nabisco*, 195 L. Ed. 2d at 493.

77. William S. Dodge, *Jurisdiction in the Fourth Restatement of Foreign Relations Law*, 40 PRIV. INT’L L. 143, 151 (2017).

78. Parrish, *Evading Legislative Jurisdiction*, *supra* note 3, at 1699.

79. Brilmayer, *supra* note 75, at 663.

80. See Parrish, *Evading Legislative Jurisdiction*, *supra* note 3, at 1699.

[not] apply) and gives virtually no guidance for extending current doctrines outside of the securities context.⁸¹

Third, as the doors to foreign-cubed transactions for securities enforcement closed for America, all eyes turned to Canada, especially for class action lawsuits.⁸² As the next closest available venue for relief, it became a very attractive forum to litigate cross-border securities cases. However, Canada is not bound by U.S. law. So, in this sense, will it apply *Morrison*'s transactional test or the United States' previous approaches—the conduct or the effects tests, as codified by Dodd-Frank Section 929P(b)? Thus, here, we can see how *Morrison*'s legacy is felt in Canada. While *Morrison* ended the long-standing trend of the United States as the gold mine for class action suits,⁸³ it paved the way for the move to Canada.

Should Canada employ the transactional test, it will likely experience the same negative consequences faced by the United States. However, implementing the conduct/or the effects tests as the standard in determining extraterritorial applications will similarly allow foreign claims, perhaps even foreign-cubed transactions, to be litigated in Canadian courts, something that also carries negative consequences. Nevertheless, this is an unsolved issue and Canada will soon have to answer and confront such implications.⁸⁴

B. Potential Problems with Over-Regulating the Conduct of Another State

Extraterritorial application is nothing more than global over-regulation. It involves the imposition of U.S. economic, political, and social regulation on foreign investors and foreign securities markets. How the United States has used this power—both historically and presently—impacts how foreigners perceive the United States as a global representative actor.

Professor Parrish describes these unilateral extensions of U.S. law as “exorbitant,” “aggressive,” and representative of “its own form of parochialism.”⁸⁵ Upon further examination, Parrish reveals that this is because the United States displays an unwillingness to think outside of the comfort of its own laws; indeed, attempts to rationalize U.S. actions are nothing more than “weak way[s] to justify American exceptionalism.”⁸⁶

81. *Id.* at 1699–1700 (In making the above points, Parrish further concludes that “[l]egislative jurisdiction thus becomes overly malleable: providing judges cover to make what otherwise would be tendentious or merits-driven decisions . . .”).

82. See Kaal & Painter, *Forum Competition*, *supra* note 33, at 188 (“The growth in the Canadian class action bar suggests that plaintiffs’ attorneys view Canadian courts as an increasingly attractive venue for investors to pursue their claims.”).

83. *Morrison v. National Australia Bank*, 561 U.S. 247, 270 (2010) (In criticizing the loose application of U.S. securities laws abroad under the conduct/effects tests, Justice Scalia observed how “some fear that [the United States] has become the Shangri-La of class-action litigation for lawyers . . .”).

84. See Kaal & Painter, *Forum Competition*, *supra* note 33, at 191.

85. Austen L. Parrish, *Fading Extraterritoriality and Isolationism? Developments in the United States*, 24 IND. J. GLOBAL LEGAL STUD. 207, 210–22 (2017) [hereinafter Parrish, *Fading Extraterritoriality*].

86. *Id.* at 222.

Aside from these general consequences, over-regulation has some specific problems. Professors Kaal and Painter advance the possibility that exporting rules via extraterritoriality may negatively affect cooperation in “combating securities fraud” because securities regulators are unwilling to work with each other.⁸⁷ Such unwillingness to even participate with global partners perpetuates the use of U.S. domestic law, which applies extraterritorially and may result in unintended “jurisdictional conflict[s] with other countries seeking to regulate the same transaction.”⁸⁸

This will result in unnecessary redundancies and inappropriate cross-border extensions of U.S. securities law. Over-regulation additionally results in arbitrary, unpredictable, and widespread decision-making. Going one step further, over-regulation can harm efforts at establishing cooperative methods of cross-border securities regulation and enforcement,⁸⁹ which is the precise objective this study seeks to promote.

C. The Need for an International Solution

The inconsistencies and problems noted above demonstrates that the United States’ regulatory power has a tremendous impact on shaping the globalized world in securities regulation and enforcement. However, current practices are lacking: the attitude of the United States reflects an unwillingness to engage in the global sphere due to its contentment in its unilateral power to prescribe rules abroad and obscures further progress towards sustainable harmonization in state securities laws. Thus, the need for an international solution arises, and it is time for the United States to promote global cooperation to achieve this goal.

Before continuing, note that scholars generally agree about three dimensions of the project to reform securities laws. First, it is largely settled that in the global economy, U.S. regulatory interest transcends its borders and “encompasses *shared* concerns with other countries”⁹⁰ To say otherwise, or to act contrary to this principle—for example, by engaging in unilateral extraterritorial regulation indiscriminately—would be to foster a “single country into a global litigation mill for a particular subject matter” and would be unlikely to “enhance[] that country’s role in the world economy.”⁹¹

Second, common consensus exists to conclude that “strict territoriality had long been discarded domestically,”⁹² as Parrish asserts. International solutions are needed in today’s world, given the advances in technology and communications. The desire to find such a solution is more critical now due to the United

87. See Kaal & Painter, *Extraterritorial Application*, *supra* note 47, at 90–97.

88. See Genevieve Beyea, *Transnational Securities Fraud and the Extraterritorial Application of U.S. Securities Laws: Challenges and Opportunities*, 1 GLOBAL BUS. L. REV. 139, 156 (2011).

89. Young Chang, *supra* note 27, at 120–21.

90. Hannah L. Buxbaum, *Morrison v. National Australia Bank: Defining the Domestic Interest in International Securities Litigation*, 105 AM. SOC’Y OF INT’L L. PROC. 402, 404 (2012).

91. See Kaal & Painter, *Extraterritorial Application*, *supra* note 47, at 90–97.

92. Parrish, *Fading Extraterritoriality*, *supra* note 85, at 219.

States' lack of desire to enter into multilateral agreements.⁹³ Furthermore, territoriality, or location-based standards, are simply contrary to the nature of transactions in a globalized world. "[I]n a world where physical location is becoming increasingly illusory,"⁹⁴ it is unrealistic to assert that a transaction can never touch upon multiple borders or implicate multiple jurisdictions.

Third, there are some aspects that the United States must give up, or surrender, in order to advance the globalized world in the securities context. For example, the United States would need to give up its claim to American exceptionalism and be content with the fact that sometimes "international obligations would run counter to immediate American interest."⁹⁵ In further elaborating on this third point, Professor Mark Gibney outlines the qualities needed that are currently not reflected in U.S. extraterritorial application procedures. These include incorporating more balance in the U.S. system, creating a system where U.S. protections coincide with U.S. enforcement, ensuring that its laws do not exploit or harm others, and understanding that underlying any legal system are the principles of justice and fairness.⁹⁶

Although some scholars advocate a modified approach to extraterritoriality,⁹⁷ this is neither necessary nor desirable. Why must we settle with an anti-democratic approach, or, more simply, why must we settle with extraterritoriality at all, even a revised, purportedly *better* version? Would not the same problems occur with a modified approach? Perhaps such problems will just be postponed for another year, decade, or century. Instead, the United States has several advantages in promoting a unified approach. For example, developing standardized international principles of securities laws protects the United States' position in the world while avoiding the current challenges extraterritoriality presents.⁹⁸

This discussion of extraterritoriality seems to always return to *Morrison*, although *Morrison* arguably just highlighted the undesirability of extraterritoriality in the process of creating its new unworkable standard—the transactional and domestic "focus" test. Much of the available scholarship discusses the negative implications of *Morrison*, including the foreclosure of the private right of action, ignoring the conduct/or the effects of the harm, rendering nationality irrelevant, disturbing investor confidence, etc.; the list is almost infinite. However, Parrish

93. *Id.*

94. Case Comment, *Securities Regulation—Securities Exchange Act—Second Circuit Holds that Transactions in Unlisted Securities Are Domestic If Irrevocable Liability is Incurred or If Title Passes Within the United States*: Absolute Activist Value Master Fund Ltd. v. Ficeto, 126 HARV. L. REV. 1430, 1437 (2013).

95. See Parrish, *Reclaiming International Law*, *supra* note 27, at 872–73.

96. See Gibney, *supra* note 27, at 321.

97. *Id.* at 307–08 (concluding that in order for extraterritorial application by the United States to be seen as "morally legitimate" and "true to its democratic principles," two changes must occur: (1) the judicial branch must not take the lead in applying U.S. law extraterritorially; and (2) the United States must acknowledge that extraterritoriality is, by definition, anti-democratic in nature "nearly always non-reciprocal," and "not reflective of the relative political power of countries . . .").

98. Parrish, *Reclaiming International Law*, *supra* note 27, at 870.

makes one point that is particularly interesting and inspires confidence and hopefulness even in light of *Morrison*: “The Supreme Court’s recent pronouncements curtailing private enforcement of extraterritorial regulation might then be viewed as *an opportunity and an invitation to reinvigorate multilateral negotiation and international lawmaking*.”⁹⁹ Other literature, including additional research from Parrish, reflects this optimism as well.¹⁰⁰

In light of all these hurdles and agreed upon variables, what are the possible international solutions? What comes to mind are usually forms of either procedural or substantive harmonization of securities laws between states.

IV. THE DEBATED SOLUTIONS: PROCEDURAL OR SUBSTANTIVE HARMONIZATION?

A. *Pros of Procedural Harmonization*

The objective of procedural harmonization is to create rhyme or reason between states with differing laws, which ensures there are “minimum standards for investor protection.”¹⁰¹ The advantages of procedural harmonization of securities laws include the resulting compromise between more states;¹⁰² less under- and over-regulation.¹⁰³ It also has the ability to provide a clearer, bright-line standard and give more choice to investors.¹⁰⁴ Of course, this would involve radical reductions on the U.S. system of utilizing extraterritoriality.

Proponents of procedural harmonization promote it over territorial or substantive efforts because it accounts for the differences (jurisdictions, laws, etc.) of the many nations in the global securities world. For example, Professor Milena Sterio criticizes the territorial and substantive approaches as suffering from “one-sidedness,” in that they can only do what domestic courts are able to do.¹⁰⁵ Instead, to genuinely address international issues, Professor Sterio asserts that “a more global perspective should be adopted.”¹⁰⁶

In adopting a global perspective, several preconditions have been noted: giving the investor the ability to make a clear and defined choice regarding the

99. Parrish, *Fading Extraterritoriality*, *supra* note 85, at 222 (emphasis added).

100. See Parrish, *Interplay*, *supra* note 5, at 12 (“The United States would benefit from a return to responsible multilateral engagement in which traditional consentbased international law regains its central role.”); Clopton, *supra* note 26, at 53 (“Because international law reflects the collective judgment and agreement of the states, it is international law (specifically the international jurisdictional law) that has the best chance of rationalizing the transnational legal system.”); Beyea, *supra* note 27, at 574 (“[W]hile [*Morrison*] may let more fraud slip through the cracks, in the bestcase scenario it may also provide a catalyst for securities fraud enforcement reform in other countries, and for better crossborder cooperation in enforcement.”); Parrish, *Reclaiming International Law*, *supra* note 27, at 820 (“Also, the use of international treaties combined with robust international institutions may be one of the best ways to reclaim sovereign integrity.”).

101. See Kaal & Painter, *Forum Competition*, *supra* note 33, at 147.

102. See Kaal & Painter, *Forum Competition*, *supra* note 33, at 149.

103. Milena Sterio, *Clash of the Titans: Collisions of Economic Regulations and the Need to Harmonize Prescriptive Jurisdiction Rules*, 13 U.C. DAVIS J. INT’L L. & POL’Y 95, 114 (2007).

104. Choi & Guzman, *supra* note 21, at 228.

105. Sterio, *supra* note 103, at 113.

106. *Id.*

governing jurisdiction, allowing the state with the greatest interest in the transaction to take priority, and acknowledging the underlying goals as to why states want harmonization. For example, a buyer-choice-of-law method, has been advanced as “more effective than trying to impose a single body of law on securities transactions within a certain geographic area”¹⁰⁷ Such a system recognizes that different states have different substantive and procedural laws and allows for parties to control which law ought to govern their transactions.¹⁰⁸

Additionally, Professors Choi and Guzman advocate for a “connection test” under this type of harmonization whereby the “country with the *greatest* amount of contact with the transaction obtains territorial jurisdiction.”¹⁰⁹ According to Professors Choi and Guzman, one of the benefits of this approach is that investors and issuers can choose the choice of jurisdiction they prefer, which should be the location with the “most relation” to the buyer and seller.¹¹⁰

Moreover, with a purely optimistic attitude for this approach, its proponents urge that—no matter how different regulatory policies may appear—a common ground between state laws for a global approach can be found in the shared need for “participation in the world market.”¹¹¹ Perhaps such an attitude is the prerequisite to proceeding into more formal arrangements for whether any form of harmonization, including procedural or substantive.

B. Cons of Procedural Harmonization

The disadvantages of procedural harmonization are as follows: political impediments; unrestrained competition among jurisdictions, leading to a “race to the bottom” attitude; the imposition of transaction costs; and additional externalities on third persons.¹¹²

For example, a clear global procedural rule, such as the location of the transaction, poses many difficulties already illustrated by *Morrison*. Indeed, the prospect of extending *Morrison* abroad should send chills up the spines of investors, issuers, and regulators alike. Why? The *Morrison* standard enables manipulation, denies a private right of action to U.S. investors transacting in foreign markets, and hampers efforts to diversify investment portfolios. Moreover, judicial applications of *Morrison* appear arbitrary because the standard provides uncertain guidance about what transactions are and are not “domestic.”

Professors Kaal and Painter elaborate on the disadvantages of implementing such a location-based standard, especially considering *Morrison*. They begin by noting the difficulty of identifying the location and the ease of its manipulation. This risk is greater where the company is listed on *multiple exchanges* or if the

107. Kaal & Painter, *Forum Competition*, *supra* note 33, at 192.

108. *Id.* at 201.

109. Choi & Guzman, *supra* note 21, at 230.

110. *Id.*

111. See Horatia Muir Watt, *Choice of Law in Integrated and Interconnected Markets: A Matter of Political Economy*, 9 COLUM. J. EUR. L. 383, 408 (2003).

112. Kaal & Painter, *Forum Competition*, *supra* note 33, at 149.

transaction is executed *electronically*.¹¹³ What is the result if an investor purchases shares on the Tokyo Stock Exchange *electronically* from their home in the United States? Technically, the location of the transaction was completed in the United States from the investor's home, but that stock is based and tied entirely to Japan. To add more complexity to the example, what if this stock is *dually listed* in both Japan and the United States? Does that make the situation easier? Or harder?

Why does this matter? It matters if we want to promote a system of procedural harmonization. However, as we can see, this system does not reduce the weaknesses exhibited by the hegemony of the U.S. system of extraterritoriality. This cuts against procedural harmonization as a viable option in securities harmonization.

C. Pros of Substantive Harmonization

There are several advantages endorsed for fostering a system of substantive harmonization for securities laws, meaning a uniform set of securities laws amongst states. These include promoting multilateral agreements among states and preventing the potential threat of differing rules across jurisdictions.¹¹⁴ What is this *threat* from different rules? It seems to stem again from the uncertainty in pinning a transaction to a single controlling jurisdiction. Yet again, this concern is exacerbated by modern advances and novel techniques that tend to obscure where the transaction did in fact take place. It also stems from the uncertainty in pinning down a transaction to a single controlling jurisdiction. And this concern is yet again exacerbated by modern advances and novel techniques—the internet, the use of brokers and dealers, dually listed stock, etc.—that tend to obscure the location of the transaction. This invokes the concerns previously discussed regarding procedural harmonization; nevertheless, this threat is likely to vanish if a form of substantive harmonization is developed in securities law.

The generally agreed-upon strategy for achieving substantive harmonization is to use multilateral agreements.¹¹⁵ Multilateral agreements harmonizing securities law stop courts from imposing domestic law on foreign subjects and develop a system of predictability and consistency. Professor Parrish also suggests that, because U.S. courts are a “less viable” means of “redress,” substantive harmonization may provide the impetus needed to “reinvigorate . . . more cooperative and multilateral approaches to solving global challenges.”¹¹⁶ He also correctly contends that such a strategy is “critical to addressing global problems.”¹¹⁷

113. *Id.* at 193.

114. *Id.* at 148.

115. See Parrish, *Evading Legislative Jurisdiction*, *supra* note 3, at 1703 (“Simply put, global challenges usually require comprehensive, harmonized responses, with cooperation and agreement among many states”); Kaal & Painter, *Forum Competition*, *supra* note 33, at 147 (“One alternative to jurisdictional competition is harmonization of the law in different jurisdictions through multilateral agreements or some other form of standardization.”).

116. Parrish, *Fading Extraterritoriality*, *supra* note 85, at 224.

117. *Id.* at 223.

Substantive harmonization would solve most of the complications associated with unifying securities laws among states, but it is the hardest harmonization to achieve. For instance, like procedural harmonization, this approach entails abandoning the practice of utilizing extraterritoriality. While drastic, it is an important step needed in a modern world with an *interconnected system*.

D. Cons of Substantive Harmonization

The arguments against substantive harmonization focus on the differences between states—not their differing outward manifestations but their *inherent* differences. Professor John McGinnis analyzed these issues. While McGinnis limited his thesis to discussions of antitrust (competition) laws, his reasoning can be analogized to the securities context as both involve many similar features. For example, he concludes that this approach involves high agency costs due to the absence of democratic control of the international lawmaking system and discourages changes because a system like substantive harmonization will be difficult to alter.¹¹⁸ Also, the laws in many states differ depending on the size of markets, sophistication, trade capability, competence in enforcement procedures, wealth, etc. Thus, in a dynamic world, McGinnis concludes, “an international regime might well lead to an overall worse world competition policy.”¹¹⁹

Although it is debatable whether this will be worse than an expanding global practice of U.S. unilateral decision-making, U.S. hegemonic expansion should be more feared than a standardized international system. While we do favor consistency, we do not want one state to hold that power of consistent application—*its own*. A better approach would balance the goals of many states’ securities laws so that no state is the leading driver behind the harmonization efforts.

Three other important objections to substantive harmonization include the following: (1) harmonization attempts may cement the wrong rule because circumstances change; (2) there is no central authority that can preempt states, making it difficult to accomplish politically; and (3) standardization efforts give “rogue” jurisdictions opportunities to profit by attracting investors opposed to legal harmonization.¹²⁰

Professors Kaal and Parrish further worry that such an approach may even be “a political and practical impossibility.”¹²¹ But political feasibility is dependent upon the ability of states to decide that a certain approach is more favorable for their state than alternatives. More than that, an agreement that U.S. unilateral extraterritoriality is detrimental will prompt multilateral efforts. This is likely the case here, as the negative implications of U.S. extraterritorial practices have been markedly illuminated.

118. John O. McGinnis, *The Political Economy of International Antitrust Harmonization*, 45 WM. & MARY L. REV. 549, 551–52 (2003).

119. *Id.* at 552.

120. Kaal & Painter, *Forum Competition*, *supra* note 33, at 148.

121. *Id.*

Offering an alternative approach to substantive harmonization, after criticizing proposals that “uncritically apply a single approach to all types of cases,”¹²² Professor Zachary Clopton advances an intriguing approach that utilizes several different standards depending on the type of case at issue. For example, he first introduced the assertion that different statutes need different rules and then proposed the following thesis: “the *Charming Betsy* doctrine for private civil litigation, a rule of lenity for criminal statutes, and *Chevron* deference for administrative cases.”¹²³

While intriguing, Clopton’s approach fails to account for the problems that are likely to arise if several different standards are in place, such as feasibility issues and the costs involved. The distinction between civil, criminal, and administrative is hard to determine, and a small difference between two options could yield opposite results. Often, both civil and criminal liability can arise from the same federal statute, such as under § 10(b) of the Exchange Act. It is unreasonable to assume that one standard will be used for the civil case and another for the criminal, especially when interpreting the same section.

As another example, the SEC and DOJ frequently work together to coordinate parallel investigations when charging or prosecuting an individual. These proceedings generally involve sharing information regarding the same individual for the same conduct at issue. It is irrational to conclude that the person’s culpability—arising from the *same* actions—will be judged first civilly by one standard and then once more criminally by a different standard. This exposes how lines can blur under yet another option that entails different standards. However, it is important to note that Clopton’s thesis refers to managing the application of extraterritoriality and can be rendered unnecessary if we find the most efficient strategy to dispense with extraterritoriality.

E. The Optimal Path Delineated

1. Working Towards the Solution

When mapping out the different ways states can respond to these challenges, Dr. Gunnar Schuster identifies three different patterns of state behavior that are relevant to our analysis: “(1) noncooperative or unilateral strategies, (2) partially cooperative strategies, and (3) cooperative strategies.”¹²⁴

The first option—noncooperative or unilateral strategies—is solely, as the name implies, a unilateral approach. States under this category will choose to act according to their own interests. Dr. Schuster argues that could result in a “friendly” strategy or a “hostile” strategy.¹²⁵ A friendly strategy entails the state confining all regulation to its own territory and not extending its laws to

122. Clopton, *supra* note 26, at 2.

123. *Id.*

124. Gunnar Schuster, *Extraterritoriality of Securities Laws: An Economic Analysis of Jurisdictional Conflicts*, 26 LAW & POL’Y INT’L BUS. 165, 174 (1994).

125. *Id.*

transactions outside its territory—the “classic territoriality principle.”¹²⁶ We can discard this strategy immediately for the United States, since it clearly has a predilection to find ways to apply its laws outside its territory based on varying justifications over the decades (e.g., U.S. conduct, harm to U.S. investors and markets, policy reasons, reputational concerns, etc.). The hostile strategy, on the other hand, involves state action that is not limited to considerations of its borders. The state will apply its laws abroad if doing so advances its own interests, regardless of the interests of the affected state.¹²⁷ This strategy appears to characterize the United States more accurately.

The second option—partially cooperative strategies—implies more of a mix between some form of complete harmonization and unilateral extraterritorial application. It can be defined, according to Dr. Schuster, as the exercise of extraterritorial jurisdiction by the acting state when the foreign transaction has effects within the state’s territory, but with the consideration of the interests of the other state affected by the exercise of such extraterritorial jurisdiction.¹²⁸ While the United States would, under this option, consider the interests of other states, that “consideration . . . is made *unilaterally*” because the other state does not participate and is not consulted.¹²⁹ Accordingly, this option leaves us with the functional equivalent of a noncooperative or unilateral approach.

The third option—cooperative strategies—has one key feature that Dr. Schuster immediately points out: negotiation.¹³⁰ That feature appears in each of the three cooperative strategy categories identified by Dr. Schuster: (1) bilateral or multilateral negotiations between states; (2) internalizing the issue by establishing an international organization that will resolve disputes case by case; and (3) a system of harmonizing laws governing cross-border disputes—without using an international organization—and deciding on which rules would govern jurisdictional conflicts.¹³¹

Each category parallels approaches we have already analyzed: the first category is like substantive harmonization, the second category parallels an international system of courts or arbitrators, and third category mirrors procedural harmonization. While keeping in mind the advantages and disadvantages of each, the proper solution should include the establishment of international democracy and a global marketplace of free trade and transparency while reducing foreign friction—a solution best accomplished by observing category one of the cooperative strategies option (substantive harmonization).

126. *Id.* at 174–75.

127. *Id.* at 175.

128. *Id.*

129. *Id.* (emphasis added).

130. *Id.* at 176.

131. *Id.*

2. Current Desirability

Efforts at harmonization are considered drastic in that they involve the state giving up some of its sovereignty. States likely may have to compromise on a variety of issues that it otherwise would not have assented to domestically in order to achieve multi-state harmony. Despite this, harmonization would solve many problems, including the unilateral decision-making of dominant states and the over-regulation of foreign conduct via extraterritoriality, to name a few. In other words, are the advantages to be gained from such an approach greater than the costs of keeping the existing system? More simply, is this desirable?

While the desirability and advantages have already been listed, several arguments against its desirability have so far gone unmentioned, and those include political resistance and economic concerns.¹³² For example, these arguments maintain that different national laws keep the market alive for differing capital market laws.¹³³ Also, while harmonization has been advanced as beneficial in the short run, it entails “enormous” costs, such as the negotiation of future contingency agreements among states, which would be “very tedious and time-consuming.”¹³⁴

Furthermore, a uniform system has been urged as undesirable because the system in place will be “static” and therefore cause laws to become outdated over time,¹³⁵ but the alternative must be analyzed as well in order to determine the best approach. Immutable laws can be inconsistent with the immediate and long-term needs of a constantly changing world; however, the current system of different laws and inconsistent standards is arguably an inefficient one.

3. Current Feasibility

Regardless of desirability, is this plan for efforts at harmonization—whether procedural or substantive—even feasible? For instance, there are major differences in state securities systems, such as the sophistication of markets and the political economies.

Professor Milena Sterio observes that “[h]armonization is easier said than done,” and that negotiations over multilateral agreements are difficult and do not necessarily guarantee they will lead to the best result.¹³⁶ However, if she had to pick, Sterio notes that procedural harmonization may be easier to achieve than substantive harmonization. She notes this is especially true in areas like securities law that have already exhibited some degree of harmonization.¹³⁷ Thus, she advocates for “the need to start at least contemplating such a solution.”¹³⁸

132. *Id.* at 194.

133. *Id.*

134. *Id.* (emphasis added).

135. *Id.*

136. See Sterio, *supra* note 103, at 115 (“How can we possibly get all countries in the world to agree when their regulations should apply to certain situations?”).

137. *Id.* at 116.

138. *Id.* at 117.

Delving into the “why” of harmonization is similarly difficult, as Professor Gibney observes. For example, “both the judiciary and the Congress are simply too wedded to precedent to envision any dramatic change.”¹³⁹ They do not want to change. Congress’ efforts to address these issues have not succeeded (e.g., the attempted revision of Dodd-Frank 929P(b)) nor has the executive revived its willingness or efforts to enter into multilateral agreements. Also, “this seeming inconsistency serves some very useful political ends” for the United States like allowing it to dominate global securities law, control foreign investors and markets, and hold the upper hand in international negotiations.¹⁴⁰

It also can be argued that the United States will tend to extend its laws to promote its own position in the global sphere. Similarly, the United States will tend to deny extraterritorial application and apply a strict territorial approach when that too would serve its own interests. The question that remains, therefore, is whether these “feasibility” hurdles can be overcome, but this question is the same as asking whether it is possible to overcome the political will of the United States in maintaining the status quo of its hegemonic power. Framed like this, the hurdle appears harder to overcome.

Furthermore, according to the IOSCO Task Force on Cross-Border Regulation Consultation Report, even if these goals are achievable in some way, there is no consensus on whether it can be accomplished by full coordination and total harmonization of jurisdictions.¹⁴¹ The Report concludes by noting, “such a result is not achievable in the current context, noting the absence of any *supranational* institution with legal authority to impose harmonized regulations from the top down.”¹⁴² This implies that some institution must be in place before negotiations towards harmonization can begin. However, this is not entirely true. What needs to arise is for the United States to revive its interest in participating in multilateral agreements. Nevertheless, while pessimistic, the Report clearly insinuates the holes in the current system.

CONCLUSION

The arguments presented by this study demonstrate a steady trend of overreliance on extraterritorial applications to the extent of becoming hegemonic against foreign states. Attempts to deal with this abuse, such as the reinvigoration of the presumption and statutory construction techniques (including the focus analysis), have been unsuccessful and are a pretext under which the United States can continue applying its laws abroad indiscriminately. Confusing standards such as *Morrison*’s transactional test or Dodd-Frank’s codification of the conduct and

139. Gibney, *supra* note 27, at 303.

140. *Id.* at 304.

141. BD. OF INT’L ORG. OF SEC. COMM’N, IOSCO TASK FORCE ON CROSS-BORDER REGULATION CONSULTATION REPORT (2014), <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD466.pdf> [https://perma.cc/7GLT-GRQU].

142. *Id.* (emphasis added).

effects tests create inconsistencies in the judicial system and allow for easy manipulation of the law's reach by investors, issuers, courts, and lawyers.

The trend examined under this study creates concerns regarding the health of foreign relationships, unwilling attitudes towards multilateral agreements, and the injurious effects on foreign investors and markets from excessive extraterritorial applications. Also, the over-regulation consequences of extraterritoriality place the United States in a position where it is adjudicating other states' cases in which it has little to no interest. In today's globalized world, where the Exchange Act's regulatory capabilities transcend territorial borders, it is important to develop an approach that reduces foreign friction and breaches of international comity. The optimal path should aim to enhance (1) the welfare of foreign investors without arbitrarily disadvantaging domestic investors, (2) the competitiveness of foreign markets without drastic information gaps from those of domestic markets, and (3) global cooperation among the states in promoting harmonization of securities laws.

This study highlighted some of the severe shortcomings of the extraterritorial application of U.S. securities laws. One remedy is to revive the desire of U.S. lawmakers to engage in efforts at international harmonization. It may not be the only remedy, but it underscores the important role collaboration must play in designing effective global securities laws. An effective system of global securities laws should place accountability, free trade, transparency, and protection front and center. And we can take the first step towards that more effective system by encouraging U.S. lawmakers to work with their counterparts in foreign governments to harmonize—both procedurally and substantively—global securities laws.