

11-1-2011

## How American Are American Depositary Receipts? ADRs Rule 10B-5 Suits, and *Morrison v. National Australia Bank*

Vincent M. Chiappini  
vincent.chiappini@bc.edu

Follow this and additional works at: <http://lawdigitalcommons.bc.edu/bclr>

 Part of the [International Trade Law Commons](#), and the [Jurisdiction Commons](#)

---

### Recommended Citation

Vincent M. Chiappini, *How American Are American Depositary Receipts? ADRs Rule 10B-5 Suits, and Morrison v. National Australia Bank*, 52 B.C.L. Rev. 1795 (2011), <http://lawdigitalcommons.bc.edu/bclr/vol52/iss5/5>

This Notes is brought to you for free and open access by the Law Journals at Digital Commons @ Boston College Law School. It has been accepted for inclusion in Boston College Law Review by an authorized editor of Digital Commons @ Boston College Law School. For more information, please contact [nick.szydowski@bc.edu](mailto:nick.szydowski@bc.edu).

# HOW AMERICAN ARE AMERICAN DEPOSITARY RECEIPTS? ADRs, RULE 10b-5 SUITS, AND *MORRISON v. NATIONAL AUSTRALIA BANK*

**Abstract:** Over the previous several decades, federal courts employed two tests—the conduct test and effects test—to determine whether a securities fraud suit with foreign elements was sufficiently connected to the United States to proceed in American courts. In its 2010 decision in *Morrison v. National Australia Bank Ltd.*, the U.S. Supreme Court held that only domestic transactions may be subject to securities fraud suits. The Court then created a bright-line test to determine which transactions were domestic. Unfortunately, the Court’s resultant “transactional test” was not the model of clarity that it hoped to be. In particular, American Depositary Receipts (“ADRs”) frustrate the Court’s quest for clarity because, as foreign securities attempting to transform themselves into domestic securities, they occupy a borderland that is difficult to reconcile with *Morrison*’s transactional test. This Note analyzes the reasoning of *Morrison* as well as the district court cases that have implemented the Court’s transactional test. Based on these cases, this Note argues that the determination of whether the purchase and sale of ADRs qualify as domestic transactions should depend on the extent to which the issuer has purposefully entered the U.S. market and its regulatory system.

## INTRODUCTION

Investors who believe that they have been the victims of securities fraud can sue the issuer of the security under Securities and Exchange Commission Rule 10b-5.<sup>1</sup> For decades, when the alleged fraud involved foreign elements, the federal courts of appeals used two tests, the “conduct test” and the “effects test,” to determine whether a fraud was “American enough” to be subject to suit under Rule 10b-5.<sup>2</sup> The U.S. Supreme Court, in its 2010 decision in *Morrison v. National Australia Bank Ltd.*, harshly criticized the vagueness of the conduct and effects tests and held that section 10(b) of the Securities Exchange Act of 1934 (“the 1934 Act”), from which Rule 10b-5 derives, had no extraterritorial

---

<sup>1</sup> See 17 C.F.R. § 240.10b-5 (2010); LARRY D. SODERQUIST & THERESA A. GABALDON, *SECURITIES LAW* 151–52 (4th ed. 2011).

<sup>2</sup> See *Morrison v. Nat’l Austral. Bank Ltd.*, 130 S. Ct. 2869, 2879, 2880 (2010).

application.<sup>3</sup> Therefore, Rule 10b-5 applies only to domestic transactions, which the Court identified as those that are “in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States.”<sup>4</sup> The terms of this bright-line “transactional test,” however, were not further defined, and applying the transactional test to complex, modern financial products may prove nearly as difficult as applying the previous tests that the Court rejected.<sup>5</sup>

In particular, the status of American Depositary Receipts (“ADRs”) in this new framework is uncertain.<sup>6</sup> There are several types of ADRs, but all are hybrids of American and foreign securities.<sup>7</sup> ADRs are vehicles for Americans to invest in foreign corporations through an intermediary bank, which holds the actual foreign security, and through which the investor receives an ADR representing his ownership interest.<sup>8</sup> This Note examines how the new test from *Morrison* affects ADRs.<sup>9</sup> It concludes that under *Morrison*, the fate of two classes of ADRs can be predicted with a fair degree of confidence.<sup>10</sup> Those sponsored ADR programs that are listed on American exchanges should be subject to Rule 10b-5, and unsponsored ADR programs—those whose issuances do not involve the foreign corporations—should not create potential Rule 10b-5 liability for companies abroad.<sup>11</sup> ADR programs that do not trade on American exchanges, on the other hand, are in a much more ambiguous situation.<sup>12</sup> Nevertheless, they too should be covered under section 10(b) of the 1934 Act because their issuer’s purposeful and relatively extensive entry into the U.S. securities market ultimately makes them domestic transactions.<sup>13</sup>

---

<sup>3</sup> See *id.* at 2879, 2884.

<sup>4</sup> *Id.* at 2888.

<sup>5</sup> See *id.* at 2884, 2886; see also *Stackhouse v. Toyota Motor Co.*, No. 10-0922, 2010 WL 3377409, at \*1–2 (C.D. Cal. July 16, 2010) (noting the ambiguity in the *Morrison* test).

<sup>6</sup> See *infra* notes 218–339 and accompanying text. There is a technical difference between ADRs and American Depositary Shares (“ADSs”) but, for the reader’s ease, the term ADRs is used throughout, including occasions where ADS may be more precise. See *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 521 n.2 (S.D.N.Y. 2011). The Securities and Exchange Commission (SEC) eliminated the distinction in 1991. American Depositary Receipts, Exchange Act Release No. 34-29226, [1990–1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,740, at n.5 (May 23, 1991).

<sup>7</sup> See *infra* notes 186–217 and accompanying text.

<sup>8</sup> See *infra* notes 186–217 and accompanying text.

<sup>9</sup> See *infra* notes 218–337 and accompanying text.

<sup>10</sup> See *infra* notes 296–310, 331–339 and accompanying text.

<sup>11</sup> See *infra* notes 296–310, 331–339 and accompanying text.

<sup>12</sup> See *infra* notes 311–330 and accompanying text.

<sup>13</sup> See *infra* notes 311–330 and accompanying text.

Part I of this Note establishes the relevant statutory background, including section 10(b) of the 1934 Act and Rule 10b-5.<sup>14</sup> It then summarizes *Morrison* and explains the new transactional test it established.<sup>15</sup> Part II examines the federal district court cases interpreting *Morrison* and identifies themes emerging from those decisions.<sup>16</sup> Part III introduces and discusses the different types of ADRs.<sup>17</sup> Next, it considers how district courts have previously ruled on section 10(b) liability for ADRs, proposes several guiding factors for analysis, and suggests how courts should rule in the future.<sup>18</sup>

## I. THE SECURITIES REGULATION FRAMEWORK AND THE SUPREME COURT

The 1934 Act and the U.S. Supreme Court's 2010 decision in *Morrison* guide the inquiry concerning where ADRs fit within the regulatory framework governing securities fraud suits.<sup>19</sup> Section A discusses the two key statutes, the Securities Act of 1933 ("the 1933 Act") and the 1934 Act, and particularly notes the purposes of the 1934 Act, which are integral to the Note's analysis of where ADRs fit into the new regulatory framework.<sup>20</sup> It also explains the 1934 Act's relationship to Rule 10b-5.<sup>21</sup> This Part then describes the regulatory framework surrounding Rule 10b-5.<sup>22</sup> Section B then goes on to describe *Morrison*, placing particular emphasis on the Court's rationale and its view of the problems with the extraterritorial application of section 10(b) of the 1934 Act.<sup>23</sup>

### A. *The 1933 Act, 1934 Act, and Rule 10b-5*

In the wake of the stock market crash of 1929 and in the midst of the Great Depression, Congress passed the 1933 Act.<sup>24</sup> The 1933 Act controls the offering and sale of securities through registration and disclosure requirements.<sup>25</sup> It also provides causes of action if there are ma-

---

<sup>14</sup> See *infra* notes 19–48 and accompanying text.

<sup>15</sup> See *infra* notes 49–96 and accompanying text.

<sup>16</sup> See *infra* notes 97–180 and accompanying text.

<sup>17</sup> See *infra* notes 186–217 and accompanying text.

<sup>18</sup> See *infra* notes 218–237 and accompanying text.

<sup>19</sup> See *infra* notes 218–237 and accompanying text.

<sup>20</sup> See *infra* notes 24–48 and accompanying text.

<sup>21</sup> See *infra* notes 24–48 and accompanying text.

<sup>22</sup> See *infra* notes 32–36 and accompanying text.

<sup>23</sup> See *infra* notes 49–96 and accompanying text.

<sup>24</sup> Securities Act of 1933, ch. 38, 48 Stat. 74 (codified at 15 U.S.C. §§ 77a–77bbbb); see SODERQUIST & GABALDON, *supra* note 1, at 12.

<sup>25</sup> 15 U.S.C. §§ 77a–77bbbb (2006).

terial omissions or misstatements in those disclosures.<sup>26</sup> In sum, the 1933 Act regulates the primary securities market—sales directly from the issuers of the securities to the first investors.<sup>27</sup>

The following year, Congress passed the 1934 Act, a broader companion piece of legislation.<sup>28</sup> The 1934 Act aimed to regulate the secondary securities market—sales between investors after the securities have already been issued.<sup>29</sup> Perhaps most importantly, it established the Securities and Exchange Commission (SEC) and granted it expansive rulemaking authority.<sup>30</sup> The 1934 Act's breadth has increased over the decades since its enactment because of frequent and significant congressional amendments.<sup>31</sup>

The beginning of the 1934 Act details the exigencies for the legislation.<sup>32</sup> It notes that the need for regulation arises because “transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest.”<sup>33</sup> The 1934 Act offers several more justifications, including the need “to insure the maintenance of fair and honest markets in such transactions.”<sup>34</sup> It also explains the danger that unregulated securities pose to the national economy.<sup>35</sup> The only mention of foreign markets in the section of the 1934 Act that describes its necessity is a single line stating that the prices of transactions would be “disseminated and quoted . . . in foreign countries.”<sup>36</sup>

<sup>26</sup> *Id.* §§ 77k–77l.

<sup>27</sup> *See id.* §§ 77a–77b; JOHN C. COFFEE, JR. & HILLARY A. SALE, *SECURITIES REGULATION: CASES AND MATERIALS* 26, 93 (11th ed. 2009).

<sup>28</sup> *See* Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a–78pp (2006)); COFFEE & SALE, *supra* note 27, at 56.

<sup>29</sup> COFFEE & SALE, *supra* note 27, at 26, 563.

<sup>30</sup> *See* 15 U.S.C. § 78d (2006 & Supp. IV 2010).

<sup>31</sup> *See* COFFEE & SALE, *supra* note 27, at 57–58 (listing the amendments to the 1934 Act).

<sup>32</sup> *See* 15 U.S.C. § 78b (2006).

<sup>33</sup> *Id.* “Over-the-counter markets” refer to sales that take place directly between buyers and sellers without the involvement of an exchange. *See* BLACK’S LAW DICTIONARY 1214 (9th ed. 2009).

<sup>34</sup> 15 U.S.C. § 78b. The 1934 Act also lists the following objectives: “to protect interstate commerce, the national credit, the Federal taxing power, [and] to protect and make more effective the national banking system and Federal Reserve System . . .” *Id.*

<sup>35</sup> *See id.* § 78b(1)–(4). Certainly influenced by the economic crash that led to the Great Depression, the 1934 Act explains the enormous reach of the securities market and the terrible and widespread consequences that follow from “manipulation and control” of the prices of securities sold on exchanges and over-the-counter markets. *See id.*

<sup>36</sup> *See* 15 U.S.C. § 78b(2).

Section 10(b) of the 1934 Act forbids certain conduct “in connection with the purchase or sale of any security.”<sup>37</sup> In particular, it prohibits “any manipulative or deceptive device or contrivance” and the violation of any rules and regulations that the SEC may implement to protect investors.<sup>38</sup> The SEC established Rule 10b-5 pursuant to its authority under section 10(b).<sup>39</sup> Proposed in 1942 by the SEC’s regional administrator in Boston, Rule 10b-5 aimed to address fraudulent purchases not prohibited by the regulations of the time, which only covered sales.<sup>40</sup> The SEC merged the language of section 10(b) with section 17(a) of the 1934 Act, which also describes forms of prohibited conduct.<sup>41</sup> The resultant Rule 10b-5 forbids deceptive practices that could mislead investors in the purchase or sale of a security.<sup>42</sup>

---

<sup>37</sup> 15 U.S.C. § 78j(b) (2006 & Supp. IV 2010).

<sup>38</sup> *Id.* The full text of the relevant section reads:

To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

*Id.*

<sup>39</sup> *Id.*; 17 C.F.R. § 240.10b-5 (2010)

<sup>40</sup> See SODERQUIST & GABALDON, *supra* note 1, at 151.

<sup>41</sup> 15 U.S.C. § 77q (2006) (codifying § 17(a) of the 1933 Act); 15 U.S.C. § 78j(b) (2006 & Supp. IV 2010) (codifying as amended § 10(b) of the 1934 Act); 17 C.F.R. § 240.10b-5; see SODERQUIST & GABALDON, *supra* note 1, at 151. Rule 10b-5 reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

<sup>42</sup> 17 C.F.R. § 240.10b-5. Rule 10b-5 is most commonly used in five situations: (1) insider trading, (2) tipping, (3) corporate mismanagement in connection with securities transactions, (4) market manipulation related to over-the-counter securities, and (5) misleading disclosures by a corporation or silence when disclosure is required. SODERQUIST & GABALDON, *supra* note 1, at 152. It is unnecessary to discuss the precise requirements of a Rule 10b-5 suit here, but such requirements can be easily found elsewhere. See COFFEE & SALE, *supra* note 27, at 936–1050; SODERQUIST & GABALDON, *supra* note 1, at 151–74.

Rule 10b-5 and section 10(b) are silent about their applicability outside of the United States.<sup>43</sup> To fill this gap, the U.S. Court of Appeals for the Second Circuit developed two tests for the extraterritorial application of Rule 10b-5.<sup>44</sup> The tests were neither truly interdependent nor completely independent, and permitted the courts to exercise significant discretion in weighing the relative importance of each.<sup>45</sup> Both focused on the details of the alleged deception rather than on the details of the transaction.<sup>46</sup> The “effects test” examined “whether the wrongful conduct had a substantial effect in the United States or upon United States citizens,” and the “conduct test” asked “whether the wrongful conduct occurred in the United States.”<sup>47</sup> Several other circuits adopted variations of the Second Circuit’s tests.<sup>48</sup>

### B. *The Supreme Court Steps In: Morrison*

The decades of jurisprudence underlying the conduct test and effects test suddenly became irrelevant in the summer of 2010.<sup>49</sup> Speaking for a Court that was unanimous in its judgment, Justice Antonin Scalia held in *Morrison* that section 10(b) of the 1934 Act, and consequently the right of action under Rule 10b-5, only reached frauds “in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States.”<sup>50</sup> Called a transactional test by the Court, this new test replaced the conduct and effects tests and transformed the legal remedies available in securities fraud suits with extraterritorial elements.<sup>51</sup>

---

<sup>43</sup> See 15 U.S.C. § 78j(b) (2006 & Supp. IV 2010); 17 C.F.R. § 240.10b-5.

<sup>44</sup> *Morrison*, 130 S. Ct. at 2879, 2880; see also, e.g., SEC v. Berger, 322 F.3d 187, 192 (2d Cir. 2003) (giving two factors for determining whether a court has subject matter jurisdiction over extraterritorial claims under the 1934 Act: “(1) whether the wrongful conduct occurred in the United States, and (2) whether the wrongful conduct had a substantial effect in the United States or upon United States citizens”).

<sup>45</sup> See *Morrison*, 130 S. Ct. at 2879.

<sup>46</sup> See *id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.* at 2880 (“Although the circuits . . . seem to agree that there are some transnational situations to which the antifraud provisions of the securities laws are applicable, agreement appears to end at that point.” (quoting Kauthar SDN BHD v. Sternberg, 148 F.3d 659, 667 (7th Cir. 1998))).

<sup>49</sup> See *id.* at 2888.

<sup>50</sup> *Id.* Although the Court was unanimous in the judgment, Justice Stephen Breyer only concurred in part with the majority’s opinion and Justices John Paul Stevens and Ruth Bader Ginsburg concurred only in the judgment; Justice Sonia Sotomayor took no part in the case. See *id.* at 2874–75.

<sup>51</sup> See *Morrison*, 130 S. Ct. at 2886; see also William C. Fredericks, “*Foreign-Cubed*” and “*Foreign-Squared*” Securities Litigation in the Wake of *Morrison v. National Australia Bank*, in

The facts in *Morrison* are popularly described as those of a “foreign-cubed” or “f-cubed” suit—“foreign plaintiffs suing foreign . . . defendants for misconduct in connection with securities traded on foreign exchanges.”<sup>52</sup> The Australian plaintiffs purchased shares of National Australia Bank (“National”) on the Australian Stock Exchange.<sup>53</sup> National traded its “Ordinary Shares—what in America would be called ‘common stock’ — . . . on the Australian Stock Exchange Limited and on other foreign securities exchanges, but not on any exchange in the United States.”<sup>54</sup> The plaintiffs alleged that National’s subsidiary HomeSide Lending, Inc. (“HomeSide”), a mortgage service company headquartered in Florida and a co-defendant, employed unrealistic models to calculate the value of its mortgage-servicing rights.<sup>55</sup> According to the plaintiffs, this practice artificially raised the price of National’s shares because National’s disclosures and the company’s executives “touted the success of HomeSide’s business.”<sup>56</sup> Unfortunately for National’s investors, any such success was apparently illusory: National eventually had to write down HomeSide’s assets by more than two billion dollars over two months in 2001.<sup>57</sup>

The U.S. District Court for the Southern District of New York dismissed the suit for lack of subject-matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1) and failure to state a claim under Rule 12(b)(6).<sup>58</sup> The Second Circuit affirmed mainly because of the centrality of Australia and the attenuated effects upon American inves-

---

“BET THE COMPANY” LITIGATION 2010: BEST PRACTICES FOR COMPLEX CASES 85, 97–110 (Practising Law Inst. ed., 2010) (discussing possible remedies for a hypothetical plaintiff whose options have been reduced by *Morrison*).

<sup>52</sup> *Morrison*, 130 S. Ct. at 2875; *Cornwell v. Credit Suisse Grp.*, 729 F. Supp. 2d 620, 622 (S.D.N.Y. 2010) (defining “foreign cubed plaintiffs” as “foreign plaintiffs who bought foreign stock on a foreign exchange”). In addition to the foreign defendant (National Australia Bank), there were also American defendants (the subsidiary company and two executives). See *Morrison*, 130 S. Ct. at 2875, 2876. The presence of the American defendants does not change the analysis because the claims against them depend entirely on the claims against National. *Id.*

<sup>53</sup> *Morrison*, 130 S. Ct. at 2875.

<sup>54</sup> *Id.* Interestingly, National also listed ADRs on the New York Stock Exchange (NYSE), but the district court dismissed the only plaintiff who bought National ADRs for failing to allege damages. *Id.* at 2875, 2876.

<sup>55</sup> *Id.*

<sup>56</sup> See *id.* at 2875.

<sup>57</sup> *Id.* at 2875–76.

<sup>58</sup> *In re Nat’l Austl. Bank Sec. Litig.*, No. 03 Civ. 6537(BSJ), 2006 WL 3844465, at \*8 (S.D.N.Y. Oct. 25, 2006), *aff’d*, 547 F.3d 167 (2d Cir. 2008), *aff’d*, 130 S. Ct. 2869 (2010).



tors.<sup>59</sup> Although the Supreme Court affirmed the Second Circuit's decision, it rejected the relevance of subject matter jurisdiction and held instead that "what conduct § 10(b) prohibits is a merits question."<sup>60</sup> The Court said that the proper question was whether the plaintiffs' allegations warranted relief.<sup>61</sup> After vigorously examining the 1934 Act, the Court emphatically answered that they did not.<sup>62</sup>

Section 10(b) is silent regarding its extraterritorial reach.<sup>63</sup> Because Rule 10b-5 derives from section 10(b) of the 1934 Act, it cannot extend any further than section 10(b).<sup>64</sup> The Court rejected three different arguments that attempted to read extraterritorial applications into the statute.<sup>65</sup> First, the plaintiffs claimed that section 10(b) included "trade, commerce, transportation, or communication . . . between any foreign country and any State" in its definition of "interstate commerce."<sup>66</sup> The Court, however, said that a "general reference to foreign commerce" would not overcome the presumption against extraterritoriality.<sup>67</sup> Second, the plaintiffs claimed that in the 1934 Act, Congress considered the fact that "the 'prices established and offered in such transactions are generally disseminated and quoted throughout the United States and foreign countries.'"<sup>68</sup> Still, the Court deemed this only a "fleeting reference" that did not indicate an interest in "transactions conducted upon *foreign* exchanges and markets."<sup>69</sup> Finally, the plaintiffs cited section 30(b), the only part of the 1934 Act that relates explicitly to extraterritorial application, which states that the 1934 Act

<sup>59</sup> See *Morrison v. Nat'l Austl. Bank Ltd.*, 547 F.3d 167, 176–77 (2d Cir. 2008), *aff'd*, 130 S. Ct. 2869 (2010).

<sup>60</sup> *Morrison*, 130 S. Ct. at 2877. The Court noted that this framework was Second Circuit precedent since 1968, and that it was also followed at least by the U.S. Courts of Appeals for the Eighth and Eleventh Circuits. *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 2881–83, 2888.

<sup>63</sup> 15 U.S.C. § 78j(b) (2006 & Supp. IV 2010); *Morrison*, 130 S. Ct. at 2881.

<sup>64</sup> *Morrison*, 130 S. Ct. at 2881. Because the scope of Rule 10b-5 depends on section 10(b) of the 1934 Act, this Note uses both to discuss *Morrison's* effect on transactions. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5 (2010); *Morrison*, 130 S. Ct. at 2881.

<sup>65</sup> *Morrison*, 130 S. Ct. at 2882–83.

<sup>66</sup> *Id.* at 2882 (quoting 15 U.S.C. § 78c(a)(17)).

<sup>67</sup> *Id.* Concerning the presumption against extraterritoriality, the Court wrote, "[U]nless there is the affirmative intention of the Congress clearly expressed' to give a statute extraterritorial effect, 'we must presume it is primarily concerned with domestic conditions.'" *Id.* at 2877 (quoting *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991)).

<sup>68</sup> *Id.* (quoting 15 U.S.C. § 78b(2)).

<sup>69</sup> *Id.* The idea that the statute's interest or "focus" limits the statute's "reach" could be criticized on grounds that the two are "not necessarily coterminous." Daniel Hemel, Comment, *Issuer Choice After Morrison*, 28 YALE J. ON REG. 471, 483–84 n.79 (2011).

“shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States,’ unless he does so in violation of regulations promulgated by the Securities and Exchange Commission ‘to prevent . . . evasion of [the Act].’”<sup>70</sup> The Solicitor General, on behalf of the plaintiffs, contended that such a provision would be superfluous unless the 1934 Act applied “to securities transactions that occurred abroad.”<sup>71</sup> The Court doubted, however, that the extraterritorial application for the entire law would be declared in such an obscure way.<sup>72</sup> Instead, the Court saw the language as “directed at actions abroad that might conceal a domestic violation.”<sup>73</sup> Having rejected all three attempts to overcome the presumption against extraterritoriality, the Court held that section 10(b) of the 1934 Act does not apply extraterritorially.<sup>74</sup>

After the Court narrowed the reach of the 1934 Act, the conduct and effects tests, which had previously determined the validity of Rule 10b-5 suits, were no longer viable.<sup>75</sup> The Court found that the conduct and effects tests were incompatible with the text of the statute.<sup>76</sup> The presumption against extraterritoriality does not limit Congress’s power to regulate matters outside America’s borders but rather limits the judiciary’s power to assume that Congress has regulated matters outside America’s borders; the conduct and effects tests were just such an unacceptable assumption.<sup>77</sup> Section 10(b) does not mention extraterritoriality, and the 1934 Act says nothing about the conduct and effects tests, which were created entirely by the judiciary.<sup>78</sup> Most significantly, the *Morrison* Court threw out the old tests because the 1934 Act gave no indication that it was meant to apply overseas, regardless of whether

---

<sup>70</sup> 15 U.S.C. § 78dd(b) (2006); *Morrison*, 130 S. Ct. at 2882 (quoting Brief for United States as Amicus Curiae Supporting Petitioners at 14, *Morrison*, 130 S. Ct. 2869 (2010) (No. 08-1191)).

<sup>71</sup> *Morrison*, 130 S. Ct. at 2882.

<sup>72</sup> *Id.* The Court wrote, “[I]n the first place, it would be odd for Congress to indicate the extraterritorial application of the whole Exchange Act by means of a provision imposing a condition precedent to its application abroad.” *Id.* Also, the Court questioned why the section only refers to “evasion” if it was meant to have such a large scope. *Id.*

<sup>73</sup> *Id.* at 2882–83.

<sup>74</sup> *Id.* at 2883. At least one commentator emphasized that the Court’s decision did not rely solely on the presumption against extraterritoriality, but also on “close statutory construction” and the lack of textual support for the conduct and effects tests. John C. Coffee, Jr., *What Hath ‘Morrison’ Wrought?*, N.Y. L.J., Sept. 16, 2010, at 5, col. 2.

<sup>75</sup> See *Morrison*, 130 S. Ct. at 2883; *supra* notes 44–48 and accompanying text.

<sup>76</sup> See *Morrison*, 130 S. Ct. at 2879, 2881.

<sup>77</sup> See *id.* at 2877.

<sup>78</sup> *Id.* at 2881.

alleged fraudulent conduct occurred in America or what effect it may have had on American investors.<sup>79</sup>

The Court took issue not only with the lack of statutory support for the conduct test and effects test, but also with the quality of the tests themselves.<sup>80</sup> The tests were criticized for being “vague” and “not easy to administer.”<sup>81</sup> For example, the conduct test, which looks at the wrongful act’s relationship to the United States, forced courts to make too many fine distinctions, such as “distinguish[ing] between mere preparation [in the United States] and using the United States as a ‘base’ for fraudulent activities in other countries.”<sup>82</sup> Furthermore, because no single factor could be dispositive in future cases, foreign corporations could not be sure whether they were subject to suit under Rule 10b-5.<sup>83</sup> This meddling with foreign corporations interfered with foreign markets and attempts by foreign governments to enforce their own securities regulations.<sup>84</sup> Therefore, according to the majority, the conduct and effects tests wreaked havoc on both domestic courts and foreign corporations.<sup>85</sup>

Even though the Court held that Rule 10b-5 could never be used for foreign transactions, it could still apply to domestic transactions with some foreign elements.<sup>86</sup> A new test was needed to determine when a

---

<sup>79</sup> See *id.*

<sup>80</sup> See *id.* at 2879.

<sup>81</sup> *Id.*

<sup>82</sup> See *Morrison*, 130 S. Ct. at 2879.

<sup>83</sup> See *id.* (citing *ITT v. Cornfield*, 619 F.2d 909, 918 (2d. Cir. 1980)).

<sup>84</sup> See *id.* at 2885–86.

<sup>85</sup> See *id.* at 2879–81. Reports of the deaths of the conduct and effects tests may be greatly exaggerated, however, because Congress quickly pushed back against the *Morrison* decision. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 929P, 929Y, 124 Stat 1376, 1864–65, 1871 (2010). In the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Congress included provisions to allow the SEC and the Department of Justice to sue under Rule 10b-5 if the complaint could pass the conduct and effects tests, which the Dodd-Frank Act effectively codified. See *id.* § 929P(b). Counsel for National in *Morrison* claimed that the statute will be ineffective because the Dodd-Frank Act gives district courts “jurisdiction,” and the Supreme Court expressly rejected the jurisdictional framework. See *id.* §§ 929P(b), 929Y; George T. Conway III, *Extraterritoriality After Dodd-Frank*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Aug. 5, 2010, 8:58 AM), <http://blogs.law.harvard.edu/corpgov/2010/8/05/extraterritoriality-after-dodd-frank>. It should be noted that the Dodd-Frank Act did not change the position of private plaintiffs; they remain without a cause of action under Rule 10b-5 for foreign transactions. See Dodd-Frank Act §§ 929P(b), 929Y; see also, Hemel, *supra* note 70, at 479–80 (noting that private plaintiffs bring the majority of “enforcement actions against cross-listed firms for violations of U.S. securities laws”).

<sup>86</sup> See *Morrison*, 130 S. Ct. at 2883–84.

transaction would be considered domestic under section 10(b).<sup>87</sup> The conduct test had focused on the location of the wrongful conduct, but the Court held, “[T]he 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.”<sup>88</sup> The statute seeks to protect parties to such transactions irrespective of the geographic location of the initial wrong.<sup>89</sup>

Thus, the Court created a new transactional test with two independent prongs for determining what *transactions* were subject to section 10(b) and Rule 10b-5.<sup>90</sup> The first prong states that section 10(b) applies to “transactions in securities listed on domestic exchanges.”<sup>91</sup> The second prong states that section 10(b) also applies to “domestic transactions in other securities.”<sup>92</sup> The “primacy” of “the domestic ex-

---

<sup>87</sup> See *id.* at 2884.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* The two prongs of the transactional test appear to be independent for three reasons. *Id.* at 2884, 2886. First, on one occasion, the prongs are listed disjunctively: “[W]hether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange.” *Id.* at 2886. Elsewhere, the two prongs are joined by “and”: “[I]t is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies.” *Id.* at 2884. There, “and” does not appear to require both prongs, but rather suggests that “domestic transactions in other securities” is an alternative means for a transaction to qualify as domestic. *Id.* Finally, the use of “other” implies that the securities that satisfy this prong are separate from those that satisfy other prong of the transactional test. *Id.* at 2886.

<sup>91</sup> *Id.* at 2884. The first prong is also described as a transaction that “involves a security listed on a domestic exchange.” *Id.* at 2886. Although that description is similar to the other phrasing—“transactions in securities listed on domestic exchanges”—the two are certainly not the same. See *id.* at 2884, 2886. The former description, only requiring that a transaction “involve[] a security listed on a domestic exchange,” is significantly more permissive than a requirement that the transaction actually be in the “securities listed on a domestic exchange.” See *id.* The district court opinions have not commented on the incongruity between the two definitions. See *id.* This inconsistency lies dormant in the *Morrison* decision and awaits a shrewd litigant to capitalize on it. See *id.*

<sup>92</sup> *Morrison*, 130 S. Ct. at 2884, 2886. The Court used two different phrasings for the second prong: A “purchase or sale . . . made in the United States” and “domestic transactions in other securities.” *Id.* It is apparent that these alternate phrasings refer to the same prong of the transaction test. See *id.* This is so for two reasons: first, both phrasings were used alongside the listing requirement, indicating that both were meant to be the other prong in the transactional test. See *id.* Second, both phrasings seem to describe similar topics, though situations could exist where the two phrasings of the prong would treat the same securities differently. See *id.* Absent that context, however, their similarity is underwhelming, and the Court’s wisdom in supplying two descriptions of the same requirement without truly explaining either is questionable. See *id.* In any event, the alternative phrasing in itself does not answer any questions. See *id.*; see also *Stackhouse*, 2010 WL 3377409, at \*1–2 (considering possible readings of the second prong of *Morrison*’s transactional test). In a request for comments for a study commissioned by the Dodd-Frank Act, the SEC acknowledged this ambiguity and solicited criteria “for determining where a purchase or sale can

change” in the 1934 Act’s prologue was the impetus for the transactional test’s first prong.<sup>93</sup> The second prong—“domestic transactions in other securities”—emerged from sections 30(a) and through (b) in which “the foreign location of the *transaction* . . . establishes (or reflects the presumption of) the Act’s inapplicability, absent regulations by the Commission.”<sup>94</sup> Regrettably, the transactional test is not as unambiguous as it may seem because the *Morrison* Court did not clearly define “listed on a domestic exchange” or “domestic transactions in other securities.”<sup>95</sup> For many transactions, the application of the tests will not cause any confusion, but for others—including the purchase and sale of some classes of ADRs—these undefined terms will cause significant difficulties.<sup>96</sup>

## II. AFTER *MORRISON*: THE DISTRICT COURTS REACT

The U.S. Supreme Court in *Morrison v. National Australia Bank Ltd.* attempted to clarify what suits could proceed under Rule 10b-5, but its bright-line test falls short of the simplicity that the Court intended.<sup>97</sup> This Part illuminates the challenges of enforcing *Morrison* by presenting the federal district court cases that have dismissed plaintiffs involved in Rule 10b-5 suits with extraterritorial elements.<sup>98</sup> Most courts have read *Morrison* broadly—applying the transactional test to cases beyond *Morrison*’s own “foreign-cubed” or “f-cubed” fact pattern.<sup>99</sup> These cases mostly focus on the “domestic transactions in other securities” prong of the *Morrison* test and generally find a sweeping prohibition of Rule 10b-5

---

be said to take place in various transnational securities transactions.” See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929Y, 124 Stat. 1376, 1871 (2010); Study on Extraterritorial Private Rights of Action, Exchange Act Release No. 63,174, 75 Fed. Reg. 66,822, 66,823 (Oct. 29, 2010).

<sup>93</sup> *Morrison*, 130 S. Ct. at 2884. The prologue to the 1934 Act reads: “To provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes.” Securities Exchange Act of 1934, ch. 404, 48 Stat. 881, 881.

<sup>94</sup> See *Morrison*, 130 S. Ct. at 2885. In support of both prongs, the Court noted that if Congress had wanted the laws to apply extraterritorially, it would have provided more guidance in the legislation. *Id.*

<sup>95</sup> See *id.* at 2884. Both commentators and courts have noted this difficulty. See *Stackhouse*, 2010 WL 3377409, at \*1; Fredericks, *supra* note 51, at 90–93.

<sup>96</sup> See *Morrison*, 130 S. Ct. at 2884; *infra* notes 218–339 and accompanying text.

<sup>97</sup> See 130 S. Ct. 2869, 2884 (2010); *Stackhouse v. Toyota Motor Co.*, No. 10-0922, 2010 WL 3377409, at \*1–2 (C.D. Cal. July 16, 2010); Fredericks, *supra* note 51, at 90–93.

<sup>98</sup> See *infra* notes 99–180 and accompanying text.

<sup>99</sup> See *Cornwell v. Credit Suisse Grp.*, 729 F. Supp. 2d 620, 625 (S.D.N.Y. 2010); *Stackhouse*, 2010 WL 3377409, at \*1–2.

suits with foreign elements, leaving little room for loopholes.<sup>100</sup> In sum, these cases suggest that the presence of significant foreign elements in a transaction will likely make a transaction foreign, regardless of any subtle reasoning for the transaction's domestic essence.<sup>101</sup>

At least one court has analyzed the limits of the first prong of the *Morrison* transactional test—securities “listed on a domestic exchange.”<sup>102</sup> In September 2010, Judge Victor Marrero of the U.S. District Court for the Southern District of New York dismissed the claims of plaintiffs seeking extraterritorial application of section 10(b) in *In re Alstom SA Securities Litigation*.<sup>103</sup> The court was only reviewing the claims of those who purchased their shares on a foreign exchange.<sup>104</sup> Although the shares were admittedly purchased on a foreign exchange, the plaintiffs argued that they could satisfy the *Morrison* transactional test because the shares were also listed on a domestic exchange.<sup>105</sup> The plaintiffs advanced a theory that commentators have called the “listed securities theory.”<sup>106</sup> The theory was that even though the contested class pur-

---

<sup>100</sup> See, e.g., *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, 753 F. Supp. 2d 166, 177–78 (S.D.N.Y. 2010); *In re Société Générale Sec. Litig.*, No. 08 Civ. 2495, 2010 WL 3910286, at \*2 (S.D.N.Y. Sept. 29, 2010); *Cornwell*, 729 F. Supp. 2d at 624.

<sup>101</sup> See *In re Société Générale*, 2010 WL 3910286, at \*2; *In re Alstom S.A. Sec. Litig.*, 741 F. Supp. 2d 469, 471, 473 (S.D.N.Y. 2010); *Cornwell*, 729 F. Supp. 2d at 622–23.

<sup>102</sup> See *In re Alstom*, 741 F. Supp. 2d at 471–73. In addition to their arguments for satisfying the first prong of *Morrison*, the plaintiffs contended that they could also satisfy the second prong because the transactions were initiated in the United States. *Id.* at 471–72. Due to the similarities between this contention and the arguments rejected in *Cornwell*, the *In re Alstom* court discarded this alternative argument. See *id.*; *infra* notes 116–339 and accompanying text.

<sup>103</sup> *In re Alstom*, 741 F. Supp. 2d at 470, 473.

<sup>104</sup> *Id.* at 471. The plaintiffs in *In re Alstom* fell into three categories: purchasers of the defendant corporation's ADRs on the NYSE, purchasers of securities directly from the corporation, and purchasers of shares on a foreign exchange (the Premier Marché of Euronext Paris). *Id.*

<sup>105</sup> *Id.* at 471–72. In October 2010, Judge George Daniels of the Southern District of New York ruled in *In re Celestica Inc. Securities Litigation* that plaintiffs who purchased shares of a Canadian corporation on the Toronto Stock Exchange could not sue under Rule 10b-5, even though the corporation also traded on the NYSE. No. 07 CV 312, 2010 WL 4159587, at \*1 (S.D.N.Y. Oct. 14, 2010). The court quickly dismissed their claims for lack of subject matter jurisdiction—despite the *Morrison* Court's rejection of “subject matter jurisdiction” as the appropriate question in these cases—without considering the possibility that the corporation's securities listed on the NYSE satisfied the first prong of *Morrison*'s transactional test. See *Morrison* 130 S. Ct. at 2877; *In re Celestica*, 2010 WL 4159587, at \*1.

<sup>106</sup> See *In re Alstom*, 741 F. Supp. 2d at 471–72; see also George T. Conway III, *Postscript to 'Morrison v. National Australia Bank,'* N.Y. L.J., Oct. 14, 2010, at 5, col. 2 (opposing the listed securities theory); Irwin H. Warren & Margarita Platkov, *Further Look at 'Morrison': A Plain Meaning Analysis*, N.Y. L.J., Nov. 2, 2010, at 4, col. 1 (arguing that a security is listed on an exchange when it is actually traded on that exchange); Hemel, *supra* note 70, at 482–85 (creating a distinction between a “registered securities theory” of liability and a

chased the securities on a foreign exchange, they still technically satisfied the listing prong because American Depositary Receipts (“ADRs”) of Alstom are also listed on the New York Stock Exchange (NYSE).<sup>107</sup> The *In re Alstom* court called this a “selective and overly-technical reading of *Morrison*,” which was impermissible if one looks at *Morrison* in its entirety.<sup>108</sup> It noted, “[T]he [*Morrison*] Court was concerned with the territorial location where the purchase or sale was executed.”<sup>109</sup> Therefore, the focus should not have been on where the stock was listed; the controlling factor was where the transaction occurred.<sup>110</sup> Effectively, the *In re Alstom* court held that the listing prong of *Morrison*’s transactional test does not literally mean what it says.<sup>111</sup> It is in fact not enough for a security to be merely listed on a domestic exchange.<sup>112</sup> Rather, the transaction must also occur on that domestic exchange.<sup>113</sup> In short, *In re Alstom* stands for the proposition that plaintiffs must purchase their securities on a domestic exchange to claim that the securities were listed on a domestic exchange.<sup>114</sup>

The majority of cases have not dealt with the first prong of the transactional test, but rather the second prong, “domestic transactions in other securities.”<sup>115</sup> One such decision, *Cornwell v. Credit Suisse Group*, a case also in the Southern District of New York and decided just weeks after *Morrison* in 2010, demonstrated a robust interpretation of *Morrison* that would neither limit the case to its facts nor allow subtle exceptions

---

“listed-for-trading theory”). In a 2010 class action securities fraud suit in the Southern District of New York, *Sgalambo v. McKenzie*, the court employed a narrow understanding of “listed” to dismiss plaintiffs who purchased the defendant corporation’s stock on a Canadian exchange, even though the stock was also both listed and traded on the American Stock Exchange. See 739 F. Supp. 2d 453, 464, 487 (S.D.N.Y. 2010).

<sup>107</sup> *In re Alstom*, 741 F. Supp. 2d at 471–72. Judge Richard Holwell of the Southern District of New York thoroughly explained, assessed, and rejected the listed securities theory in *In re Vivendi Universal, S.A. Securities Litigation*. See 765 F. Supp. 2d 512, 527–31 (S.D.N.Y. 2011).

<sup>108</sup> *In re Alstom*, 741 F. Supp. 2d at 472.

<sup>109</sup> *Id.*

<sup>110</sup> See *id.* at 472–73.

<sup>111</sup> See *id.* at 473. At least one other court has noted this as well: “[P]erhaps Justice Scalia simply made a mistake. He stated the test as being whether the alleged fraud concerned the purchase or sale of a security ‘listed on an American stock exchange,’ when he really meant to say a security ‘listed and traded’ on a domestic exchange.” *In re Vivendi*, 765 F. Supp. 2d at 530 (internal citations omitted).

<sup>112</sup> See *In re Alstom*, 741 F. Supp. 2d at 473.

<sup>113</sup> See *id.*

<sup>114</sup> See *id.*

<sup>115</sup> See, e.g., *Swiss Reinsurance*, 753 F. Supp. 2d at 177; *In re Société Générale*, 2010 WL 3910286, at \*2; *Cornwell*, 729 F. Supp. 2d at 624.

to its transactional test.<sup>116</sup> In this class action suit, the plaintiffs fell into two categories: those purchasing their shares of the defendant corporation on the Swiss Exchange and those purchasing their shares on the NYSE as ADRs.<sup>117</sup> Judge Marrero's opinion dealt only with the plaintiffs who had purchased their shares on the Swiss exchange.<sup>118</sup>

The plaintiffs argued that although the shares were purchased on a foreign exchange, the transaction could still satisfy the transactional test's second prong because the transactions had several American aspects.<sup>119</sup> The *Cornwell* court rejected the plaintiffs' argument because it found that *Morrison* was unambiguous in its rejection of Rule 10b-5 suits that relate to any security purchased on a foreign exchange.<sup>120</sup> The court stated emphatically,

The standard the *Morrison* Court promulgated to govern the application of § 10(b) in transnational securities purchases and sales does not leave open any of the back doors, loopholes or wiggle room to accommodate the distinctions Plaintiffs urge to overcome the decisive force of that ruling on their § 10(b) claims here.<sup>121</sup>

As the *Cornwell* court understood *Morrison*, there was no reason to confine *Morrison* to its f-cubed facts because the number of foreign elements present was not the dispositive factor in the *Morrison* decision.<sup>122</sup> Instead, the *Cornwell* court stressed that "no affirmative language in the Exchange Act . . . suggest[s] that § 10(b) extends to foreign transac-

---

<sup>116</sup> *Cornwell*, 729 F. Supp. 2d at 622–23. The case was decided by Judge Marrero of the Southern District of New York, the same judge who decided *In re Alstom*. See *In re Alstom*, 741 F. Supp. 2d at 470; *Cornwell*, 729 F. Supp. 2d at 627.

<sup>117</sup> *Cornwell*, 729 F. Supp. 2d at 622. This situation could be described as "f-squared" because, although the case involved foreign defendants and the stock was traded on a foreign exchange, the plaintiffs were American. See *id.* F-squared lawsuits are "claims brought by or on behalf of U.S. domiciled investors who bought their shares in foreign companies on foreign exchanges." Kevin LaCroix, *O.K., F-Cubed Claims Are Out, But What About F-Squared Claims?*, D&O DIARY (July 21, 2010), <http://www.dandodiary.com/2010/07/articles/securities-litigation/ok-fcubed-claims-are-out-but-what-about-fsquared-claims/>. Because the suit in *Morrison* was f-cubed, the *Cornwell* court could have limited *Morrison* to its facts and allowed these f-squared plaintiffs to remain in the class action. See *Morrison*, 130 S. Ct. at 2875; *Cornwell*, 729 F. Supp. 2d at 622, 625.

<sup>118</sup> *Cornwell*, 729 F. Supp. 2d at 622.

<sup>119</sup> *Id.* The chief American aspects of the transaction were that the plaintiffs decided to purchase the stock in the United States, they put the stock in an American account, and they took the economic risk in the United States. See *id.*

<sup>120</sup> See *id.* at 622–23.

<sup>121</sup> See *id.*

<sup>122</sup> See *id.* at 623, 625.



tions.”<sup>123</sup> Although the concern may have been irrelevant in *Cornwell* because the contested transactions did have strong foreign ties, the court’s analysis begs the question: how does a court determine what qualifies as a foreign transaction?<sup>124</sup>

For the *Cornwell* court, there was no room left for clever arguments and subtle distinctions to expand the scope of section 10(b).<sup>125</sup> The central thrust of *Morrison* was to foreclose such arguments.<sup>126</sup> The plaintiffs’ argument stretched *Morrison* to allow Rule 10b-5 suits with extraterritorial elements if certain aspects of the transaction occurred in America or some of the parties were American.<sup>127</sup> This argument struck the *Cornwell* court as a thinly disguised resurrection of the conduct and effects tests.<sup>128</sup> Such analysis required too many narrow, case-by-case distinctions.<sup>129</sup> The *Cornwell* court wrote, “[T]he [*Morrison*] Court manifested an intent to weed the doctrine at its roots and replace it with a new bright-line transactional rule embodying the clarity, simplicity, certainty and consistency that the tests from the Second and other circuits lacked.”<sup>130</sup> Based on the *Cornwell* court’s reading of the *Morrison* test as unambiguous, the court dismissed the claims of the plaintiffs who purchased their securities on the Swiss Exchange.<sup>131</sup> Under *Morrison*’s “bright-line transactional rule,” any transaction on a foreign exchange is beyond the reach of section 10(b) even if one of the parties was American or “some aspects . . . of such foreign transactions occur[ed] in the United States.”<sup>132</sup> The *Cornwell* court understood *Morrison* to be an unambiguous and sweeping decision, but it did not consider whether oth-

---

<sup>123</sup> *Id.* at 623.

<sup>124</sup> *See Morrison*, 130 S. Ct. at 2884; *Cornwell*, 729 F. Supp. 2d at 623.

<sup>125</sup> *Cornwell*, 729 F. Supp. 2d at 622–23.

<sup>126</sup> *See id.*

<sup>127</sup> *Id.* at 622.

<sup>128</sup> *Id.* at 622, 624. It is important to recall that *Morrison*’s transactional test did not aim to decide which extraterritorial suits under Rule 10b-5 could proceed as had the conduct and effects tests, but rather which suits are not extraterritorial at all. *See Morrison*, 130 S. Ct. at 2883. Of course, this does not mean a priori that no foreign elements can be present—that would be nearly impossible in today’s world of global commerce—but that their domestic essence must be proven through at least one of the two prongs of the transactional test. *See id.* at 2884.

<sup>129</sup> *See Cornwell*, 729 F. Supp. 2d at 624.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.* at 627. The case later settled for \$70 million. *Credit Suisse Group*, STANFORD L. SCH. SEC. CLASS ACTION CLEARINGHOUSE, [http://securities.stanford.edu/1039/cs\\_01](http://securities.stanford.edu/1039/cs_01) (last visited Oct. 9, 2011). The settlement included not only the ADR plaintiffs, but also the plaintiffs who purchased their shares on the Swiss exchange, despite their dismissal in district court. *See id.*

<sup>132</sup> *Cornwell*, 729 F. Supp. 2d at 624.

er transactions could be too complex to be adequately analyzed using a test of such “clarity, simplicity, certainty and consistency.”<sup>133</sup>

Less than a month after *Morrison* in July 2010, the U.S. District Court for the Central District of California also considered possible definitions of “domestic transactions in other securities” in *Stackhouse v. Toyota Motor Co.*<sup>134</sup> The court in *Stackhouse* was attempting to recommend a lead plaintiff in a class action lawsuit against Toyota, a foreign corporation.<sup>135</sup> Some plaintiffs purchased their shares as ADRs on a U.S. exchange and others purchased their shares on a foreign exchange.<sup>136</sup> The court posited two possible definitions of “domestic transactions.”<sup>137</sup> The first potential definition gave “domestic transactions” an expansive meaning: “[I]f the purchaser or seller resides in the United States and completes a transaction on a foreign exchange from the United States, the purchase or sale has taken place in the United States.”<sup>138</sup> On the other hand, the second potential definition interpreted *Morrison* as a broader prohibition against most transactions with foreign elements: “[B]ecause the actual transaction takes place on the foreign exchange, the purchaser or seller has figuratively traveled to that foreign exchange—presumably via a foreign broker—to complete the transaction.”<sup>139</sup> The first definition would preserve causes of action for plaintiffs who purchased their securities on a foreign exchange as long as they initiated the purchase or sale from the United States.<sup>140</sup> The second would only allow “purchases and sales of securities explicitly solicited by the issuer within the United States rather than transactions in foreign-traded securities where the ultimate purchaser or seller has physically remained in the United States.”<sup>141</sup> The former definition focuses on the actions of the *investor*, while the latter gives the *issuer* much more control over where it could be sued because under the latter definition, the issuer itself must seek out the investors in the United

---

<sup>133</sup> *See id.*

<sup>134</sup> *Morrison*, 130 S. Ct. at 2884; *Stackhouse*, 2010 WL 3377409, at \*1.

<sup>135</sup> *See Stackhouse*, 2010 WL 3377409, at \*1.

<sup>136</sup> *See id.* at \*1–2.

<sup>137</sup> *Id.*

<sup>138</sup> *See id.* at \*1.

<sup>139</sup> *See id.* In a footnote, the court mentioned the possibility that “the actual ‘transaction’ takes place between two brokers/traders in the foreign country and that the ultimate purchasers and sellers are irrelevant.” *Id.* The argument may be too clever to be earnest, but at the very least it acknowledges the complex reality of the modern financial markets and the difficulty of creating any effective bright-line test for a constantly evolving financial world. *See id.* at \*1.

<sup>140</sup> *See id.*

<sup>141</sup> *Stackhouse*, 2010 WL 3377409, at \*1.

States.<sup>142</sup> Under the first definition, if the issuer sold a security in a foreign country to a foreign citizen and that person resold the security to an American resident in the United States, the issuer could be subject to lawsuits under Rule 10b-5 by that U.S. resident—even though the foreign issuer only sold the security to other foreign citizens outside of the United States.<sup>143</sup>

The *Stackhouse* court decided that the latter reading of “domestic transactions,” which would allow fewer suits with foreign elements, was “better supported by *Morrison*.”<sup>144</sup> In the end, the court seemed most concerned with the 1934 Act’s legislative intent as illuminated by the *Morrison* Court: “The Supreme Court emphasized that the Exchange Act was not intended to regulate foreign exchanges.”<sup>145</sup> Allowing American investors to sue foreign corporations under section 10(b) would necessarily mean that the United States is regulating foreign exchanges to some degree.<sup>146</sup> This reflects the Court’s concerns in *Morrison* with international comity.<sup>147</sup> After selecting the more prohibitive definition of “domestic transaction,” the court recommended the appointment of ADR purchasers as lead plaintiffs.<sup>148</sup> *Stackhouse* emphasized international comity and fidelity to the text of the 1934 Act, both of which would allow corporations greater control over their legal liabilities and would tend to prohibit more suits with foreign elements.<sup>149</sup>

Another court has looked to the 1934 Act itself to define “purchase and sale made in the United States,” the alternative phrasing of *Morrison*’s second prong.<sup>150</sup> In the October 2010 case of *Plumbers’ Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, Judge John Koeltl of the Southern District of New York held that section 10(b) did not cover plaintiffs who purchased foreign shares in the defendant Swiss corporation on the Swiss stock exchange but placed the purchase orders in Chicago.<sup>151</sup> The case concerned the meaning of section 3 of the 1934

---

<sup>142</sup> See *id.*

<sup>143</sup> See *id.*

<sup>144</sup> See *id.* The court also considered defining “domestic transaction” as the opposite of an “offshore transaction,” a term with a clear meaning under the SEC’s Regulation S. See 17 C.F.R. § 230.902(h) (2010) (defining “offshore transaction”); *Stackhouse*, 2010 WL 3377409, at \*2.

<sup>145</sup> See *Stackhouse*, 2010 WL 3377409, at \*1.

<sup>146</sup> See *id.*

<sup>147</sup> See *Morrison*, 130 S. Ct. at 2885–86; *Stackhouse*, 2010 WL 3377409, at \*1.

<sup>148</sup> See *Stackhouse*, 2010 WL 3377409, at \*2. It should be noted that at this point, the court did not dismiss any plaintiffs’ claims. *Id.* at \*1.

<sup>149</sup> See *id.* at \*1–2.

<sup>150</sup> *Swiss Reinsurance*, 753 F. Supp. 2d at 177–78.

<sup>151</sup> *Id.* at 179.

Act, which “provides that, ‘unless the context otherwise requires,’ the term ‘purchase’ ‘include[s] any contract to buy, purchase, or otherwise acquire.’”<sup>152</sup> This language could suggest that the purchase occurred where the investors placed the buy order because that is where they entered into the contract.<sup>153</sup> The court rejected this argument because it considered this “expansive construction” to be unsustainable after *Morrison*.<sup>154</sup> The court sought to avoid meddling with foreign securities regulation and the “fact-bound, case-by-case inquiry into when exactly an investor’s purchase order became irrevocable” that the plaintiffs’ contract argument would require.<sup>155</sup> Instead, the *Swiss Reinsurance* court adopted the following rule:

[A] purchase order in the United States for a security that is sold on a foreign exchange is insufficient to subject the purchase to the coverage of section 10(b) of the Exchange Act. There may be unique circumstances in which an issuer’s conduct takes a sale or purchase outside this rule, but the mere act of electronically transmitting a purchase order from within the United States is not such a circumstance.<sup>156</sup>

The court dismissed the plaintiffs’ claims and refused to consider the “identity”—effectively the American citizenship—of the purchaser or the location of the harm, wrongful conduct, or investor at the time of purchase.<sup>157</sup> Although *Swiss Reinsurance* acknowledged the possibility of more complex transactions in the future, the case demonstrates the trend in these post-*Morrison* cases to err on the side of prohibiting suits with foreign elements and avoiding case-specific distinctions.<sup>158</sup>

The U.S. District Court for the Southern District of Florida rejected a clever argument that relied on the first words of the *Morrison* test—“in connection with.”<sup>159</sup> In July 2010, the court in *In re Banco Santander Securities-Optimal Litigation* dismissed a Rule 10b-5 suit regarding an offshore transaction in which the plaintiff investors desired ulti-

<sup>152</sup> *Id.* at 177 (quoting 15 U.S.C. § 78c(a), (a)(13)).

<sup>153</sup> *See id.*

<sup>154</sup> *Id.*

<sup>155</sup> *See id.* The *Cornwell* court had a similar aversion to subtle analysis when implementing *Morrison*’s transactional test. *See Cornwell*, 729 F. Supp. 2d at 622–23.

<sup>156</sup> *Swiss Reinsurance*, 753 F. Supp. 2d at 178.

<sup>157</sup> *See id.* at 178–79.

<sup>158</sup> *See id.* at 178; *In re Société Générale*, 2010 WL 3910286, at \*2; *In re Alstom*, 741 F. Supp. 2d at 472; *Cornwell*, 729 F. Supp. 2d at 622–23.

<sup>159</sup> *See In re Banco Santander Sec.-Optimal Litig.*, 732 F. Supp. 2d 1305, 1317, 1318 (S.D. Fla. 2010).

mately to own an American fund.<sup>160</sup> The plaintiffs invested in a fund that pledged to subsequently invest that money in Bernard Madoff's fund, which was supposedly composed of U.S. securities.<sup>161</sup> The plaintiffs argued that because "their purchase was made 'in connection with' Madoff's investment fund," it was intended to be an investment in U.S. securities and was thus a domestic transaction.<sup>162</sup> The fund actually purchased by the plaintiffs, however, was "registered under the laws of the Bahamas" and "the Plaintiffs purposefully went off-shore to invest."<sup>163</sup> The court described the transactions as "off-shore purchases in off-shore Bahamian investment funds closed to United States investors."<sup>164</sup> Because of the prominence of foreign elements, discomfort with unpredictability, and possibility of endangering international comity, the court dismissed the plaintiffs' claim.<sup>165</sup>

The court reasoned that the intent to own U.S. securities indirectly or eventually does not make a transaction American.<sup>166</sup> Instead, the court looked to the transaction's location and res at the time of the purchase and sale, not at the parties' intents or subsequent related transactions.<sup>167</sup> In addition to the trends also present in the other cases, *In re Banco* stands for the ideas that a court should examine a security as it was at the time of the investor's purchase and also that the phrase "in connection with" should not be used as a loophole for foreign transactions in Rule 10b-5 suits.<sup>168</sup>

Most importantly for this Note, *Morrison* has even been used to dismiss the claims of plaintiffs who purchased ADRs on a U.S. exchange.<sup>169</sup> In September 2010, Judge Richard Berman of the Southern District of New York in *In re Société Générale Securities Litigation* dismissed the Rule 10b-5 claims of plaintiffs who purchased the defendant corpo-

<sup>160</sup> See *In re Banco*, 732 F. Supp. 2d at 1317, 1318.

<sup>161</sup> *Id.* at 1317. This transaction was, in a sense, the reverse of an ADR. See *Pinker v. Roche Holdings Ltd.*, 292 F.3d 361, 367 (3d Cir. 2002); *In re Banco*, 732 F. Supp. 2d at 1317. With an ADR, an investor purchases a U.S. security with an indirect intent to own a foreign security. See *Pinker*, 292 F.3d at 367. Here the investors purchased a foreign security with an indirect intent to own a domestic security. *In re Banco*, 732 F. Supp. 2d at 1317.

<sup>162</sup> *In re Banco*, 732 F. Supp. 2d at 1317.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

<sup>165</sup> See *id.* at 1317-18.

<sup>166</sup> See *id.* at 1317.

<sup>167</sup> See *id.*

<sup>168</sup> See *In re Banco*, 732 F. Supp. 2d at 1317.

<sup>169</sup> Compare *Société Générale*, 2010 WL 3910286, at \*6 (dismissing ADR plaintiffs), with *In re Alstom*, 741 F. Supp. 2d at 471 (not considering the possibility of dismissing ADR plaintiffs), and *Cornwell*, 729 F. Supp. 2d at 622 (same), and *Stackhouse*, 2010 WL 3377409, at \*2 (recommending ADR plaintiffs to be lead plaintiffs).

ration's securities not only on a foreign exchange, but also through ADRs on a U.S. exchange.<sup>170</sup> Although the defendants requested that the court dismiss only the claims of the plaintiffs who purchased their securities on foreign exchanges, the court dismissed the claims of the ADR plaintiffs *sua sponte*.<sup>171</sup> The court relied on an ambiguous quotation from the 2010 case *Copeland v. Fortis*, which called ADRs “predominantly foreign securities transaction[s].”<sup>172</sup> The court also inaccurately claimed that *Cornwell* held that section 10(b) is inapplicable to ADR plaintiffs.<sup>173</sup> It is difficult to predict how the *In re Société Générale* court would have ruled if its analysis of ADRs had been more thorough or its reading of precedent more precise; thus, the future impact of this decision on ADR plaintiffs in Rule 10b-5 suits is uncertain.<sup>174</sup> Nonetheless, the case further exemplifies the tendency to assume that the presence of any foreign elements necessarily means that a transaction is foreign.<sup>175</sup>

These district court cases have been primarily interested in the second prong of *Morrison*—“domestic transactions in other securities.”<sup>176</sup> In these cases the courts have been reluctant to allow Rule 10b-5 suits with foreign elements.<sup>177</sup> Plaintiffs have searched for loopholes in American aspects of their transactions, in the definition of “purchase” in the 1934 Act, in the phrase “in connection with,” and in ADRs.<sup>178</sup> All attempts have failed.<sup>179</sup> Many of these cases, however, in-

---

<sup>170</sup> *Société Générale*, 2010 WL 3910286, at \*1, \*6–7.

<sup>171</sup> *Id.* at \*6–7.

<sup>172</sup> *See id.* (quoting *Copeland v. Fortis*, 685 F. Supp. 2d 498, 506 (S.D.N.Y. 2010)). The court quotes *Copeland v. Fortis*, but the case that the *Copeland* court cites seems only to have described ADRs as such *arguendo*. *See* 685 F. Supp. 2d at 506 (quoting *In re SCOR Holding* (Switz.) AG Litig., 537 F. Supp. 2d 556, 561 (S.D.N.Y. 2008)); *In re SCOR Holding*, 537 F. Supp. 2d at 561–62. Regardless, it is clear that the *In re Société Générale* court did not fully examine the complexities of ADRs. *See* 2010 WL 3910286, at \*6.

<sup>173</sup> *See id.* In fact, the *Cornwell* court did not rule on ADR plaintiffs at all and instead only addressed plaintiffs who purchased their securities on a foreign exchange. *See Cornwell*, 729 F. Supp. 2d at 622.

<sup>174</sup> *See In re Société Générale*, 2010 WL 3910286, at \*6; *see also* 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, 565 n.170 (2011) (criticizing the analysis of the *In re Société Générale* court).

<sup>175</sup> *See, e.g., In re Société Générale*, 2010 WL 3910286, at \*2; *In re Alstom*, 741 F. Supp. 2d at 472–73; *Cornwell*, 729 F. Supp. 2d at 622–23.

<sup>176</sup> *See, e.g., Swiss Reinsurance*, 753 F. Supp. 2d at 177–78; *In re Société Générale*, 2010 WL 3910286, at \*2; *Cornwell*, 729 F. Supp. 2d at 624.

<sup>177</sup> *See In re Société Générale*, 2010 WL 3910286, at \*2; *In re Alstom*, 741 F. Supp. 2d at 472–73; *Cornwell*, 729 F. Supp. 2d at 622–23.

<sup>178</sup> *See Swiss Reinsurance*, 753 F. Supp. 2d at 177–78; *In re Société Générale*, 2010 WL 3910286, at \*6; *In re Banco*, 732 F. Supp. 2d at 1317; *Cornwell*, 729 F. Supp. 2d at 624.

volve obviously foreign transactions, like stocks purchased on a foreign exchange; left unanswered are questions about less obviously foreign transactions.<sup>180</sup>

### III. APPLYING THE TRANSACTIONAL TEST TO AMERICAN DEPOSITARY RECEIPTS

Although the bright-line test set forth by the Supreme Court in the 2010 case *Morrison v. National Australia Bank Ltd.* works well for clearly foreign transactions, such as stock purchased on a foreign exchange, other securities may pose a more difficult question for the courts.<sup>181</sup> American Depositary Receipt (“ADRs”) are one type of security that could challenge the “clarity, simplicity, certainty and consistency” of *Morrison’s* transactional test.<sup>182</sup> Section A of this Part gives a basic explanation of ADRs, paying particular attention to the differences between the various classes.<sup>183</sup> The distinctions between these categories are significant because they impact how courts should treat different types of ADRs.<sup>184</sup> Building on that discussion, Section B suggests a way in which ADRs of these various classes should be treated in light of *Morrison* and the district court cases that have interpreted *Morrison*.<sup>185</sup>

#### A. American Depositary Receipts

Dating back to 1927, ADRs are hybrids of U.S. and foreign securities.<sup>186</sup> They are sold in the United States and represent shares in a foreign corporation.<sup>187</sup> Large, U.S. depositary banks purchase foreign se-

---

<sup>179</sup> See *Swiss Reinsurance*, 753 F. Supp. 2d at 178; *In re Société Générale*, 2010 WL 3910286, at \*7; *In re Banco*, 732 F. Supp. 2d at 1318; *Cornwell*, 729 F. Supp. 2d at 624.

<sup>180</sup> See *Swiss Reinsurance*, 753 F. Supp. 2d at 178; *Cornwell*, 729 F. Supp. 2d at 622.

<sup>181</sup> See *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2884 (2010); *infra* notes 218–339 and accompanying text.

<sup>182</sup> See *Cornwell v. Credit Suisse Grp.*, 729 F. Supp. 2d 620, 624 (S.D.N.Y. 2010).

<sup>183</sup> See *infra* notes 186–217 and accompanying text.

<sup>184</sup> See *infra* notes 292–339 and accompanying text.

<sup>185</sup> See *infra* notes 218–339 and accompanying text.

<sup>186</sup> See J.P. Morgan Chase & Co., *Depositary Receipts: Reference Guide 1, 3* (2005) <https://www.adr.com/Library/Overview> (follow “DR Reference Guides” hyperlink) [hereinafter *Depositary Receipts*]. ADRs are a significant part of the economy; for example, in the first half of 2007 alone, trading in depositary receipts was forty-two percent higher than it had been in the same period of 2006, reaching twenty-three billion dollars. Citibank, N.A., *The Role of the Depositary Bank 1* (2007), <https://wss.citibsb.com/adr/common/linkpage.aspx?linkFormat=l&pageId=6&subpageId=169> (follow “The Role of the Depositary Bank” hyperlink).

<sup>187</sup> See *Pinker v. Roche Holdings Ltd.*, 292 F.3d 361, 367 (3d Cir. 2002).

curities in foreign markets and issue ADRs in America.<sup>188</sup> The trades “clear and settle in U.S. dollars,” and dividends are also paid in U.S. dollars.<sup>189</sup> An investor who purchases an ADR does not own title to the foreign share.<sup>190</sup> The share is technically owned by the depositary bank and is held by and registered to a custodian, a foreign bank owned by or allied with the U.S. depositary bank.<sup>191</sup> Usually the investor still retains voting rights to the foreign share by directing the depositary bank to vote in a specific way.<sup>192</sup> A publication of the SEC, without distinguishing between sponsored and unsponsored programs, notes that when investing in ADRs, one is “trading in the U.S market.”<sup>193</sup>

There are two basic categories of ADRs: unsponsored and sponsored.<sup>194</sup> For an unsponsored ADR, a depositary bank sells ADRs, which represent actual shares in the foreign corporation, without establishing a formal relationship between itself and the foreign corporation.<sup>195</sup> Typically, the foreign corporation has little involvement in the creation of an unsponsored ADR.<sup>196</sup> The issuers of sponsored ADRs, on the other hand, actively participate in the issuance of the ADR and enter into an agreement with the depositary bank.<sup>197</sup> Sponsored ADR programs can be further divided into four categories: Rule 144A offerings and Level I, Level II, and Level III ADR programs.<sup>198</sup> The categories vary based on

<sup>188</sup> *Id.*

<sup>189</sup> OFFICE OF INVESTOR EDUC. & ADVOCACY, U.S. SEC, INTERNATIONAL INVESTING (2007), available at <http://www.sec.gov/investor/pubs/ininvest.htm>.

<sup>190</sup> *Pinker*, 292 F.3d at 367.

<sup>191</sup> *Id.*; see JIM BARTOS, UNITED STATES SECURITIES LAW: A PRACTICAL GUIDE 283 (3d ed. 2006).

<sup>192</sup> Depositary Receipts, *supra* note 186, at 38.

<sup>193</sup> See OFFICE OF INVESTOR EDUC. & ADVOCACY, *supra* note 190.

<sup>194</sup> See *Pinker*, 292 F.3d at 367.

<sup>195</sup> See American Depositary Receipts, Exchange Act Release No. 34-29226 [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,740, at n.5 (May 23, 1991).

<sup>196</sup> *Id.*

<sup>197</sup> See 14A GUY LANDER, U.S. SECURITIES LAW FOR INTERNATIONAL FINANCIAL TRANSACTIONS AND CAPITAL MARKETS § 8:15 (2d ed. 2010).

<sup>198</sup> Depositary Receipts, *supra* note 186, at 9. Rule 144A offerings are not technically ADR programs. See BARTOS, *supra* note 191, at 87-88. In contrast to purchasing an ADR, an investor in a Rule 144A offering owns the actual security issued by the foreign company, not just a receipt representing a security. See *id.* Rule 144A offerings remain relevant to the inquiry, however, because—as a method for foreign corporations to raise capital and expand their investor basis in the United States without issuing securities on an American exchange—they resemble ADR programs and present similar issues in the context of Rule 10b-5 suits. See *id.* at 87-88, 283-84. For the reader's ease, this Note does not always expressly differentiate Rule 144A offerings from ADRs. See *infra* notes 199-339 and accompanying text.



eligible purchasers, reporting requirements, ability to raise new capital, and whether the securities are listed on American exchanges.<sup>199</sup>

Level II and Level III ADRs are sponsored ADR programs traded on the American Stock Exchange, the NYSE, or the National Association of Securities Dealers Automated Quotation System (NASDAQ).<sup>200</sup> These foreign corporations are subject to the same reporting requirements imposed by the SEC and their respective exchanges as are U.S. corporations listed on the same exchanges.<sup>201</sup> The primary difference between Level II and Level III programs is that new shares are not issued for Level II ADRs; therefore, Level II ADRs do not raise new capital.<sup>202</sup> In contrast, new shares of the foreign corporation are issued for Level III ADRs.<sup>203</sup> Because Level III ADR programs venture more directly into the U.S. securities market, they have greater reporting requirements.<sup>204</sup> Both categories are distinguished from other ADR programs by their trading on American exchanges and significant reporting requirements.<sup>205</sup>

Two of the sponsored ADR categories, Level I ADRs and Rule 144A offerings, are not listed on any exchange and thus trade in the over-the-counter market.<sup>206</sup> Level I ADRs, though unlisted, can be traded to retail investors using the pink sheets.<sup>207</sup> Because new shares in the corporation are not issued for the ADRs, Level I ADRs do not raise new capital.<sup>208</sup> Due to an exception in 1934 Act Rule 12g3-2(b), the foreign corporation in such an ADR program is not subject to the same reporting requirements as are U.S. corporations issuing securities.<sup>209</sup> Still, the depositary bank has to register the ADRs on a document

<sup>199</sup> See BARTOS, *supra* note 191, at 287; 14A LANDER, *supra* note 197, § 8:22, at 25.

<sup>200</sup> See Depositary Receipts, *supra* note 186, at 9.

<sup>201</sup> BARTOS, *supra* note 191, at 283–84. To register the security, for example, foreign corporations must file Forms F-6 and 20-F with the SEC and make other ongoing disclosures. See Depositary Receipts, *supra* note 186, at 26–27.

<sup>202</sup> See Depositary Receipts, *supra* note 186, at 11.

<sup>203</sup> *Id.*

<sup>204</sup> See *id.* Level III ADRs are subject to greater reporting obligations than Level II ADR program, such as filing a Form F-1 and drafting a prospectus. *Id.*

<sup>205</sup> BARTOS, *supra* note 191, at 283–84.

<sup>206</sup> *Id.* at 88, 283.

<sup>207</sup> Depositary Receipts, *supra* note 186, at 9. Pink sheets refer to the NASDAQ over-the-counter securities market. BARTOS, *supra* note 191, at 248–49. Securities issued by foreign corporations that trade in the pink sheets do not need to fulfill the SEC registration requirements associated with the 1934 Act. *Id.* Rather, these securities only need to supply the information required by Rule 12g3-2(b). 17 C.F.R. 240.12g3-2(b) (2010); BARTOS, *supra* note 191, at 249.

<sup>208</sup> Depositary Receipts, *supra* note 186, at 9.

<sup>209</sup> 17 C.F.R. 240.12g3-2(b); Depositary Receipts, *supra* note 186, at 10.

called a Form F-6 to comply with the Securities Act of 1933.<sup>210</sup> Because the foreign corporation has sponsored the ADR program, the company and its upper management must also sign the registration statement.<sup>211</sup> Level I ADRs are characterized in chief by their trading in the over-the-counter market, reduced reporting requirements, and inability to raise new capital in the United States.<sup>212</sup>

Rule 144A offerings are private transactions, which can only be sold to Qualified Institutional Buyers in both the primary and secondary markets.<sup>213</sup> Limitations on the number of offerings are strictly maintained, and parties to the offering are effectively prohibited from generating any publicity related to the offering.<sup>214</sup> Like Level I ADRs, Rule 144A offerings are also not listed on American exchanges and are exempt from almost all American reporting requirements.<sup>215</sup> Unlike Level I ADRs, Rule 144A offerings do raise new capital in the United States.<sup>216</sup> In short, Rule 144A offerings are distinguished by their restriction on eligible purchasers, limitations on publicity, trading in the over-the-counter market, reduced reporting requirements, and ability to raise new capital in the United States.<sup>217</sup>

### B. ADRs: Citizens or Aliens?

The multinational character of ADRs presents an interesting challenge to the black-and-white *Morrison* test.<sup>218</sup> To determine whether ADRs fulfill *Morrison's* transactional test, the guiding question is deceptively simple: are the purchases and sales of ADRs foreign or domestic transactions?<sup>219</sup> The Supreme Court provided a transactional test with two independent prongs.<sup>220</sup> Pursuant to that test, the inquiry is whether ADRs either are "listed on domestic exchanges" or are "domestic transactions in other securities."<sup>221</sup>

<sup>210</sup> See BARTOS, *supra* note 191, at 283.

<sup>211</sup> See *id.*

<sup>212</sup> 14A LANDER, *supra* note 197, § 8:24.

<sup>213</sup> Depositary Receipts, *supra* note 186, at 10. "[Qualified Institutional Buyers] manage at least \$100 million in securities, or are registered broker-dealers that own or invest, on a discretionary basis \$10 million in securities of non-affiliates." *Id.*

<sup>214</sup> See BARTOS, *supra* note 191, at 90–92.

<sup>215</sup> See Depositary Receipts, *supra* note 186, at 10.

<sup>216</sup> See *id.*

<sup>217</sup> See BARTOS, *supra* note 191, at 88, 89, 90; Depositary Receipts, *supra* note 186, at 10.

<sup>218</sup> See *infra* notes 219–339 and accompanying text.

<sup>219</sup> *Morrison*, 130 S. Ct. at 2884.

<sup>220</sup> See *id.*

<sup>221</sup> See *id.* at 2884.

ADRs are subject to the *Morrison* transactional test, but how that test ought to be applied is less clear.<sup>222</sup> Particularly for complex hybrid securities like ADRs, it is not readily apparent that their nationality can be discovered or defined using *Morrison*.<sup>223</sup> Section III.B.1 reviews the treatment of ADRs by the district courts since *Morrison* and notes that although ADR plaintiffs have received favorable treatment so far, other trends latent in these opinions do not bode well for future plaintiffs.<sup>224</sup> This Section goes on to establish the criteria that should be used to scrutinize the status of ADRs.<sup>225</sup> In particular, Section III.B.2 identifies the goals of *Morrison* as the district courts understood them, and considers how these goals should impact the treatment of ADRs in future Rule 10b-5 suits.<sup>226</sup> Next, Section III.B.3 examines how the jurisdictional concept of purposeful availment could be used as a fairness principle for determining the nationality of a transaction.<sup>227</sup> Section III.B.4 shows that the essential transaction for the *Morrison* inquiry could be either the depository bank's purchase of the foreign security or the investor's purchase of the ADR.<sup>228</sup> Finally, Section III.B.5 synthesizes these factors and proposes a post-*Morrison* treatment of the different categories of ADRs.<sup>229</sup>

## 1. The Treatment of ADRs by the District Courts

Thus far the district courts have generally treated ADR plaintiffs favorably in post-*Morrison* Rule 10b-5 suits.<sup>230</sup> In *Cornwell v. Credit Suisse Group* and *In re Alstom SA Securities Litigation*, for example, the courts did not even consider the possibility of dismissing plaintiffs who had purchased shares of the corporations as ADRs.<sup>231</sup> The court in *Stackhouse v. Toyota Motor Co.* actually favored ADR plaintiffs by recommending their appointment as lead plaintiffs in a class action suit.<sup>232</sup> On the other hand, the court in *In re Société Générale Securities Litigation* called ADRs

---

<sup>222</sup> See *infra* notes 230–339 and accompanying text.

<sup>223</sup> See *infra* notes 230–339 and accompanying text.

<sup>224</sup> See *infra* notes 230–241 and accompanying text.

<sup>225</sup> See *infra* notes 242–291 and accompanying text.

<sup>226</sup> See *infra* notes 242–261 and accompanying text.

<sup>227</sup> See *infra* notes 262–270 and accompanying text.

<sup>228</sup> See *infra* notes 271–291 and accompanying text.

<sup>229</sup> See *infra* notes 292–339 and accompanying text.

<sup>230</sup> See, e.g., *In re Alstom SA Sec. Litig.*, 741 F. Supp. 2d 469, 471 (S.D.N.Y. 2010); *Cornwell*, 729 F. Supp. 2d at 622; *Stackhouse v. Toyota Motor Co.*, No. 10-0922, 2010 WL 3377409, at \*2 (C.D. Cal. July 16, 2010); see also *infra* notes 231–232 and accompanying text.

<sup>231</sup> *In re Alstom*, 741 F. Supp. 2d at 471; *Cornwell*, 729 F. Supp. 2d at 622.

<sup>232</sup> See *Stackhouse*, 2010 WL 3377409, at \*2.

“predominantly foreign securities transaction[s]” and dismissed the ADR plaintiffs, even though the defendant had not even requested that the court do so.<sup>233</sup>

It might seem from the above discussion of district court rulings that ADRs are by and large safe from challenges that they cannot satisfy *Morrison*'s transactional test.<sup>234</sup> That conclusion may not be so certain, however, if one considers the trends present in the first group of district court cases to interpret *Morrison*.<sup>235</sup> There is a general reluctance to allow suits that have any foreign elements.<sup>236</sup> Despite the decision's flaws, *In re Société Générale* exemplifies the possibility that *Morrison*'s presumption against extraterritorial application could become a presumption against domestic status for transactions with foreign elements.<sup>237</sup> Furthermore, only one court since *Morrison* has distinguished between types of ADR programs, and none have examined their varied characteristics.<sup>238</sup> As future courts consider the differences between the classes of ADRs, they may determine that different categories merit different levels of liability under Rule 10b-5.<sup>239</sup> Commenting on post-*Morrison* litigation, one prominent New York law firm noted, “Although exchange-traded securities appear to be subject to a bright-line test, continued litigation is expected over what are considered ‘domestic transactions in other securities’—including derivatives, over-the-counter ADRs and

<sup>233</sup> See *In re Société Générale Sec. Litig.*, No. 08 Civ. 2495, 2010 WL 3910286, at \*6–7 (S.D.N.Y. Sept. 29, 2010).

<sup>234</sup> See *In re Alstom*, 741 F. Supp. 2d at 471; *Cornwell*, 729 F. Supp. 2d at 622; *Stackhouse*, 2010 WL 3377409, at \*2; see also Theresa L. Davis & James Michael Scheppele, *Transnational Fraud Claims and the Extraterritorial Reach of U.S. Securities Laws: The Beginning of a New Era?*, in UNDERSTANDING THE SECURITIES LAWS 2010, at 323, 336–37 (Practising Law Inst. ed., 2010) (noting that *Morrison*'s transactional test creates many ambiguities for future litigation, including the treatment of certain categories of ADRs).

<sup>235</sup> See *In re Société Générale*, 2010 WL 3910286, at \*6–7; *In re Alstom*, 741 F. Supp. 2d at 472–73; *Cornwell*, 729 F. Supp. 2d at 622–23; *Stackhouse*, 2010 WL 3377409, at \*1.

<sup>236</sup> See, e.g., *In re Société Générale*, 2010 WL 3910286, at \*2; *In re Alstom*, 741 F. Supp. 2d at 472–73; *Cornwell*, 729 F. Supp. 2d at 624.

<sup>237</sup> See *Morrison*, 130 S. Ct. at 2877–78; *In re Société Générale*, 2010 WL 3910286, at \*6–7. The “flaws” of *In re Société Générale* refer to its simplistic analysis of ADRs and incorrect claim that the *Cornwell* court said that § 10(b) of the Exchange Act of 1934 did not apply to ADR plaintiffs. See *In re Société Générale*, 2010 WL 3910286, at \*6; *Cornwell*, 729 F. Supp. 2d at 622.

<sup>238</sup> Compare *In re Société Générale*, 2010 WL 3910286, at \*6 (distinguishing over-the-counter ADRs from exchange traded ADRs), with *In re Alstom*, 741 F. Supp. 2d at 471 (not considering different varieties of ADRs), and *Cornwell*, 729 F. Supp. 2d at 622 (same), and *Stackhouse*, 2010 WL 3377409, at \*2 (same). The court in *In re Société Générale* noted that ADRs “traded on the over-the-counter market in New York,” but its analysis did not consider what effect that detail might have. See 2010 WL 3910286, at \*1, \*6.

<sup>239</sup> See *infra* notes 292–339 and accompanying text.

other non-exchange traded securities.”<sup>240</sup> Indeed, future defendant corporations will likely attempt to capitalize on the trend against suits with foreign elements in order to exclude ADR plaintiffs.<sup>241</sup>

## 2. The Goals of *Morrison*

In considering how the courts should treat ADRs in the future, it is helpful to review the goals of the *Morrison* transactional test as identified by the district courts.<sup>242</sup> The principal goals are: (1) predictability, (2) international comity, and (3) preserving the language and intent of the 1934 Act.<sup>243</sup> These goals have mostly been used as justification to dismiss plaintiffs—a logical outcome considering that the *Morrison* test was intended to reduce the scope of Rule 10b-5.<sup>244</sup>

First, because the *Morrison* Court criticized the previous conduct and effects tests as “unpredictable,” it presumably wanted its test to re-introduce predictability.<sup>245</sup> The district courts have enforced this bright-line test vigorously.<sup>246</sup> One court, for example, criticized a plaintiff’s proposed gloss on *Morrison* as “requir[ing] a fact-bound, case-by-case inquiry.”<sup>247</sup> Another court made plain its desire for simplicity over subtlety when it stated, “The standard the *Morrison* Court promulgated to govern the application of section 10(b) in transnational securities purchases and sales does not leave open any of the back doors, loopholes or wiggle room to accommodate the distinctions Plaintiffs urge to overcome the decisive force of that ruling . . . .”<sup>248</sup> This stern language derived from the court’s understanding of the virtues of *Morrison*: “[T]he [Supreme] Court manifested an intent to weed the doctrine at its roots and replace it with a new bright-line transactional rule embodying the *clarity, simplicity, certainty and consistency* that the [conduct and effects]

---

<sup>240</sup> Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates, 2011 Skadden Insights 37 (2011), [http://www.skadden.com/newsletters/Compendium\\_2011\\_011011\\_web.pdf](http://www.skadden.com/newsletters/Compendium_2011_011011_web.pdf).

<sup>241</sup> See *Plumbers’ Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, 753 F. Supp. 2d 166, 178–79 (S.D.N.Y. 2010); *In re Société Générale*, 2010 WL 3910286, at \*6; *In re Banco Santander Sec.-Optimal Litig.*, 732 F. Supp. 2d 1305, 1317–18 (S.D. Fla. 2010); *Cornwell*, 729 F. Supp. 2d at 624.

<sup>242</sup> See *Swiss Reinsurance*, 753 F. Supp. 2d at 176, 177; *In re Société Générale*, 2010 WL 3910286, at \*6; *Cornwell*, 729 F. Supp. 2d at 624.

<sup>243</sup> See *Swiss Reinsurance*, 753 F. Supp. 2d at 176, 177; *In re Société Générale*, 2010 WL 3910286, at \*6; *Cornwell*, 729 F. Supp. 2d at 624.

<sup>244</sup> See *Morrison*, 130 S. Ct. at 2884; *Swiss Reinsurance*, 753 F. Supp. 2d at 176; *In re Société Générale*, 2010 WL 3910286, at \*2; *Cornwell*, 729 F. Supp. 2d at 627.

<sup>245</sup> See *Morrison*, 130 S. Ct. at 2878, 2879, 2884.

<sup>246</sup> See *Swiss Reinsurance*, 753 F. Supp. 2d at 178; *Cornwell*, 729 F. Supp. 2d at 622–23.

<sup>247</sup> See *Swiss Reinsurance*, 753 F. Supp. 2d at 178.

<sup>248</sup> See *Cornwell*, 729 F. Supp. 2d at 622–23.

tests . . . lacked.”<sup>249</sup> The mixed and ambiguous natures of securities like ADRs, however, may make it difficult to obtain clear, simple, certain, and consistent results.<sup>250</sup> Indeed, an emphasis on predictable results could simply lead to predictable dismissals for Rule 10b-5 suits with any foreign elements.<sup>251</sup>

Second, concerns regarding international comity—particularly an aversion to interfering with foreign markets and a fear of duplicative and possibly conflicting regulation—have also influenced the district court decisions interpreting *Morrison*.<sup>252</sup> The *Cornwell* court, for example, noted that if section 10(b) applied to foreign securities, U.S. courts would be forcing U.S. regulations on foreign securities also governed by the foreign nation’s laws and the rules of the exchange upon which they are traded.<sup>253</sup> The many differences between U.S. and foreign laws would be important to corporations attempting to balance legal obligations with their interests in raising capital and developing new markets.<sup>254</sup> In addition to foreign corporations’ interests in controlling where they are liable to legal action, foreign markets also have an interest in controlling their countries’ corporations without competing U.S. regulations.<sup>255</sup> Because U.S. suits against foreign corporations, whether the plaintiffs are private or public, would indirectly regulate foreign markets, the judicial desire to avoid meddling in foreign markets will reduce the likelihood of section 10(b)’s application to ADRs.<sup>256</sup>

Finally, *Morrison* and its progeny have stressed the lack of textual support in the 1934 Act for any extraterritorial application.<sup>257</sup> *Morrison* observed, “[T]he Exchange Act is silent as to the extraterritorial application of § 10(b) . . . .”<sup>258</sup> The *Cornwell* court found this important in its understanding of the *Morrison* decision: “[T]he *Morrison* Court . . . found no affirmative language in the Exchange Act to suggest that § 10(b) extends to foreign transactions . . . .”<sup>259</sup> If the 1934 Act was

<sup>249</sup> See *id.* at 624 (emphasis added).

<sup>250</sup> See *In re Société Générale*, 2010 WL 3910286, at \*6–7; *supra* notes 186–217 and accompanying text.

<sup>251</sup> *In re Banco*, 732 F. Supp. 2d at 1317–18; *Cornwell*, 729 F. Supp. 2d at 624, 627.

<sup>252</sup> See *Morrison*, 130 S. Ct. at 2885–86; *In re Banco*, 732 F. Supp. 2d at 1317; *Stackhouse*, 2010 WL 3377409, at \*1.

<sup>253</sup> *Cornwell*, 729 F. Supp. 2d at 624–25.

<sup>254</sup> See *Stackhouse*, 2010 WL 3377409, at \*1 (quoting *Morrison*, 130 S. Ct. at 2885).

<sup>255</sup> See *Morrison*, 130 S. Ct. at 2885–86; *Swiss Reinsurance*, 753 F. Supp. 2d at 176.

<sup>256</sup> See *Morrison*, 130 S. Ct. at 2885–86.

<sup>257</sup> See *id.* at 2883; *Swiss Reinsurance*, 753 F. Supp. 2d at 177; *Cornwell*, 729 F. Supp. 2d at 623.

<sup>258</sup> See *Morrison*, 130 S. Ct. at 2878.

<sup>259</sup> See *Cornwell*, 729 F. Supp. 2d at 623.

meant to extend to foreign transactions, Congress would have been more explicit.<sup>260</sup> After *Morrison*, it is irrefutable that section 10(b) does not apply extraterritorially, but the courts' continued stress on that fact will likely expand the prohibition from foreign transactions to all transactions with foreign elements.<sup>261</sup>

### 3. "Purposeful Availment"

The district court opinions also evidence a trend toward defining "domestic transactions in other securities" based on the purposeful availment, so to speak, of the foreign corporation.<sup>262</sup> In the foreign-squared scenarios, where American residents have purchased foreign securities on a foreign exchange, courts have found that the plaintiffs' unilateral actions were foreign transactions.<sup>263</sup> Implicitly, because the issuer has remained in its own foreign market, the investor had to travel—in some sense—to the foreign exchange and purchase the security in what was necessarily a foreign transaction.<sup>264</sup> Therefore, it would be unfair to subject a foreign corporation to a U.S. suit if the corporation had not attempted to enter the U.S. market.<sup>265</sup> One court exemplified this viewpoint in its definition of "domestic transactions": "purchases and sales of securities explicitly solicited *by the issuer* within the United States rather than transactions in foreign-traded securities where the ultimate purchaser or seller has remained in the United States."<sup>266</sup> This

<sup>260</sup> See *Morrison*, 130 S. Ct. at 2885.

<sup>261</sup> See *In re Société Générale*, 2010 WL 3910286, at \*6–7.

<sup>262</sup> See *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475–76 (noting that when a party "purposefully avails itself of the privilege of conducting activities within the forum State," "it is presumptively not unreasonable to require him to submit to the burdens of litigation in that forum as well"); *infra* notes 263–278 and accompanying text. The listing requirement receives less discussion here because it is more straightforward. See *Morrison*, 130 S. Ct. at 2884. Subsequent cases have addressed, however, the clarity of even that prong. See *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 527–30 (S.D.N.Y. 2011); *In re Alstom*, 741 F. Supp. 2d at 472.

<sup>263</sup> See *Cornwell*, 729 F. Supp. 2d at 624. The *Stackhouse* court did not dismiss plaintiffs who purchased shares on a foreign exchange, but it endorsed a definition of "domestic transactions" that would likely disfavor such plaintiffs and appointed those who had purchased ADRs in the defendant corporation as the lead plaintiffs. See *Stackhouse*, 2010 WL 3377409, at \*1, \*2.

<sup>264</sup> See *In re Société Générale*, 2010 WL 3910286, at \*5; *In re Banco* 732 F. Supp. 2d at 1317; *Stackhouse*, 2010 WL 3377409, at \*1.

<sup>265</sup> See *In re Société Générale*, 2010 WL 3910286, at \*5; *In re Banco* 732 F. Supp. 2d at 1317; *Stackhouse*, 2010 WL 3377409, at \*1–2.

<sup>266</sup> See *Stackhouse*, 2010 WL 3377409, at \*1 (emphasis added).

definition implicitly incorporates notions of purposeful availment.<sup>267</sup> It suggests that it is only fair to call a transaction domestic when the foreign corporation has purposefully entered into the U.S. market and sought out American investors.<sup>268</sup> This concept may be important for ADRs because they vary in the extent of their purposeful entry into the U.S. market.<sup>269</sup> The degrees of purposeful availment should impact a court's view of the fairness of subjecting a foreign corporation to a Rule 10b-5 suit.<sup>270</sup>

#### 4. The Relevant Transaction

An ADR basically involves two transactions: the depositary bank's purchase of the underlying foreign security and the investor's purchase of the ADR in America.<sup>271</sup> If the inquiry is limited to the purchase of the ADR itself, then the inquiry, at least for listed ADRs, is fairly easy.<sup>272</sup> Level II and Level III ADR programs fulfill *Morrison's* listing prong because they are listed and traded on a U.S. exchange.<sup>273</sup> All ADRs, except for Rule 144A offerings, however, represent entirely foreign securities purchased on a foreign exchange.<sup>274</sup> If the inquiry goes a level deeper and

---

<sup>267</sup> See *id.* Something like the concept of minimum contacts and purposeful availment has been employed in a similar context before *Morrison*. See *Pinker*, 292 F.3d at 371 (holding that a corporation's sponsored over-the-counter ADR program "amounted to an active marketing of its equity interests to American investors"). The term is illustrative of the fairness and reasonableness concerns inherent in the issuance of these securities, but it deserves emphasis that this inquiry has no relation to personal or subject matter jurisdiction, as the *Morrison* Court made clear. See *Morrison*, 130 S. Ct. at 2877.

<sup>268</sup> See *Stackhouse*, 2010 WL 3377409, at \*1. The court in *In re Vivendi* made a similar observation:

When a foreign issuer decides to access U.S. capital markets by listing and trading ADRs, it subjects itself to SEC reporting requirements, and it would not be illogical to subject that company to the antifraud provisions of the exchange Act at least where there is a sufficient nexus to the United States. Indeed, that premise underlies both the conduct and effects tests and the *Morrison* bright line test. Although these standards diverge on the issue of extraterritoriality, as Justice Scalia noted, transnational transactions have both domestic and foreign aspects and the issues becomes one of line-drawing under either test.

765 F. Supp. 2d at 529. This quote also subtly raises the possibility that the rejected conduct and effects tests could never be entirely eradicated because, where foreign and domestic elements are present, it is difficult to carry out this "line-drawing" without considering the conduct of the corporation or its effects on American investors. See *id.*

<sup>269</sup> See 14A LANDER, *supra* note 197, §§ 8:15, :16.

<sup>270</sup> See *In re Vivendi*, 765 F. Supp. 2d at 529.

<sup>271</sup> See *Pinker*, 292 F.3d at 367.

<sup>272</sup> See *Morrison*, 130 S. Ct. at 2884.

<sup>273</sup> See Depositary Receipts, *supra* note 186, at 10.

<sup>274</sup> See *Pinker*, 292 F.3d at 367.



looks at the underlying foreign securities, ADRs may not satisfy either of *Morrison's* prongs because the purchase of those underlying securities was a foreign transaction.<sup>275</sup> The underlying securities are shares in a foreign company purchased on a foreign exchange by the depository bank or its custodian, which itself might even be a foreign bank.<sup>276</sup> The relevance of the background transaction—the depository bank's purchase of the foreign security—should largely determine whether ADR plaintiffs continue to receive such favorable treatment.<sup>277</sup>

The majority of decisions so far seem to view the investor's purchase of the ADR issued by the depository bank as the relevant transaction.<sup>278</sup> Nonetheless, it is not self-evident that this should be considered the essential transaction.<sup>279</sup> After all, the American purchaser of an ADR virtually owns the underlying foreign security, and the foreign corporation that issued that security is the one accused of deceptive or fraudulent conduct.<sup>280</sup> In many cases the investor may even exchange the ADRs for the underlying foreign securities.<sup>281</sup> ADRs muddy the *Morrison* holding because they occupy a borderland between foreign and domestic transactions.<sup>282</sup>

Along with purposeful availment, it apparently also matters *where* the transaction occurred.<sup>283</sup> Courts ask whether the transaction happened on a U.S. exchange or if the trade was physically solicited and purchased in America.<sup>284</sup> Except for *In re Société Générale* and to a lesser extent in *In re Banco Santander Securities-Optimal Litigation*, courts have hardly looked at the res of the transaction—the security itself.<sup>285</sup> The

<sup>275</sup> *Morrison*, 130 S. Ct. at 2884; *Pinker*, 292 F.3d at 368.

<sup>276</sup> See BARTOS, *supra* note 191, at 282.

<sup>277</sup> See *Morrison*, 130 S. Ct. at 2884; see also *supra* notes 231–232 and accompanying text.

<sup>278</sup> See *In re Alstom*, 741 F. Supp. 2d at 471; *Cornwell*, 729 F. Supp. 2d at 622; *Stackhouse*, 2010 WL 3377409, at \*2.

<sup>279</sup> See *infra* notes 280–282 and accompanying text.

<sup>280</sup> See 17 C.F.R. § 240.10b-5 (2010); *Pinker*, 292 F.3d at 367.

<sup>281</sup> *In re Vivendi*, 765 F. Supp. 2d at 521 n. 2 (internal citations omitted).

<sup>282</sup> See *infra* notes 292–339 and accompanying text.

<sup>283</sup> See *In re Société Générale*, 2010 WL 3910286, at \*5; *In re Banco* 732 F. Supp. 2d at 1317; *Stackhouse*, 2010 WL 3377409, at \*1. Of course, in an electronic age, it is difficult to specify exactly where a transaction occurs. See *Stackhouse*, 2010 WL 3377409, at \*1. Courts tend to look at the exchange on which the transaction occurred. See *Cornwell*, 729 F. Supp. 2d at 623–24. Yet even that invokes the further question of which transaction to use for that determination. See *supra* notes 271–277 and accompanying text. Furthermore, for ADRs that trade in the over-the-counter market, an exchange is not implicated, and the inquiry becomes more complex and fact-specific. See 14A LANDER, *supra* note 197, § 8:24.

<sup>284</sup> *In re Alstom*, 741 F. Supp. 2d at 472; *Stackhouse*, 2010 WL 3377409, at \*1.

<sup>285</sup> *In re Société Générale*, 2010 WL 3910286, at \*6; *In re Banco*, 732 F. Supp. 2d at 1317. *In re Banco* provides a less compelling example because the transaction took place off-shore

definition of “transaction” has focused on the process of how the security was offered and sold, not on the nature of the security itself.<sup>286</sup> Only *In re Société Générale* and *In re Banco* show that the essence of the purchased security may be as important as the process of that transaction.<sup>287</sup> Despite *In re Société Générale*’s superficial analysis of ADRs, its shift toward examining the security itself and not just the process of the transaction could be significant and restrictive for future Rule 10b-5 suits regarding ADRs.<sup>288</sup>

Nonetheless, under section 10(b) the most relevant transaction is the purchase of the ADR by the investor, not the transaction between the depositary bank and the foreign corporation.<sup>289</sup> Because the statute’s purpose is to protect investors, the investor’s perspective should be the first concern.<sup>290</sup> In the context of ADRs, courts should consider only the investor’s primary transaction, the purchase or sale of the ADR, and not the preceding purchase and sale between the depositary bank and the foreign corporation.<sup>291</sup>

---

and thus did not give the court reason to thoroughly examine the importance of the transaction’s substance. See 732 F. Supp. 2d at 1317.

<sup>286</sup> See *Swiss Reinsurance*, 753 F. Supp. 2d at 177–79; *In re Banco*, 732 F. Supp. 2d at 1317; *Stackhouse*, 2010 WL 3377409, at \*1.

<sup>287</sup> *In re Société Générale*, 2010 WL 3910286, at \*6; *In re Banco*, 732 F. Supp. 2d at 1317.

<sup>288</sup> See *In re Société Générale*, 2010 WL 3910286, at \*6.

<sup>289</sup> See *infra* notes 290–292 and accompanying text.

<sup>290</sup> See Securities Exchange Act of 1934, 48 Stat. 881, 881 (codified at 15 U.S.C. §§ 78a–78pp(2006)) (listing “to prevent inequitable and unfair practices on [securities] exchanges and markets” as one of the 1934 Act’s purposes); BARTOS, *supra* note 191, at 1–2 (noting that the Securities Act of 1933 and the 1934 Act “were designed to protect U.S. investors by promoting public disclosure of material facts with respect to companies whose securities are publicly offered or traded in the securities market”). A more extreme version of this argument has already been rejected. *Cornwell*, 729 F. Supp. 2d at 624. In *Cornwell*, the court said a transaction could not be considered domestic even if the plaintiffs decided to make the investment, took the economic risk, and received all stock in the United States because purchasing the stocks on the foreign exchange made the transaction foreign irrespective of any other factors. See *id.* The plaintiff’s argument in *Cornwell* was weaker because it focused on details ancillary to the transaction, not on the actual purchase and sale. See *id.*

<sup>291</sup> See *Morrison*, 130 S. Ct. at 2884; *supra* notes 271–290 and accompanying text. For the study commissioned by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC solicited comments regarding what factors should impact a future private right of action under Rule 10b-5. See Study on Extraterritorial Private Right of Action, Exchange Act Release No. 63,174, 75 Fed. Reg. 66,822, 66,823, 66,824 (Oct. 29, 2010). The SEC’s questions suggest a list of possible considerations to determine what this Note calls “the relevant transaction”: the method of purchase and sale, the parties to the transactions, the nature of the security, the effect on international relations, and the need to protect investors. *Id.*

## 5. Not a "Level" Playing Field

There are multiple types of ADR programs, each of which deserves separate analysis.<sup>292</sup> The ADRs that enter most directly into the U.S. market are Level II and Level III ADRs.<sup>293</sup> Both comply to varying degrees with American reporting requirements and both are listed on American exchanges.<sup>294</sup> Level III ADRs differ from Level II programs in that their reporting requirements are more extensive and that they raise new capital by issuing shares corresponding to the ADRs.<sup>295</sup>

Because Level II and Level III ADR programs submit to the regulatory framework of the SEC and their respective American exchanges, they will likely satisfy *Morrison's* first prong, but there are valid reasons for not considering them to be domestic transactions.<sup>296</sup> The prices quoted for these ADRs still depend upon the value of a foreign corporation, and the ADRs only have value at all because they represent foreign securities.<sup>297</sup> In addition, the *Morrison* decision contains cautionary language about assuming a transaction is domestic "whenever *some* domestic activity is involved."<sup>298</sup> Because of the intimate relationship between ADRs and foreign securities, it is a stretch to deem them domestic transactions simply on account of where they were listed, sold, and purchased.<sup>299</sup> In essence, a Level II or Level III ADR is really the foreign share held indirectly.<sup>300</sup>

Notwithstanding these concerns, Level II and Level III ADR programs should be subject to Rule 10b-5 because such suits: (1) can have predictable results, (2) do not necessarily interfere with foreign markets, (3) are sensible considering the purposes of the 1934 Act, and (4) are fair in light of the purposeful availment discussion.<sup>301</sup> The results of Rule 10b-5 suits involving Level II and Level III ADRs are predictable because they do not require subtle case-by-case analysis.<sup>302</sup> Rather, courts can find that section 10(b) covers all ADRs listed and traded on a U.S. exchange.<sup>303</sup> Considering Level II and Level III ADRs sufficiently

---

<sup>292</sup> See *supra* 186–229 and accompanying text.

<sup>293</sup> See 14A LANDER, *supra* note 197, §§ 8:25–:26.

<sup>294</sup> See *id.*

<sup>295</sup> See Depositary Receipts, *supra* note 186, at 11.

<sup>296</sup> See *id.*

<sup>297</sup> See *Pinker*, 292 F.3d at 367.

<sup>298</sup> See *Morrison*, 130 S. Ct. at 2884.

<sup>299</sup> See *id.*

<sup>300</sup> See *Pinker*, 292 F.3d at 367.

<sup>301</sup> See *infra* notes 302–310 and accompanying text.

<sup>302</sup> See 14A LANDER, *supra* note 197 §§ 8:25–:26.

<sup>303</sup> See *id.*

American to warrant potential liability under Rule 10b-5 also does not excessively interfere with foreign regulation because companies that sell these types of securities have chosen to extend their base of investors to include Americans and consequently have accepted the risks of that decision.<sup>304</sup> Additionally, potential liability under section 10(b) in suits involving Level II or Level III ADRs listed on American exchanges furthers the purposes of the 1934 Act.<sup>305</sup> Foreign corporations that have submitted to the SEC's and a U.S. exchange's reporting requirements have entered into the U.S. regulatory machinery that includes section 10(b).<sup>306</sup> A corporation's submission to the SEC's and an exchange's reporting requirements would naturally and fairly engender liability for deceptive acts related to the U.S. securities it caused to be issued.<sup>307</sup> Listing a Level II or Level III ADR on an American exchange is not a mere technicality nor is it only "some domestic activity"; rather, it demonstrates the strengths of their connection to America.<sup>308</sup> These intentional offerings of ADRs on American exchanges could fairly be considered the relevant transaction for the *Morrison* inquiry.<sup>309</sup> Because of these factors, an investor's purchase of a Level II or Level III ADR should satisfy the listing prong of the *Morrison* test.<sup>310</sup>

Rule 144A offerings and Level I ADRs, both of which are unlisted and sold in the over-the-counter market, occupy a much more ambiguous space.<sup>311</sup> Unlike Level II and Level III ADRs, these two species of ADRs are not listed on U.S. exchanges and therefore do not fulfill the listing prong of *Morrison's* transactional test.<sup>312</sup> To be considered "domestic transactions," Rule 144A offerings and Level I ADR programs must satisfy the second prong of the *Morrison* test—they must be "domestic transactions in other securities."<sup>313</sup>

Both classes of securities have significant connections to the United States.<sup>314</sup> Both trade entirely in U.S. dollars.<sup>315</sup> Both are designed by foreign corporations with the intent to gain American investors and, in the

---

<sup>304</sup> *In re Vivendi*, 765 F. Supp. 2d at 529.

<sup>305</sup> See 15 U.S.C. § 78b (2006).

<sup>306</sup> See BARTOS, *supra* note 191, at 283–84; Depositary Receipts, *supra* note 186, at 11.

<sup>307</sup> See *In re Vivendi*, 765 F. Supp. 2d at 529.

<sup>308</sup> See *Morrison*, 130 S. Ct. at 2884; BARTOS, *supra* note 191, at 283–84.

<sup>309</sup> See *Morrison*, 130 S. Ct. at 2884; *In re Vivendi*, 765 F. Supp. 2d at 529.

<sup>310</sup> See *Morrison*, 130 S. Ct. at 2884.

<sup>311</sup> See BARTOS, *supra* note 191, at 87–88, 283.

<sup>312</sup> See *Morrison*, 130 S. Ct. at 2884; BARTOS, *supra* note 191, at 87–88, 283.

<sup>313</sup> See *Morrison*, 130 S. Ct. at 2884.

<sup>314</sup> See BARTOS, *supra* note 191, at 87–88, 283.

<sup>315</sup> See *id.*

case of Rule 144A offerings, also to raise new capital in the United States.<sup>316</sup> In a Level I ADR, the foreign corporation signs a contract, called a deposit agreement, with a U.S. depository bank to gain access to American investors; in a Rule 144A offering, the foreign issuer usually places the securities through an arrangement with an American firm.<sup>317</sup> Level I ADR programs are even subject to some, albeit limited, SEC reporting requirements.<sup>318</sup> Furthermore, unlike the foreign shares represented by ADRs, the securities sold in a Rule 144A offering are not really even foreign securities; they are new securities created exclusively for American investors.<sup>319</sup> These connections to America reveal foreign corporations who have desired to enter the U.S. market, notwithstanding their care in doing so only to a limited extent.<sup>320</sup>

Still, those American elements do not ensure that these classes of ADRs are “domestic transactions in other securities.”<sup>321</sup> As mentioned previously, the *Morrison* Court implied that “some domestic activity” would not transform a foreign transaction into a domestic transaction.<sup>322</sup> The *Morrison* Court’s fears of unpredictability are more convincing here because—as compared to the listing of a Level II or Level III ADR program on a U.S. exchange gives a clear indicator of when a program will satisfy the first prong of *Morrison*—over-the-counter sales do not have a parallel indicator to ensure predictability.<sup>323</sup> Rather, companies could argue about the manner in which they limited their exposure to the U.S. market and its regulatory system.<sup>324</sup> Furthermore, suits involving Rule 144A and Level I ADRs would inevitably impose competing regulations on the foreign market, and determining the fairness of the American regulations would require a fact-specific inquiry that would raise similar unpredictability concerns.<sup>325</sup>

Notwithstanding these arguments against section 10(b) liability, the key consideration should be that by sponsoring a Level I ADR program or a Rule 144A offering, the foreign corporation has declared its intention to enter the U.S. market and, therefore, ought to be liable for

---

<sup>316</sup> BARTOS, *supra* note 191, at 283; Depository Receipts, *supra* note 186, at 10.

<sup>317</sup> BARTOS, *supra* note 191, at 88; 14A LANDER, *supra* note 197, § 8:15.

<sup>318</sup> See BARTOS, *supra* note 191, at 283.

<sup>319</sup> See *id.* at 87–88.

<sup>320</sup> See *id.*; 14A LANDER, *supra* note 197, § 8:24.

<sup>321</sup> See *Morrison*, 130 S. Ct. at 2884.

<sup>322</sup> See *id.*

<sup>323</sup> See *id.*; 14A LANDER, *supra* note 197, §§ 8:24, :25, :26.

<sup>324</sup> See BARTOS, *supra* note 191, at 87–88; 14A LANDER, *supra* note 197, § 8:24.

<sup>325</sup> See *Morrison*, 130 S. Ct. at 2879, 2885–86.

wrongs committed against the American investors it has sought out.<sup>326</sup> In a sense, the foreign corporation has attempted to convert what would be a foreign transaction into a domestic one.<sup>327</sup> Considering that the investor is the plaintiff in a Rule 10b-5 suit, the relevant transaction should be the American investor's purchase of an over-the-counter Level I ADR or Rule 144A security.<sup>328</sup> Otherwise, a corporation could use ADRs as a loophole to gain many of the advantages of the U.S. market without accepting the consequences of violating its rules.<sup>329</sup> Consequently, to protect American investors from the deceptive actions of issuers who have chosen to enter the U.S. market, Level I ADR programs and securities offered under Rule 144A should fall within the scope of section 10(b).<sup>330</sup>

Finally, the case for allowing a Rule 10b-5 suit for an unsponsored ADR is very weak.<sup>331</sup> First, unsponsored ADRs are not listed on a U.S. exchange and therefore cannot satisfy *Morrison's* listing test.<sup>332</sup> Second, the foreign corporations have not entered into a depositary agreement with a U.S. bank or directly solicited American investors.<sup>333</sup> They also raise no new capital through these unsponsored ADRs.<sup>334</sup> As with any ADR program, the same concerns remain regarding the fact that the underlying security is foreign and was purchased on a foreign exchange.<sup>335</sup> In short, companies whose securities are sold in unsponsored ADR programs have not proactively sought the benefits of the SEC or the U.S. market; thus, it would not be fair to subject them to lawsuits for violating U.S. law.<sup>336</sup> In addition, when purchasing these securities, investors know that the program is unsponsored.<sup>337</sup> Consequently, investors assume the responsibility for the risks they take because these companies have neither arranged to offer these securities in the United States nor have they submitted to either SEC regulations

---

<sup>326</sup> See BARTOS, *supra* note 191, at 87–88, 283.

<sup>327</sup> See *id.*

<sup>328</sup> See *Morrison*, 130 S. Ct. at 2884; SODERQUIST & GABALDON, *supra* note 1, at 149. “[I]t is the ‘public interest’ and ‘the interests of investors’ that are the objects of the statute’s solicitude.” *Morrison*, 130 S. Ct. at 2894 (Stevens, J., concurring) (citing *Eur. & Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 125 (2d Cir. 1998)).

<sup>329</sup> See *In re Vivendi*, 765 F. Supp. 2d at 529.

<sup>330</sup> See *supra* notes 311–329 and accompanying text.

<sup>331</sup> See *Pinker*, 292 F.3d at 367.

<sup>332</sup> *Pinker*, 292 F.3d at 367; 14A LANDER, *supra* note 197, § 8:16.

<sup>333</sup> See 14A LANDER, *supra* note 197, § 8:16.

<sup>334</sup> See *id.*

<sup>335</sup> See *supra* notes 271–291 and accompanying text.

<sup>336</sup> See *supra* notes 271–291 and accompanying text.

<sup>337</sup> See *supra* notes 271–291 and accompanying text.

or U.S. law.<sup>338</sup> Therefore, the transaction is properly regarded as foreign and should not be subject to 10b-5 liability.<sup>339</sup>

#### CONCLUSION

In *Morrison*, the Supreme Court rejected any extraterritorial application of section 10(b) of the Securities Exchange Act of 1934. The Court also attempted to simplify a complicated and unpredictable area of law with a bright-line transactional test. Based on whether a security was listed on a U.S. exchange or purchased or sold in the United States, lower courts were to decide whether a transaction was domestic and therefore subject to suit under Rule 10b-5. The trend among early cases interpreting *Morrison* has been to apply the transactional test strictly with little regard for complex and subtle arguments.

Because ADRs fuse foreign and domestic elements, however, they challenge the simplicity of *Morrison's* transactional test. Some categories of ADRs—Level II and Level III ADR programs—are very likely within the scope of Rule 10b-5 because they are listed on American exchanges and substantially enter the American regulatory system. On the other hand, unsponsored ADRs are very likely not within the scope of Rule 10b-5 because the foreign companies have no involvement in their issuance. Although their status is less certain, Level I programs and Rule 144A offerings, which trade over the counter and are not listed on American exchanges, should also be liable to suit under Rule 10b-5 as domestic transactions in other securities.

VINCENT M. CHIAPPINI

---

<sup>338</sup> See *supra* notes 271–291 and accompanying text.

<sup>339</sup> See *supra* notes 271–291 and accompanying text.