Morrison's Effects Test

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MORRISON'S EFFECTS TEST

William S. Dodge*

Morrison v. National Australia Bank Ltd.1 is the most important
decision construing the geographic scope of a statute in almost twenty
years. This is not just because the Supreme Court in Morrison addresses
the reach of U.S. rules on securities fraud for the first time, but also because
Morrison changes the presumption against extraterritoriality, one of main
interpretive tools that U.S. courts use to determine the reach of federal
statutes. Morrison changes the presumption by shifting its focus from the
location of the conduct to the location of the effects. The change is a good
one for at least two reasons. First, it is consistent with the presumption's
underlying rationale: that Congress is primarily concerned with domestic
conditions. Second, it harmonizes many of the Supreme Court's prior
decisions, allowing order to emerge from a seemingly inconsistent series of
precedents.

The presumption against extraterritoriality was born from the marriage
of the Charming Betsy canon that statutes should be construed not to violate
international law and an international law rule that jurisdiction was
generally territorial.2 During the twentieth century, however, the
presumption against extraterritoriality broke free of international law and
came to rest on other justifications—first on "comity,"3 and then on "the
assumption that Congress is primarily concerned with domestic
conditions."4 But this rule of statutory interpretation was not consistently
applied. In American Banana Co. v. United Fruit Co., the Supreme Court
invoked the presumption against extraterritoriality to hold that the Sherman

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1. 130 S. Ct. 2869 (2010).
2. David L. Sloss, Michael D. Ramsey & William S. Dodge, International Law in the
   Supreme Court to 1860, in International Law in the U.S. Supreme Court: Continuity

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Act did not reach anticompetitive conduct abroad, but in *United States v. Sisal Sales Corp.* it reversed course and applied the Sherman Act to almost identical facts. 

Foley Bros. v. Filardo relied on the presumption to hold that the federal Eight Hour Law did not apply to work in Iraq, yet three years later *Steele v. Bulova Watch Co.* held that the Lanham Act covered trademark infringement in Mexico. In *EEOC v. Arabian American Oil Co. (Aramco)*, the Court applied the presumption against extraterritoriality to Title VII, but just two years later it ignored the presumption in *Hartford Fire Insurance Co. v. California*, holding that the Sherman Act reaches foreign conduct that causes substantial effects in the United States.

Over the past decade, the Supreme Court has experimented with other principles of interpretation to determine the reach of statutes. Justices Breyer and Ginsburg have articulated and applied new canons such as a presumption against "unreasonable interference with the sovereign authority of other nations" and a presumption that "Congress generally legislates with domestic conditions in mind." Justices Scalia and Thomas, on the other hand, have favored the presumption against extraterritoriality, often applying it rather mechanically based on the location of the conduct.

*Morrison* provided Justice Scalia with a vehicle to bolster the presumption against extraterritoriality, and he did not miss his chance. Scalia began by quoting *Aramco*: "It is a ‘longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.’" *Aramco* had based the presumption on two justifications: (1)
that it "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord;" and (2) that Congress "is primarily concerned with domestic conditions." The first justification became difficult to maintain after the Court applied the presumption in situations presenting no risk of conflict with foreign law, and Morrison officially jettisoned it. Thus, the presumption now rests solely "on the perception that Congress ordinarily legislates with respect to domestic, not foreign matters." 

Justice Scalia also used Morrison to articulate a standard for overcoming the presumption against extraterritoriality: "When a statute gives no clear indication of an extraterritorial application, it has none." This does not mean that the presumption is a "clear statement rule"—"[a]ssuredly context can be consulted as well"—but some "clear indication of extraterritoriality" was required. Morrison also noted that even "when a statute provides for some extraterritorial application, the presumption against extraterritoriality operates to limit that provision to its terms." Finally, Morrison tried to resolve the uncertainty about when the presumption applies: "Rather than guess anew in each case [about what Congress would have wanted], we apply the presumption in all cases, preserving a stable background against which Congress can legislate with predictable effects."

Morrison was an odd vehicle for interpreting and applying the presumption against extraterritoriality because the fraudulent conduct alleged in the complaint occurred in the United States. But that fact did not mean that Section 10(b) necessarily applied. "[F]urther analysis" was required—specifically an analysis of the statute's "focus." Justice Scalia concluded "that the focus of the Exchange Act is not upon the place where

17. 130 S. Ct. at 2877-78 ("The canon or presumption applies regardless of whether there is a risk of conflict between the American statute and a foreign law.").
18. Id. at 2877; see also id. ("[W]e must presume [Congress] is primarily concerned with domestic conditions." ) (quoting Aramco, 499 U.S. at 248).
19. Id. at 2878.
20. Id. at 2883.
22. Morrison, 130 S. Ct. at 2881 (emphasis added). The statement should be viewed as aspirational since, as noted above, the Court itself has hardly been consistent in applying the presumption.
23. Id. at 2884.
the deception originated, but upon purchases and sales of securities in the United States. To support that conclusion, he looked to the language of Section 10(b), which refers to manipulation and deception “in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . .” With respect to the latter phrase, which might be read to include securities listed on foreign exchanges, Justice Scalia looked to other provisions of the Act that focused on the location of a transaction as well as Congress’s failure to address the possibility of conflict with foreign laws and procedures. It was this domestic “focus” that led Morrison to conclude that Section 10(b) reaches securities fraud only in connection with sales in the United States.

One might argue that the evidence Justice Scalia cited with respect to the Exchange Act’s focus should have been sufficient to support the Court’s holding without resort to a presumption against extraterritoriality. But if one takes the Court at its word that the presumption is “a necessary first step in the analysis,” Morrison significantly changes our understanding of the presumption against extraterritoriality. Traditionally, courts applying the presumption focused on the location of the conduct. As Justice Holmes put it in American Banana, “the character of an act as lawful or unlawful must be determined wholly by the law of the country where the act is done.” Under Morrison, however, the location of the conduct is irrelevant. Section 10(b) reaches fraudulent conduct anywhere in the

24. Id.
25. 15 U.S.C. § 78j(b) (2006); see Morrison, 130 S. Ct. at 2884. Scalia also looked to the Act’s prologue and the scope of its registration requirements. See id. at 2884-85.
27. Id. at 2888.
28. See id. at 2894 (Stevens, J., concurring) (“The real motor of the Court’s opinion, it seems, is not the presumption against extraterritoriality but rather the Court’s belief that transactions on domestic exchanges are ‘the focus of the Exchange Act’ and ‘the objects of [its] solicitude.’”). As Professor Brilmayer points out, there is a tension between the Court’s assertion in Part III of Morrison that there is little evidence of congressional intent with respect to the Act’s territorial reach and its assertion in Part IV that there is clear evidence of congressional intent with respect to the Act’s domestic focus. Lea Brilmayer, The New Extraterritoriality: Morrison v. National Australia Bank, Legislative Supremacy, and the Presumption Against Extraterritorial Application of American Law, 40 SW. U. L. REV. 655, 668 (2011).
29. Morrison, 130 S. Ct. at 2884 n.9.
30. See William S. Dodge, Understanding the Presumption Against Extraterritoriality, 16 BERKELEY J. INT’L L. 85, 88 (1998). In two recent opinions, Justice Thomas (joined in each case by Justice Scalia) has taken the similar view that the presumption is not applicable where the prohibited conduct occurs in the United States. See Pasquantino v. United States, 544 U.S. 349, 371 (2005); Small v. United States, 544 U.S. 385, 400 (2005) (Thomas, J., dissenting).
32. Morrison, 130 S. Ct. at 2884.
world so long as the sale occurs on an American exchange or otherwise takes place in the United States. What is relevant instead is the location of the transaction affected by the fraudulent conduct—in other words, the location of the effects. Section 10(b) did not apply in *Morrison*, Justice Scalia explained, because “the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States.”

One might argue that *Morrison* still focuses on conduct, just different conduct. Rather than looking to the fraud as the relevant conduct for purposes of applying the presumption, it looks to the conduct of purchasing or selling. The first problem with this reading is that it ignores the language of the Exchange Act. Section 10(b) makes it unlawful “[t]o use or employ . . . any manipulative or deceptive device or contrivance” in connection with the domestic purchase or sale of a security. Section 10(b) does not make it unlawful to purchase or sell a security by means of a manipulative or deceptive device. To pretend that the sale rather than the fraud is prohibited is to rewrite the statute. The second problem is that this reading avoids the real question. It is often possible to recharacterize effects as conduct. When the effects test was young, courts used to imagine that the shooter accompanied a bullet across state lines so that his conduct actually occurred in state where the effects were felt. But courts soon abandoned the fiction and permitted regulation simply on the basis of effects. The European Court of Justice still prefers to speak of an anticompetitive agreement’s “implementation” rather than its effects, but it generally recognized that the ECJ has “accepted [the effects doctrine] in all but name.”

One might also wonder how *Morrison* can be read to have adopted an effects test when the opinion was so critical of the effects test developed by

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33. *Id.*
35. *See, e.g.,* Simpson v. State, 17 S.E. 984, 985 (Ga. 1893) (“[I]f a man in the State of South Carolina criminally fires a ball into the State of Georgia, the law regards him as accompanying the ball, and as being represented by it, up to the point where it strikes.”).
36. *See, e.g.,* Strassheim v. Daily, 221 U.S. 280, 285 (1911) (“Acts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a state in punishing the cause of the harm as if he had been present at the effect, if the state should succeed in getting him within its power.”); RESTATEMENT OF THE CONFLICT OF LAWS § 65, cmt. a (1934) (“A state may impose a liability upon any person whose conduct produces consequences within the state.”).
the Second Circuit. But it is important to remember that the Second Circuit’s effects test was significantly broader than *Morrison*’s. The Second Circuit, for example, applied the Exchange Act to transactions on a foreign exchange that affected the price of U.S.-listed shares in the same company. It also counted as “effects” the sending of misleading information into the United States from abroad. And it allowed a combining of effects and conduct in the United States to determine whether the U.S. interest was strong enough to justify application of the Exchange Act. It was this broad effects test that Scalia condemned—in tandem with the Second Circuit’s conduct test—as “vague,” “unpredictable,” and “not easy to administer.” In its place, *Morrison* substituted a narrower effects test that turns solely on the location of the specific transaction affected by the fraud.

*Morrison*’s shifting the presumption against extraterritoriality to focus on effects is cause for celebration. For one thing, this shift aligns the presumption with its modern justification—that Congress “is primarily concerned with domestic conditions.” As noted above, this appears to be the sole justification for the presumption after *Morrison*. Concern with “domestic conditions” must mean concern with domestic effects. When Congress prohibits conduct—from securities fraud, to restraints of trade, to environmental pollution—it does so to prevent harms that flow from such conduct. This is confirmed by what Congress has done when place of the conduct and the place of the effects diverge. In the antitrust context, Congress has created a number of exceptions that permit anticompetitive

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41. See *Consolidated Gold Fields PLC v. Minarco, S.A.*, 871 F.2d 252, 262 (2d Cir. 1989); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 991 (2d Cir. 1975).
42. See *Itoba Ltd. v. Lep Group PLC*, 54 F.3d 118, 122 (1995).
43. *Morrison*, 130 S. Ct. at 2879-80. Indeed, it would be fair to say that more of Justice Scalia’s venom was directed at the Second Circuit’s conduct test than at its effects test.
44. *Id.* at 2886. Application of this test to listed securities is relatively straightforward. Its application to unlisted securities, on the other hand, may prove to be as vague and unpredictable as the Second Circuit’s conduct and effects tests. See, e.g., *Quail Cruises Ship Management Ltd. v. Agencia de Viagens CVC Tur Limitada*, 732 F. Supp. 2d 1345, 1350 (S.D. Fla. 2010) (closing in Florida of transaction in unlisted securities would be insufficient under *Morrison*).
45. *Morrison*, 130 S. Ct. at 2877 (quoting *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991)); see also *id.* (the presumption “rests on the perception that Congress ordinarily legislates with respect to domestic, not foreign matters”); *Smith v. United States*, 507 U.S. 197, 204 n.5 (1993) (the presumption rests on “the commonsense notion that Congress generally legislates with domestic concerns in mind”); *Foley Bros. v. Filardo*, 336 U.S. 281, 285 (1949) (the presumption “is based on the assumption that Congress is primarily concerned with domestic conditions”).
46. For a critical review of other possible justifications, see *Dodge, supra* note 30, at 112-23.
47. *See id.* at 118.
activity in the United States so long as the effects of that activity are only felt abroad.48 And, of course, in the securities fraud context, Congress has prohibited not the use of “any manipulative or deceptive device or contrivance,” but only the use of such a device or contrivance “in connection with the purchase or sale of any security registered on a national securities exchange” or in connection with domestic transactions in unlisted securities.49 Not only is it reasonable to think that Congress is primarily concerned with domestic effects, that concern has been manifested in congressional legislation.

Refocusing the presumption against extraterritoriality on the location of the effects also makes sense of past cases in which the Supreme Court has applied some statutes extraterritorially but not others. After an early misstep in American Banana,50 the Court has consistently applied U.S. antitrust law extraterritoriality on the basis of effects.51 Similarly, the Supreme Court in Steele v. Bulova Watch Co. applied the Lanham Act to trademark infringement abroad, noting that the defendant’s “operations and their effects were not confined within the territorial limits of a foreign nation” because the counterfeit watches sold in Mexico could affect the value of Bulova’s trademark in the United States.52 And Morrison has now held that Section 10(b) of the Exchange Act applies extraterritorially to foreign conduct that affects transactions in the United States.53

In contrast, the cases in which the Supreme Court has applied the presumption against extraterritoriality over the past century have all been ones in which there were no effects in the United States. Foley Bros. and Aramco involved alleged violations of employment laws in foreign countries, which is where the effects of such violations would have been fallen.

49. 15 U.S.C. § 78j(b) (2006); see Morrison, 130 S. Ct. at 2884-85.
51. See, e.g., F. Hoffman-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 165 (2004) (“[O]ur courts have long held that application of our antitrust laws to foreign anticompetitive conduct is nonetheless reasonable, and hence consistent with principles of prescriptive comity, insofar as they reflect a legislative effort to redress domestic antitrust injury that foreign anticompetitive conduct has caused.”); Hartford Fire Ins. Co. v. California, 509 U.S. 764, 796 (1993) (“[I]t is well established by now that the Sherman Act applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States.”); United States v. Sisal Sales Corp., 274 U.S. 268, 276 (1927) (applying Sherman Act to conspirators who, “by their own deliberate acts, here and elsewhere, they brought about forbidden results within the United States.”).
52. 344 U.S. 280, 286 (1952).
53. See supra notes 28-44 and accompanying text.
Indeed, *Aramco* distinguished *Steele* on the ground that “the allegedly unlawful conduct had some effects within the United States.” In *Sale* and *Amerada Hess*, the effects of the conduct were felt on the high seas. And in *Smith*, the effects were felt in Antarctica. What had appeared to be a vacillating and inconsistent approach to the presumption against extraterritoriality becomes clear once we shift our gaze from the location of the conduct to the location of the effects.

The next frontier in extraterritoriality litigation is likely to be RICO. Applying *Morrison*, the Second Circuit held in *Norex Petroleum Ltd* v. *Access Industries, Inc.* that RICO did not apply extraterritorially, but the court did not examine the “focus” of the statute. Two district courts have done so—one before *Norex* and one after—and concluded that the focus of RICO is on domestic enterprises. “It is plain on the face of the statute,” the court noted in *Cedeño v. Intech Group Inc.*, that RICO “is focused on how a pattern of racketeering affects an enterprise.” “But nowhere does the statute evidence any concern with foreign enterprises . . . .” This meant that RICO would not apply to predicate acts of racketeering in the United States where “the alleged enterprise and the impact of the predicate activity upon it are entirely foreign.” The district court in *European Community v. RJR Nabisco, Inc.* agreed. In language that paralleled Justice Scalia’s in *Morrison*, the district court noted that RICO “does not punish the predicate acts of racketeering activity . . . but only racketeering activity

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54. See EEOC v. Arabian Am. Oil Co., 499 U.S. 244 (1991) (violation of Title VII in Saudi Arabia); Foley Bros. v. Filardo, 336 U.S. 281 (1949) (violation of Eight Hour Law in Iraq). In both cases, the plaintiff was an American citizen, but international law has long distinguished between effects within a country’s territory and effects upon a country’s nationals. The latter is not a widely accepted basis for jurisdiction to prescribe except in the context of crimes like terrorism that target a person on the basis of nationality. See *RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW* § 402 cmt. g (discussing passive personality principle).

55. *Aramco*, 499 U.S. at 252. *Aramco* also noted the Lanham Act’s broad definition of “commerce,” id. at 252-53, but such boilerplate definitions have generally been considered insufficient to overcome the presumption. See *Morrison* v. Nat’l Australia Bank Ltd., 130 S. Ct. 2869, 2882 (2010); see also *Aramco*, 499 U.S. at 251-53.


59. 631 F.3d 29 (2d Cir. 2010) (per curiam).


62. *Id.*

63. *Id.* at 474.
in connection with an 'enterprise.'” 64 “Because the 'focus' of RICO is the 'enterprise,'” the court concluded, “a RICO 'enterprise' must be a 'domestic enterprise.'”65 Thus, RICO should not apply to racketeering activity in the United States that causes effects abroad in or through a foreign enterprise. Norex, Cedeño, and European Community each involved predicate acts in the United States but no domestic enterprise and no domestic effects. Given RICO's focus on domestic enterprises, each was properly dismissed under Morrison.

By the same reasoning, RICO should apply to racketeering activity abroad that causes effects in the United States on or through a domestic enterprise. The focus of RICO is on domestic enterprises, and under Morrison the location of the conduct is irrelevant.66 This means the district court in United States v. Philip Morris USA, Inc. was wrong to release British American Tobacco (BATCo) from the court’s final order on the ground that RICO did not apply after Morrison.67 The court seems to have focused on Morrison's rejection of the Second Circuit's effects test,68 without recognizing that Morrison itself adopted a narrower effects test. Ironically, the Philip Morris court quoted Cedeño's observation that RICO "is focused on how a pattern of racketeering affects an enterprise,"69 but seemed to forget its own findings of fact five years earlier. In 2006, the same district court specifically found that defendants had established a RICO enterprise in the United States70 and that "BATCo's activities and statements furthered the Enterprise's overall scheme to defraud, which had a tremendous impact on the United States."71 Those findings are sufficient to establish RICO liability after Morrison irrespective of where the predicate acts occurred.72

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64. European Community, 2011 WL 843957, at *5.
65. Id.
66. See id. at *4 (noting that under Morrison the "focus [of a statute] is not necessarily the 'bad act,' or the actus reus, prohibited by the statute").
68. Id. at *3 & n.5. *5.
69. Id. at *4 (quoting Cedeño v. Intech Group Inc., 733 F. Supp. 2d 471, 473 (S.D.N.Y. 2010)).
71. Id. at 873.
72. The district court's decision is particularly odd given that the Supreme Court denied BATCo’s petition for certiorari just four days after Morrison rather than remanding for reconsideration. British American Tobacco (Investments) Ltd. v. United States, 130 S. Ct. 3502 (2010). The Court again refused to grant, vacate, and remand in light of Morrison on a petition for reconsideration. British American Tobacco (Investments) Ltd. v. United States, 131 S. Ct. 57 (2010).
In sum, *Morrison* turns the presumption against extraterritoriality into an effects test. It counsels courts to ignore the location of the prohibited conduct and examine the "focus" of the statute.\(^7\) Because Congress "is primarily concerned with domestic conditions,"\(^7\) the focus of a statute will most often be—as it was in *Morrison*—on preventing harmful, domestic effects.

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74. *Id.* at 2877 (quoting EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991)).