Extraterritoriality’s Watchdog After *Morrison v. National Australia Bank*

*By George T. Conway III*

*Morrison v. National Australia Bank Ltd.* typified a species of securities litigation known as a “foreign-cubed” or “f-cubed” class action—litigation involving foreign investors suing a foreign company for losses on foreign exchanges. This sort of lawsuit, ironically, was the indirect product of the Supreme Court’s formerly fickle approach to the presumption against extraterritoriality. The Justices had discarded the presumption in antitrust, replacing it with the effects test, and the Second Circuit, in addressing the territorial reach of the securities laws, gave the presumption similarly short shrift. The court of appeals imported the effects test into the securities laws in the 1960s, and in the 1970s went a major step further, adopting a second “test,” the conduct test, a doctrine that was in essence the reverse of the effects test: conduct in the United States that caused harm outside its territory could violate the federal securities laws.

Unlike its antitrust progenitor, the securities law effects test did not provoke global outcry. The conduct test did. Lower courts found themselves unable to delimit precisely and narrowly the amount and kind of domestic activity it took to satisfy the conduct test, which led to foreign-cubed cases that produced huge settlements and judgments, sometimes in the billions of dollars. Far from welcoming and reciprocating these suits, other nations vigorously objected to them as “threaten[ing] substantial—and unreasonable—interference with [their] sovereign interests, policies, and laws.”

In the U.S. Supreme Court in 2010, these sovereign amici could not have found a forum more receptive to their pleas. Over the past two decades, while the lower courts were losing their struggle to define the conduct test, the Supreme Court had rediscovered, and reinvigorated, the presumption against extraterritoriality and the presumption’s forerunner, the *Charming Betsy* rule. In the antitrust arena, for example, the Court in 2004—by a vote of 8-0—applied a variant of *Charming Betsy* dismiss a foreign-cubed antitrust case, one with foreign plaintiffs seeking treble damages from foreign companies for price-fixing in foreign companies. It would be an “act of legal imperialism,” the Court held, to allow such a case to proceed. The equally lopsided result in *Morrison* was practically foreordained.

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1 130 S. Ct. 2869 (2010).
3 See Schoenbaum v. Firstbrook, 405 F.2d 200, 208 (2d Cir.) (citing Alcoa, 148 F.2d at 443–44), modified en banc on other grounds, 405 F.2d 215 (2d Cir. 1968).
4 See Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir. 1975).
7 See Empagran, 542 U.S. at 159–60, 163–69.
8 Id. at 169.
What was remarkable about the majority’s opinion was not its explanation of the presumption against extraterritoriality. That was straightforward, as was its conclusion that Section 10(b) of the Securities Exchange Act of 19349 contained no indication of extraterritorial applicability. The Court simply repeated what it had said in earlier cases applying the presumption,10 and like the lower courts that had refused to apply the presumption, found nothing but silence in Section 10(b) on the issue of its territorial scope.11 The striking part of the Court’s opinion was its condemnatory history of the courts of appeals’ tests of extraterritoriality.12 The tone was harsh—perhaps unduly so, given the Court’s own inconsistent approach to the presumption. The unmistakable moral of the Court’s story was that abandonment of the presumption had led to doctrines that were unpredictable, incoherent, and completely unfounded in the statute being applied. And there was a surprise: the Court condemned not only the conduct test, but also the effects test13—even though that test was not even remotely involved in the case, and even though the Court had itself established that test under the Sherman Act. The Morrison Court’s message to the lower courts is clear: do not do what you did with the securities laws—and what we did in antitrust—ever again.

The part of Morrison that will provide the most fertile ground for discussion—and litigation—addressed the petitioners’ argument that the conduct at issue in the case was not really extraterritorial. The conduct at the foreign company’s domestic subsidiary, petitioners argued, justified application of American law. The Court’s answer, in effect, was that accepting this argument would nullify the presumption against extraterritoriality. This response came in the opinion’s money quote: “[I]t is a rare case of prohibited extraterritorial application that lacks all contact with the territory of the United States,” for the presumption “would be a craven watchdog indeed if it retreated to its kennel whenever some domestic activity is involved in the case.”14 To say that “some domestic activity” was not enough, however, still left open whether the domestic activity in Morrison actually sufficed. To answer that question, Justice Scalia examined the Exchange Act’s text and structure to find the law’s “focus.” That “focus,” he concluded, was “not upon the place where the deception originated, but upon purchases and sales in the United States,” and because the plaintiffs didn’t purchase shares in the United States, they were out of court.

How such an examination of the domestic “‘focus’” of a statute will work with other statutes and in other contexts will determine how great, and how lasting, Morrison’s effect will be. One question, raised by Professor Dodge, is whether the “‘focus’” analysis effectively embodies the effects test—because domestic transactions are domestic effects.15 A related question, raised by Professor Parrish, is whether the “‘focus’” analysis will undermine the presumption against extraterritoriality by permitting the regulation of all manner of extraterritorial activity whenever a particular sliver of domesticity happens to coincide with what a court deems to be the “‘focus’” of congressional concern.16 The answer to both questions is no. Justice Scalia’s opinion does not embody an “effects test,” and the “‘focus’” analysis will not undermine the presumption. Here’s why.

10 See Morrison, 130 S. Ct. at 2877–78, 2882.
11 See id. at 2881–83; cf., e.g., Bersch, 519 F.2d at 993.
12 See Morrison, 130 S. Ct. at 2878–82.
13 See id. at 2878–79.
14 Id. at 2884.
15 See William S. Dodge, The Presumption Against Extraterritoriality After Morrison, infra.
First, the Court, as I have noted, went out of its way—way out of its way—to criticize the effects test. The effects test had nothing to do with the Australian plaintiffs’ claims, but Justice Scalia knew—in fact, he cites the relevant cases, just as he cited them in his dissent in *Hartford Fire*—that it was the effects test that had obliterated the presumption against extraterritoriality in antitrust. The Court was trying to make sure that what happened there was not going to happen again.

Second, the specific holding reached by the Court—that the focus of the statute is on “domestic transactions”—is not consistent with the effects test. Under the pre-*Morrison* effects test, it was widely assumed, to the point where defendants would not even argue otherwise, that *Americans* who purchased shares on foreign exchanges could sue under the securities laws, because they suffer the effects of the fraud at home. But under *Morrison*, as Justice Stevens disapprovingly pointed out in his concurring opinion, those Americans can no longer sue. And district judges are all reading *Morrison* the same way. The effects test is dead.

Third, *Morrison*’s “focus” analysis cannot be construed to restrict the scope of what is considered to be extraterritorial under the presumption. To the contrary, the “focus” analysis was about restricting what can be considered *domestic*: it was an effort to demonstrate why particular domestic conduct was not enough to cause extraterritoriality’s watchdog to lose its bite; it was not an attempt to define what would always suffice. *Morrison* should thus be understood to mean that having domestic conduct that coincides with the domestic “focus” of congressional concern is a necessary, but not always sufficient, condition for avoiding the presumption.

Finally, the Court’s holding was quintessentially territorialist. The Court held that “the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States.” Someone once proposed rather similar choice-of-law rules to govern common-law fraud—“When a person sustains loss by fraud, the place of wrong is where the loss is sustained, not where fraudulent misrepresentations are made”—and for torts generally: “The place of the wrong is the state where the last event necessary to make an actor liable for an alleged tort takes place.” These rules are from Section 377 of the First Restatement of Conflicts. Professor Beale, I suspect, would have unreservedly applauded *Morrison*.

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19 See *Morrison*, 130 S. Ct. at 2895 (Stevens, J., concurring in judgment).
22 *Morrison*, 130 S. Ct. at 2884.
23 RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 377 & note 4, at 457 (1934).